

## **Consultation of the Basle Committee concerning the principles for enhancing corporate governance**

### **RESPONSE GIVEN BY CREDIT AGRICOLE, Group BPCE (CAISSES d'ÉPARGNE and BANQUES POPULAIRES) and CREDIT MUTUEL**

The reference text is the document in french which is also sent with this answer.

#### **Introduction**

Cooperative banks play a fundamental role in the financing of the European economy, as recognized by the European Commission<sup>1</sup>. Europe has more than 4,200 cooperative banks, with a market share of approximately 20%. In France, cooperative banks account for nearly two thirds of the retail banking activity and play an irreplaceable role because of their community relationships and their proximity with their clients and within their territories. Among the clients of the French cooperative banks, more than twenty million are also their members and thus participate directly<sup>2</sup> in the governance of these financial institutions.

At first, cooperative companies were created by bringing together their members who shared a joint project in order to respond to economic needs that were not being satisfied in the most diverse industries (agricultural cooperatives, housing, production, consumption, retail or crafts cooperatives).

These cooperatives were created by men and women who joined forces in order to take their economic destiny into their own hands and for the purposes of sharing resources among their members, according to a solidarity principle between its members. The main key feature of all of these organisations is to be found in their project, i.e. the development of an activity in order to serve their members. As they are partnerships, their legal form, as well as their purpose, have always set, as priority objectives, local development and the service of their members. The cooperative status, recognized by the Treaty of Rome, was strengthened by the creation of the status of the Cooperativa europea<sup>3</sup>.

We wish to thank the Basle Committee for the opportunity afforded to us to contribute to its review of the document entitled: "Enhancing corporate governance". In this respect, we would like to submit several general comments and propose a few adaptations, so that certain provisions of the guidelines suggested by the Basle Committee may not paradoxically lead to a weakening of the cooperative banks' governance model.

---

Consultation document concerning possible changes to be made to the capital requirements directive, as published on 26 February 2010: "Unlisted enterprises, such as mutual companies, cooperatives and savings banks play a vital role in the financial system and the European economy."

<sup>2</sup> Members participate each year in the general meeting of their local bank, their regional bank and their local savings bank and elect their representatives.

<sup>3</sup> Cooperativa europea; Directive 2003/72/EC and Regulation (EC) No. 1435/2003 of 22 July 2003.

## **General Observations**

In the same manner as for all French banks, cooperative banks endorse the objective of enhancing corporate governance, which is of prime concern to Government authorities and to central banks. We would like to recall that cooperative banks did not originate the crisis. Instead, they were able to better withstand the crisis because of the importance of their retail banking activity which remains as close as possible to their members. Cooperative banks are developing diversified operations in order to be able to respond to their members' expectations. Finally, their greater resilience to the crisis is also explained by the lesser dependence of networks to the financial markets. This has made it possible for us to reassure our members and to maintain our operations. This robustness of the cooperative model as well as cooperative banks' contribution to financial stability during the crisis are largely recognized. More specifically, the report prepared by the International Labour Organisation concerning the cooperative economic model's resilience during times of crisis, as published in 2009, concludes that "future regulations that might result from this crisis must clearly recognize that cooperative financial institutions were not the source of these problems, were materially less affected by the economic crisis, and should not be punished by being included in a series of new rules adopted in order to correct a problem that they did not cause".<sup>4</sup>

Also, we welcome the proportionality principle, which is proposed with a view to the application of the rules. This makes it possible to account for the fact that there are several development models and that, among banks and in particular cooperatives, certain players are smaller than others.

In Part II which is entitled "Overview of bank corporate governance vision of corporate governance", cooperative banks are cited under item 18. We welcome the recognition of the development model represented by cooperative banks. However, it seems to us that it is unfortunate that cooperative banks are dealt with in the same paragraph as banks belonging to a State or which have been supported by a State. Cooperative banks correspond to a specific development model which has not known a single bankruptcy and is independent of States. We consider that cooperative banks should be covered by an entirely separate paragraph.

Before submitting our comments and proposals concerning this document, we describe below the functioning of corporate governance within cooperative banks. Combined with geographic proximity to clients, such governance allows for sound management and risk control. The balance of power (elected officials / salaried managers; regional organisation / central body), a non-centralized banking network, comprised of local banks and full-fledged regional banks, and the existence of a central body guarantee a sound awareness of risks, close to the grassroots level, with a keen sense of decision-makers' responsibilities and a consolidated control.

### **1. A different structure, supporting an effective governance**

<sup>4</sup>

Johnston Birchall and Lou Hammond Ketilson, International Labour Organisation 2009.

### 1.1 Strong geographic proximity

Through their members, cooperative banks are connected to the community that they serve. Their development is focused on individuals, groups, persons and communities. The members and the organisation are developing and growing together, as part of a balance and convergence between their interests.

Unlike centralized banking groups, whose activities are developed “from the top down”, the local and regional organisations of the French cooperative banks have been built on the basis of a territorial area purview that these organisations themselves have defined.

Differences exist between the organisational patterns of the various French cooperative banks: Crédit Mutuel and Crédit Agricole have 3 territorial levels; within Caisses d'épargne the local level is represented by the *sociétés locales d'épargne* (local savings companies - SLEs), while within the Banques Populaires network, there are two levels (regional and national). In a cooperative bank, members are defined instead by the fact that they are at the same time members and clients of the bank.

### 1.2 A united and non-centralised group, whose pyramid structure relies on a mutual base

Cooperative banks have been created gradually, as non-centralised networks of local and regional credit cooperatives, whose unity and consistency have been secured (a) politically, by the central body or the federal association regrouping all of the regional banks, and (b) for prudential purposes, as regards liquidity and solvency, risk control and development strategy, by the central body and the “tête de réseau” of the group.

At the end of these historical developments, cooperative banks are organised in a pyramid structure, on the basis of the two or three levels described below:

- local banks, which are first-level cooperatives, are the mainstay of the cooperative banking organisation (Crédit Agricole, Crédit Mutuel, Caisse d'Epargne) and bring together members on the basis of a geographic criterion. They are in particular responsible for representing members within corporate bodies of the regional bank with which they are affiliated;
- regional or federal banks are second-level cooperatives, approved as credit institutions. They are the entities conducting most of the banking operations and own the branches. Their capital is held by affiliated local banks;
- the central body (the network's ultimate entity). The regional or federal banks are central bodies coupled with national federal associations, the whole forming a representation, information, dialogue and expression body available to regional banks.

This pyramid structure reflects an original organisation mode, based on subsidiarity and on representative democracy principles, according to which each territorial level has specific competencies and in which members directly or indirectly elect the Group's officers.

### 1.3 A democratic organisation mode in which banks are close to their territories

As opposed to companies limited by shares, in which, under the prevailing proportionality principle, the number of votes corresponds to the number of shares held, cooperative companies are organized according to the “one person, one vote” democratic principle.<sup>5</sup>

Thus, each member, when holding an interest share and regardless of the fraction of the capital held, has a right to cast one vote at general meetings.

Such a democracy is very much alive and is structured, depending on the organisation of each cooperative bank, by meetings organized each year in accordance with the articles of association, in particular from January to the end of May:

- the local banks of each of the French cooperative banks bring together their members during general meetings, in order to vote on the financial statements and in particular to elect their board of directors, which shall appoint the chairmen that will represent them at the general meeting of the Regional Bank with which they are affiliated: this is the model applied to Crédit Agricole and to Crédit Mutuel, within the Savings Banks through their local savings companies and within the Banques Populaires network through their mutual guarantee companies;
- the regional banks bring together their members in general meetings in order to vote on the financial statements and in particular to appoint new directors.

These local and regional meetings are prime forums for information, exchange and debates with the members. During these meetings, the chairmen submit a report concerning in particular the banks' activities, performance and strategy.

In connection with these annual general meetings, the directors representing the members/clients stand for re-election. This elective system, which is a fundamental feature of the governance of cooperative banks, ensures that the enterprise will be controlled by its members, through the political rights attaching to the interest shares. Throughout all French cooperative networks, the members' physical participation rate at the various general meetings provided for in the articles of association is much higher than that of shareholders of listed companies.

Thus, the number of general meetings is equal to the number of local banks, and this heightens democracy and corporate governance, by allowing for numerous exchanges between members and their banks. Such an organisation fosters better understanding, close to the grassroots level, of the bank's functioning and strategy.

The balance of power in a cooperative bank is made at each of the geographic levels.

## **2. Governance based on the balance of powers and the synergy of competencies**

The cooperative banks' organisation and functioning modes resulting from their status as cooperatives and their belonging to a group equipped with a central body have intrinsically three features that

---

<sup>5</sup> Certain banks apply a variant based on a capping at 5% of the number of votes that may be held by the member.

secure a governance system, based, at all levels, on a balance of powers: (a) the rule and practice of the “four eyes” principle, (b) responsibility towards its members, and (c) the central body’s powers.

### *2.1 A mutual practice: the “4-eyes” principle*

First, this governance has, for a long time, been structured around the balance between (i) the board of directors and its chairman, and (ii) the managing director.

The cooperative rule – and our practice – of the 4-eyes principle, coupling an elected chairman with an executive managing director, led us, well before the passing of the French national banking act imposing on all banks the obligation to have two senior executive officers (the “4 eyes” principle) and the Act on New Economic Regulations (NER), to dissociate in our banks: (a) the functions consisting in the definition of strategic policies and the supervision of their implementation incumbent on the board of directors and its chairman, and (b) executive responsibilities discharged by senior management.

### *2.2 Control of officers through their election mode*

The balance of powers resulting from this feature specific to the governance of cooperative entities is further strengthened by the principle according to which directors and chairmen of local banks are responsible to the members, as a result of their election mode.

As has already been indicated, after the general meetings of local banks and regional banks, held from January to May, in order to renew their boards of directors, the said directors elect each year their chairmen.

The frequency of the renewal of their office as well as their election mode, in accordance with the representative democratic principle, enable members to ensure that the interests advocated by their directors and chairmen are consistent with the members’ collective interest.

### *2.3 The powers of the central body*

In French decentralized mutual groups, this control mechanism is completed by the powers entrusted to the central body which guarantees compliance with statutory and regulatory rules and ensures liquidity **and solvency**<sup>6</sup>.

In particular, although decided by the Board of directors upon a recommendation made by the Chairman, their nomination of the managing directors must, according to the provisions of the French

---

<sup>6</sup> Article L511-31 of the French Monetary and Financial Code. “Central bodies are responsible for ensuring the cohesion of their network and the proper functioning of the institutions affiliated with them... They take all steps necessary, in particular in order to guarantee the liquidity and solvency of each of these institutions. They may also decide to prohibit or limit the distribution of a dividend to shareholders or a remuneration of the members’ interests. They enforce statutory and regulatory provisions and exercise administrative, technical and financial supervision over their organisation and management, extended to their direct or indirect subsidiaries, and to the institutions affiliated with them.”

Monetary and Financial Code <sup>7</sup>, be approved by the board of directors of the central body and may not be accompanied by any commitment to maintain the relevant officers in office for any specific period.

In the same manner, a managing director of a regional bank may at any time be dismissed by the board of directors or pursuant to a decision made by the central body, after consulting the board of directors.

Finally, if a regional bank makes any decision contrary to provisions of law or to the instructions given by the central body, the said body may terminate the board of directors and appoint a management commission substituting for the said board. Moreover, if the very bases of a regional bank are under threat, its activities may be continued by another regional bank<sup>8</sup>. In general, in France, no member/client of a cooperative bank has suffered any loss arising from any commercial default of its bank.

### **3. Independent and trained directors**

#### **3.1 Boards attuned to the needs of their territory and elected by and exclusively comprised of members**

In cooperative companies, the general meeting of members elects, each year, from among the participants, directors in order to replace those directors whose term of office has expired.

Because directors are elected exclusively from among members, they represent the members and the diversity of the territories in which the local banks are located.

Furthermore, directors have at the same time a professional occupation in the territory of the regional bank. This enables the directors to keep very strong ties with the social and economic life of their region and with clients and to listen to their expectations.

Cooperative banks' refusal to yield to short-term approaches along with their territorial roots have enabled them to maintain a large number of locations and jobs in rural and suburban areas.

#### **3.2 Volunteer directors strongly involved in banks' governance**

The offices of director and chairman of the local banks are strictly discharged on a unpaid basis. Nevertheless, directors are strongly involved in the governance of the banks, as they are regularly

---

<sup>7</sup> Article L.512-40 of the French Monetary and Financial Code.

<sup>8</sup> Article L. 512-38 of the French Monetary and Financial Code. This option was actually implemented through the history of the Crédit Agricole Group and in particular as regards Caisse Régionale de l'Aude in 1989, Caisse Régionale de l'Yonne in 1993 and Caisse Régionale de la Corse, which at this juncture and since 1998 continues to be managed by a management committee. Also, Crédit Mutuel's regional federations for Champagne-Ardenne and Artois-Picardie were dissolved in 1993, and all of their operations and commitments were assumed by the Fédération Régionale du Nord.

consulted as regards any major decision and meet whenever required by the company's interests, during meetings of the board's bureau ( for the directors who are members of the bureau) and during meetings of the board of directors.

In order to facilitate the discharge of the directors' and chairmen's duties, numerous training programs are organized as regards the knowledge of banking businesses and banking products, the role of elected officials, managerial approaches, etc. The objective pursued by these programs is clear: to strengthen the elected officials' initial competencies in order to enable them to optimally discharge their office as directors. Several training sessions are organized jointly for elected officials and salaried officers. These requirements expressed by financial institutions themselves as regards the directors' banking competencies also make it possible to respond to the supervisory authorities' requirements.

### 3.3 Directors who are independent of any shareholder or group of shareholders and who protect the members' collective interests

Unlike the situation observed in companies with by shares, the directors of cooperatives are not the representatives of a given shareholder or a group of shareholders, as they are elected democratically by the majority of the members during their general meeting.

Because directors are members and because of their democratic appointment mode, the directors of cooperative banks are, by definition, the representatives and guarantors of the members' collective interest. The said collective interest corresponds to the quality of the service to clients, which is by nature different from an exclusively financial interest.

In addition, the directors of regional banks have a highly diversified social and geographic profile, which has no equivalent among listed companies, in which the social cross-breeding of directors is often criticized.

No director of a regional bank may be at the same time a director of another regional bank, and may therefore not be subject to the reproaches very often made as regards the composition of boards of directors of companies listed on the CAC 40 index. Therefore, the presence of external directors in cooperative companies is not only contrary to the cooperative spirit <sup>9</sup>, but is also:

- unnecessary, as the independence of the members of the board of directors is guaranteed by their election mode, by their status which is generally that of a volunteer, and by the very organisation of our groups;
- and not desirable , as a director elected according to democratic rules, from among members, is ideally placed in order to voice the collective aspirations of the meeting of members.

Therefore, the recent discussions among the various supervisory authorities aimed at increased transparency and improved governance rules among listed companies converge in many ways with these features that mutual organisations have been embodying and enshrining for a long time.

---

<sup>9</sup> Only the members and therefore the holders of a share may be members of the various representative bodies.

#### **IV- Our observations and proposals**

##### **Preliminary remark**

We would like to recall that in Part II (Overview of bank corporate governance ), cooperative banks are cited in item 18. In fact, cooperative banks constitute a specific development model independent from the States and have nothing in common with public banks. Thus, a complete separate paragraph should be devoted to cooperative banks.

##### **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.

**This principle does not raise any problem for cooperative banks or other French enterprises, as this principle is in compliance with French law.**

**The board has a general responsibility, and salaried managers (senior management) under the appointed managing director's authority are responsible towards the elected board of directors. The same is true for cooperative banks which operate with a supervisory board and a management board.**

##### **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.

**Cooperative banks' strength stems from the diversity of their directors who are members/clients who may also be merchants, members of the professions, farmers, entrepreneurs or chief executive officers of industrial and commercial enterprises. This considerable variety makes it possible to elect directors who are highly familiar with the economic environment in which the local bank is trading. Such excellent knowledge and the resulting exchange of information make it possible to grant appropriate loans, optimize risk management, and anticipate reimbursement issues with clients.**

**Directors thus have a unique expertise and are regularly in contact with the members. As regards their initial and continuing training, except for the arguments that have been developed above, it is necessary to recall that cooperative banks allocate considerable budgets for the continuing training of their directors.**

**Numerous training programs (banking, finance, anti-money laundering, risk management, etc.) are developed for directors in compliance with the proportionality principle recalled in the introduction of the Basle Committee's consultation document (item No. 6, pages 3 and 4).**

##### **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 raise any issue for French cooperative banks. The practice of the boards of cooperative banks, consisting in the creation of various bodies, has very often been implemented ahead of similar French regulatory changes. Thus, various committees or commissions grouping members of the board are organized in order to allow for sound knowledge and control of the bank's functioning (corporate life-cooperative life commission, human resources commission, audit and risk committee, appointment committee, cooperative committee, etc.).

#### **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.

**French cooperative banks have development models based on decentralization. It is necessary to recall that regional cooperative banks are always collectively the parent company of their central bodies. The very large majority of the members of the board of directors at national level is comprised of chairmen or managing directors of regional and local entities. Thus, they participate in and facilitate the circulation of the best governance and risk management practices at regional and local level. Finally, regional entities are independent in the management of their operations within the limits set by the central body. In addition, the central body supervises the banks affiliated to it through its supervision function.**

#### **Principle 5**

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

**Within cooperative banks, risk control is applied at all levels and first at the level of each regional bank. Furthermore, regional managing directors, all managers and the risk managers adapt and implement the common strategy and risk policy, under the leadership and control of the elected board of directors.**

#### **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).

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks. There is a "risk" organisation within each regional bank which inserts itself in a national network supervised by the central body.**

#### **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.

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks.**

Through regulation 97-02, governing the functioning of the internal control of credit institutions, French regulations already enshrine all of the said principles.

#### **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.

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks in accordance with Regulation 97-02 concerning the internal control of credit institutions.**

#### **Principle 9**

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

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks in accordance with Regulation 97-02 concerning the internal control of credit institutions.**

#### **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.

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks.**

#### **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 does not call for any observation on our part, as this rule is already applied within cooperative banks.**

**Also, it is necessary to recall that, since the financial crisis, variable remuneration and stock options are much more strictly monitored and are linked to long-term positive performance.**

**Within cooperative banks, variable remuneration is determined on the basis of pre-set criteria and marked by the payment of liquidity that does not dilute the members' power.**

#### **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").

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks.**

#### **Principle 13**

Where a bank operates through special-purpose or related structures or in jurisdictions 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”).

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks.**

#### **Principle 14**

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

**This principle does not call for any observation on our part, as this rule is already applied within cooperative banks.**

**Transparency and the information of members/clients form part of cooperative banks’ identity.**

**At local level, financial democracy is implemented in particular through members’/clients’ participation in general meetings and in information meetings. At national level, the publication of various reports or benchmark documents strengthens this global transparency.**