

**Consultation Document of Basel Committee on Banking Supervision:  
Strengthening the resilience of the banking sector**

**RESPONSE OF CREDIT AGRICOLE, the BPCE GROUP (CAISSES d'ÉPARGNE and  
BANQUES POPULAIRES) and CREDIT MUTUEL  
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**EXECUTIVE SUMMARY**

Cooperative banks play a fundamental role in financing the economy. Europe has 4 200 cooperatives banks (with a market share of around 20%). In France, they represent nearly 2/3 of the activity of the retail banking business, and perform a vital local service for customers. Over 20 million of them are members and thus participate directly in the governance of those institutions.

We most favourably welcome the proposals made in this document with regard to the strengthening of the quality, composition and transparency of capital. Indeed, it is necessary to ensure capital stability alongside capital growth. Nevertheless, we think that the prudential authorities work should respect the principle of neutrality as far as the legal forms of credit institutions are concerned, and thus it should not weaken the cooperative model through the simple “collateral effect” of a definition based on the model of joint stock companies without any prudential justification. Thus, the “footnote” which concerns the 14 criteria and the specificities of cooperative companies must be integrated in the text itself and more specifically in one of the paragraphs of the text (68, 74 or 80), in particular point 74 would appear to be the most appropriate.

Among this list of 14 criteria, 3 of them are problematic to cooperative banks:

**In case of liquidation, securities representing the capital must provide a right to the net assets in proportion with the capital that they represent (criterion 2)**

The nature of non-distributable reserves which is the basis of the cooperation status enables cooperatives to guarantee the stability and the future of the institution. By joining the cooperative model it implies a choice by the investor to limit his return on his investment to the nominal value of the shares and to favour the development of the cooperative institution. In case of dissolution, the net asset, after repayment of the nominal value of ordinary shares, is transmitted to other cooperatives, which have the same development model. This system is more acceptable on a prudential point of view than the one which is considered for the joint stock companies.

**Perpetual nature of the securities issued in order to represent the capital : absence of mechanisms for the repayment (criterion 3)**

Especially for the cooperative banks which have, by definition, a variable capital (due to the effects of subscription and redemption requests), which cannot be traded on an organised

market, this criterion is problematic as it would imply that a member's departure is necessarily followed by the arrival of a new member.

The capital variability is counterbalanced by high legal and status obligations. Thus, in this way, for example, the repayment is not automatic and must be authorised by the entity's Board of Directors.

**Compensation of the securities drawn on the distributable items with no link with the redemption value or issue price of these securities and not subject to a ceiling (criterion 5)**

The ceiling played its role effectively and totally in the last few years and cannot be assimilated to a fixed remuneration.

Its disappearance would favour the dispersal of profits to the detriment of the accumulation of reserves, while at the same time the Basel Committee is defending the establishment of buffers in the same document.

## DETAILED RESPONSE

Co-operative banks play a fundamental role in financing the economy. Europe has 4,200 co-operative banks, with a combined market share of around 20%. In France, they represent nearly two-thirds of retail banking business and play a vital local role serving customers and communities. Over twenty million customers of French co-operative banks are also members, enabling them to participate directly in the governance of their bank.

Co-operative banks were initially founded as a means of uniting their members around a collective project to satisfy unmet economic needs in a wide variety of sectors (agricultural, housing, workers' and consumers' co-operatives, and mutual insurers).

The impetus for the founding of co-operative banks came from ordinary people getting together to take control over their economic destiny and pool their resources, based on the principle of solidarity between members. The common feature of all co-operatives is their mission of creating a business at the service of their members. This mission, and their legal status, makes local development and service to members an end in itself.

Co-operative banks carry on their business, which has a commercial purpose, in a competitive environment and with a view to make a profit. So like any other business, they need to adopt rigorous management techniques. In France, this approach has led to co-operatives achieving some of the best cost-to-income ratios in the industry (for example, 51% for the Crédit Agricole Regional Banks in 2009). The drive to provide useful services to the customer and to the local community- which is inherent to the status and to the values of the co-operative banks- calls for profitability and business efficiency.

Co-operative banks have two essential features, derived from their legal status:

- They make only limited distributions to members out of profits, and use their undistributed profits to build up reserves to safeguard their future.

- Because of the law on co-operative status, these reserves are inalienable and non-distributable, thereby securing the bank's stability and future.

Usually, CAC 40 companies pay out more than 40% of their profits to reward their providers of equity capital. By contrast, co-operatives pay out an average of only 15% of their profits, the rest being transferred to reserves. This means that nearly 85% of co-operative banks' profits are used to strengthen their own funds, directly benefiting the regions where the banks are based by increasing their capacity to lend and to finance the local economy.

It should therefore be kept in mind that:

- (i) a cooperative bank, or non joint stock company in the Basel Committee's terminology, uses a totally different system than that of "joint stock company" banks. In France, the cooperative banking sector has a market share of 60% in the banking system.
- (ii) This alternative model is a total model, which means that one must not underestimate the risk that seemingly isolated reforms could actually denature the foundations of the overall model.

## **1. Founding principles**

- Non joint stock companies belong to their customers that use their services: these include individuals, heads of households, small and medium-sized enterprises, as well as self-employed professionals. Cooperative banks were historically created by them and for them, in a spirit of sharing and cooperation. As such co-operators hold one or more shares not for speculation purposes but rather in a spirit of cooperative ownership and participation in a common endeavour.
- One of the purposes of the cooperative model is to encourage capital ownership amongst a large number of small shareholders (hence the cap on the number of cooperative shares that a given cooperative shareholder can own), with the objective to involve them in the decision of the cooperative, namely during the annual general meeting where the principle is either "one share = one vote", or "one person = one vote". This operating method differs totally from that of a joint-stock company.

## **2. The operating differences**

- Held by the cooperative shareholder by way of his use of the cooperative's services, the cooperative share is a component of the non joint stock company's capital which by essence evolves over time, along with the actual number of members,
- As they are required to offer the possibility of repayment at a value that is not subject to speculation, non joint stock companies reimburse their cooperative shares at an amount that can never exceed the par value or in other words the purchase value.
- As the cooperative must operate without fits and starts, independently of the arrival and departure of cooperative shareholders, the latter never have rights to the reserves, which therefore remain within the company in order to cover its commitments.
- As the owner seeks an improvement of the cooperative's operation, capital compensation is limited so that the bulk of the cooperative's profits remain within the

company (this is the notion, long-standing within the cooperative world, of the establishment of unavailable reserves, which is quite similar to the more recent idea of capital buffers).

- In consideration of this, it is not the cooperative shareholders intention to speculate on the share's value.
- In all other respects, cooperative shares have the same characteristics as any other ordinary shares (absorption of losses, subordination relative to all other elements, absence of maturity...)

### **3. The need to take these specific features into account**

The Basel Committee's document has chosen to use the ordinary share of a listed company as the unique reference, while nevertheless providing a "footnote" on the specificities of cooperative companies, and to mention them in points 68, 74 and 80.

**We wish to see this "footnote" become an integral part of the text.**

We believe that the work of the prudential bodies should respect the principle of neutrality between different legal forms and organisational structures, and hence should not weaken co-operative models purely as a result of collateral damage inflicted by definitions based solely on joint stock companies, with no prudential justification.

We would not want an exception to be made for our capital just because a single (and debatable) benchmark is used. An exception largely based on a national assessment raises the issue of legal security, on which we cannot accept any uncertainty.

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<b>Our response to the consultation follows the numbering used in the text</b>
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## **II. Strengthening the global capital framework**

**62.** In the current banking system, it would appear that the definition of capital suffers from a number of flaws which relate both to a lack of transparency in the information provided by banks, and to a lack of harmonization of the rules and of their enforcement within various countries.

We totally agree with this observation, which prompts us to request a uniform application of the rules for defining capital, but one that will also consider the specificities of cooperative banks.

We would further add that the comments made in response to the consultation are of no value unless the regulations are applied in a uniform and generalized manner.

**64.** We most favourably welcome the proposals made in this document with regard to the strengthening of the quality, composition and transparency of capital. Indeed, it is necessary to ensure capital stability alongside capital growth.

We nevertheless wish to point out that the preparation of rules intended to strengthen the quality of capital must not be made to the detriment of economic growth, nor to that of the development of credit distribution.

Hence it is very important for transition and grandfathering rules to remain subject to the appreciation of national regulators, while complying with the need for uniform worldwide application.

**66.** One of the objectives targeted by the preparation of the new capital definition is to allow the recognition of Core tier 1 as being the best quality element of capital. To this end, it has been proposed that it should meet a certain number of criteria, namely:

- subordinated to all other elements of funding,
- absorbs losses as and when they occur,
- full flexibility of dividend payments ,
- the absence of a maturity date.

To begin with, we note that the criterion regarding the full flexibility of dividend payments is of a different nature to the other criteria. While the criterion regarding absorption of losses does not need to be discussed or justified, that of the flexibility of dividend payments would require to be substantiated if one considers that they are operating models for credit institutions in which the absence of this criterion has no consequence on the quality of the capital, a fact that the consultation overlooks.

Moreover, the criterion of the total flexibility of payments may appear to be contradictory with the objective of the establishment of capital buffers, notably in view of cooperatives that are legally required to systematically establish capital reserves that will, by definition, be allocated to periods of crisis.

**68.** After having defined the criteria that Core tier 1 elements must meet, it is firstly stipulated that the banks must not excessively rely on elements that do not meet these criteria and are therefore not considered Core tier 1, and secondly that the system must be adapted to the specific needs of mutuals and cooperatives, in other words companies which do not issue ordinary shares.

We very favourably welcome this principle that strives to assert the very existence of the specific nature of cooperative banks. We would also add that the consequences of such an assertion must be drawn with regard to the handling of the cooperative shares issued by these banks that must be categorized as Core tier 1 without any limitation. Our request is solely aimed at guaranteeing an equal treatment of cooperative and non-cooperative banks. We will come back to these criteria in more detail in paragraph 87.

**70 to 74.** We fully support the proposed new definition of capital, but under the twofold condition that it is applied by everyone in a uniform manner (i.e. equal treatment of joint stock companies and non joint stock companies), while taking into account the specific features of the cooperative status. To this end, we would like for footnote 19 on page 18 of the consultation document to be returned to the body of the text as a supplement to the current point 74 in order to indicate "the criteria developed in point 87 also apply..."

Indeed, this footnote is of particular importance for non joint stock companies in general and for our organisations in particular, since it asserts the principle whereby the criteria that apply to equity securities must take into account the specific features of "mutual and cooperative" companies.

Moreover, this footnote stipulates that the supervisors must exchange information on how these criteria will be applied. This is a very important point and, with regard to the regulator's role, we wish to add that it must ensure that the text's application is uniform but without interfering in the company's actual operations, for example by authorising or refusing the distribution of profits.

**87.** To be eligible for Core tier one, capital instruments must meet the 14 criteria upon which we wish to comment.

To begin with, we would point out that the approach adopted by Basel presupposes that the purest capital consists solely of shares that can be traded on an organised market. This idea overhangs the definition of the 14 criteria which have been elaborated on the basis of the thought that a share that can be traded on a market is, by nature, the ideal form of capital, as confirmed by the relegation of cooperative shares to a footnote.

Yet, during the crisis, the market amplified the devaluation of shares even as, at the same time, cooperatives remained insensitive to speculative movements and continued to increase their capital with dedicated supports (shares, Cooperative Certificates of investment (CCI), CCA...).

We will examine the 14 criteria of eligibility, three of them raising a problem because they contradict the founding principles of cooperatives:

- claim of the residual assets
- no repayment
- distributions not subject to a cap

**Criterion 1 : Final subordination rank of the equity securities relative to all of the company's other securities and commitments in case of the bank's liquidation**

The securities issued by cooperative banks are cooperative shares. They are equity securities according to the terms of the French law of 10 September 1947 relative to cooperation (hereafter "Law of 1947"), and to article L. 512-1 of the French Monetary and Financial Code. Moreover, they constitute the most subordinate securities that are likely to be issued by a company. This subordination is explicitly conveyed in article 19 of the Law of 1947, which stipulates that in case of dissolution, "the remaining net assets after payment of the liabilities and reimbursement of the actually paid capital is conferred by decision of the general assembly..."

Similarly, in case of the company's dissolution, the liquidators are directed to realise the assets, to pay off the corporate debts and, finally, to possibly repay the issued capital. It is therefore clearly established that the reimbursement of the capital can only occur after the defeasance of all liabilities, subordinate or not.

**Criterion 2 : In case of liquidation, securities representing the capital must provide a right to the net assets in proportion with the capital that they represent (= right to the liquidation surplus).**

As it stands, this criterion is not applicable to a non joint stock company. Indeed, the reserves are not available, neither during periods of "normal" operations nor in case of liquidation.

In case of liquidation, the cooperative shareholder has no right to the company's residual net assets since the capital was invested for the purpose of financing the production tool, and not in order to generate a financial profit. Consequently, the cooperative shareholder cannot claim any more than the face value for which s/he has subscribed. Waiving this rule would mean abandoning the cooperative status. This provision is legal in France since it is contained in article 19 of the Law of 1947 which provides that in case of liquidation the residual net assets after discharging of the losses cannot be allocated to the cooperative shareholders, and that the corresponding fraction of the net assets must be allocated to another cooperative.

It is incorrect to assert that the absence of a right to the reserves would create, for the cooperative shareholder, no positive inducement to control the company's management. In

this regard, one must recall the special relation between the member and the cooperative. Benefiting from an access to the cooperative's services, the cooperative shareholder has every interest in the cooperative company's proper operation and its healthy and balanced management, since the quality and the continued existence of the services provided to him/her are directly dependent upon this. Moreover, it must be stipulated that the accountability of the holder is, in a cooperative company, similar to the one that would exist for ordinary shares. This serves to re-assert that the cooperative share is a share of equity and that as such, just like an ordinary share, it is also intended to absorb losses (in equal measure with the other equity securities, if any, as well as the CCI and CCA).

Finally, on an economic level, nothing substantiates the idea that the cooperative model would render the cooperative shareholders indifferent to the losses or gains incurred by the company, thereby resulting in poor management of the company. In prudential terms, the most important aspect relates to the absorption of losses (criterion 8). Also, no bankruptcy or recognised difficulty has been seen amongst cooperative companies, particularly in the banking sector that includes companies of a significant size in their respective zones, both in France (BPCE, Crédit Mutuel, Crédit Agricole) and in Europe.

Inversely, we note that the right to the liquidation surplus, and more generally to the reserves, very often does not constitute a decisive criterion that would encourage stockholders to get more involved in their company's management: unlike in the cooperative model, stockholders of joint stock companies most often behave as ordinary investors, and are more interested in their investment's short-term profitability, all the more so since the securities that they hold are listed on a regulated market.

In the end, the absence of the right to the liquidation surplus does not constitute a relevant element both on a legal or on an economical level to dispute the eligibility of the cooperative shares to be included in Core tier 1.

Quite the contrary, in view of the stated objectives in response to the financial crisis, it should be noted that the system used by cooperative companies is more satisfactory from a prudential standpoint than the one envisaged by joint stock companies. Indeed, cooperative shareholders can in no way lay claim to the company's net assets by any means whatsoever (repayment, amortisation, financial engineering operations, etc.), which strengthens the financial solidity of cooperative companies (notably in view of the permanency criterion, for example).

The decision to join the cooperative model implies that the investor limits his return on investment to the nominal value of shares and gives priority to the development of the cooperative. In case of dissolution, the residual net asset, after repayment of the nominal value of shares, is transmitted to other cooperatives which pursue the same development model.

**Criterion 3 : Perpetual nature of the securities issued in order to represent the capital: absence of mechanisms for the repayment, redemption or amortisation of equity securities**

This criterion really only makes sense in the case of companies in which criterion 2 can apply, and the securities of which are listed on the market. In the case of cooperative companies, which, by definition, have a variable capital (with the variability of the capital resulting from the effects of subscription and redemption requests), this criterion is problematic, notably for variable capital cooperative banks, as it would imply that a member's departure is necessarily followed by the arrival of a new member.

Like criterion 2, it therefore does not apply to cooperative banks.

Indeed, variable capital cooperative companies are governed by a specific legal system relative to cooperative companies that, in view of the very nature of the method of their establishment, their status and their purpose, have a variable capital, meaning that their cooperative shares cannot be traded on an organised market. Indeed, in this particular legal framework, repayment is a substitute for trading on an organised market in order to allow cooperative shareholders to terminate their relations with the company, as is the case with investors relative to the capital of commercial companies. Overall, in practice, structures strive to maintain the level of their capital by carrying out an active policy for the investment of shares with potential cooperative shareholders.

Finally, we recall that for the application of the IAS standards, the criterion for differentiating between debts and capital is the existence, in the first case, of a right to repayment for the holder and of a contractual obligation incumbent upon the issuer (IAS 32 and IFRIC 2).

In fact, a cooperative bank may hinder the repayment of equity securities through the following mechanisms:

- according to the articles of association, repayment is made on proposal of the Board of Directors. Repayment must be authorized by the Board of Directors which has an unconditional right to refuse it.
- repayment is not possible if it implies that capital would fall short of the level required by article 13 of the law of 1947. According to this article, for cooperative banks, the central body's prior approval is required if repayment would lower the issued capital below 75% of the highest amount reached since the company's establishment.
- finally, the members can be discharged from their commitments towards the cooperative bank only after liquidation of the operations concerning them at the moment of their departure.

These legal restrictions on the repayment of the cooperative shares indicate that this repayment does not constitute, for the holder, a right that is acquired at the time of subscription, and that it is not automatic upon the cooperative shareholder's departure: as such, it does not represent a right that the cooperative shareholder can claim in absolute terms. Similarly, a cooperative shareholder's arrival presupposes the relevant person's prior approval by the cooperative company's Board of Directors, since this involves authorising access to a partnership in which the notion of *intuitu personae* plays an important role.

The variability of the capital logically results from the twofold capacity as user and cooperative shareholder of the contributors to the capital, with the cooperative shareholder's capital contribution most often being related to the intensity of this person's relation with the cooperative in the capacity of a user.

In this type of cooperative company, the capital variability is counterbalanced by high obligations relative to the placing of the profits in the reserves, and by the principle of the unavailability of these reserves.

The continued existence of the production tool is thereby ensured by the unavailability of the reserves, upon which the cooperative shareholders can never lay their hands, nor during normal operation, nor in the event of its liquidation. The company's net assets constitute an absolute guarantee of the company's ability to absorb losses in equal proportion with the amount shown in the balance sheet, independently of subsequent capital variations. Inversely, in a classical limited company, the reserves can be distributed and disappear from the balance sheet.



*It was in consideration of all of the above-mentioned characteristics and other texts that govern the status of shares of mutualist and cooperative banks that lawmakers modified, by decree of 22 January 2009, article L. 512-1 of the French Monetary and Financial Code in order to indicate that "the shares of mutualist and cooperative banks constitute capital stock".*

**Criterion 4 : At the time of issue, absence of an indication to the holders of any possibility for them to subsequently request the redemption or repayment of their shares.**

This criterion goes hand-in-hand with the previous one and creates a problem for a non joint stock company given that the articles of association of non joint stock companies as well as the subscription forms for shares must necessarily, in order to be valid, list the rules for repayment of the shares.

This information includes the legal restrictions on the repayment of the cooperative shares (cf. criterion 3 "permanency"), that are also indicated to the subscriber at the time of issue (via the subscription form and, if relevant, the prospectus approved by the Financial Markets Authority).

**Criterion 5 : Compensation of the securities drawn on the distributable items (earnings or reserves) with no link with the redemption value or issue price of these securities and not subject to a ceiling.**

In fact, the wording of this criterion conceals several successive sub-criteria relative to the payment of dividends.

In the end, these sub-criteria are not viewed as problematic, except for one.

As regards to the remuneration cap, it is contained in the Statement on co-operative identity of the International Co-operative Alliance as one of the 7 principles defining cooperatives; in France it is contained in article 14 of the law of 1947. It would be a great paradox if the Basel Committee were to impose the disappearance of a remuneration cap, thereby favouring the dispersal of profits to the detriment of the establishment of reserves, while nonetheless defending the establishment of buffers within the same document.

On the contrary, by limiting the amount distributed, the cap enables to raise the proportion of earnings retained by the bank, and hence to increase the bank's own funds. The cap undeniably constitutes a guarantee of stability, and not a risk factor from a prudential point of view.

One must also add that the usage of the par value in order to determine the remuneration paid to the capital serves to limit this compensation, thereby contributing to the improvement of the company's solvency. In other words, the most important element in a cooperative bank is the establishment of reserves and therefore of its permanent funds, with the cooperative shareholder's motivation being the service provided to him/her by the cooperative rather than the prospect of an increased value for his share.

Under no circumstances can a reference to the share's par value be used in order to express a remuneration floor.

In conclusion, from a prudential standpoint, the most important factors that describe the remuneration of cooperative shares are:

- the fact that it is impossible to determine the remuneration in advance,
- the necessary approval by the General Meeting,
- an element of the distribution of the profits.
- the remuneration cap

These prudent and virtuous characteristics contribute to strengthening the quality of the capital of cooperative banks.

**Criterion 6 : Remuneration of the securities never mandatory (non-payment is not the equivalent of a default)**

This criterion is not a problem, given that, by definition, any remuneration of the shares is optional, being in the sovereign hands of the institution's General Meeting and in any case depending on the availability of profit for distribution on the financial year considered, in accordance with article 16 of the Law of 1947.

In view of the application of the IAS standards, we would point out that the remuneration paid on the shares constitutes neither a right for the holder, nor a contractual obligation for the issuer.

**Criterion 7 : Absence of preferential distribution**

No comments in this regard.

**Criterion 8 : Capital instruments absorb losses "pari passu", in proportion with the capital that they represent**

There is no problem with the application of this criterion. Indeed, in compliance with the Law of 1947, the capital of cooperative companies can only consist of shares, CCI's or CCA's. No legal or regulatory provision would allow for the introduction of a difference between these instruments in terms of loss absorption.

The cooperative shares are therefore subject to social hazards under the same conditions as other securities that represent the capital stock (they are "pari passu" with the latter).

With regard to the cooperative shareholders, article 18 of the Law of 1947 stipulates that the repayment of the outgoing cooperative shareholder's shares (par value) must be reduced in an amount equal to this member's contribution to the losses included in the balance sheet (provided that these losses are not charged against the reserves). This serves to ensure that the outgoing cooperative shareholder absorbs the losses before the company's dissolution, just like the absorption of the losses by a shareholder at the time of the dissolution of a limited company.

**Criteria 9 to 12 : Accounting**

There is no problem with the application of these criteria: under French law, the remuneration of cooperative shares decided upon by the General Meeting is identified as such in the cooperative company financial statements and paid to the holders of the securities as quickly as possible.

In practice, this question therefore does not arise.

**Criterion 13 : Issuing of equity securities**

This criterion is not a problem for non joint stock company given that the issuing of cooperative shares is subject to the following rules:

- The Board of directors approves the new cooperative shareholders, but makes no ruling regarding their initial subscription or subsequent subscriptions. In certain cases, it makes a ruling on the implementation of significant share issue programmes.
- The annual General Meeting determines, after the fact, the change of capital that occurred during the previous fiscal year.

**Criterion 14 : Capital instruments are identified as such in the company's balance sheets and financial statements.**

This criterion is not a problem, given that, in compliance with the accounting provisions applicable to all banks, capital instruments and capital are identified as such in the company's annual financial statements (balance sheet).