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Resolution Issues for Financial Cooperatives- Overview of Distinctive Features and Current Resolution Tools

Research Paper

Prepared by the Research and Guidance Technical Committee Subcommittee on Resolution Issues for Financial Cooperatives

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ABBREVIATIONS

BRRD	Bank Recovery and Resolution Directive
CoCos	Contingent convertible capital instruments
DIO	Deposit insurance organisation
D-SIFI	Domestic Systemically Important Financial Institution
ECB	European Central Bank
EXCO	Executive Council
FC(s)	Financial cooperative(s)
FSB	Financial Stability Board
G-SIFI	Global Systemically Important Financial Institutions
IADI	International Association of Deposit Insurers
NVCC	Non-viability contingent capital
OECS	Organization of Eastern Caribbean States
RA	Resolution authority
SRIFC	Subcommittee on Resolution Issues for Financial Cooperatives
WOCCU	World Council of Credit Unions

This paper is mainly based on an IADI survey on resolution issues for financial cooperatives, which was distributed in July 2015 to more than 100 organisations worldwide, including all IADI members as well as other deposit insurers that are not members of IADI. Since, some survey respondents have made changes to their legislative and resolution framework. This paper is also based on case studies received in September 2015 from SRIFC members and non-members. Therefore, although some of the examples given in this paper may now no longer apply they are useful references to how these issues have been approached in the past. This paper's purpose is to highlight the need to adapt bank resolution tools to financial cooperatives as necessary, given their distinctive features.

1. EXECUTIVE SUMMARY

Financial deposit-taking institutions such as credit unions, "caisses populaires", "cajas", cooperative banks or mutuals, collectively referred to as "financial cooperatives" (FCs) in this paper, are an important player in the financial sector/system of a large number of jurisdictions around the world, with some of them designated as global or domestic systemically important financial institutions (SIFIs). Even in jurisdictions where no individual FC is a SIFI, the FCs in the aggregate may be a systemically important component of the financial sector due to their overall proportion of the market.

There are various types of FCs around the world. Generally speaking, FCs have distinctive features that make them different from banks. These differences relate to their objective, the ownership structure, the participation in the decision-making process, the ways in which they access capital, the business model, etc.

Due to differences between banks and FCs, tools used for the resolution of banks cannot always be used directly for FCs. Most of these tools need to be adapted because their use for FCs raises specific challenges, such as the need for demutualisation or, in most cases, the difficulty in accessing external capital because of their cooperative nature. However, some resolution tools can be used in the same way as for banks.

The purpose of the Subcommittee on Resolution Issues for Financial Cooperatives (SRIFC) is to further research on the importance of FCs, and to highlight the need to adapt bank resolution tools to FCs as necessary, given their distinctive features. The main objective of the SRIFC is ultimately to develop a toolbox for deposit insurance organisations (DIOs) and/or resolution authorities (RAs) to use when resolving an FC.

For this purpose, the International Association of Deposit Insurers (IADI) plans to publish at least two papers. Using data mainly from the SRIFC survey and the case studies completed by some IADI members and non-members, this first paper (research paper) seeks to provide an overview of FCs' distinctive features and the tools used for their resolution, along with the challenges associated with the use of those tools. The second paper (guidance paper) will aim to enhance the resolution tools applicable to FCs. The present paper is structured as follows: Section 2 describes the creation of the SRIFC and outlines the goals of this paper; Section 3 presents the research methodology used in the paper; Section 4 gives the types of FCs and their key characteristics; Section 5 describes the resolution tools and the challenges associated with their use; Section 6 presents other resolution challenges, while Section 7 presents some particularities of small and large FCs in a resolution process. Section 8 concludes.

2. INTRODUCTION

Following the financial crisis of 2007–2009, international standard-setting bodies have enhanced the regulation, supervision, intervention and resolution of financial institutions. By incorporating the lessons learned from the financial crisis, this enhancement has raised the bar for best practices for deposit insurance organisations and/or resolution authorities (DIOs/RAs).

While best practices for intervention and resolution are aimed at all types of financial institutions, research projects from international standard-setting bodies remain essentially bank-oriented. As a result, recommendations stemming from these studies may not be applicable to other types of deposit-taking institutions such as Financial Cooperatives (FCs) because of their unique characteristics.

As such, the different, complex and unfamiliar resolution issues inherent to FCs have not yet been the subject of comprehensive discussion or research within the IADI. Given the importance of FCs worldwide, in June 2014 the IADI Executive Council (EXCO) approved the creation of the Subcommittee on Resolution Issues for Financial Cooperatives (SRIFC).[1]

The purpose of the SRIFC is to further research on the importance of FCs for the financial system of a very large number of jurisdictions, and to highlight the need to adapt bank resolution tools to FCs as necessary, given their distinctive features.

With that in mind, the main objective of the SRIFC is ultimately to develop a toolbox for DIOs and/or RAs to use when resolving an FC.

[1] As of September 2015, there were 11 member jurisdictions of the Subcommittee on Resolution Issues for Financial Cooperatives: British Columbia (Canada), Chinese Taipei, Colombia, Italy, Japan, Kenya, Poland, Quebec (Canada), Trinidad and Tobago, Ukraine and the UK. Since then, six new member jurisdictions have joined the Subcommittee: Barbados, Brazil, the Czech Republic, India, Iran and Jamaica.

2.1. PURPOSE

The purpose of this first research paper is to provide an overview of the distinctive features of FCs and the resolution tools currently available to DIO and/or RAs responsible for the resolution of FCs. To this end, we first describe FCs around the world, focusing not only on their common features, but also on the specificities of FCs in certain jurisdictions, before taking stock of the resolution tools currently available to DIOs/RAs.

2.2. BACKGROUND

The first FCs were created in Europe. The earliest ones date back to the end of the 18th century in Germany and the beginning of the 19th century in England. A few decades later, they took root in Italy and Poland. In the Caribbean, building and loan associations were introduced in the late 19th century (Trinidad and Tobago, Jamaica) and the first credit unions in the 20th century (Grenada, Saint Vincent, Dominica) (Astaphan et al., 2015). In 1900, the first FC in North America was established in Quebec (Canada) to provide affordable credit to working class families. Nearly a decade later, the concept extended to the US. During the 1920s, FCs became increasingly popular in North America.[2]

As of 2014, the World Council of Credit Unions (WOCCU) reports the existence of about 57,000 credit unions in 105 countries around the world, serving 217 million people[3]. For the same year, according to the European Association of Cooperative Banks, there were nearly 4,200 independent local cooperative banks in 20 European countries.[4] The deposit market share of these banks is more than 60% in France, about 35% in Austria, Finland, Italy and the Netherlands, and over 20% in Germany and the UK.[5] In the US, there were over 6,200 credit unions in 2014, while in Canada there were 694.[6] In each of these North American countries, the penetration rate of credit unions is over 40% (World Council of Credit Unions, 2015).[7] FCs are also very popular in the English-speaking Caribbean where more than 45% of the active population are members of a credit union. In particular, in

[2] Adapted from https://www.ncua.gov/About/Pages/history.aspx and https://www.desjardins.com/ca/about-us/desjardins/who-we-are/our-history-museum/timeline/index.jsp.

[3] See www.woccu.org

[4] See http://www.eacb.coop/en/cooperative-banks/key-figures.html

[5] FCs in the UK range from the largest deposit-takers, in the form of a building society, to the smallest, in the form of credit unions. All are regulated by the Bank of England/Prudential Regulation Authority. Under the Banking Act 2009, a code of practice must be published on how resolution may be exercised, and it includes a number of paragraphs on its application to building societies as mutuals.

[6] See National System Results 2014 4Q from:

https://www.ccua.com/about/facts_and_figures/documents?filterlist=Quarterly%20System%20Results and https://www.ncua.gov/Legal/Documents/Reports/IAG201412.pdf

[7] The penetration rate is calculated by dividing the total number of reported credit union members by the economically active population age 15–64 years old.

member countries of the Organization of Eastern Caribbean States (OECS),[8] this percentage goes up to 75% (Astaphan et al., 2015).

All these figures show that FCs are very important financial institutions worldwide. Moreover, some FCs, such as Crédit Agricole and BPCE of France, have been designated as Global Systemically Important Financial Institutions (G-SIFIs) by the Financial Stability Board (FSB). There are also FCs that have been designated as Domestic Systemically Important Financial Institutions (D-SIFIs) by their jurisdictions. These D-SIFIs include Central 1 Credit Union for British Columbia (Canada), Desjardins Group for Quebec (Canada), DZ Bank for Germany, Norinchukin Bank for Japan, and Rabobank for the Netherlands.

FCs have inherent characteristics which distinguish them from banks. There are significant differences, for example, in terms of ownership, access to capital, the feeling of belonging that customers may have towards their financial institution, and participation of customers (and as such members) in the decision-making process.

These unique features and often complex differences can present challenges when resolving FCs. For smaller institutions, challenges may include: an often small pool of potential acquirers (if any); the fact that the FC is often the only financial link with a specific region – especially in remote areas – community or group of workers; the feeling of belonging that members (who are generally also customers and depositors) may have towards their FC; the trade-off for deposit insurers and resolution authorities between maintaining community services and adequate intervention and resolution strategies.

For larger and, in particular, systemically important FCs, the challenges described above may be supplemented by other difficulties, such as the absence of a key legal entity or a holding company at the parent level (making a single point of entry resolution strategy less likely or more difficult), and the difficulty in applying certain resolution tools more relevant for systemically important financial institutions, due to the FC's capital structure.

The rest of the paper is structured as follows: Section 3 describes the research methodology used in the paper; Section 4 presents the types of FCs and their key characteristics. Section 5 describes the resolution tools and the challenges associated with their use; Section 6 focuses on other resolution challenges and Section 7 presents some particularities of small and large FCs in a resolution process. Section 8 concludes.

[8] The OECS comprises Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, and the British Virgin Islands.

3. METHODOLOGY

The data used in this research paper come mainly from five sources:

- The IADI survey on resolution issues for FCs, which was distributed in July 2015 to more than 100 organisations worldwide, including all IADI members as well as other deposit insurers that are not members of IADI. At the cut-off date of December 2015, the participation rate of the survey was 42%, among which 28 jurisdictions had FCs.

- The case studies were received in September 2015[9] from SRIFC members and non-members. The aim of the case studies was to provide a detailed account of resolution experience by a DIO and/or RA, or a detailed explanation of how a DIO and/or RA have implemented a resolution framework for FCs. These case studies also presented some lessons learned by various jurisdictions.[10]

- The jurisdiction reports filled out by SRIFC members at each Subcommittee meeting since June 2015. The goal of these reports is to share the main initiatives and developments in the respective jurisdictions of members with regard to financial cooperatives resolution, regulations and/or legislation.

- The workshop held by the SRIFC in Basel in March 2016, at which the results of the SRIFC survey were presented. A total of 41 participants attended the workshop.

- The existing literature on FCs and the resolution of deposit-taking institutions.

Table 1 lists the DIOs/RAs with FCs in their jurisdiction that participated in the case studies and/or the survey.

[9] India did not submit a case study in September 2015, but did provide some information in January 2017. This new information was added in case studies, template B.

[10] Case studies are presented in Annex 2. The number of case studies (13) in this annex differs from the number of case studies received (17-as showed in Table 1), due to the fact that some jurisdictions did not provide a confirmation for the publication.

Table 1: Survey respondents or case study providers whose jurisdictions contain financial cooperatives

Jurisdiction	Organisation	Case study	Survey
Albania [2]	Albanian Deposit Insurance Agency		✓
Alberta (Canada)	Credit Union Deposit Guarantee Corporation		✓
Australia	Australian Prudential Regulation Authority		✓
Bolivia	Banco Central de Bolivia	✓	
British Columbia (Canada)	Credit Union Deposit Insurance Corporation of British Columbia	✓	✓
Chile	Economy Ministry	✓	
Chinese Taipei	Central Deposit Insurance Corporation	✓	✓
Colombia	Fondo de Garantias de Entidades Cooperatives	✓	✓
Czech Republic	Deposit Insurance Fund		✓
France	Fonds de Garantie des Dépôts et de Résolution		✓
Germany	Institutional Protection Scheme of the National Association of German Cooperative Banks		✓
Greece	Hellenic Deposit and Investment Guarantee Fund		✓
Hungary	National Deposit Insurance Fund of Hungary		✓
India	Deposit Insurance and Credit Guarantee Corporation	✓	✓
Italy	Fondo di Garanzia dei Depositanti del Credito Cooperativo	✓	
Italy	Fondo Interbancario di Tutela dei Depositi		✓
Japan	Deposit Insurance Corporation of Japan	✓	✓
Japan	Agricultural and Fishery Cooperatives Savings Insurance Corporation		✓
Lithuania [1]	State company "Deposit and Investment Insurance"		✓
Manitoba (Canada)	Deposit Guarantee Corporation of Manitoba	✓	
Mexico	Fideicomiso Fondo de Supervision Auxiliar de Sociedades Cooperatives de Ahorro y Prestamo y de Proteccion a sus Ahorradores	✓	✓
New Brunswick (Canada)	New Brunswick Credit Union Deposit Insurance Corporation		✓
Netherlands	De Netherlands Bank		✓
Ontario (Canada)	Deposit Insurance Corporation of Ontario	✓	✓
Philippines[1]	Philippine Deposit Insurance Corporation		✓
Poland	Bank Guarantee Fund	✓	✓
Prince Edward Island (Canada)	Prince Edward Island Credit Union Deposit Insurance Corporation		✓
Quebec (Canada)	Autorité des marchés financiers	✓	✓
Saskatchewan (Canada)	Credit Union Deposit Guarantee Corporation	✓	✓
Ukraine	Deposit Guarantee Fund	✓	
United Kingdom [3]	Financial Services Compensation Scheme	✓	✓
Uruguay	Corporacion de Proteccion del Ahorro Bancario		✓
Vietnam	Deposit Insurance of Vietnam		✓

(1) These jurisdictions only responded to questions on the types of financial institutions that are members of their jurisdictions. They do have FCs but have not given further information. Therefore, they are not included in the percentage calculations in the paper.

(2) As of September 2015, Albania was planning to include savings and credit associations (a type of FC) in its DIO. Although its legislation came into force only at the end of December 2015, Albania filled out the survey. Therefore, its responses are included in the percentage calculations in the paper.

(3) The UK submitted two case studies.

4. TYPES AND KEY CHARACTERISTICS OF FINANCIAL COOPERATIVES

4.1. TYPES OF FINANCIAL COOPERATIVES

There are various types of FCs around the world. These different types are often defined in specific legislation of the jurisdiction concerned, and the legislation may have some particularities that make the FCs of that jurisdiction slightly different from other types of deposit-taking institutions. In the survey, out of the 28 DIOs and/or RAs which have FCs as members, 19 (68%) have a legal definition of the term "financial cooperatives" which includes credit unions or "caisses populaires", cooperative banks, mutuals, building societies, etc.

Based on the information used in this research paper, including the legal definitions in Annex 3, the SRIFC defines a financial cooperative as:

> *"a member-owned financial institution, set up with the purpose of providing financial services such as receiving deposits and making loans primarily to its members, in which membership is often based on residence or another common bond and where each member participates to some extent in the decision-making process, generally via the one member - one vote principle."*

Even if some FCs have the same names across jurisdictions, those names do not necessarily mean exactly the same thing in every jurisdiction. For example, a credit union in one jurisdiction could have a different meaning in another. Moreover, a cooperative bank and a credit union in two different jurisdictions could have the same meaning. Furthermore, in many publications about cooperatives, the terms *financial cooperative* and *mutual* are often synonyms. However, in some jurisdictions the term *mutual* could have a different meaning entirely, as is the case in France, where it may refer to a health insurance cooperative (Galor, 2008). In this paper, this latter definition of *mutual* is not taken into account. Only FCs that take deposits and make loans are considered here.

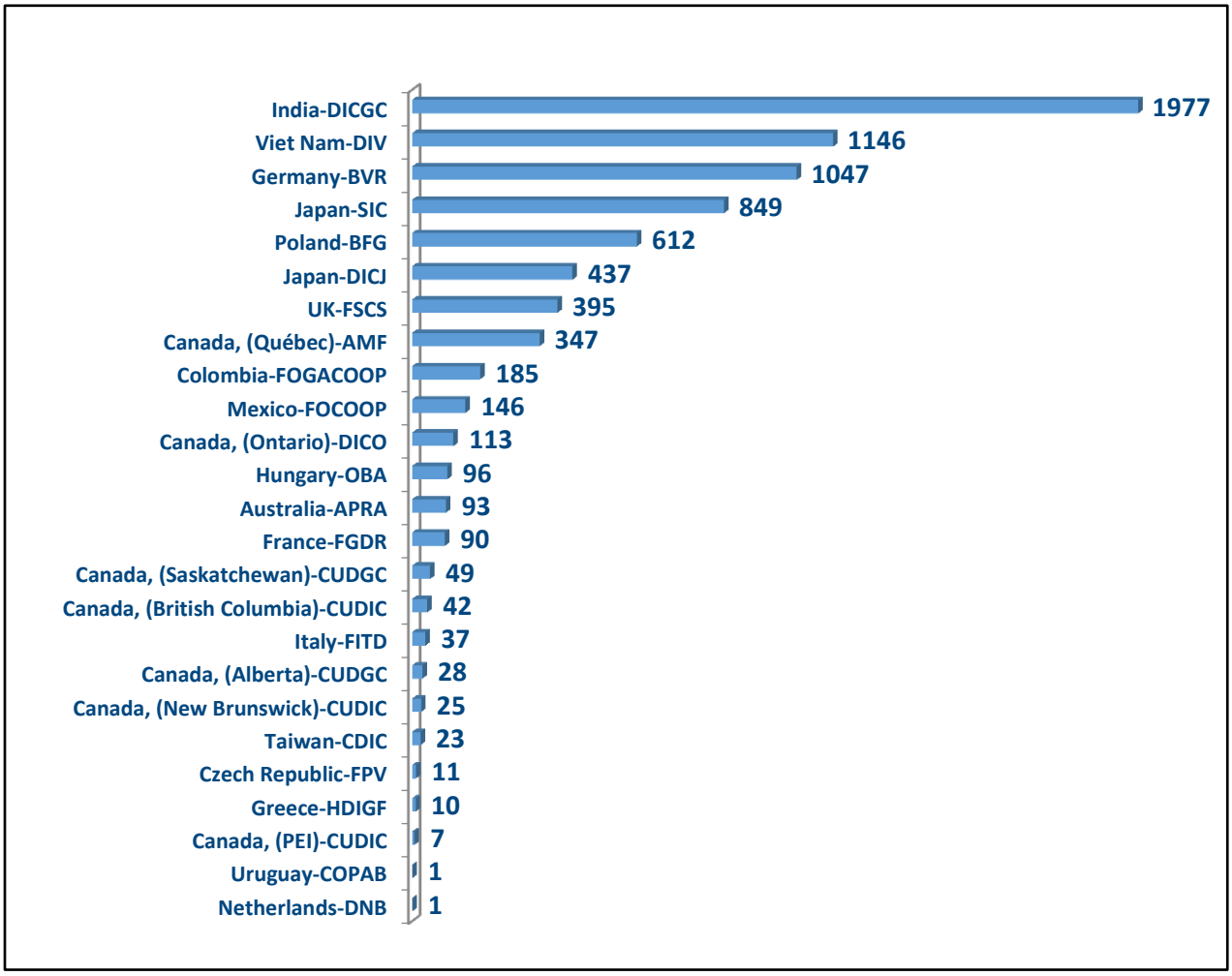
Table 2 presents the most common types of FCs that are members of DIOs and/or RAs, while Figure 1 presents the number of FCs that are members of DIOs and/or RAs in the jurisdictions that responded to the survey. As can be seen in the table, many jurisdictions deal with different types of FCs. These types may have many common characteristics but also some differences.

Table 2: Types of financial cooperatives in participating jurisdictions based on the SRIFC survey

Jurisdiction	Credit unions/ "caisses"	Mutuals	Cooperative banks	Savings banks/savings and credit associations	Rural banks/community banks	Other types of FCs
Albania				✓		
Alberta (Canada)	✓					
Australia	✓	✓	✓	✓	✓	
British Columbia (Canada)	✓					
Chinese Taipei	✓					✓
Colombia						✓
Czech Republic	✓			✓		
France	✓	✓	✓	✓	✓	
Germany			✓			
Greece			✓			
Hungary	✓		✓	✓		
India			✓		✓	
Italy (FITD)			✓			✓
Japan (DICJ)	✓		✓			✓
Japan (SIC)						✓
Lithuania	✓					
Mexico (FOCOOP)[(1)]	✓					
Netherlands			✓			
New Brunswick (Canada)	✓					
Ontario (Canada)	✓					
Philippines			✓	✓	✓	
Poland	✓		✓			
Prince Edward Island (Canada)	✓					
Quebec (Canada)	✓					
Saskatchewan (Canada)	✓					
United Kingdom	✓	✓	✓	✓		
Uruguay	✓					
Vietnam	✓		✓			

(1) Credit unions in Mexico are regulated by the supervision authority, Fideicomiso Fondo de Supervision Auxiliar de Sociedades Cooperativas de Ahorro y Prestamo y de Proteccion a sus Ahorradores (FOCOOP), but they do not participate in any DIO.

Figure 1: Number of FCs that are members of DIOs and/or RAs in participating jurisdictions



Source: SRIFC survey (2015)

4.2. KEY CHARACTERISTICS

Notwithstanding the differences in the types of FCs, there are some core characteristics that describe almost all of them.

4.2.1. Objectives of financial cooperatives

In general, the mission of FCs is to promote the economic interest and social and economic benefits of their members/customers. Their activities are founded on ideas such as mutuality, solidarity, cohesion, ethics or local development. Since in many cases, their customers are also members, the main focus of many FCs – as distinct from commercial banks – is on the quality and the condition of serving or financing their members/customers, while profitability may be no more than a condition for survival (Boscia et al., 2009). It is, among other things, because FCs' primary objective is not necessarily profit maximisation that some of them are

prepared to operate branches in remote or sparsely populated areas. For example, FCs are located in remote areas in many jurisdictions (e.g. Chinese Taipei and Quebec (Canada)).

4.2.2. Ownership structure

In general, to join an FC (and thus become a member), a person must be within its field of membership. The most common fields of membership include employees or industrial groups, religious affiliations, associations or residential areas.

In FCs, the members are simultaneously owners of the organisation and its customers (borrowers and lenders). In general, all members have an equal voice regardless of the amount of savings, number of accounts, capital contributions or loans they have with the institution. Thus the voting right is based, in most cases, on the one-member-one-vote principle.

Other forms of ownership structure apply in some jurisdictions. In Greece for example, two kinds of shares exist for FCs operating specifically as credit institutions. In that case, the number of a member's votes is determined by the number of shares with voting rights. However, a member cannot have more than either five votes or 2% of the total number of votes. A different ownership structure also exists in the Czech Republic, where members get one vote for the basic member contribution and additional votes for further contributions. Other jurisdictions let FCs decide for themselves. In Poland for example, although the Cooperative Law entitles one member of a cooperative to one vote, an FC whose members can only be legal persons may set other voting rules.

4.2.3. Services to members

In terms of service, most FCs generally serve only their members, but there are cases in which some of them may offer financial services to non-members. However, restrictions may apply to non-members, as in Shinkin banks (a type of FC) in Japan, where deposits from non-members are allowed but loans are limited to members, with some exceptional conditions for non-members, or in Saskatchewan (Canada), where services to non-members have to be authorised by the articles of the credit union.

In Colombia, the main characteristic that differentiates the types of cooperatives is whether or not they are allowed to offer financial services to non-members. This is also one of the characteristics that distinguish credit unions from cooperative banks in Poland. Credit unions are entitled to provide financial services only for their members, while cooperative banks have no such constraint. Nevertheless, this right granted to cooperative banks is accompanied by capital constraints. Cooperative banks have to possess initial capital of at least EUR 1 million, whereas there is no minimum capital requirement in the case of credit unions.

In Mexico, one of the main differences between FCs and commercial banks is the type of services that can be provided. By law, FCs are not permitted to provide checking accounts, derivatives, and international services, regardless of their size.

There are also jurisdictions, such as France and Germany, where some FCs are open, without restriction, to all people who want to be customers.

4.2.4. Participation of members in the decision-making process

Participation of members in decision-making is the essence of FCs. In all jurisdictions surveyed, customers (and as such members)[11] participate, at least to some extent, in the decision-making process.

In an FC, power is most often exercised according to the one-member-one-vote principle. In general, the members are convened to a general meeting to elect the members of the board of supervision and in some cases to elect the members of the board of directors.[12] Where applicable, the chairperson of the board of supervision can then be selected, as well as the president (chairperson of the managing board) and other management officials of the FC. Not all the board members need necessarily be members of the FC. Nonetheless, in jurisdictions like Japan, there is a principle that restricts the participation of non-members: two-thirds of the board of directors must be selected from members.

However, the one-member-one-vote principle does not apply everywhere. For example, in the Czech Republic, members' participation depends on the amount of their contribution.[13]

Some jurisdictions have a system of FCs with two levels. Members are owners and decision-makers in individual cooperatives, which in turn are decision-makers in central entities. For example, in Quebec (Canada), the main FC is made up of individual caisses and each caisse participates in the election of the board of the central organisation. In Japan, in the case of labour banks (a type of cooperative bank), the members are labour unions and the central entity is the Rokinren Bank.[14] Each depositor is an indirect member through the labour union(s) to which he/she belongs, and is involved in the decision-making at the labour banks through the labour union(s). The same principle is applied in France, where individual members are the decision-makers within local cooperative banks, which are themselves the shareholders of the central organisation.

[11] In Poland cooperative banks (as FC's) can provide some services to customers who are not members.
[12] In Germany, the general assembly of the members (or the delegates) elects the members of the supervisory board but not the members of the "normal" board of managing directors. In this jurisdiction, there is a chairperson of the managing board in *some cases* but in *every case* there is a chairperson of the supervisory board.
[13] Since 1 July 2015, a new regulation is introduced which has some restrictions, such as a minimum share amount for one member set at CZK 1,000.
[14] Labour unions are not financial institutions but labour banks are. Although individual membership in labour banks is allowed, individual members do not have voting rights at the general meeting.

The voting rights of members can be exercised at the annual general meetings or at meetings on issues raised by the governing body (e.g. in the UK) or initiated by members (e.g. in British Columbia (Canada)).

4.2.5. Access to capital

The way capital is built up in FCs is different from the way it is built up in publicly traded banks. A publicly traded bank can issue stock to raise equity on the financial markets, and this stock can be bought by any investor and transferred from one shareholder to another. In FCs, capital cannot be raised externally, except in a few cases.[15] In general, to join the FC, a member must acquire a membership share that makes him/her an owner of the FC, like other members. Paid-in capital resulting from these shares is an important element of the capital base, but may prove insufficient in a dire situation potentially leading to resolution. To increase paid-in capital, FCs need to broaden their membership base. This is not always easy, especially when restrictions like common bond and location apply.

The most common way for FCs to increase their level of capital, apart from paid-in capital, is to accumulate retained earnings. This allows them to build up sufficient capital internally over time. However, building up retained earnings by increasing profitability may not always be easy for FCs, whose mission may not necessarily be profit maximisation. Other ways to build up capital internally may include contributed surplus, reserve funds, revaluation reserves, and additional funds such as general risk funds.

There are, however, a few jurisdictions where FCs are allowed to raise capital externally. Several mechanisms can be used, when permitted. Some jurisdictions, such as France, make external capital issuance possible for FCs as long as the FC adapts its structure (when allowed) to become a commercial corporation or bank able to issue equity on the financial markets. Examples of external sources of capital to which FCs may have access are subordinated debt, eligible convertible debt, securities without specified maturity, and other Tier II and III capital. It may also be possible to issue preferred equity or investment shares in jurisdictions like Japan or the Canadian provinces of British Columbia and Ontario. In the case of Japan, preferred equity may be issued subject to some restrictions, such as (1) submitting the conditions of each offer to approval by the administrative agencies of the FC and (2) limiting total participation for preferred equity units to less than half that for normal shares in each financial cooperative. In Poland, in addition to some of the external sources of capital mentioned above, credit unions have access

[15] It could be argued that privately held banks would also have difficulty raising equity capital from the market in a period of distress. Indeed, in contrast to publicly held banks, privately held banks cannot raise equity capital directly through the financial market without altering their ownership structures and becoming public (Nichols et al. 2005).

to funds as subordinated debt, such as the stabilisation fund of the NACSCU (National Association of Cooperative savings and Credit Unions), the Bank Guarantee Fund and other funds if approved by the supervisory authority. The SRIFC survey revealed that some jurisdictions require FCs to be financed only by internal capital. Some other jurisdictions allow a mix of internal and external capital. In general, there are no particular limits or proportions of internal capital required in relation to the FC's total capital. However, in a few jurisdictions, there may be a limit on external capital. For example, in Colombia, no natural or legal person may own more than 49% of an FC's capital. In the province of Ontario in Canada, external capital cannot be more than one-third of total capital.

The way in which FCs can access capital may give rise to specific challenges during their resolution. When the FC is no longer viable or is likely to become non-viable in the near future, the supervisory authority may require the FC to increase its capital. Unlike banks, where shareholders can be asked directly to increase the level of capital or the bank can raise capital on the financial markets, for FCs in some jurisdictions it is unlikely that they can raise capital by asking members to increase their share contribution.[16] Moreover, raising capital on the financial markets may be impossible for FCs, except in limited cases, such as in France, where access to external capital is possible as long as the FC adapts its structure to become a commercial corporation or bank able to issue equity. Therefore, resolution tools that directly involve FCs' capital structure (such as bail-in, contingent capital or recapitalisation) may not be easily applicable to them.

4.2.6. Specific links of financial cooperatives

Most FCs are based upon a common bond linking the members of the organisation. The most recurrent common bond according to the survey is the geographical region in which the members live or work. In such a context, FCs are primarily designed to serve the residents of the region. Indeed, in some cases, they are the region's only financial institution. Nevertheless, there are also FCs that operate nationwide. This may depend upon their nature or size. In some jurisdictions, certain types of FCs are restricted to specific regions or do not have the capacity to expand across the whole jurisdiction, while others have the ability and the right to operate in different parts of the jurisdiction. For instance, in India, urban cooperatives are concentrated in a few provinces, whereas rural cooperatives are spread across the jurisdiction. In the Czech Republic, FCs are present across the whole jurisdiction.[17]

[16] There may be exceptions in some jurisdictions. Historically, in Japan, there have been many FCs which requested increased capital contributions from their members, and it was also normal practice in the past.

[17] In the Czech Republic, when an FC's total assets exceed the limit of Czech Koruna 5 billion (about USD 200 million), it must apply for a regular banking licence.

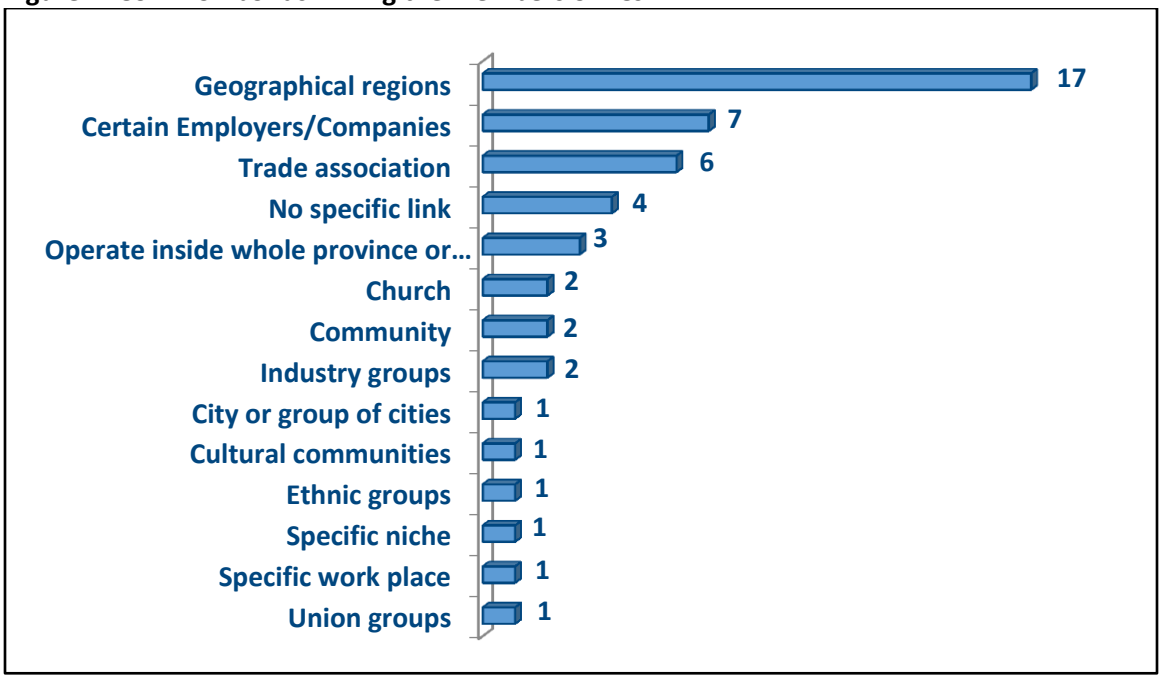
The restriction to a local region may be a measure imposed by the supervisory authority to ensure that the FC focuses primarily on its local clientele and develops the necessary skills and resources before expanding across the jurisdiction. In Poland, for example, a cooperative bank with initial capital between EUR 1 and 5 million can operate only within the "voivodeship" (province) of its registered head office, while a cooperative bank with initial capital above EUR 5 million can operate jurisdiction-wide.

There are also FCs for which the common bond is defined by the profession, the industry or employer group, or the religious, cultural or ethnic affiliation. This kind of FC exists in many jurisdictions, namely Australia, Colombia, Japan, Poland, and the Canadian provinces of Alberta, British Columbia, Ontario and Quebec, among others.

It must be noted that there are jurisdictions, for example Uruguay and Mexico, in which there is neither a regional nor any other kind of common bond between the members of an FC. Thus, anyone can be a member of an FC in these jurisdictions.

Figure 2 lists the common bonds between FCs that can exist in survey respondent jurisdictions.

Figure 2: Common bonds linking the members of FCs



Source: SRIFC survey (2015)

4.2.7. Roles and mechanisms of central/umbrella organisations

Since many FCs are small, with only a few branches and limited capital, they do not always have the necessary resources to make efficiency gains through economies of

scale, and provide their members and customers with the requested products and services. For this reason, FCs often unite under or cooperate with umbrella or central organisations, which enables them to offer a wider range of financial services and achieve their goals of satisfying the needs and maximising the welfare of their customers/members. [18] Such umbrella organisations exist in most jurisdictions that have FCs (81% of the survey respondent jurisdictions).

The central organisations provide their members with a variety of services, including representing the cooperatives to the central bank and other banking system authorities, state or federal administration, and international organisations. The role of central organisations also includes financial assistance when capital requirements are not met or when liquidity is needed, as well as legal, managerial and technical assistance, sometimes with a special focus on newly created FCs. Some jurisdictions also have institutional protection schemes (IPSs), which are contractual or statutory arrangements for a group of banks or FCs aimed at protecting the member institutions and, in particular, ensuring their liquidity and solvency (e.g. IPS for cooperative banks in Germany, Poland and Quebec (Canada); a similar initiative is ongoing in Italy for cooperative banks).

Central organisations may also host the online banking platform and provide an integrated system, such as ICCREA Group in Italy and Central 1 in British Columbia (Canada).

In some cases, the central organisation can perform supervisory tasks over its members, ensuring that they comply with the law, statutes and contracts of the association. The central organisation in such cases plays a first-stage supervisory role, like the NACSCU (National Association of Cooperative Savings and Credit Unions) or the Associating Banks, both from Poland[19] or the Cooperative Bank of Vietnam. It thus appears that the presence of a central organisation can contribute to strengthening the resilience of the FC system and promote the activities of FCs.

Nonetheless, there are jurisdictions in which some FCs do not have a central umbrella organisation. These include Chinese Taipei, the Czech Republic, Greece and Uruguay.

4.2.8. Regulation and supervision of financial cooperatives

There are different forms of supervision and different supervisory organisations for FCs around the globe.

[18] Umbrella or central organisations may also take the form of an association. They are referred to as "trade associations" in some jurisdictions.

[19] In Poland, although FCs and commercial banks are supervised by the same authority, the regulatory requirements for small credit unions are less strict than those for large ones and for commercial banks.

Poprawa (2009) describes four models of supervision for FCs. The first approach is direct supervision of all FCs, in which uniform standards of regulation are used for all FCs in the jurisdiction. The second is direct supervision of the largest FCs, in which the financial sector regulator directly supervises only the country's [jurisdiction's] largest FCs, based on asset size or deposit base. The third is delegated supervision, in which the government formally assigns supervisory enforcement powers via law or regulation to a third party, most often the FCs' national association or an arm of the association. The fourth approach is supervision by restructured ministries of cooperatives, in which the ministry of cooperatives is restructured to become the prudential FC supervisor.

The survey shows that in some jurisdictions, FCs are supervised by the same authority as banks (e.g. France, Germany, Poland and the UK), while in others a supervisor is specially dedicated to FCs. This is the case in Canada, where each province is constitutionally mandated as the regulator of its own credit unions or caisses, while all banks are regulated federally.[20] In Colombia, different types of FCs are supervised by different authorities. Some are treated like banks while others are considered as pure FCs.

There are also jurisdictions in which the same FCs are supervised by two different authorities. In Chinese Taipei, for example, in addition to being supervised by the central authority, which is the same as that for banks, FCs are also under local government supervision. Likewise, in Mexico, supervision of FCs works on a two-tiered scheme, with the National Banking and Securities Commission (CNBV) as the main supervisor, supported by the auxiliary supervision committees at the Protection Fund for Cooperatives (FOCOOP).[21]

Just as with banks, FCs considered to be of systemic importance may be subject to stricter requirements than their non-systemic counterparts. This is the case in Japan, the Netherlands and Quebec (Canada). Furthermore in Quebec, the regulator has adapted the Basel III capital rules to this D-SIFI in its guideline on capital adequacy requirements, and is designing specific resolution plans. In Europe, three FCs in France, three in Germany and four in Italy have been declared "systemically important" by the European Central Bank (ECB) and placed under direct ECB supervision.

[20] On 29 March 2010, the Government of Canada introduced Bill C-9 being *An Act to implement certain provisions of the budget tabled in Parliament on March 4, 2010 and other measures*. Bill C-9 introduced a framework enabling provincial credit unions and caisses populaires to incorporate, or continue as, federal credit unions. Since then, one provincial credit union has continued as a federal credit union.

[21] CNBV is also the supervisor of the full-service commercial banks of Mexico.

5. DESCRIPTION OF RESOLUTION TOOLS FOR FINANCIAL COOPERATIVES

Since FCs' business model is different from that of banks, their resolution may also be different and may give rise to specific challenges. Indeed, there are some resolution tools that cannot be applied to FCs in the way they are applied to banks, because those tools could require a change in the cooperative nature of the FC. In fact, given FCs' capital structure, demutualisation may be required before certain resolution tools can be applied.

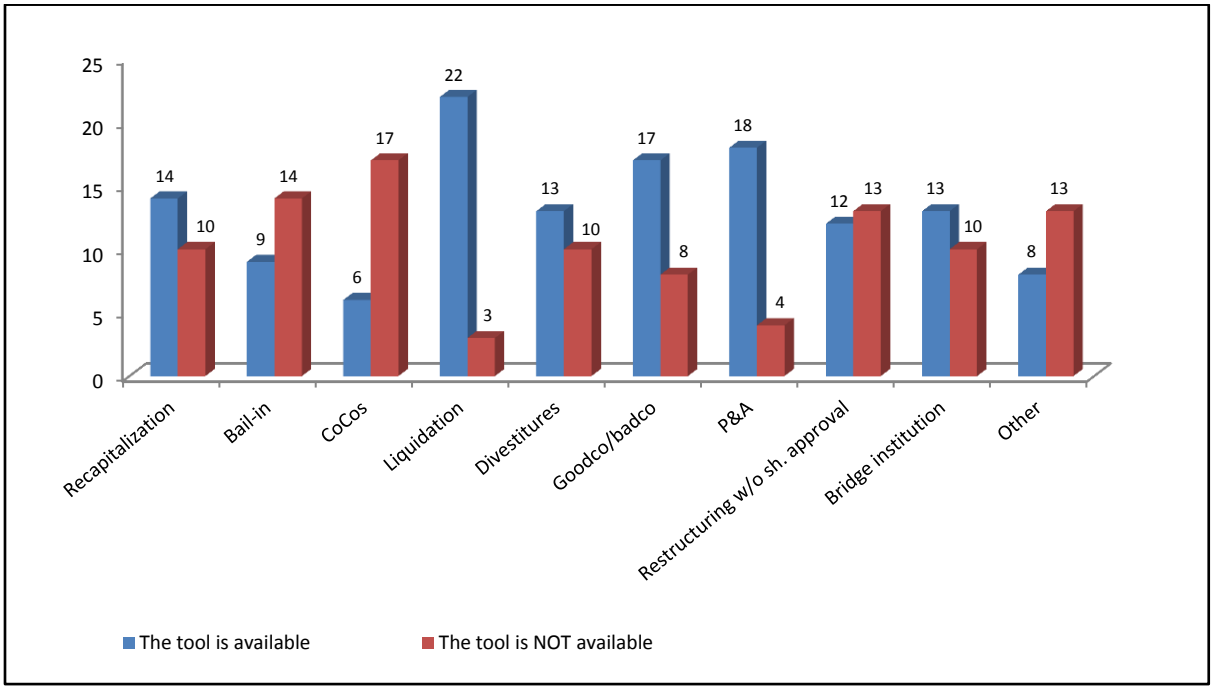
This section provides an overview of resolution tools available to DIOs and/or RAs of FCs, followed by the characteristics and challenges associated with each of them. Thereafter, the concept of the demutualisation is briefly presented.

5.1. OVERVIEW OF RESOLUTION TOOLS

There are several resolution tools that can be used for the resolution of deposit-taking financial institutions. Some of these tools are used more frequently than others, partly because they align better with the statutory mandate or written policy objective of the jurisdiction.

Figure 3 shows the number of survey respondent jurisdictions (among jurisdictions with FCs) that have a given resolution tool available. It shows that the liquidation tool is the most widely available among survey respondent jurisdictions, followed by the purchase and assumption tool (P&A).

Figure 3: Number[1] of survey respondent jurisdictions that have a given resolution tool[2] available for FCs[22]



Source: SRIFC survey (2015)

(1) The total number of respondents with FCs is not always the same because some respondents did not mention whether a specific tool is available. Across the entire survey, the number of respondents with FCs is 28.

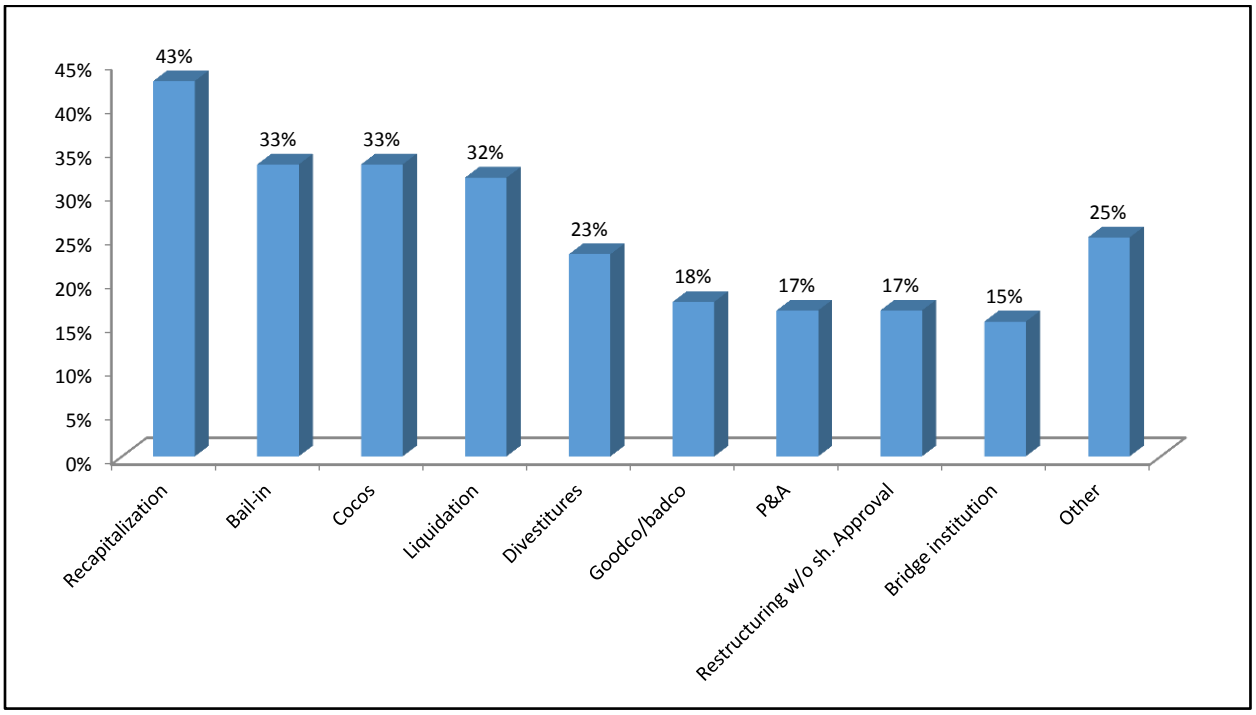
(2) Other resolution tools may include advancing money, guaranteeing payment of the failed institution's debt (Quebec), a temporary stay on early termination rights (Japan), and temporary public ownership (UK).

Figure 4 shows the proportion of respondent jurisdictions with a given resolution tool available that would apply this tool to FCs in a different way than to banks. Among the jurisdictions with FCs, some of them would apply the available resolution tools in the same way to both FCs and banks, while others would apply them differently to FCs. One of the objectives of this paper is to highlight the differences in the use of resolution tools for FCs.

The tools that would most commonly be applied differently to FCs are those that relate more directly to FCs' specific capital structures, such as recapitalisation, bail-in and contingent capital instruments.

[22] "Restructuring w/o sh. approval" means "restructuring without shareholder approval".

Figure 4: Percentage of survey respondent jurisdictions with a given resolution tool available that would apply this tool differently to FCs and banks



Source: The SRIFC survey (2015)

5.2. Characteristics of Resolution tools for Financial Cooperatives

As the preceding charts indicates, while the resolution tools for FCs are almost the same as those used for banks those tools may need to be used slightly differently for FCs. The use of each resolution tool presents opportunities and challenges when used for FCs, as is the case when used for banks. In the analysis of the survey data, we found that the opportunities associated with resolution tools for FCs are similar to those for banks, while differences in challenges are significant. Therefore, in this paper, we focus only on challenges specific to FCs.

5.2.1. Contingent convertible capital instruments

Contingent convertible capital instruments (CoCos), such as contingent convertible bonds or non-viability contingent capital (NVCC), are hybrid financial instruments that have the traits of both debt and equity securities. By converting to common equity under certain conditions, these hybrid capital securities can absorb losses when the capital of the issuing deposit-taking institution falls below a certain level. In some cases, CoCos may be written down before being converted into equity. Jurisdictions where this tool is available include Australia and Quebec (Canada),[23]

[23] The regulator has included the Basel III NVCC requirement in its capital adequacy guideline, but the legislation is now under review.

where it is applied differently from banks, and France, Italy and Japan, where it is applied in the same way as for banks.

Challenges

One of the main challenges in using CoCos would be finding the right type of Common Equity Tier 1 (CET1) capital into which the liabilities can be converted[24]. Moreover, converting liabilities into equity may introduce new shareholders in the FC's ownership, which may necessitate gaining the understanding of the current FC members. It may also be difficult to win current investors over as regards the conditions of loss absorption. Therefore, there must be appropriate information disclosure to members and investors. This is all the more significant for FCs, whose owners are also customers/investors who may not have the same level of financial expertise as bank shareholders.

In some jurisdictions, one of the most important challenges in the potential use of CoCos is the fact that, in the case of FCs, demutualisation may be needed before this resolution tool can be applied.

5.2.2. Bail-in

According to IADI,

> *"bail-in is a mechanism to recapitalize a bank [or another deposit-taking financial institution] in resolution or effectively capitalize a bridge institution, under specified conditions, through the write-down, conversion or exchange of debt instruments and other senior or subordinated unsecured liabilities of the bank in resolution into, or for, equity or other instruments in that firm, the parent company of that firm or a newly formed bridge institution, as appropriate to legal frameworks and market capacity".*[25]

"Bail-inable" debt is therefore a debt instrument (not initially considered to be capital, unlike contingent capital) that is written down and/or converts to common equity when the financial condition of a deposit-taking institution is judged by its supervisor or DIO and/or RA to have deteriorated to the point where it is no longer viable or is likely to be non-viable.

In all but one of the jurisdictions in the SRIFC survey where bail-in can be used (France, Germany, Greece, Hungary, Italy, Japan, the Netherlands, Poland and the UK), it consists of a write-down of eligible liabilities and/or their conversion into

[24] EU legislation offers the possibility to issue different types of CET1 instruments, e.g. instruments without voting rights and with higher dividends or cooperative shares

[25] This definition is line with the IADI glossary of 23 January 2017, which adapted it from *FSB (April 2013),* available at http://www.fsb.org/wp-content/uploads/r_130411a.pdf, p. 2. However, *FSB (March 2016)* gives a slightly different definition. Article 77 of the BRRD also refers to bail-in.

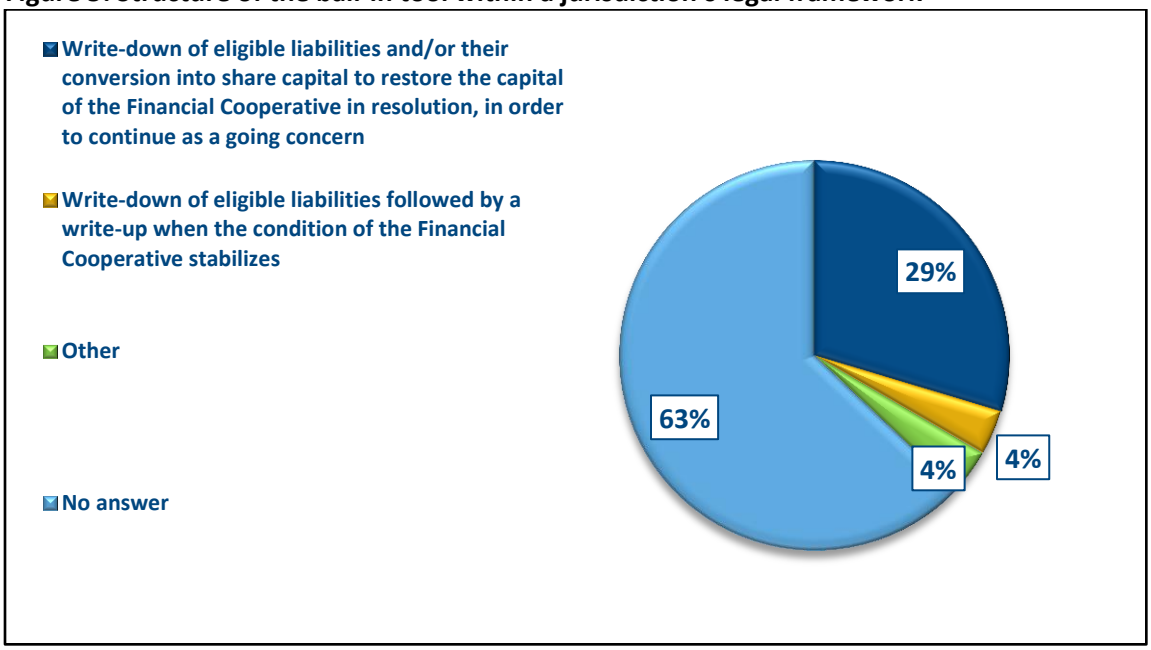
share capital, in order to restore the capital of the FC in resolution and allow it to continue as a going concern. The exception is Colombia, where it consists of a write-down of eligible liabilities followed by a write-up when the condition of the FC stabilises. Figure 5 shows the bail-in structure among the survey respondent jurisdictions.

Challenges

The challenges inherent to the application of bail-in to FCs are significant. One of the most important challenges in the use of bail-in, specifically eligible liabilities are converted into share capital, is the fact that demutualisation may be needed for the application of this resolution tool to a cooperative.

In addition, many of the challenges associated with the use of CoCos are also associated with bail-in within resolution. Indeed, finding the right type of CET1 capital to convert liabilities into could be an important challenge. Moreover, as in the case of CoCos, the use of bail-in may require conversion of part of the FC's debt into equity (or a capital instrument meeting the definition of CET1 capital). If this happens, the debt must be converted into a number of shares corresponding to the amount of debt converted. As a result, more voting rights may be given to the new members in some jurisdictions, which may violate the one-member-one-vote principle, thereby losing one of the main features of the FC. Therefore, the legislation governing FCs must set the rules for selling "bail-inable" debt (and CoCos) to non-members. In this case, one challenge will be to determine the rights (e.g. voting rights) of this new category of "member" after a conversion of debt into equity.

Figure 5: Structure of the bail-in tool within a jurisdiction's legal framework



Source: SRIFC survey (2015)

5.2.3. Recapitalisation

There are other recapitalisation methods that can be used in the resolution of a deposit-taking financial institution. Recapitalisation can be done in a number of ways, including a restructuring, an outright nationalisation in which shareholders are wiped out and management is replaced, or a capital injection in which shareholders are diluted but remain and management does not change (White and Yorulmazer (2014)).

Challenges

For FCs, finding the appropriate method of private recapitalisation can be very challenging, especially if the cooperative form of the FC must be retained. If the only shares of the FC are membership shares, it is difficult, or even impossible, to achieve a significant recapitalisation unless new forms of shares are designed and issued.[26] In fact, in general, FCs have more difficulty in accessing equity capital because it is unlikely that they can raise equity capital by asking members to increase their share contribution. Nonetheless, FCs that operate as a commercial corporation (as is the case in some jurisdictions like France) can raise capital on financial markets more easily.

5.2.4. Restructuring without members' approval

Having the option to restructure without members' approval gives the DIO and/or RA a free hand to take the right decision without necessarily obtaining the consent of the FC's management or owners (members). This resolution tool may require the DIO and/or RA to take control of the institution, replace management and limit the powers of members, in order to implement various operational and organisational changes to help restore the FC's viability.

Challenges

As is the case for banks, the main challenge is that this resolution tool can be contested in the courts unless it is clearly stipulated in law. Questions about how the restructuring will be conducted and what financial instruments are involved may also arise when the process is implemented. For FCs, whose members are owners, the lack of members' approval could affect the franchise value. Indeed, such restructuring could be seen by members as a move by the DIO and/or RA to bypass their rights, which could entice some of them to stop doing business with their FCs, resulting in deposit withdrawals, market share loss and further erosion of franchise value.

[26] In Jamaica, each member of an FC must hold a minimum amount of non-withdrawable shares i.e. permanent shares. Members can also opt to hold deferred shares, which must be held for a minimum period of five years. Both permanent and deferred shares are used by FCs to shore up their capital base.

5.2.5. Bridge institution

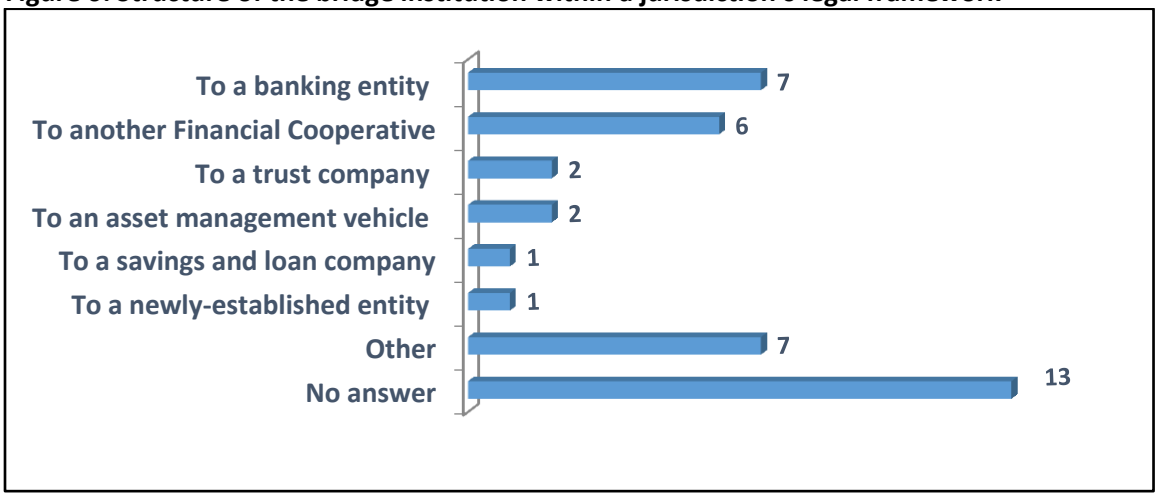
A bridge institution is an entity, authorised or licensed in accordance with any applicable requirements under national law, established to temporarily take over and maintain certain assets, liabilities and operations of a failing institution as part of the resolution process.[27] This tool is often considered as a special case of P&A.

Most jurisdictions that have the bridge institution tool available for resolution of FCs would apply it in the same way as they apply it to banks. Figure 6shows the structure of bridge institutions in survey respondent jurisdictions.

Challenges

There are specific challenges associated with the setup of a bridge institution in the case of FCs. In fact, the use of this resolution tool may require demutualisation in order that the "good assets" and liabilities of the failing FC can be transferred to the new entity (idem for the "bad portion" of the FC), notably because the bridge institution may not be required to be of the same type (FC) as the failing institution. It may be impossible for the bridge institution to hold the capital of FCs, as is the case in France, which means that only the non-cooperative part of the failing institution (if this exists) can be transferred. Besides, even years after setting up the bridge institution, it is not obvious that an assuming institution will be found, especially if only FCs are allowed to purchase and assume the failing FC (e.g. in Canadian jurisdictions), which can largely increase the costs of resolution while some jurisdictions may have a 'least cost resolution' requirement. This is also particularly relevant in cases where the FCs serve a specific niche clientele or are located in remote areas.

Figure 6: Structure of the bridge institution within a jurisdiction's legal framework



Source: SRIFC survey (2015)

[27] http://www.fsb.org/wp-content/uploads/r_130411a.pdf, p. 2.

As DIOs and/or RAs for FCs are often smaller, this tool could be relatively more costly for them. It requires the business to be transferred twice: first from the failing institution to the bridge institution, then from the bridge institution to the acquiring institution. It may also require more work from the DIO and/or RA, especially because the assets of the failing institution may need to be divided into good and bad assets. More importantly, the DIO and/or RA may be required to run the bridge institution for a lengthy period, which may be very costly in terms of financial, human and operational resources. This is all the more significant for relatively small DIOs and/or RAs, which are the ones typically overseeing FCs. It could also be a challenge to preserve the value of the failing institution while the tool is being implemented.

5.2.6. "Goodco/badco" model

In this case, the FC in distress is split in two: a "good cooperative" that retains the performing assets, and a "bad cooperative" that receives the remaining assets that are to be restructured or liquidated. Often, a trust or asset management company structure is used. This is a more general tool that could also be used in conjunction with restructuring and recapitalisation (White and Yorulmazer, 2014).[28]

In the survey, most jurisdictions that have goodco/badco model available would apply it to FCs in the same way as they apply it to banks.

Challenges

There are challenges associated with the goodco/badco model. Generally speaking, for both banks and FCs, the separation of good and bad assets may necessitate some form of public assistance for bad assets, which may be criticised if taxpayers' money is used. But in the case of FCs, if the bad assets are transferred to an asset management vehicle, there may need to be a change in ownership structure, thereby adding more complexity to such transactions. Moreover, the restructuring or liquidation of "bad assets" may take a lengthy and unspecified period of time, thereby increasing administrative costs. As mentioned above, as DIOs and/or RAs for FCs are often smaller, this tool could also be relatively costlier for them.

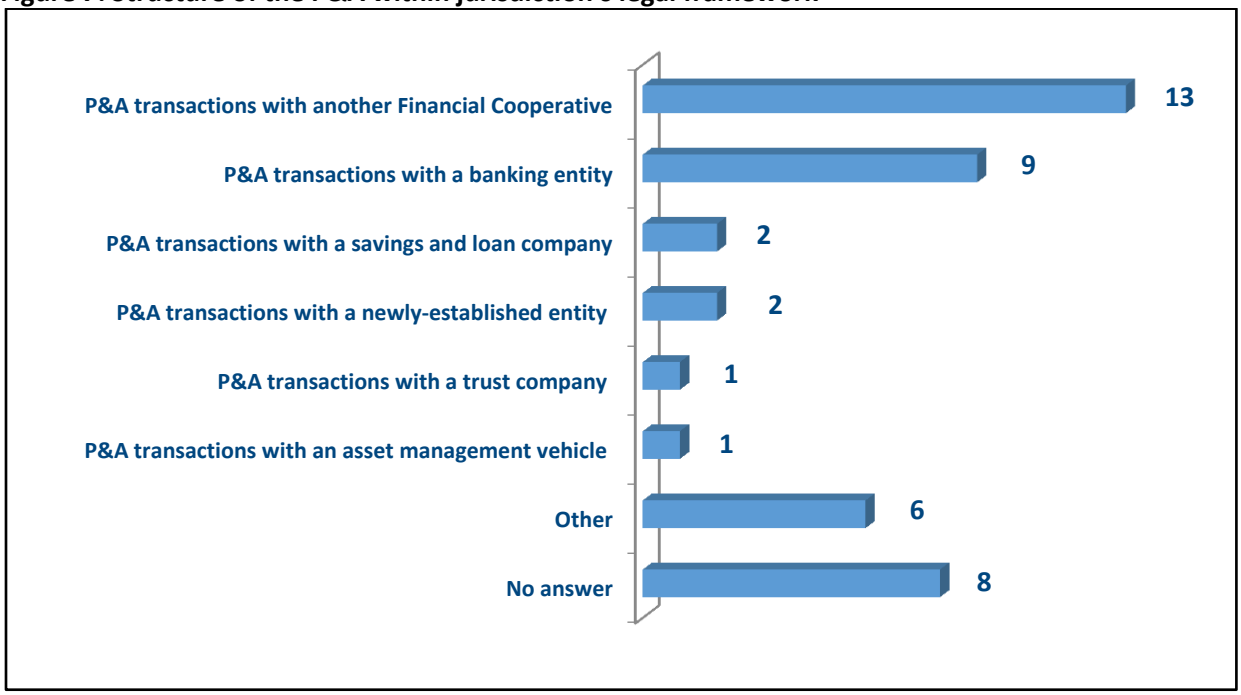
5.2.7. Purchase and assumption transactions

Purchase and assumption (P&A) is a resolution method in which a healthy institution purchases some or all of the assets of a failing institution and assumes some of the liabilities, including all insured deposits (FDIC, 2014). There are different types of P&A: basic P&A, whole bank P&A, loan purchase P&A, P&A with

[28] In Europe, the "goodco/badco" model is somewhat similar to the asset separation tool described in Article 42 of the European Bank Recovery and Resolution Directive (BRRD).

put option, P&A with asset pools, and loss share P&A.[29] The process usually involves the withdrawal or cancellation of the troubled institution's licence, the termination of the owners' rights in the institution, the assumption of the troubled deposits and good assets, and the takeover of some or all of the institution's problem assets by the DIO and/or RA.[30] Figure 7shows P&A structures in the survey respondent jurisdictions.

Figure 7: Structure of the P&A within jurisdiction's legal framework



Source: The SRIFC survey (2015)

Challenges

Among the challenges, there is the exposure to current market conditions. Difficult economic conditions will make it harder to find an assuming institution, since this resolution tool requires the assets and liabilities of the failing institution to be purchased and assumed by another financial institution. This is especially true for FCs, which are often linked to a specific region or group, and/or may be the sole institution representing such region or group. Besides, as time goes by, assets' value can decline, making it even harder to find an assuming institution willing to buy at an acceptable price. For the DIO and/or RA, handling simultaneous P&As and finding an assuming institution for each of them may also be very challenging. This is all the more relevant for FCs given contagion between them (especially when many FCs carry the same brand) and the lack of potential acquirers.

[29] Adapted from the FDIC Resolutions Handbook. Details of some P&A types are given in the FDIC Resolutions Handbook at https://www.fdic.gov/about/freedom/drr_handbook.pdf.

[30] P&A has similarities with the "sale of business" resolution tool in the BRRD.

Moreover, the relatively smaller appetite of most FCs for profit maximisation, which means that they are prepared to operate branches in remote and sparsely populated areas, may give rise to some challenges in the event of resolution. Indeed, there could be a lack of potential acquirers within the region where the FC is located and the remoteness can be less attractive to other investors in the event of resolution.[31]

Furthermore, retaining the common bond between FC members can give rise to new challenges during resolution. Indeed, it may reduce the number of potential buyers during the P&A.

Finally, there are forms of P&A (e.g. loss share P&A) in which the DIO and/or RA agrees to share with the acquirer the losses on certain types of loans. The issue of resolution funding may then be a challenge, for both banks and FCs. The DIO and/or RA must accumulate sufficient resources to deal with possible future losses. This issue is even more significant for smaller DIOs and/or RAs typically regulating FCs.

5.2.8. Divestitures

If there is a temporary administration or conservatorship established for closing a financial institution, the resolution team will have to support the management team operating the financial institution in adopting and executing a business plan, which may include shrinking the balance sheet and/or taking other actions to prepare the financial institution for sale. The management team is expected to financially restructure and resize the financial institution so as to sufficiently improve its financial condition to the point where viability is restored and/or a sale to a suitable acquirer would be possible with a minimum injection of financial resources from the government.[32] In this process, the FC may be required to divest itself of certain assets and liabilities.

Challenges

Divesting assets and liabilities can be challenging, especially in remote areas, where FCs may be predominant. In addition, prices can be very low, especially if the market perceives that the divestitures are a regulatory requirement. In certain circumstances, depending on the kind of divestiture, retaining the common bond between FC members could be an objective. However, this would pose a challenge in that it may reduce the number of potential buyers during the divestiture. It could also be challenging for the DIO and/or RA to sell some specific business lines of FCs

[31] In Chinese Taipei, in previous cases, potential acquirers have been offered incentives, such as the option of opening new branches or moving the branches to other regions, in an attempt to attract acquiring financial institutions during the resolution process.

[32] See McGuire (2012), p. 13 and Appendix A, p. 28.

when those FCs are the only financial institutions to serve a region in this specific business.

5.2.9. Liquidation (receivership)

Liquidation is the winding-down (or winding-up, as used in some jurisdictions) of the business affairs and operations of a failing financial institution through the orderly disposition of its assets after its licence has been revoked and it has been placed in receivership. In some jurisdictions, it is synonymous with "receivership" (IADI, 2014), while in jurisdictions like Poland and the UK, liquidation and receivership are two separate legal processes.[33]

When an institution is liquidated, it is closed, its licence is withdrawn, and its assets are sold over time to pay its liabilities to depositors and other creditors (McGuire, 2012). Liquidation is followed by deposit payout in jurisdictions with deposit insurance schemes. There is also a form of winding-down in which the institution does not take new deposits or make or renew loans until the maturity date or the time of closure, whichever is earlier.

The majority of jurisdictions with the liquidation tool available liquidate FCs in the same way as banks are liquidated. There are a few respondent jurisdictions (with FCs) in the survey where the liquidation tool is not available for FCs' resolution (Albania, the Netherlands and Prince Edward Island (Canada)).

Challenges

First, liquidating an FC could be detrimental in some remote areas where FCs are the only deposit-taking institutions in operation, or where they offer transactional accounts not readily available elsewhere. Indeed, the liquidation of an FC could potentially have a negative impact on regional economies, particularly on the financing of small and medium-sized businesses, as well as on individual business owners, who are typical customers of FCs in some jurisdictions. The liquidation of an FC could also weaken the feeling of belonging which people living in those areas have towards the FC.

Moreover, the liquidation of an important FC can have systemic consequences, especially for FCs with the same brand. As is the case for banks, since liquidation may necessitate payout, precautions must be taken so that depositors receive their money quickly, but achieving timely payout may be a challenge for some jurisdictions. For example, with small institutions, it may be difficult to ensure that

[33] In Poland, liquidation and receivership are two separate legal processes: (1) liquidation may take place towards an entity which is solvent and a liquidator is appointed by the Polish Financial Supervision Authority, (2) receivership takes place within the bankruptcy (insolvency) procedure, it is used when the entity is insolvent and a receiver is appointed by the court.

the level of preparedness is sufficient, so that the information needed for payout is available quickly.

5.2.10. Summary of resolution tools for Financial Cooperatives and related challenges

The table 3 summarises the resolution tools for FCs, along with their main related challenges.

Table 3: A summary of resolution tools for FCs and related challenges

Resolution tools for FCs	Main challenges
CoCos	• Finding the right type of CET1 capital to convert liabilities into • Winning current investors over as regards the conditions of loss absorption • May be needed to demutualize the FC, in some jurisdictions • Determining the rights of the new category of "members" (former creditors), including voting rights, after a conversion of debt into equity
Bail-in	
Recapitalisation	• Finding the appropriate method of private recapitalisation can be very challenging, especially if the cooperative form of the FC must be retained • May be necessary to design new forms of shares • Accessing capital for FCs can be more difficult than for banks
Restructuring without members' approval	• Can be contested in the courts unless it is clearly stipulated in law • Questions about how the restructuring will be conducted and what financial instruments are involved may arise when the process is implemented • Lack of members' approval could affect the franchise value of the FC, as such restructuring could be seen by members as a move by the DIO and/or RA to bypass their rights
Bridge institution	• Setting up a bridge institution may require demutualisation in order that the "good assets" and liabilities of the failing FC can be transferred to the new entity (idem for the "bad portion" of the FC), notably because the bridge institution may not be required to be of the same type (FC) as the failing institution • May be impossible for the bridge institution to hold the capital of FCs, which means that only the non-cooperative part of the failing institution (if this exists) can be transferred • Is not obvious that an assuming institution will be found, especially if only FCs are allowed to purchase and assume the failing FC which can largely increase the costs of resolution • Could also be a challenge to preserve the value of the failing institution while the tool is being implemented
"Goodco/badco" model	• Separation of good and bad assets may necessitate some form of public assistance for bad assets, which may be criticised if taxpayers' money is used • May need a change in ownership structure if the bad assets are transferred to an asset management vehicle • Restructuring or liquidation of "bad assets" may take a lengthy and

Resolution tools for FCs	Main challenges
	unspecified period of time • Could be relatively costlier for FCs' DIOs and/or RAs which are generally smaller
Purchase and assumption	• Difficult economic conditions will make it harder to find an assuming institution, as the FC is exposed to current market conditions • Affiliation to a specific region or group may make it even harder to find a purchasing and assuming institution: lack of potential acquirers within the region where the FC is located • May be harder to find an assuming institution willing to buy at an acceptable price because assets' value often decline as time goes by • May be difficult to retain the common bond between FC members during resolution
Divestitures	• Divesting assets and liabilities can be challenging, especially in remote areas when the FC in resolution is the only financial institution to serve a region in a specific business line • Prices can be very low, especially if the market perceives that the divestitures are a regulatory requirement • The number of potential buyers may be reduced if there is an objective to retain the common bond between FC members
Liquidation (receivership)	• Liquidating an FC could be detrimental in some remote areas where the FCs are the only ones in operation or if they offer transactional accounts not readily available elsewhere • Could potentially have a negative impact on regional economies, particularly on the financing of small and medium-sized businesses, as well as on individual business owners, who are typical customers of FCs in some jurisdictions • Liquidation of an important FC can have systemic consequences, especially for FCs with the same brand • Achieving timely payout may be a challenge for some jurisdictions, since liquidation may necessitate payout

5.3. DEMUTUALISATION

According to Fulton and Girard (2015),

> *"Demutualisation is the conversion of a co-operative, credit union or mutual into an alternative organizational form (usually one owned by investors). Demutualisation can occur through the conversion of equity into investment shares, or it can occur via a merger, takeover or buyout involving companies that are not cooperatives or mutuals. Regardless of the form it takes, demutualisation involves the transfer to private investors of the capital that has been built up over the years in the cooperative."*

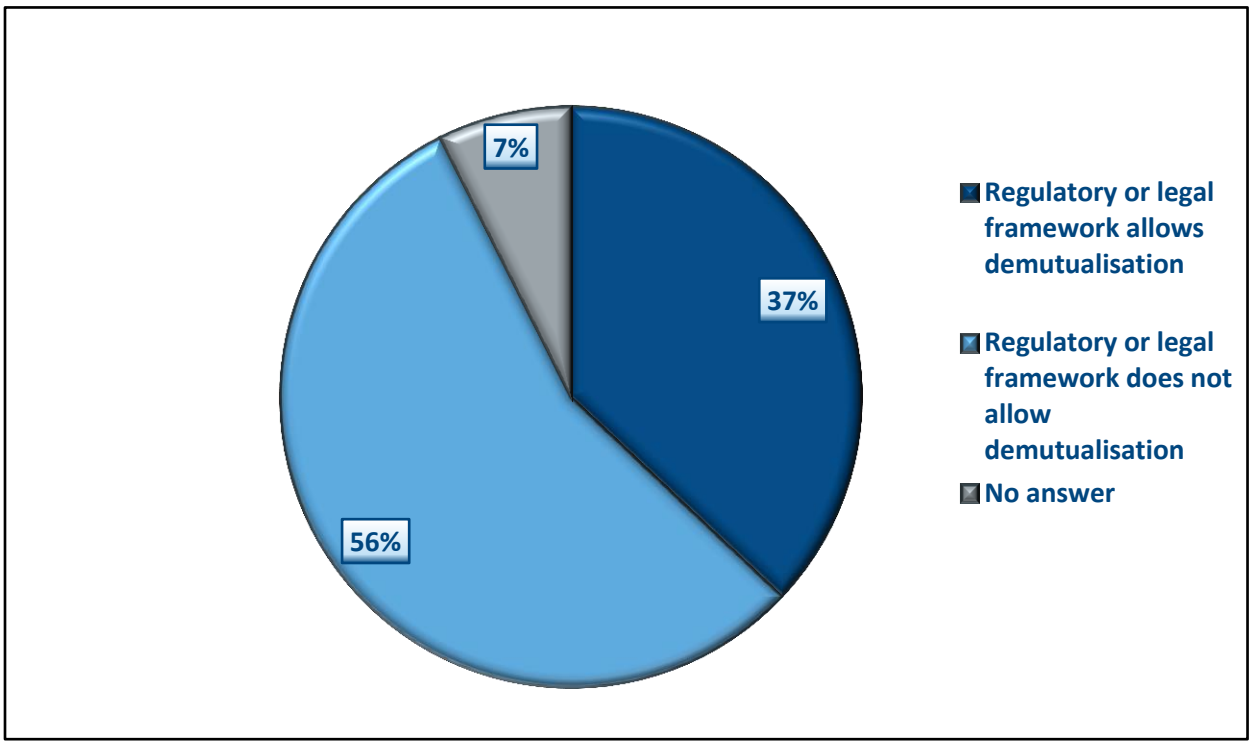
When demutualisation occurs, FCs terminate their cooperative structure and are converted into another form of ownership. In such a case, members' ownership rights change and other external investors may also become owners. More specifically, for an FC, the cessation of the cooperative structure leads to the conversion of the institution into a commercial bank or another form of deposit-taking institution with no cooperative value. For Chaddad and Cook (2004), demutualisation refers to changes in the ownership structure of user-owned and controlled organisations from a mutual to a for-profit, proprietary organisation. They point out that as a result of demutualisation, residual claim and control rights are reassigned among stakeholders, with implications for firm behaviour and performance.

According to Fulton and Girard (2015), the demutualisation of an FC is a major decision and, although there are exceptions, it is one that cannot typically be reversed. Therefore, in the resolution process, demutualisation may be a decision of last resort, which should only be used when the FC cannot be effectively resolved. Usually, demutualisation occurs when the FC is not performing well on numerous fronts, such as financial performance, member engagement and, most importantly, governance. Demutualisation may therefore be a sign of a cooperative that is unhealthy in some way – e.g. financial insolvency or lack of capital to remain effective and competitive – or is unable to meet regulatory requirements. However, demutualisation can also be a legal requirement, even when the FC is quite healthy. In Italy, for example, a recent reform of "banche popolari" (a type of FC) requires those *banche popolari* with assets over EUR 8 billion to convert to joint-stock companies, wind up or reduce their assets below that threshold within a year. As a result, institutions that do not want to be wound up and are not willing to reduce their assets below EUR 8 billion are obliged to demutualise. Another important reform was introduced in Italy in 2016 on credit cooperative banks. In particular, this legislation provides for the creation of a Cooperative Banking Group ("Gruppo Bancario Cooperativo"). A bank holding is established to exercise direction and coordination functions on the credit cooperative banks and other financial entities belonging to the group. A cohesion agreement regulates the direction and coordination functions of the parent bank. This agreement also provides for a joint guarantee of the obligations assumed by the parent and the other banks joining the group, in compliance with the prudential rules for banking groups and single member banks.

One of the advantages of demutualisation is that it can help an FC increase its level of capital, since external investors would then be able to participate in the ownership of the institution. As a result, as mentioned in Galor (2008), when there is demutualisation the cooperative institution accepts that it will lose the attractions of the cooperative form in return for other gains that are considered preferable, such as the ability to raise equity capital directly through the financial markets.

Demutualisation could be initiated and executed by the FCs, but also by the DIOs/RAs if they have the powers to do so in their jurisdictions. The SRIFC survey shows that, as of 2015, 37% of the jurisdictions that deal with FCs have a regulatory or legal framework that allows for demutualisation as part of the resolution process. Figure 8 shows the proportion of survey respondent jurisdictions with a regulatory or legal framework that allows a demutualisation, and those with a regulatory or legal framework that does not. In some jurisdictions, the authorisation to demutualise may be explicit or implicit. In France, for example, the legal framework does not prohibit demutualisation or prescribe that FCs should only be resolved in a way that prevents them from being demutualised.

Figure 8 : Jurisdiction's regulatory or legal framework allowing demutualisation



Source: SRIFC survey (2015)

Battilani and Schröter (2011) describe the legal frameworks for demutualisation of cooperatives in different regions of the world. According to them, in the European Union, over 50% of member states allow their cooperatives to demutualise; in others, such a move is illegal. They also report that in the US, demutualisation provisions vary by state (50 states plus the District of Columbia). In 2002, about two-thirds of the states (34) allowed demutualisation, 14 states did not have any conversion statutes and 3 states prohibited demutualisation.

6. OTHER RESOLUTION CHALLENGES

The application of the resolution tools described above presents broader resolution challenges. These mainly relate to funding and operations. While it may be argued that such challenges would also apply to DIOs and/or RAs regulating banks, the purpose of this section is to take stock of the broader resolution challenges and experience pertaining to DIOs and/or RAs responsible for FCs, beyond the challenges inherent to the application of specific resolution tools.

6.1. FUNDING CHALLENGES

Like a bank resolution, the resolution of an FC can be funded either by a dedicated resolution fund, the deposit insurance fund or a mix of these two funds. The survey shows that, currently, the resolution of FCs is not financed uniquely by a dedicated resolution fund in any survey respondent jurisdiction; rather, resolution is financed either entirely by the deposit insurance fund or by a mix of the resolution fund and the deposit insurance fund. This is because many resolution funds have been set up only recently, mostly after the 2008 financial crisis.

Contributions for the deposit insurance and/or resolution fund are collected ex ante in most jurisdictions, whether the fund is for FCs exclusively or for both banks and FCs. Indeed, 84% of respondent jurisdictions (with FCs) have their deposit insurance funded on an ex ante basis. These jurisdictions include Colombia, Chinese Taipei, the Czech Republic, Mexico, Albania, Uruguay and Vietnam.[34] Deposit insurance is also funded on an ex ante basis in many other non-respondent jurisdictions, notably Barbados, Brazil, Jamaica, Kenya and Trinidad and Tobago (Demirgüç-Kunt et al. (2014)).[35] Jurisdictions with specific ex ante resolution funding include the Netherlands and Hungary.

In jurisdictions with an ex post deposit insurance and/or resolution funding system, premiums must be levied when resources are needed for payout or to resolve a failing institution. This can be a challenge during tough economic times since many other deposit-taking financial institutions are facing the same difficult economic conditions. The situation can be exacerbated when the jurisdiction is dominated by one systemically important FC, or when many FCs linked to the same financial group all experience distress simultaneously (given that contagion and spillover risks would be more relevant to FCs). Indeed, in such cases, only a small number of institutions are able to contribute to resolution funding on an ex post basis in the event of failure of one systemically important FC or the simultaneous failure of

[34] In all EU countries ex-ante funding is mandatory for both deposit insurance systems and resolution funds pursuant to Deposit Guarantee Scheme Directive and BRRD respectively.

[35] In many jurisdictions with cooperatives (especially in Africa), there is currently no deposit insurance, let alone a resolution framework.

multiple FCs. Jurisdictions with ex post deposit insurance funding include Australia and New Brunswick (Canada). In the UK, an ex ante fund is raised from the bank levy and held by HM Treasury. A decision is made whether to call on the ex ante fund or raise an ex post levy at the time of failure.

6.2. Operational challenges

In addition to funding challenges, DIOs and/or RAs may face operational challenges. In practice, resolution can be a difficult task for different reasons. The case studies highlight some of the most relevant operational challenges faced by the jurisdictions that have had to deal with failures of FCs.

A frequent operational challenge in many jurisdictions is the lack of cooperation from the management and board of the failing FC. Since FCs generally belong to communities, whose members are owners, it is important to get the community involved in the resolution process for better results. For this reason, the board, which represents members, and management, which is often appointed by the community through the board of directors, must cooperate in the process. Management and board cooperation played a critical role in the resolution process in jurisdictions like Chinese Taipei and in the Canadian provinces of Ontario and Saskatchewan (Canada). Usually, the cooperation ensures that the DIO and/or RA have sufficient and accurate information concerning the various risks and problems faced by the FC. Gathering this information can also help avoid systemic contagion to other FCs by preventing the same causes from producing the same effects, hence the need for pre-planning by and cooperation with the RA. With the smaller FCs in particular, for which the managers can be volunteers in some jurisdictions (e.g. some credit unions in the UK), it can be difficult to obtain up-to-date and reliable data – on both deposits and loans. In the case of Japan, cooperation from the management is not essential, given that a failed institution's operations and property are placed under the control of a financial administrator, and the management and board of the failed institution are replaced.

It may also be challenging to resolve many FCs simultaneously, and therefore deal with different communities at the same time. For FCs, the likelihood of simultaneous interventions may be higher given their relatively higher contagion risks and spillover effects. This would require having many teams on different sites simultaneously. The simultaneous resolution challenge can be aggravated by difficult transitional service arrangements, including the difficulty in finding assuming institutions to ensure continuity of the activities of the failing FCs, especially during tough economic conditions and in remote areas.

7. SPECIFICITIES OF SMALL AND LARGE FINANCIAL COOPERATIVES

Although the above issues relate to most FCs, the resolution process for large FCs may not be the same as that for smaller ones.

In the resolution process, the impact of a small FC on the financial system is less important than that of a large one. In jurisdictions like France, a small FC's failure would only lead either to a restructuring by the other FCs of the same group or to payout, not to resolution tools as prescribed by the European Bank Recovery and Resolution Directive (BRRD), where necessary in the public interest. Likewise, the UK resolution regime applies to building societies but not to credit unions, which are smaller and are wound up in the usual way. In other words, deposits are paid out or transferred unless there are financial stability concerns. Jurisdictions like Mexico would tend to encourage small failing FCs to merge with a sounder FC, which will not necessarily be the case for large FCs. From that perspective, mergers can be considered as a resolution tool in some jurisdictions.[36] In Hungary, the resolution of a financial institution must be in the public interest. This "public interest test" is not always passed by small FCs, which means that they do not get the same treatment as large FCs in the event of resolution. In addition, the feeling of belonging that members have towards their FC may be stronger for small FCs than for large ones, which may result in more resistance from members during the resolution of a small FC.[37]

For some large FCs, especially systemically important ones, their organisational structure, with individual entities having the same brand but without a holding company at the top, may make it harder to use the single point of entry (SPE) approach in resolution.

[36] It could also be argued that a merger is a particular form of purchase and assumption.

[37] In Poland, after the entry into force of the Act of 10 June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution, the legal framework gives the possibility to effect the restructuring procedure and the resolution procedure towards credit unions.

8. Conclusion

This research paper has presented an overview of the distinctive features of the financial cooperatives (FCs) in the SRIFC survey respondent jurisdictions around the world, as well as the tools currently used for their resolution, along with the challenges associated with the use of each of these resolution tools in the case of FCs.

There are different types of FCs around the world. These deposit-taking institutions include credit unions, "caisses populaires", "cajas", mutuals and cooperative banks. FCs differ from banks mainly with regard to their objectives, their ownership structure and participation in the decision-making process, the way in which they access capital, etc.

Because of the specificities of FCs, bank resolution tools are not always directly applicable to FCs and/or may give rise to some challenges specific to FCs. Some of the resolution tools can be used in the same way as for banks, while others need some adjustment to fit with the nature of FCs. Resolution tools like bail-in may require demutualisation of the FC.

The next step for the SRIFC will be to provide guidance on the use of resolution tools in the case of FCs, addressing the practical challenges that may be faced by DIOs/RAs during the resolution of FCs.

9. GLOSSARY

BAIL-IN[38]

Restructuring mechanisms to recapitalise a deposit-taking institution in resolution or effectively capitalise a bridge institution, under specified conditions, through the write-down, conversion or exchange of debt instruments and other senior or subordinated unsecured liabilities of the deposit-taking institution in resolution into, or for, equity or other instruments in that deposit-taking institution, the parent company of that deposit-taking institution or a newly formed bridge institution, as appropriate to legal frameworks and market capacity.

BASIC P&A[39]

In basic P&As, assets that pass to acquirers are generally limited to cash, cash equivalents and marketable securities.

BRIDGE INSTITUTION (BRIDGE BANK)[40]

An entity that is established to temporarily take over and maintain certain assets, liabilities and operations of a failed deposit-taking institution as part of the resolution process.

DEMUTUALISATION[41]

Demutualisation is the conversion of a cooperative, credit union or mutual into an alternative organisational form (usually one owned by investors). Demutualisation can occur through the conversion of equity into investment shares, or it can occur via a merger, takeover or buyout involving companies that are not cooperatives or mutuals. Regardless of the form it takes, demutualisation involves the transfer to private investors of the capital that has been built up in the cooperative over the years.

GOODCO/BADCO MODEL[42]

In "goodco/badco", the troubled assets are held in a separate vehicle from the good assets of a deposit-taking institution. This model can be utilised without closing a deposit-taking institution deemed otherwise viable, through the provision of some form of government assistance or backstop for the bad assets.

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[38] Adapted from the IADI Glossary of Terms for EXCO Approval, 15 June 2015.

[39] Federal Deposit Insurance Corporation, *Resolution Handbook*, revised 23 December 2014, p. 16, https://www.fdic.gov/about/freedom/drr_handbook.pdf.

[40] Adapted from the IADI Glossary of Terms for EXCO Approval, 15 June 2015.

[41] COOP Co-operatives and Mutual Canada, *Demutualization of Co-operatives and Mutuals*, October 2015, http://www.canada.coop/en/demutualization.

[42] Adapted from Federal Deposit Insurance Corporation, *Resolution Handbook*, revised 23 December 2014, p. 16, https://www.fdic.gov/about/freedom/drr_handbook.pdf.

LIQUIDATION[43]

The winding-down (or winding-up, as used in some jurisdictions) of the business affairs and operations of a failed deposit-taking institution through the orderly disposition of its assets after its licence has been revoked and it has been placed in receivership. In some jurisdictions, it is synonymous with "receivership".

LOAN PURCHASE P&A/MODIFIED P&A[44]

In these transactions, the acquiring institution will also acquire the performing loan portfolio of the failed deposit-taking institution in addition to the cash and cash equivalents, or the performing loan portfolio and the mortgage loan portfolio.

LOSS-SHARE P&A[45]

A method in a P&A transaction in which the deposit insurer, as receiver, agrees to share with the acquirer the losses on certain types of loans. Loss-sharing may be offered by the receiver in connection with the sale of classified or non-performing loans that otherwise might not be sold to an acquirer at the time of resolution.

NON-VIABILITY CONTINGENT CAPITAL (NVCC)/CONVERTIBLE BONDS[46]

Hybrid capital securities that absorb losses when the capital of the issuing deposit-taking institution falls below a certain level.

PURCHASE AND ASSUMPTION TRANSACTION (P&A)[47]

A resolution method in which a healthy deposit-taking institution or a group of investors assumes some or all of the obligations and purchases some or all of the assets of the failed deposit-taking institution.

P&A WITH ASSET POOLS[48]

A P&A can also be offered with asset pools, with the loans from the failed institution's portfolio divided into separate pools of like loans, such as loans within the same geographic location or with the same payment terms. The pools can also be divided into performing and non-performing loans. The pools can be marketed separately from the deposit base of the failed institution. Bidders are thus able to bid on the parts of a failed institution's business that fit best with their own business model.

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[43] Adapted from the IADI *Glossary of Terms for EXCO Approval*, June 15, 2015.

[44] Adapted from World Bank, *Simple Tools to Assist in the Resolution of Troubles Banks*, Claire L. McGuire, p. 7, http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Bank_Resolution_Toolkit.pdf.

[45] Federal Deposit Insurance Corporation, *Resolution Handbook*, Revised December 23, 2014, p. 35.

[46] See Avdjiev et al. (2013) at http://www.bis.org/publ/qtrpdf/r_qt1309f.pdf, p.1.

[47] Adapted from the IADI *Glossary of Terms for EXCO Approval*, 15 June 2015.

[48] World Bank. *Simple Tools to Assist in the Resolution of Troubles Banks*, Claire L. McGuire, p. 8, http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Bank_Resolution_Toolkit.pdf.

PURCHASE-AND-ASSUMPTION TRANSACTION (P&A) WITH "PUT" OPTION[49]

To create a greater incentive for acquirers to bid on a failed institution's assets, the resolution authority can provide a "put" option on some of the transferred assets. This would allow the acquirer to have a certain period of time, such as 60 or 90 days, to transfer back to the resolution authority any assets which it does not want to keep.

WHOLE BANK PURCHASE-AND-ASSUMPTION TRANSACTION (P&A)[50]

The whole bank P&A structure emerged as the result of an effort to persuade acquirers of failed institutions to purchase the maximum amount of a failed institution's assets. Bidders are asked to bid on all assets of the failed institution on an "as is" discounted basis (with no guarantees).

[49] Adapted from World Bank, *Simple Tools to Assist in the Resolution of Troubled Banks*, Claire L. McGuire, pp. 7–8, http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Bank_Resolution_Toolkit.pdf.

[50] Federal Deposit Insurance Corporation. *Resolution Handbook*, revised 23 December 2014, p. 17, https://www.fdic.gov/about/freedom/drr_handbook.pdf.

10. ANNEX 1 - SURVEY QUESTIONNAIRE

July 2015

IADI Research and Guidance Committee
Survey of Resolution Issues for Financial Cooperatives

NOTICE

In this survey, "financial cooperatives" refer to deposit-taking institutions such as credit unions, mutuals, cooperative banks, etc.

Please refer to Draft 3, Section 9 for some definitions.

CONTACT

1. Contact person for entries in the Survey of Resolution Issues for Financial Cooperatives.

   Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
   Name of contact person:
   E-mail:
   Phone:

PART 1: SCOPE OF COVERAGE

2. What types of financial institutions are members of your DIO or RA?

   a. Commercial banks
   b. Credit unions
   c. Mutuals
   d. Cooperative banks
   e. Other types of financial cooperatives, please explain
   f. Insurance companies

g. Investment banks
h. Islamic banks
i. Microfinance institutions
j. Rural banks/Community banks
k. Savings banks
l. Securities companies/Brokers
m. Other, please explain

3. In your jurisdiction, are there deposit-taking institutions that may be treated in a different way than banks in terms of resolution? If so, which one(s) of the following?

    a. Credit unions
    b. Mutuals
    c. Cooperative banks
    d. Other types of financial cooperatives
    e. Investment banks
    f. Islamic banks
    g. Microfinance institutions
    h. Rural banks/Community banks
    i. Savings banks
    j. Securities companies/Brokers
    k. Other

4. How many financial cooperatives are members of your DIO or RA? <u>If none, you have completed the survey. Please submit it.</u>

5. Is there a legal definition of the term "financial cooperatives" in your jurisdiction?

    a. Yes
    b. No

6. In your DIO, is the coverage limit the same for financial cooperatives and banks?

    a. Yes
    b. No

7. In your DIO, are the types of eligible deposits the same for financial cooperatives and banks?

    a. Yes
    b. No

8. What is the total amount of covered or insured deposits of the financial cooperatives that are members of your DIO or RA, as of 31 December 2014 (in USD)?

9. What is the total amount of assets held by the financial cooperatives that are members of your DIO or RA, as of 31 December 2014 (in USD)?

10. What is the percentage of assets held by the financial cooperatives that are members of your DIO or RA in relation to the banking sector's assets, as of 31 December 2014 (in USD)?

PART 2: FINANCIAL COOPERATIVES' CHARACTERISTICS

11. In your jurisdiction, do financial cooperatives have a particular ownership structure (e.g. one member one vote)? Please explain.

12. In your jurisdiction, how are financial cooperatives able to access capital?

    a. Internal capital, please specify type of capital.
    b. External capital, please specify type of capital.
    c. Mix of internal and external capital. If so, please specify if there are limits for one or the other.

13. To what extent do depositors participate in the decision-making process of financial cooperatives in your jurisdiction?

14. In your jurisdiction, do financial cooperatives have a link to a specific region, community or group? Please explain.

15. Could you describe the roles of central/umbrella organisation(s) of financial cooperatives and the mechanism they provide?

16. How many financial cooperatives are large enough for their failure to affect the financial stability of your jurisdiction?

17. In your view, are there other key characteristics of the financial cooperatives in your jurisdiction (organisation, supervision, competitiveness, risk profile, limit of business, etc.)? Please explain.

PART 3: FINANCIAL COOPERATIVES' RESOLUTION – LEGAL FRAMEWORK

18. Does/Do the legislation/regulations in your jurisdiction include a legal framework for the resolution of financial cooperatives?

    a. Yes
    b. No
    c. The legal framework is being implemented

19. What are, if any, the statutory mandates or written policy objectives in the recovery process following a financial cooperative failure?

    a. None
    b. Maximise recovery value
    c. Minimise period for recovery
    d. Minimise liquidation costs and expenses
    e. Comply with the legal timeframe for bank liquidation
    f. Follow sound banking and commercial practices
    g. Follow a least-cost rule (the least cost to the DIO or RA)
    h. Market or economic stabilisation
    i. Other

20. As part of the resolution process for financial cooperatives, does your jurisdiction's regulatory or legal framework allow for demutualisation?

    a. Yes
    b. No

21. Does the regulatory/legal framework in your jurisdiction include early intervention measures specific to (or adapted from banks for) financial cooperatives?

    a. Yes
    b. No

22. What is the agency/organisation which orders the resolution of financial cooperatives in your jurisdiction?

PART 4: FINANCIAL COOPERATIVES' RESOLUTION – CHALLENGES

23. What are, in your view, the primary resolution challenges for financial cooperatives?

24. Among the resolution challenges that you have highlighted in question 23, which are more relevant for financial cooperatives that are small or large in relation to the financial cooperatives sector as a whole?

    Small financial cooperatives:

    Large financial cooperatives:

Note that, if there are some resolution challenges highlighted in question 23 that are not classified in question 24, we will conclude that there are no distinctions in terms of relevance for small or large financial cooperatives.

25. In your jurisdiction, are there legal barriers that could affect the resolution of financial cooperatives? Please explain.

26. In your jurisdiction, are there fiscal incentives in the context of financial cooperatives resolution? Please explain.

PART 5: FUNDING

27. What are the available mechanisms for resolution funding of financial cooperatives in your jurisdiction?

    a. Resolution fund
    b. Deposit insurance fund
    c. Mix of resolution and deposit insurance fund
    d. Other

28. How much of your DIO's or RA's fund is dedicated to financial cooperatives, as of 31 December 2014 (in USD)?

29. Is there a target level for the deposit insurance and/or resolution fund(s) destined for financial cooperatives established in your jurisdiction?

    a. Yes, for the deposit insurance fund
    b. Yes, for the resolution fund
    c. Yes, for both (deposit insurance and resolution fund(s))
    d. No

30. Are contributions for the deposit insurance and/or resolution fund(s) for financial cooperatives risk-based?

    a. Yes, for the deposit insurance fund
    b. Yes, for the resolution fund
    c. Yes, for both (deposit insurance and resolution fund(s))
    d. No

31. How are contributions for the deposit insurance and/or resolution fund(s) for financial cooperatives collected?

    a. Ex ante for the deposit insurance fund
    b. Ex ante for the resolution fund
    c. Ex ante for both (deposit insurance and resolution fund(s))
    d. Ex post for the deposit insurance fund
    e. Ex post for the resolution fund
    f. Ex post for both (deposit insurance and resolution fund(s))

32. What are, in your view, the primary challenges for resolution funding of financial cooperatives?

PART 6: "BANKING" RESOLUTION TOOLS – OPPORTUNITIES AND CHALLENGES

33. What resolution tools are available for the resolution of financial cooperatives in your jurisdiction?

    Non-viability contingent capital (NVCC) or convertible bonds
    a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 34.
    b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 34.
    c. No

    Bail-in
    a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer questions 35 and 36.
    b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer questions 35 and 36.
    c. No

    Bridge institution (bridge bank)
    a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer questions 37 and 38.
    b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer questions 37 and 38.
    c. No

Goodco/badco model

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 39.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 39.
c. No

Purchase and assumption (P&A transactions)

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer questions 40 through 44.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer questions 40 through 44.
c. No

Restructuring without shareholders' (members') approval

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 45.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 45.
c. No

Recapitalisation

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 46.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 46.
c. No

Divestitures

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 47.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 47.
c. No

Liquidation

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 48.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 48.
c. No

Other resolution tools

a. Yes, but there are no differences in the application between banks and financial cooperatives. Please answer question 49.
b. Yes, but there are differences in the application between banks and financial cooperatives. Please answer question 49.
c. No

34. What are, in your view, the primary opportunities and challenges of NVCC or convertible bonds as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

35. What are, in your view, the primary opportunities and challenges of bail-in as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

36. How is bail-in structured in your jurisdiction's legal framework for the resolution of financial cooperatives?

    a. Write-down and conversion of eligible liabilities into share capital to restore the capital of the financial cooperative in resolution, in order to continue as a going concern.
    b. Write-down and conversion of eligible liabilities into new type of capital units (specific to financial cooperatives) to restore the capital of the financial cooperative in resolution, in order to continue as a going concern.
    c. Write-down of eligible liabilities followed by a write-up when the condition of the financial cooperative stabilises.
    d. Other

37. What are, in your view, the primary opportunities and challenges of a bridge institution (bridge bank) as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

38. How is the bridge institution (bridge bank) option structured in your jurisdiction's legal framework for financial cooperatives specifically?
    a. "Bridge" to a banking entity
    b. "Bridge" to another financial cooperative
    c. "Bridge" to a savings and loan company
    d. "Bridge" to a trust company
    e. "Bridge" to an asset management vehicle
    f. "Bridge" to a newly established entity
    g. Other

39. What are, in your view, the primary opportunities and challenges of a goodco/badco model as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

40. What are, in your view, the primary opportunities and challenges of P&A transactions as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

41. How are P&A transactions structured in your jurisdiction's legal framework?
    a. P&A transactions with a banking entity
    b. P&A transactions with another financial cooperative
    c. P&A transactions with a savings and loan company
    d. P&A transactions with a trust company
    e. P&A transactions with an asset management vehicle
    f. P&A transactions with a newly established entity
    g. Other

42. What types of P&A transactions are mostly used in your jurisdiction?
    a. Basic P&A
    b. Whole bank P&A
    c. Loan purchase P&A/modified P&A
    d. P&A with "put" option
    e. P&A with asset pools
    f. Loss share P&A

43. What are, if any, the formal requirements which a potential acquirer of a financial cooperative has to fulfil in P&A transactions?

44. What are the incentives in P&A transactions for a potential acquirer of a financial cooperative?
    a. Subsidies
    b. Loss sharing agreements
    c. Business expansion
    d. Business diversification
    e. Other

45. What are, in your view, the primary opportunities and challenges of using restructuring without shareholders' (members') approval as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

46. What are, in your view, the primary opportunities and challenges for the recapitalisation of financial cooperatives in resolution?

    Opportunities:

    Challenges:

47. What are, in your view, the primary opportunities and challenges of divestitures as a tool for the resolution of financial cooperatives?

    Opportunities:

    Challenges:

48. What are, in your view, the primary opportunities and challenges in the liquidation of financial cooperatives in resolution?

    Opportunities:

    Challenges:

49. Are there other resolution tools that are available for financial cooperatives specifically and what are, in your view, their primary opportunities and challenges?

    Other resolution tools (please explain what they consist of):

    Opportunities:

    Challenges:

IMPORTANT

DISCLOSURE OF INFORMATION

If there is any information that you do not permit to be publicity shared, please specify in the text box below which answers should not be disclosed.

COMMENTS AND SUGGESTIONS

Please leave your comments and suggestions about this online survey in the text box below. This will help us improve the tool in the future.

1

11. ANNEX 2 - CASE STUDIES[51]

In these case studies, "financial cooperatives" refers to deposit-taking institutions such as credit unions, mutuals, cooperative banks, etc.

These case studies aim to provide a detailed account of:

- Resolution experience of a DIO/RA (**Template A**)
  - ✓ Chinese Taipei
  - ✓ Colombia
  - ✓ Italy
  - ✓ Japan
  - ✓ Poland
  - ✓ Saskatchewan, Canada
  - ✓ the UK[52]

- Detailed explanation of how a DIO/RA has implemented a resolution framework for financial cooperatives (**Template B**)
  - ✓ British Columbia, Canada
  - ✓ India
  - ✓ Manitoba, Canada
  - ✓ Quebec, Canada
  - ✓ Ukraine

[51] The number of case studies (13) in this annex differs from the number of case studies received (17-as showed in Table 1), due to the fact that some jurisdictions did not provide a confirmation for the publication.
[52] The UK submitted two case studies.

August 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Central Deposit Insurance Corporation, Taiwan

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

The financial cooperative was established in 1957, with its head office and branches all located in southern Taiwan. The cooperative joined the deposit insurance system in 1996.

At the end of 2003, the cooperative had the head office and seven branches, 147 employees, 45,091 members, TWD 503 million in capital, assets totalling TWD 17,996 million, and liabilities totalling TWD 17,995 million, of which deposits accounted for TWD 17,252 million.[53]

The cooperative's main focus was on deposits, loans and agency business.

2. ISSUES, CAUSES AND TRIGGER EVENT

At an early stage, the cooperative had adopted a strategy of making large loans to related parties, resulting in an excessive concentration of risk. Many of these loans were made in 1993. Borrowers faced liquidity problems when the real estate market failed to rise as expected, leading to mounting overdue loans from 1996. Much of the collateral for these loans consisted of large construction and agricultural land holdings that were hard to subdivide. The high auction price posed a steep barrier to general public participation in the tenders. Difficulties in getting

[53] Exchange rate as of 31 December 2003, USD 1= TWD 33.978.

the court to recall creditors' rights further increased asset impairments and untenable business risks. The non-performing loan (NPL) ratio also rose steadily, capital was severely impaired, and collection was weak. The cooperative decided to passively wait for the real estate market to recover, leading to business losses year after year.

As for operations, financial examinations showed that the cooperative had violated a number of operational restrictions imposed by the competent authority. Abnormal financial dealings were found among directors, supervisors, employees and borrowers; late loan interest payments were not recorded as overdue receivables, but rather booked as interest receivable, inflating earnings. Valuation reserves were insufficient to cover potential asset impairments, and the cooperative's adjusted net worth was negative, among many other deficiencies.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

In view of the continued deterioration of the cooperative's financial and business conditions, the competent authority designated the Central Deposit Insurance Corporation (CDIC) in November 2002 to provide on-site guidance to prevent losses from growing. Additionally, the Management Committee of the Financial Restructuring Fund (FRF, a public fund to handle the domestic financial crisis) resolved in February 2003 to list the cooperative for resolution and decided that, if three months of guidance at the cooperative still failed to produce results, the FRF Committee would wait for an opportunity to begin the resolution process.

Despite more than a year of guidance, the cooperative's asset quality continued to deteriorate. Many of the improvements suggested by the CDIC were not implemented and many of the cooperative's operations continued to violate restrictions. A financial examination conducted at the end of March 2004 showed that the cooperative had an adjusted negative net worth of TWD 1.91 billion. The cooperative also failed to complete a capital increase. In view of the significant deterioration in the cooperative's financial and business conditions, its inability to pay its debts, and the danger of harm to the rights and interests of depositors, on 1 April 2004 the competent authority assigned the CDIC to form a team to handle on-site conservatorship and market withdrawal.

4. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

Following the example of other successful market withdrawal and resolution cases, the CDIC received approval from the competent authority to appoint a certified public accountant to conduct an asset and liability assessment and auction the cooperative's entire operations, assets and liabilities by public tender. This decision was made in consideration of the time and cost of the resolution, as well as with the aim of restoring financial order, ensuring the rights and interests of depositors, and maintaining uninterrupted financial services.

The results of the tender were announced on 5 July 2004. Seven banks had participated in the tender. The winning bid of TWD 1.1 billion plus a booked loss of TWD 8.5 million during the period from the day after the assessment to the day

before the assumption totalled TWD 1,108.5 million. Compared to the negative net book value of TWD 1,875 million, this left a TWD 766.5 million payout shortfall, which was fully borne by the FRF.

5. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

Bank run and liquidity management: During the conservatorship period, some of the cooperative's branches experienced bank runs and liquidity shortages. The CDIC sent staff to help quell the bank runs and also provided assistance in acquiring working capital to maintain uninterrupted financial services.

Reduction of resolution time: The poor asset quality and ongoing business losses at the cooperative required accelerated resolution to prevent losses from increasing. After commencing on-site conservatorship on 1 April 2004, the CDIC therefore immediately began arranging the tender sale. The general assignment was completed exactly six months later on 1 October of the same year, bringing the resolution to a quick and smooth end.

Preventing moral hazard: Moral hazard controls needed to be strengthened to prevent fraud during the conservatorship period, particularly the controls on highly liquid assets. In operations with sizable losses, it was also necessary to investigate possible illegal acts and promptly seek legal redress. However, such operations required the collaboration of cooperative staff and involved conflicts of interest, complicating the investigation work.

Creating merger and acquisition incentives: The cooperative was less attractive to investors due to its poor asset quality and the remoteness of its head office and branches. The CDIC therefore secured permission from the competent authority to allow the assuming institution to add 10 branches, six of which could be freely relocated. This created channel value and helped to attract potential investors, enabling an effective competitive bid and reducing payout losses.

Planning employee rights: To increase employee cooperation, the CDIC actively communicated with the assuming institution to secure the latter's agreement to retain 80% of the cooperative's staff: a relatively high ratio among resolution cases handled by the CDIC. Moreover, the assuming institution proposed additional incentives, including the payment of one or two months' basic salary as a bonus for employees, whether retained or not, who cooperated in completing the settlement work as planned. An additional month's basic salary was provided to employees who cooperated in completing the settlement operations without applying for job-seeking leave.

Handling resistance by managers and members: During the settlement process, there were sporadic instances of irrational behaviour by directors as well as protests over member's capital stock. The CDIC used moderate means to handle these disputes, minimise resistance, and successfully complete the settlement.

6. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

Handling announcements: The competent authority, the CDIC and the cooperative are required by law to issue announcements during the conservatorship, tender sale and general assignment.

Helping to quell bank runs: The CDIC sent staff to the business locations of the cooperative to assist with quelling bank runs and inform depositors of the protection of their rights.

Supporting policing: The CDIC coordinated with police units to strengthen patrols or sent staff to assist policing work, to protect people making withdrawals from robbery.

Remittance application time and coordinated settlement: Through coordination with domestic remittance units and the central bank, arrangements were made to allow the extension of remittance times through emergency requests as needed. Applications were made in conjunction with the assuming institution at the time of settlement to carry forward the cooperative accounts and handle other matters.

Information sharing and communication: During the conservatorship period, information related to the cooperative was promptly reported to the CDIC by its conservatorship team, and sent separately to the competent authority and central bank.

Communication with the competent authorities: The CDIC applied to provide administrative incentives, in order to increase the value of the cooperative and attract bids from potential investors. It also actively contacted potential investors to explain the content of the tender to achieve an effective competitive bid.

Communication with employees and the assuming institution: Preferential pensions were secured through labour negotiations for cooperative employees according to existing laws and regulations. The CDIC also actively communicated with the assuming institution, and requested it to increase staff retention in order to protect the employment rights of employees.

Communication with members and legislators: The CDIC actively explained the cooperative's operating conditions and coverage under the FRF.

7. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

Resolution of the cooperative involved the general assignment of the entire operations, assets and liabilities. There were no retained assets. All employees were dismissed on the date of general assignment and subsequently rehired by the assuming institution. The transfer of the cooperative's real estate and related rights was registered by the assuming institution and sealed by the CDIC according to the *Financial Institutions Merger Act* and other relevant provisions.

The shares of the cooperative members were not covered by the FRF or assumed by the assuming institution. Consequently, after the general assignment of the cooperative, some aldermen led the cooperative's members in seeking repayment of the shares. The legislature, considering that the cooperative was formed by relatively disadvantaged members, revised the Financial Restructuring Fund Statute to protect the disadvantaged. The revised statute stipulated that the FRF would provide compensation for the shares of the cooperative. After the amendment, the CDIC was entrusted to handle the payouts for the shares.

8. LESSONS LEARNED

The competent authority should strictly implement prompt corrective actions and allow the CDIC to prepare the resolution in advance, accelerate the resolution process, reduce payout losses, and restore financial order.

The law should specify that, when a financial institution comes under conservatorship or is liquidated by order of the competent authority, the management rights and property management and disposition rights of the financial institution shall be exercised by the conservator or receiver, and the original functions and powers of the shareholders (and the general meeting of member representatives), board of directors (and supervisors), directors, supervisors (and board of supervisors) or audit committee shall be suspended, as well as the original members' or shareholders' distribution rights over the remaining property, in order to reduce impediments to resolution.

Procedures for handling market withdrawal should be legal and transparent to reduce external suspicion. For example, professional agencies should be appointed to handle valuations and public tenders.

Employee awareness of laws and regulations related to the market withdrawal of a financial institution at the orders of the competent authority, together with deposit insurance matters, should be strengthened and the statutory pension rights of employees should be included in the resolution strategy plan to reduce obstacles to resolution.

The resolution strategy should align with market demand. Merger and acquisition incentives should be designed with the prior approval of the competent authority, to improve the effectiveness of the tender.

August 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Fondo de Garantías de Entidades Cooperativas (FOGACOOP), Colombia

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

FOGACOOP

Fogacoop was created in 1998 by the Colombian government as a financial institution under the Ministry of Finance. The fulfilment of its duties is subject to the supervision and control of the Banking Superintendent.

The purpose of the Fund is to maintain the confidence of depositors and savers in its enrolled cooperative entities, preserving balance and economic equity, and preventing associates and managers from deriving undue economic benefit that may cause liability to cooperatives. In addition, Fogacoop acts as a manager of the reserves generated by deposit insurance, as well as other funds and reserves to be established in order to address the various risks associated with cooperatives' financial activity.

Among the functions assigned to Fogacoop is the administration of the deposit insurance system. This should operate based on the following rules:

1. Coverage must take into account the size an distribution of deposits from cooperative entities, in order to primarily serve small depositors and savers.

2. Coverage may differ depending on the type of cooperative.

3. It must comply with the principles of austerity and efficiency in risk-taking.

4. In the event that Fogacoop has to pay out deposit insurance, it shall be subrogated by law in all sums paid to depositors and savers.

It is important to point out that Fogacoop is not only responsible for the reimbursement of insured deposits; it can also perform the following operations in order to protect depositors:

- Purchase the obligations of the enrolled cooperatives.

- When necessary, Fogacoop may temporarily participate in the equity of enrolled cooperatives.

- Appoint the liquidator, special agent or temporary administrator of the respective entity, as well as the comptroller and auditor.

- Monitor the activities of the appointed liquidator, special agent or temporary administrator.

- Develop support operations: buy easily realisable assets.

- Organise and manage trust property transferred assets.

- Establish mechanisms for temporary administration of enrolled cooperatives, in order to determine the viability of the entities and attempt to restore their financial solvency.

Moreover, when Fogacoop intervenes in a cooperative, its role, in addition to appointing the special agent, is to analyse the situation of the cooperative and determine its viability, in order to support the supervisory body's decision on the future of the cooperative, which could be a takeover, a return to normal operation or liquidation.

However, although the enrolment of cooperatives in Fogacoop is mandatory, it is not automatic. Fogacoop has the power to accept or deny the membership of a cooperative, based on the results of a feasibility study performed as part of the enrolment process. Fogacoop also periodically evaluates the financial situation of cooperative members, through monitoring, measurement of financial indicators and risk assessments. Fogacoop has the power to sign performance agreements with its cooperative members when it identifies difficulties in their financial situation, in order to minimise the risk of default. If any concerns arise about the situation of the cooperative that should be brought to the attention of the supervisory body, Fogacoop immediately reports the situation to that institution.

Fogacoop's methodology for studying the viability and financial situation of a cooperative is, in general terms, based on the traditional MAT and CAMEL models. If the cooperative's membership is approved, it may be required to sign a performance agreement, depending on the results of its evaluation. If the cooperative's situation improves over time, eliminating the main identified problems, Fogacoop has the power to terminate the agreement. By contrast, if the cooperative is not subject to a performance agreement at the moment of its membership approval and its financial situation deteriorates, the cooperative must subsequently sign such an agreement.

COLOMBIA'S FINANCIAL COOPERATIVE SECTOR

In Colombia, "cooperatives with financial activities" are jointly owned associations that offer financial services. Joint ownership is on the basis of required minimum equity contributions. Once individual have paid in their equity contribution, they are referred to as "associates" or "members".

The main characteristic that distinguishes the types of cooperatives in Colombia is the ability to offer financial services to non-members. Those that are allowed to are called "cooperativas financieras" (financial cooperatives), while the others are called "cooperativas de ahorro y crédito" (saving and credit cooperatives). This second group also contains multi-active cooperatives with a savings and credit section.

Colombia has two separate supervisory institutions: one for financial cooperatives and one for saving and credit cooperatives. The first also supervises banks and other financial institutions, insurance companies and securities markets. The second supervises cooperatives in the broad sense, i.e. saving and credit cooperatives and other cooperatives.

COOPERATIVES BASIC DATA AND COMPARISON WITH THE BANKING SECTOR

Basic data on cooperatives			**Banks**		**%**
Number of enrolled cooperatives*	185				
Number of savers and depositors*	2,813,273				
Fully covered savers and depositors(1)*	94.41%				
	Billion pesos	**Billion USD**	**Billion pesos**	**Billion USD**	
Total assets**	12.222	5,11	442.117	184,80	2,76%
Total deposits**	6.650	2,78	221.667	92,65	3,00%
Equity (2)**	4.273	1,79	62.092	25,95	6,88%
Net financial result**	248	0,10	7.928	3,31	3,13%

Source: Fogacoop records

* Data as at 30 June 2015

** Data as at 31 December 2014

(1) On 1 August 2015, Fogacoop increased coverage to COP 20 million (financial cooperatives) and COP 2 million (saving and credit cooperatives) per depositor per cooperative, and eliminated the coinsurance of 25%. With that adjustment, this indicator rises to 96.34%.

(2) Part of the equity corresponds to equity contributions from members. That portion can be withdrawn if the partner so requests, based on the right of voluntary and open membership. According to NIIF, those resources must be registered as a liability instead of equity.

The total assets of the cooperatives with financial activities enrolled in Fogacoop represent 1.62% of Colombian GDP, while total banking sector assets represent 58% of Colombian GDP.[54]

It is important to highlight that the sector of cooperatives with financial activity has 2.8 million savers, while the banking sector has 21.5 million savers; [55] this represents 13% of banking sector savers, which is a very significant figure.

DEALING WITH RESOLUTIONS

Fogacoop has been operating for more than 16 years, participating in the resolution of different types of cooperatives, using various mechanisms ranging from financial support to the deposit insurance payout process, as follows:

RESOLUTION METHOD	NUMBER OF CASES	ROLE OF FOGACOOP
INTERVENTIONS (*)	2	Appoint the special agent Make an opinion on the feasibility study Grant Financial Support Monitor on the activity of the special agent
CLEARING OF FINANCIAL ACTIVITY / TAKE OVER (INCORPORATION) / MERGER	16	As a result of the analysis and monitoring process, Fogacoop recomended these cooperatives to review the benefit / cost relation of offering financial services taking into account that their financial services were marginal in terms of income and number of operations. Please note that mergers, take over (incorporations) or clearing of financial activities are determined and authorized by the supervisor.
FINANCIAL SUPPORT	3	These cases took place as a result of the 1999 Colombian financial crisis. Fogacoop granted the following types of financial support in order to anticipate situations that could have systemic effects: Purchase of real estate assets (AP), Loans purchase (LP), direct loans (DL) and equity guarantee (EG).
LIQUIDATION FOLLOWED BY DEPOSIT INSURANCE REIMBURSEMENT PAYOUT PROCESS	1	Grant Financial support before the liqidation Appoint the liquidator Monitor on the activity of the liquidator Payout process of deposit insurance
LIQUIDATION WITHOUT PAYOUT PROCESS	2	First case: Appoint the special agent and subsequently the liquidator Monitor the activity of the special agent and liquidator Promote a Purchase-and-Assumption Transaction (P&A) during the liquidation of the cooperative and monitor its implementation, so it was not necessary for Fogacoop to carry out the deposit insurance reimbursement process. Second case: Cooperative had enough liquidity to pay total deposits and savings in a short period of time, so it was not necessary for Fogacoop to carry out the deposit insurance reimbursement process.
TOTAL	24	

(*) One of these cases took place last January and corresponds to the one that is going to be the subject of this case study

[54] Source: Financial Superintendence of Colombia - Superfinanciera https://www.superfinanciera.gov.co/jsp/loader.jsf?lServicio=Publicaciones&lTipo=publicaciones&lFuncion=loadContenidoPublicacion&id=60767.

[55] Source: "Informe Trimestral de Inclusión Financiera". Cifras a diciembre de 2014. Asociación Bancaria y de Entidades Financieras.

Source of data: Fogacoop records

None of the above cases generated costs for Fogacoop. The only deposit insurance payment that Fogacoop made was fully recovered. The monetary reimbursement and financial support were backed with guarantees that were executed.

COOPETROL

The Coopetrol savings and credit cooperative was established 62 years ago by the coworkers of ECOPETROL, the biggest oil company in Colombia. The cooperative has been enrolled in Fogacoop since 2003. Coopetrol has 14 offices nationwide that cover one-third of Colombia's departments. It has 27,851 associates, 18,400 savers and 14,143 debtors. The assets amount to USD 127 million, deposits accounts to USD 57 million and equity to USD 49 million.

Coopetrol is one of the 10 largest cooperatives enrolled in Fogacoop. Its participation compared with the total enrolled cooperative sector is displayed in the following chart:

	COOPERATIVES ENROLLED TO FOGACOOP		COOPETROL		%
Number of savers and depositors	2.813.273		18.400		0,7%
Number of "associates"or "members"	2.962.373		27.851		0,9%
	Million Pesos	Million USD	Million Pesos	Million USD	
Assets	$ 12.222.020	$ 5.109	$ 303.050	$ 127	2,48%
Equity	$ 4.273.630	$ 1.786	$ 116.261	$ 49	2,72%
Credits	$ 10.471.294	$ 4.377	$ 276.222	$ 115	2,64%
Deposits	$ 6.650.326	$ 2.780	$ 136.727	$ 57	2,06%
Deposit Insurance	$ 1.908.977	$ 798	$ 23.634	$ 10	1,24%
Savers and depositors covered	94.41%		86.86%		

Source of data: Fogacoop records. Data as at 31 December 2014

The deposit insurance value of Coopetrol represents 5.9% of the total value of the technical reserves in the deposit insurance fund administered by Fogacoop.

Although the cooperative operates in a large number of department capitals (as shown in the next image), it is not considered to pose a systemic risk. This is because the cooperative is "closed" (i.e. only Coopetrol workers, former officials, pensioners or their relatives can be members of the cooperative), so risk is concentrated in this niche market. As a result, people see any risk as a problem that only impacts the cooperative and does not affect the general population. Moreover, Coopetrol holds no resources of other cooperatives because crossed operations are not allowed by law for this type of cooperative.

Coopetrol offices
Bucaramanga
Manizales
Cali
Barrancabermeja
Pasto
Bogotá D.C.
Villavicencio
Medellín
La dorada
Neiva
Cúcuta
Tibú
Cartagena
Orito

Source: https://www.coopetrol.com.co/

2. ISSUES, CAUSES AND TRIGGER EVENT

As mentioned above, Fogacoop periodically evaluates the financial indicators and assesses the risks of enrolled institutions.

In the specific case of Coopetrol, assessment models did not identify a significant risk because the cooperative had enough financial resources to service to its savers. Equity was still strong and net income before 2014 was able to support any new adjustment.

Fogacoop detected stationary behaviour in key variables associated with the core business, specifically difficulties in increasing loans and weaknesses in credit risk management, as evidenced by the portfolio quality indicators, which exceeded the industry benchmark, as well as an increased proportion of non-performing assets in the balance sheet.

Moreover, from June to October 2014, the amount of deposits and the number of depositors decreased by 10%. In addition, a growing number of complaints were received from administrative staff, who were being fired and who reported weak governance practices. Therefore, early warnings were activated in December 2014 by the Interagency Committee (composed of the DIA and supervisory authority representatives), encouraging a cooperative audit in order to confirm the true situation.

These were the main findings of the audit:

1. First, governance problems were evident, involving the manipulation of information, concealment of data relating to delinquent portfolios, regulatory and compliance breaches, and financial statements that did not reflect the true situation of the cooperative. The financial information reported by the cooperative to the supervisory body did not show the true situation or reflect the actual risk of the institution, especially the data on non-performing loans and provisions unduly granted. This last aspect delayed urgent action and preventive measures by Fogacoop and the supervisory body.

   As a result of these irregularities, the cooperative needed to increase the level of provisions for non-performing loans in its financial statements by COP 11,000 million, affecting the results of the income statement. In contrast to the profit of COP 9,000 million for 2014 that was posted by the company before the intervention, the additional provisions resulted in a loss of COP 2,000 million, losses that were recorded against retained reserves from earnings from previous periods.

2. In addition, there was a concentration of power in the council president and the management who, in developing their public functions, granted percentages, fees, perks, benefits and privileges, violating the existing regulations.[56] Key areas were under the influence of the president, due to vacancies in most key posts. These are some examples of the governance problems detected:

   - Council members' participation in the overall decisions of the cooperative (the council president was a member of most committees); they had control over most of the cooperative's decisions, resources and assets.
   - Despite the fact that the council members should perform their duties on an honorary (i.e. unpaid) basis, during the period 2012–2014 the council members were paid COP 847 million, equivalent to near half a million US dollars.
   - For the purpose of compensating management, council members knowingly disguised voluntary retirements as dismissals without just cause, financially hurting the cooperative.
   - The cooperative signed a contract with another firm, chosen to provide cooperative education to Coopetrol affiliate members. This culminated in fraud, as a result of social and education funds being transferred from the

[56] There were violations of certain laws: Article 41 of Law 454 of 1998, in accordance with Article 99 of Law 79 of 1988. The former law states that saving and credit cooperatives are specialised and can only undertake the projects provided for in Article 41. Tourism promotion and tickets are prohibited; however, this was done by Turispetrol as this was included in its social objective. The provisions of Article 60 of Law 454 of 1988 were also violated: "... The members of the Board may not enter into contracts to provide services or advice to the entity".

Turispetrol's introduction of a hiring mechanism to provide cooperative training to Coopetrol affiliate members constituted a fraud under Law 454, because it resulted in social and education funds being transferred to Turispetrol, for use by Turispetrol. This is not itself prohibited by law, but hiring board members of Coopetrol as facilitators is prohibited.

firm to the coop, and Coopetrol board members being hired as facilitators, which is prohibited by law.

3. In liquidity terms, the available resources represent a very small portion of the total assets, revealing weaknesses in the management of liquidity risk.
   Productive assets, especially loans, have not increased much, while unproductive assets have grown considerably, reflecting the acquisition of the main office building.

   The funding structure is inadequate because credits were used instead of growing the membership base, and the interest rate on deposits was much higher than the market rate, which increased the funding costs.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

The scheme for tracking and monitoring the sector is based on the work of the supervisor and analysis by Fogacoop, with the results shared in an inter-agency technical committee established under the agreement between Fogacoop and the supervisor.

In Coopetrol's case – due mainly to governance issues and inaccurate financial reports, problems revealed by the audit and additional information collected by the supervisor – in January this year the supervisory authority intervened in the cooperative, using a legal mechanism known as "business takeover of goods and assets". Under this mechanism, the existing administration of the cooperative was removed and Fogacoop appointed a special agent and auditor for the entity. Between February and March, the special agent started the feasibility study, aimed at ascertaining the true situation of the cooperative and the conditions for returning it to normal operation, if possible.

Subsequently, due to a rapid decrease in deposits and depositors, the supervisor decided to decree the suspension of payments to depositors, savers and other creditors as a measure of protection for small savers, so they could not withdraw their deposits, savings or contributions.

While the viability study was under way, several actions were taken by the special agent based on the results of the audit, in order to put the house in order. These included: refine business niches and segments, generating a real social service focus with products that have greater impact on the social basis and improve the quality of life; minimise risks through integrated management; adjust the leverage structure of the cooperative and overcome deficiencies in risk management, governance and human resources.

4. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

As mentioned above, if intervention in the cooperative becomes necessary, the special agent appointed by Fogacoop must (as in most cases) carry out a viability assessment and identify the conditions under which the cooperative must operate in this transition period, following the rules established in the intervention resolution issued by the supervisor.

The study is not limited to establishing the feasibility of the cooperative but also and, no less importantly, involves supporting the actions that must be taken by the supervisor. Based on the study, the supervisor may close the cooperative (liquidation), outline a period of time for which the cooperative will be under administration so that it can recover and return to fulfilling its original purpose, or simply determine whether it can perform other operations to achieve better conditions for stakeholders (depositors, savers, creditors, members, etc.). If the supervisor decides to liquidate the cooperative, total or partial depositor reimbursement will take place.

Fogacoop monitors the development and progress of the feasibility study and draws up a scenario, based on the possibility of returning the cooperative to normal operation.

Once Fogacoop evaluates the viability assessment, agrees with it and supports it, the study, including the recommendations of measures to be adopted, is submitted to the Superintendent. If Fogacoop determines that the cooperative is not viable, it should request the Superintendent to liquidate the cooperative, without prejudice to the autonomy of that body to order the administration or liquidation of the cooperative.

In the case of Coopetrol, as a conclusion of the study, the special agent reported that strategies such as liquidating the cooperative or clearing the financial activity could be possible. However, there was a risk that the assets would lose some value (including the portfolio value), and the negative impact on contributions would affect cooperative members and depositors, as well as having consequences related to confidence in the cooperative sector.

Instead, the special agent suggested a recovery plan based on the financial information and the administrative situation of the cooperative. Clearly, the recovery plan required a large number of administrative actions (e.g. governance policies, organisational restructuring, human resources policies, a greater focus on commercial management, restructuring costs and financing sources, productive assets and liabilities portfolio management, technological adjustments), as well as a significant adjustment in the risk management process, especially as regards operational and credit risk.

It should be noted that the submitted viability plan contained three scenarios, with assumptions on the reasonableness of the possible implementation objectives.

These three scenarios all involved: operational support from Fogacoop amounting to COP 20,000 million (about USD 7 million) to cover potential liquidity needs (this does not exceed the amount of the deposit insurance); and a credit of COP 8,000 million (about USD 3 million), both of them to be paid within 24 months.

The three scenarios simulated different variables, being the most sensitive of which was deposit and contribution withdrawal. Under the pessimistic and intermediate scenarios, the support operation and credit for COP 28,000 million would be

insufficient and the cooperative would be unbalanced, due to the amount of deposit and contribution withdrawals.

In conclusion, the viability plan was based on the optimistic scenario and the results showed that administrative and financial would be necessary, as well as possible support from the national government for liquidity needs.

The administrative efforts involved improving or implementing risk management procedures, particularly the placement, monitoring, collection and recovery of the portfolio. The financial restructuring required the rearrangement of productive assets and liabilities with costs.

Among the conditions for granting the support operation, the special agent was required to develop an effective communication plan in order to restore confidence in the cooperative, formalise (sign) all the negotiations with financial institutions within the deadlines set in the study, and obtain "promises of support" from the main depositors of the cooperative.

On this basis, in the second quarter of 2015, the viability study, backed by Fogacoop, was approved by the supervisor and in late June the decreed suspension of payments to depositors, savers and other creditors was halted. The supervisor decided, as a "**best rescue institute" or "salvage operation"**, to put the cooperative under administration for at least 24 months, with the aim of recovering the entity and returning it to its associates with a strong financial structure and efficient lending and risk management processes, based on the recovery plan designed by the special agent, which included financial support from Fogacoop.

The support operation of COP 20,000 million pesos (about USD 7 million) was approved by Fogacoop, in case the cooperative required that money for liquidity purposes.

5. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

The Fund's main challenge in this particular case was initially related to planning and restructuring the support operation, ranging from the contractual legal framework to the operational elements required for its implementation.

This was because it was necessary to choose a legal form that would allow the cooperative to have the necessary liquidity, but also give the Fund a guarantee for any operational support it provides. While the Fund is entitled to support the cooperative, it must have some kind of guarantee that it can recover the amounts involved if necessary.

After reviewing operation types, it was decided to structure the support operation as a future fulfilment operation protected by the purchase of portfolio rating (A) with a repurchase agreement for an amount of COP 20,000 million and an initial term of 180 days, with liquidity disbursements when needed.

With this operation, the cooperative will receive the necessary liquidity, not exceeding the maximum amount allowed by law by Fogacoop (the value of deposit

insurance, unless it is an entity of systemic importance, which was not the case here). This does not affect their revenue stream from the collection portfolio since the rules allow that, even when the promissory notes are committed and endorsed in favour of the Fund, the portfolio is still reflected in the balance sheet of the cooperative and if the cooperative cannot return the resources within the set deadline, Fogacoop would retain the notes and the future cash flows to recover the resources of the support operation.

For Fogacoop, this support operation demanded operational resources to perform all the required processes for its implementation: First, it was essential to establish the types of promissory notes that could be received (consumer credit, mortgages, etc.), the number of notes and maximum and minimum amounts, conditions for acceptance (which in general depend on the particular conditions of the cooperative), in order to avoid concentrating risk in notes for very high amounts, but also to avoid unduly increasing operating costs, owing to very low amounts. Second, as regards due diligence for the promissory notes and their receipt, endorsement, custody and administration (verifying that the notes to be endorsed meet the conditions established and their consolidated projected balance amount on maturity of the obligation meets the specified requirements), the Fund had to contract these services out to companies with the relevant capability and expertise. This process is equally complex because not all potential external providers have the ability to perform the process in a decentralised location, as the vast majority of them are located in the capital, Bogotà. This means that securities have to be transported from other, remote cities in cases where the cooperative does not hold its notes in Bogotà. In addition, possible risks must be considered (risk of loss during transport, risk of damage or loss of custody of promissory notes, etc.), as well as actions to deal with these risks (manage the replacement of expired notes or notes that recorded prepayments of principal, etc.)

Another challenge for the Fund was restoring cooperative savers' confidence, making the intervention process and the suspension of payments less traumatic. For this purpose, a company with extensive experience and a background in communications was hired to run a communications campaign focused on building the confidence of depositors and preventing runs on deposits, based on three key areas (see next section).

6. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

When the Superintendent took possession of the cooperative and decreed the suspension of payments, several media from different regions issued new reports highlighting the corporate governance problems at the cooperative and the disadvantage for savers whose savings had been frozen. These messages were not in line with the aim of maintaining confidence, especially in crisis situations. The government's goal was to save the coop and avoid its liquidation, and initial news reports were not appropriate or accurate, generating distrust in the cooperative and causing substantial deposit withdrawals, especially by the biggest investors.

However, the Fund, through its ongoing monitoring of the cooperative and its appointment of the special agent (and aware of the importance of instilling calm and sense of belonging among savers as a critical factor in recovery and continued

operation), supported the decision to hire a company with extensive experience and a background in communications. This company launched a communications campaign focused on rebuilding the confidence of depositors, based on three key areas:

- Preparation of entity spokespersons: several training workshops were held for management spokespersons, to ensure that they delivered a consistent message and generated high credibility and positive impact, thereby improving the corporate reputation and providing effective communication to stakeholders during the crisis;

- Disclosure in news media, most well-known radio stations and regional TV channels in the geographical regions where the largest number of savers were concentrated. For this purpose, economics editors of major newspapers were approached to issue regular new reports and articles which generated confidence and calm; interviews were also organised with radio stations and the most popular regional news programmes.

- In-house awareness campaign at the cooperative. Meetings were held with the major savers in a conducive environment, in order to obtain in-depth information on aspects of interest to the receiver. Among the issues highlighted were management issues, progress, recovery plans and implementation of new risk systems.

The news that the COP 20,000 million support operation to cover liquidity needs had been approved in May 2015 was well received by members and depositors, restoring calm and confidence as they realised that the cooperative would be receiving financial assistance from the government, which issued a comprehensive feasibility concept. This news was reported via different channels: Fogacoop's and Coopetrol's websites, emails to the members and depositors of the cooperative, posters in areas of high traffic and visibility at the cooperative's offices.

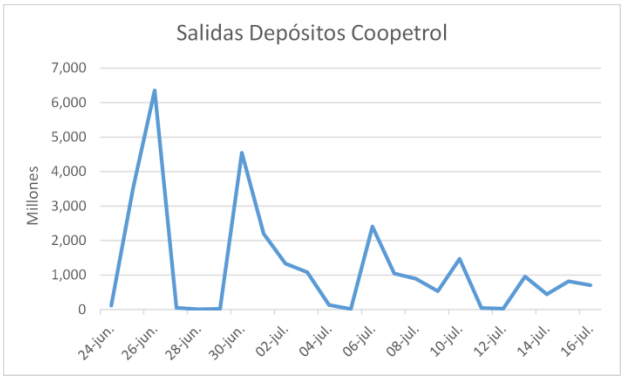
It is also important to highlight the necessity of having a consistent message from the cooperative, the supervisory body and the Fund. As regards the actions carried out directly by Fogacoop, we can underline the issuance of a written report explaining the situation of the cooperative and the decision by Fogacoop to perform the support operation, as well as the use of different channels for the petitions, complaints and claims received from those linked to the cooperative. The supervisory body approached the media directly to disclose the main causes of the intervention and the plans for its future.

7. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

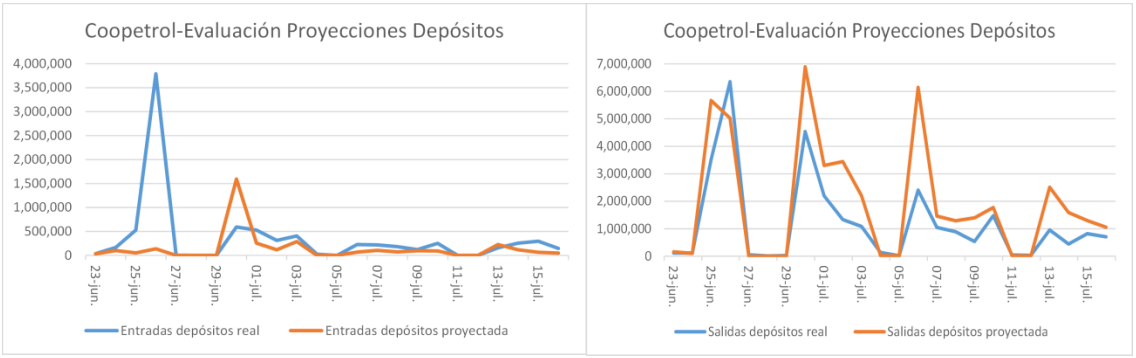
It is important to highlight that Coopetrol is still in intervention and the recovery period is projected to extend until 2016, during which time the entity is forecast to generate COP 4,200 million (about USD 1.7 million) in profits.

It could be said that the first stage of the recovery plan was completed successfully; the following events occurred:

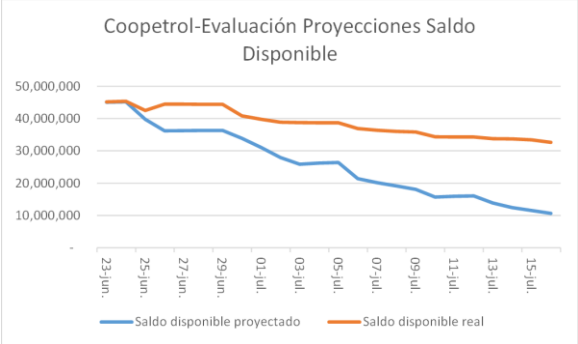
1. Restructuring of all major financial banking debts was achieved, improving the cash flow of the cooperative.
2. The Fogacoop support operation was approved, implemented and ready to be disbursed when needed.
3. Deposit withdrawals after the payments suspension was lifted were significantly lower than estimated. As shown in the graph below, deposit withdrawals slowed down in July. Compared to the months before the measure was taken, it could be concluded that this trend will be maintained; in fact, last week deposit withdrawals were less than before the intervention.



In fact, not only were deposit withdrawals lower than expected, but new deposits were also higher, as shown in the next two graphs:



As shown below, cash flow has been satisfactory, leaving the cooperative with about COP 22,000 million more funds available than the estimated value.



In this context, the cooperative management should begin migrating towards a going concern, using the unexpected resources to increase the loan portfolio.

Fogacoop will continue with the support operation, making resources available as necessary, and will be attentive to the performance of the established plan, monitoring cash flow behaviour in order to return the cooperative to its members in the shortest time possible.

8. LESSONS LEARNED

Among the main lessons learned we may include the following:

- The search for a framework of good governance practices is. from the point of view of Fogacoop, the way to encourage stronger institutional entities. Right now, the models used by Fogacoop to monitor enrolled cooperatives are based on measuring the risk of having to pay out deposit insurance. It is important for Fogacoop to develop evaluation systems that involve methodologies and indicators to identify problems or weaknesses in corporate governance that may arise in the cooperatives, in order to be able to take preventive measures instead of having to use other resolution methods such as intervention in this case study – with the adverse effects that this measure may have on the cooperative sector, mainly in terms of the loss of trust. Moreover, this evaluation system may include following up on the economic activities between the cooperative and the entities involved in or auxiliary to the cooperative.

- The measure suspending payments that were made in this case underlines the importance of this kind of tool to demonstrate that the State can intervene with full powers, if necessary, to dismantle managements that caused the company to diverge from its original mission. We consider this measure useful for generating market discipline.

- For Fogacoop it is also important to simulate the deposit insurance payment process, as in this case the cooperative's size and significant volume of savers, as well as the geographic location of most of them, would make the process more complex in terms of the operational capacity needed.

July 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organization (DIO) or Resolution Authority (RA):
Fondo di Garanzia dei Depositanti del Credito Cooperativo (FGD), Italy

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

The Italian Network of Credit Cooperatives Banks (as of December 31, 2014)

- 376 BCC (about 55% of total # of banks operating in Italy);
- 4.441 branches (14,4% of Italian banks' branches);
- presence in 101 provinces and 2.703 councils (in about 500 councils they operate under monopoly);
- about 6 million customers;
- employees amounting to 37.000 units;
- customer deposits amounting to €163,2 billion (+2,3% vs. +0,8% for Italian Banking System, on yearly basis);
- customer loans amounting to €135,3 billion (-0,6% vs. -1,1% for Italian Banking System, on yearly basis);
- loans to enterprises amounting to €86,9 billion (-2,1% vs. -1,1% for Italian Banking System, on yearly basis). Market share of 9,7%;
- capital and reserves of €20,2 billion (+ 0,3% on yearly basis);
- number of shareholders equal to 1.200.485 units (+ 2,3% on yearly basis);
- Tier 1 ratio of 16% and Total Capital Ratio of 16,5%.

The Gruppo Bancario Iccrea is the most significant Second Level Bank of the BCCs System and almost all BCCs directly (or indirectly through other entities of the

system) hold shares of the Holding of the banking group. The latter carries out complementary and subsidiary actions for BCCs, which constituted it more than 50 years ago in order to increase their capability of service offer to members and customers in their local communities, as well as to constantly increase their competitiveness.

The Second level banks do not control BCCs. On the contrary, it is the BCCs to control the central entity via the shares held in it, according to the "inverted pyramid" model, common to most of co-operative banks systems across Europe.

The Gruppo Bancario Iccrea supplies modern and technologically advanced services (system finance, especially liquidity management; corporate and extraordinary finance; point of access to ordinary and extraordinary financing operations; payment systems; IT services; it is partner to EIB-EIF-CDP; etc.) in a perspective of economies of scale and of investment concentration in development and technological innovation. It also creates/develops entities dedicated to specific business, especially where specific law provisions prevent BCCs from carrying out certain activities.

Since 1997, to prevent defaults and the associated reimbursement of deposits to customers, the network of Italian Cooperative Credit Banks relies on the early intervention system provided by the Deposit Guarantee Scheme of Cooperative Banks («FGD»[57]).

FGD is a private consortium established in compliance with the Legislative Decree n. 659 4 December 1996, implementing the EU Directives 94/19/EC and 2009/14/EC:

- Directive 1994/19/CE has provided for the compulsory establishment of DGS in member States
- Directive 2009/14/CE has introduced the following new principles:
  - ✓ coverage set to the harmonized level of € 100.000 per depositor per bank;
  - ✓ payout to depositors within 20 working days;
  - ✓ abolishment of the 10% co-insurance clause applicable to the depositor.

FGD's «innovative» model anticipates the combined features that DGS and crisis management tools should have according to the recently approved new EU regulation (Directives 14/49/EU and 14/59/EU).

The BCC Deposit Guarantee Scheme (Fondo di Garanzia dei Depositanti, FGD) follows rules of conduct consistent with the mutuality of BCCs and of the whole system that they set up.

The FGD is not only the category's instrument for the reimbursement of depositors, but it also has been carrying out for years preventive actions according to an

[57] FGD comes from the evolution of Fondo Centrale di Garanzia (FCG), the first italian voluntary IPS founded in 1978, by the network of cooperative credit banks.

advanced model of prevention and management of crises, also facilitating solutions within the category of BCCs.

Thanks to its statutory model and its operational conduct the FGD secured that never public resources have been necessary to resolve a crisis and never repayment of depositors was needed.

In addition to FGD, the Financial Safety Net of the Italian Credit Cooperative Banks includes also a Bondholders' Guarantee Fund (since 2005) and a voluntary contractual IPS (Institutional Protection Scheme named Fondo di Garanzia Istituzionale, shortly FGI), which can now be considered in the advanced definition stage.

The FGI has been set up by Federcasse, by all Local Federations and by the 3 Second Level Banks of the System. In the past months it has started a revision process in order to be fit in the new rules under DGSD, BRRD, and State Aid rules.

Banca Romagana Cooperativa (shortly BRC) is a bank, member of the Cooperative credit Network, which has been recently put through a resolution-like process, in the context of the existing Italian banking insolvency procedure.

The main figures of BRC are:

Employees	al 30 aprile 2015	187
Branches	al 30 aprile 2015	22
Banks Shareholders	al 30 aprile 2015	7.903
Loans	al 30 aprile 2015	€ 610.553.000
Customer Deposits	al 30 aprile 2015	€ 891.490.000
Capital and Reserves	al 30 aprile 2015	- € 33.905.000
Protected Deposits	al 31 marzo 2015	€ 445.262.000
Protected Bonds (by FGO)	al 31 marzo 2015	€ 63.651.000
Subordinated bonds (354 retail customers)		€ 14.786.000
Subordinated bonds (subscribed by Iccrea and guaranteed by FGD)		€ 9.000.000

2. ISSUES, CAUSES AND TRIGGER EVENT

In July 2012, the BRC showed necessity of financial support (capital and liquidity). Then FGD provided guarantees. It was a typical FGD early intervention named "Additional Support interventions to distressed member banks" (Statute, art. 35).

The bank issued subordinated loans and ordinary bonds, subscribed by Iccrea and other banks members of the regional Federation.

The Governance Bodies were entirely renewed and a specific 3-year recovery plan was designed.

Unfortunately, after on sites inspections by the Italian supervision authority (Bank of Italy), on November 2013 BRC was put through the "special administration" procedure.

Malfunctioning of governance bodies, flaws in internal control activities and territorial influences are the main causes of inefficient selection and revision of credit, and "discretional" bad loans recovery.

As a consequence of the recovery plan failure, the "special administrators" appointed by Supervision Authority have looked for the appropriate potential buyer of the Bank, over a 18-months period, in order to minimize value destruction and ensure financial stability.

In the end, after the competitive selection, the selected buyer was Banca Sviluppo, a bank controlled by Iccrea Holding Group.

3. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

The resolution-like procedure that was adopted is based on the involvement of FGD, namely the so called "Intervention in transfer of assets and liabilities as an alternative to pay-out (Statute, art. 33)".

Taking into account the "least cost" principle (in comparison with depositors reimbursement), the key features of FGD intervention are:

1) Payment of the negative balance of net assets to Banca Sviluppo;
2) Coverage of liquidation expenses;
3) Purchase «pro-soluto» of bad loans;
4) Purchase of Deferred Tax Assets;
5) Contribution to personnel reduction expenses;
6) Purchase of liability actions against board directors/auditors committee members/general manager liable for having caused the crisis of BRC.

Funding came entirely from ex post contributions and loans provided by member banks.

4. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

The first issue deals with State Aid regulations. The European Commission has decided that the liquidation measure in favour of cooperative bank "Banca Romagna Cooperativa – Credito Cooperativo Romagna Centro e Macerone" (Banca Romagna Cooperativa) is compatible with EU state aid rules.

In detail, the Italian mandatory deposit guarantee scheme ("Fondo di Garanzia dei Deposanti del Credito Cooperativo") covered the negative difference between the transferred assets and liabilities. Deposit guarantee schemes are mandatory under EU law to ensure that covered deposits are paid out when a bank is liquidated and exits the market, in which case there are no State aid issues. In this case, however, the deposit guarantee scheme's intervention constitutes State aid, because it is acting beyond this pay-out function, namely in a transfer of asset and liabilities, under the control of the Italian authorities. The Commission's assessment showed that this aid is compatible with EU state aid rules, in particular the Commission's 2013 Banking Communication.

Equity and subordinated debt has not been transferred but remained in the entity in liquidation, which means shareholders and junior bondholders have fully contributed reducing the need for State aid to the necessary minimum in line with burden sharing principles.

To avoid further reputational risk, the above mentioned FGI also played a role in the intervention by reimbursing retail subordinated bondholders.

The second issue is the future application of the bail-in, which presents a number of different criticalities for BCCs, starting from the "structural" limits of their share holding base (50.000 euros is the maximum quota for a single member).

Equally, by applying the bail-in as conversion of debt into equity, non-members creditors would be transformed into members/shareholders, joining the existing share holding base, however in the absence of the test on the adhesion to the principles and of presence on the requirements to be a member, in full contrast with the provision of the TUB (the Italian Banking Law) and of the Civil Code.

5. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

The communication strategy was primarily concerned with the reassurance of national customers so as to avoid spillover effects to other BCCs. This was particularly important given the interrelationships among network member banks, sharing a common brand identity.

6. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

Banca Sviluppo will continue conducting its business operations with the inclusion of assets and liabilities transferred from BRC.

The remaining assets and liabilities of BRC will be liquidated under the ordinary insolvency procedure.

7. LESSONS LEARNED

To sum up, Banca Romagna Cooperativa had been under special administration since 2013, and was put into liquidation by the Italian authorities on 17 July 2015 under national insolvency law. Its assets and liabilities, including deposits, were transferred to Banca Sviluppo, which is part of the ICCREA Group. This will ensure that Banca Romagna Cooperativa's transferred activities return to long-term viability within the new entity.

In terms of actual take aways from the case, FGD member banks should think of rebalancing their liabilities structure, to avoid the dangerous effect of a future application of both the burden sharing and bail-in mechanisms and the associated reputational risk.

Additionally, in the face of the regulatory constraints arising from depositor preference and State Aid rules on the DGS activity, some important actions should

be taken to reorganize the functioning of the FGD towards bank crises prevention measures and early intervention tools.

September 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Deposit Insurance Corporation of Japan

TEMPLATE A

8. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

The financial institutions covered by the deposit insurance system of the DICJ are as follows:

a. Banks stipulated in the Banking Act
b. Long-term credit banks stipulated in the Long-Term Credit Bank Act
c. Shinkin banks
d. Credit cooperatives
e. Labour banks
f. The Shinkin Central Bank
g. The Shinkumi Federation Bank
h. The Rokinren Bank
i. The Shoko Chukin Bank

Of these, c, d, e, f, g and h are categorised as financial cooperatives by the Financial Services Agency (FSA).[58]

[58] Comprehensive Guidelines for supervision of small and medium-sized and regional financial institutions, April 2015.

A comparison of financial cooperatives and banks as regards the number of institutions, the legal basis and the eligible deposits is shown in the table below.

	Banks	Financial Cooperatives		
		Shinkin banks	Credit cooperatives	Labor banks
Legal basis	Banking Act Companies Act	Shinkin Bank Act	Small and Medium-Sized Enterprise Cooperatives Act Act on Financial Businesses by Cooperatives	Labor Bank Act
Number of institutions	141	267	154	13
Eligible Deposits (2014 FY) (Unit: Billion JPY)	776,225.1	129,321.2	18,966.9	17,836.3
Eligible Deposits (ratio in total)	81.82%	13.63%	2.00%	1.88%

Note: Figures above does not include the related figures of their federations such as f, g, h above.

For a general overview of financial institutions in Japan, please refer to the URL below:
http://www.zenginkyo.or.jp/en/banks/financial-institutions/

In Japan, there are agricultural and fishery cooperatives (AFC), comprehensive entities which operate marketing business and insurance other than credit business, which largely differentiates them from other general financial institutions such as banks. In order to protect depositors in AFCs, the Agricultural and Fishery Cooperative Savings Insurance Corporation (AFCSIC), which was established under the Agricultural Cooperatives Act, operates a savings insurance scheme.[59]

9. Issues, causes and Trigger event

Issues

The DICJ dealt with 161 cases of financial cooperative failure in the period between 1991 and 2002, and provide financial assistance in 160 cases. Of these, 152 cases of financial assistance were conducted 1996 and 2002. In this period, a number of financial institutions had large amounts of non-performing loans and, in the prevailing financial environment, credit concerns were easily triggered. Against this background, special arrangements were introduced to protect deposits in full. Thus, all deposits were protected in this period.

All 161 failures were resolved through transfer of business or merger. The DICJ provided financial assistance in the form of monetary grants or asset purchases.

[59] Agricultural cooperatives ("JAs"), fishery cooperatives ("JFs"), credit federations of agricultural cooperatives (CFACs), credit federations of fishery cooperatives (CFFCs) and the Norinchukin Bank (NB) are covered by the AFCSIC.

CAUSES

According to Deposit Insurance Research No. 4 published by the DICJ in September 2005, all the failures of financial institutions up until 2002 were analysed and categorised according to three main causes, as shown in the table:

	Number of cases	Average size of asset (Unit: billion JPY)	Non-performing loans				Failure in investing securuties	Irregularities/unlawful incidents
				Credit concentration into real estates related bussiness	Credit concentration into non-real estates related bussiness	Economic slump		
Credit cooperatives	134	100	91.8%	44.0%	28.4%	28.4%	29.9%	5.2%
Shinkin banks	27	230	85.2%	37.0%	18.5%	37.0%	37.0%	7.4%
Banks(reference only)	19	3,500	100.0%	73.7%	21.1%	5.3%	0.0%	0.0%

TRIGGER EVENT (*Deposit Insurance Act*, Article 49, section 2, parts 1 and 2)

Trigger events for the deposit insurance system (insurable contingencies) are divided into two types: the suspension of the repayment of deposits, etc. by a financial institution (Category One Insurable Contingency); and the cancellation of a financial institution's licence to conduct business, a decision to commence bankruptcy proceedings and a resolution to dissolve the financial institution (Category Two Insurable Contingency).

10. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

We will answer this section assuming "contingency plan" as a method to ensure the DICJ's readiness for the failure of financial institutions in normal times.

The DICJ's contingency plans for financial institutions are not specific to financial cooperatives. The DICJ continues to study failure resolution schemes under limited coverage and, in anticipation of its appointment as a financial administrator, keeps itself ready to initiate administrative procedures for failure resolution.

The DICJ also conducts periodic practical training on failure resolution procedures in order to ensure appropriate failure resolution by through the proper implementation of the prepared failure resolution procedures. In addition, based on its past experiences of failure resolution and under various assumptions – including failure resolution through the insurance payment method – the DICJ continuously reviews the procedures to make a more appropriate and effective resolution of failed financial institutions possible.

Regarding the lessons learned, please refer to Section 5.

11. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

The DICJ does not have resolution methods specific to financial cooperatives.
In general, the insurance payout method or the financial assistance method is used in cases of financial institution failure. In past failures of financial cooperatives, the financial assistance method has been used.

The following table shows the number of cases of financial assistance to financial cooperatives and the amount spent so far as of the end of March 2015.

(Unit: billion JPY)

		Number of cases	Monetary grants		Purchase of assets	
			Number	Amount	Number	Amount
Financial cooperatives	**Shinkin banks**	27	27	972.6	25	550.0
	under full protection system	25	25	926.6	25	550.0
	Credit cooperatives	133	133	5,322.0	125	12,406.0
	under full protection system	127	127	5,131.3	125	12,406.0

Notes:

1. The above figures for amounts are rounded to the nearest JPY 100 million.
2. Monetary grants: The grants comprise (1) monetary grants to assuming financial institutions, and (2) monetary grants to failed financial institutions to ensure equitability among the creditors of these failed financial institutions (equitable financial assistance; enforced in April 2001).
3. Purchase of assets: This includes purchases of assets from assuming financial institutions in re-assumption in accordance with Article 101 of the Deposit Insurance Act.

MEASURES AGAINST FINANCIAL CRISIS (no previous application to financial cooperatives)

Provided that the Prime Minister recognise that, unless one of the following measures against financial crisis is taken, the maintenance of an orderly credit system in Japan or in a certain region in Japan where the insured financial institution conducts its business could be severely hindered, one of those measures may be taken subject to deliberation by the Financial Crisis Response Council.

Measures to be taken	Insured financial institutions
i) Capital injection (Article 102, paragraph (1), item (i) of the *Deposit Insurance Act*)	Financial institutions (excluding failed or insolvent financial institutions)
ii) Financial assistance in an amount exceeding the insurance payout cost (Article 102, paragraph (1), item (ii) of the *Deposit Insurance Act*)	Failed or insolvent financial institutions
iii) Special crisis management (Article 102, paragraph (1), item (iii) of the *Deposit Insurance Act*)	Failed financial institutions that are insolvent banks

Under (iii) special crisis management, the DICJ acquires the shares of the insured bank, and appoints the directors, auditors and other officers of the bank as nominated by the FSA Commissioner. This is only applicable to banks due to the fact that financial cooperatives are not joint stock companies and the DICJ cannot acquire capital through ordinary shares in the case of financial cooperatives.

12. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

In Japan, taking the convenience to depositors and the maintenance of financial functions into account, the financial assistance method, whereby the business of a failed financial institution is transferred to an assuming financial institution and the DICJ provides financial assistance to that institution, is preferred to liquidation. The past failures of financial cooperatives have been resolved using the financial assistance method.

An analysis of past failures of financial institutions reveals that, in general, the longer it takes to complete the resolution, the more losses are incurred. Given that the business assets to be transferred to the final assuming financial institutions deteriorate during the period of resolution, the longer it takes to complete the resolution, the more the assets deteriorate.

Therefore, for smooth resolution of failed financial institutions, it is important to find assuming financial institutions as soon as possible. However, this is not easy in the continued economic slump and the tough conditions in the financial system. For these reasons, when two credit cooperatives failed in 1994, a new assuming financial institution was created. There have been cases in the past where other types of financial institution, such as banks, have assumed the assets of financial cooperatives.

In Japan, although there have been no financial cooperative failures since 2002, in the event of such a failure, it is important to find an assuming financial institution promptly, and to prepare a bridge bank scheme ready for operating the business and maintaining assets temporarily, just in case no assuming financial institutions are available.

13. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

We will answer this section assuming "crisis communication" as a strategy to communicate to both creditors (including depositors) and the general public.

The DICJ does not anticipate any crisis communication issues specific to financial cooperatives.

14. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

The DICJ does not have an exit strategy specific to financial cooperatives. However, in general, at the same time as the transfer of business to the assuming financial institution, given that some assets will remain in the failed financial institution even after the transfer, the DICJ tries to liquidate the failed financial institution as early as possible.

15. LESSONS LEARNED

Financial cooperatives, which are generally small in size, failed simultaneously during the last financial crisis. Thus, the DICJ needed to handle the failures of multiple financial institutions in parallel. Based on this experience, the DICJ has learned that it is important to resolve financial institutions promptly, using methods such as mergers and the transfer of business.

July 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Bank Guarantee Fund, Poland

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

In the Polish financial system there are three main categories of financial institution: commercial banks, cooperative banks and credit unions. Basic data concerning the last category are presented below, in comparison with the total banking sector.

Basic data on credit unions' sector in Poland*			Total banking sector (commercial and cooperative banks)	
Number of credit unions		50		
Number of branches		1607		
Employment (number of posts)		4214		
	billion PLN or %	billion USD	billion PLN or %	billion USD
Balance sheet total	12.92	3.47	1545.83	413.75
Total loans	6.99	1.88	1069.20	286.18
Deposits	11.82	3.17	1195.7	320.04
Capital adequacy ratio (%) (according to financial statements)[60]	1.39	-	15.4	-
Net financial result (according to financial statements)[61]	-0,1	-0.027	4.05	1.08

[60] The capital adequacy ratio (after on-site supervision) is estimated at –3.81%;
Source: PFSA, https://www.knf.gov.pl/Images/Informacja_o_sytuacji_skok_Ikw_2015_tcm75-42099.pdf .

[61] The net financial result (after on-site supervision) is estimated at PLN –0,72 billion/USD –0,193 billion;
Source: PFSA, https://www.knf.gov.pl/Images/Informacja_o_sytuacji_skok_Ikw_2015_tcm75-42099.pdf.

**Publicly available data of the Polish Financial Supervision Authority, as of the first quarter of 2015. Source: "Report on the credit unions' system as of the first quarter of 2015"; PFSA, July 2015, "Information on the situation of banks as of the first quarter of 2015", PFSA, July 2015.*

The regulatory framework for the resolution of financial cooperatives[62] in Poland is based on the following legal acts:

A) The *Act on Cooperative Savings and Credit Unions* of 5 November 2009.
B) The *Act on the Bank Guarantee Fund* of 14 December 1994.[63]
C) Internal regulations of the Bank Guarantee Fund, which concern resolution issues, especially the resolution of the BGF Council regulating the principles for granting financial support to acquiring entities during resolution.

An example of the BGF's involvement in the resolution of a financial cooperative are activities connected with the restructuring of the St. John of Kęty credit union, which was acquired by Alior Bank. Analogous activities were performed in the case of the Nicolaus Copernicus credit union acquired by Pekao S.A. The St. John of Kęty credit union was a small entity – it had approximately 18,000 clients and the value of their assets was about EUR 13.9 million (0.22% of the assets of the acquiring bank).[64]. The case of the St. John of Kęty credit union, in 2014, was the first in Poland in which a credit union was acquired by a commercial bank.

2. ISSUES, CAUSES AND TRIGGER EVENT

Issues and causes:

On 29 July 2013, the Polish Financial Supervision Authority (PFSA) appointed a receiver for the St. John of Kęty credit union for the period of implementation of the recovery programme. The aim of the receiver was to reinforce the financial and economic situation of the entity by increasing its capital strength, enhancing efficiency and improving the risk management standards.

The trigger event:

The trigger event was the fulfilment of the condition stipulated in Article 74c, para. 1 of the *Act on Credit Unions* of 2009, according to which, if the balance sheet loss causes the ratio of own funds to total assets to decrease below 1%, and the credit union has not received financial assistance from the National Association of Cooperative Savings and Credit Unions (NACSCU), the PFSA starts activities concerning an acquisition of the credit union.

[62] The term "financial cooperative" in our case study refers only to a credit union.

[63] A new Act (Act of 10 June 2016) on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution came into force on 9 October 2016 and has since become the deposit insurance and resolution framework in Poland. With the introduction of the new Act, Polish authorities decided to expand the national resolution framework to credit unions (Cus) and apply the same resolution regime as that for banks, although CUs are not obligatorily covered by the BRRD requirements (see Article 1, Section 1, Item a and Article 2, Section 1, Items 2 and 23 of the BRRD in conjunction with Article 2, Section 5, Item 18 of the CRD). As a result of the inclusion, CUs in Poland may be liquidated in two ways: (i) through general resolution rules for all credit institutions – resolution within the meaning of the BRRD; (ii) through special restructuring measures applying solely to the CU sector, as described in the case study in this chapter.

[64] Official data published by the Polish Press Agency.

The sequence of events:

Since there was not any other credit union which would have met the criteria for the acquisition, in line with Article 74c, para. 1 of the *Act on Credit Unions* of 2009, on 17 July 2014 the PFSA announced a seven-day deadline (until 24 July) for applications by national banks interested in participating in the restructuring process for the St. John of Kęty credit union.

The PFSA established the following criteria which potential acquirers had to meet:[65]

- The acquiring entity does not implement a recovery programme and does not have a receiver,.
- The capital adequacy ratio is above 12%.
- The Tier I ratio is above 9%.
- The stress-test projection of the capital adequacy ratio is above 12% in the reference scenario, and the Tier I stress-test projection is above 9%.
- The entity's management board is correctly appointed; after the acquisition supervisory norms will be fulfilled by the acquiring entity.
- The SREP assessment[66] is at least 2.5.
- The SREP assessment in the area of capital adequacy is at least 2.5.
- The capital adequacy ratio, after including all possible forms of aid, is above 8%.
- The Tier I ratio, after including all possible forms of aid, is above 6%.
- The scale of activities of the acquiring entity (the balance sheet total) is considerably higher than in the case of the acquired entity.

On 14 August 2014, the PFSA issued a decision on the acquisition of the credit union by Alior Bank SA, with the consent of the bank. According to the PFSA's decision:

- From 18 August 2014, the credit union should be under the sole management of Alior Bank's management board.
- Until the acquisition day, the credit union should continue its operations and offer services to its members in the usual scope.
- On 1 September 2014 the credit union should be taken over by Alior Bank.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

According to Article 72a, para. 1 of the *Act on Cooperative Savings and Credit Unions* of 5 November 2009, in the event of a balance sheet loss in the credit

[65] Criteria apply to commercial banks; for credit unions, the PFSA has established separate criteria, indicated in the PFSA's Communique of 4 February 2014. Source: http://www.knf.gov.pl/Images/KNF_SKOK_4_02_2014_tcm75-36936.pdf.

[66] The SREP is a methodology for the supervisory assessment of commercial and cooperative banks, used in Poland by the Polish Financial Supervision Authority.

union, or a substantial risk of such loss occurring, or if insolvency or liquidity risk arises, the management board of the credit union is obliged to notify the PFSA and the NACSCU immediately and start preparing the recovery programme. The programme is submitted to the NASCU and is subject to approval by the PFSA, which is entitled to impose changes or to decide on its complete redesign within specified deadlines.

In addition, in line with Article 72c of the above-mentioned act, the PFSA may appoint a trustee, whose task is to supervise execution of the recovery programme and to report to the PFSA. The trustee also has the right to participate in meetings of the credit union governing bodies, to exercise a veto against their decisions and to obtain all necessary information. In the case of the St. John of Kęty credit union, a trustee was not appointed. Instead, the PFSA appointed a receiver on 29 July 2013, for the period of implementation of the recovery programme.

Under Article 73, para. 1 of the *Act on Cooperative Savings and Credit Unions* of 5 November 2009, if a recovery programme for a credit union is not submitted or implemented effectively, the PFSA may appoint a receiver for the period of its implementation. Such an appointment can also take place if there is conspicuous violation of laws by the credit union. On the day of the appointment of the receiver, the management board of the credit union is dissolved and its powers expire. The receiver is entitled to make decisions on every aspect of the entity's activities (with the exception of changes to its statutes), and is responsible for implementation of the recovery programme, as well as for reporting to the PFSA.

In the area of contingency planning, possible financial assistance from the NACSCU can also be used as a tool. According to the Article 74c of the *Act on Cooperative Savings and Credit Unions* of 5 November 2009, if a balance sheet loss causes the ratio of own funds to total assets to decline below 1%, the credit union is required to inform the PFSA, the BGF and the NACSCU immediately. The NACSCU submits to the PFSA a decision on granting financial assistance to the credit union from the stabilisation fund, or on the refusal to grant it. The minimum amount of the assistance should enable the credit union to maintain the ratio of own funds to total assets above the level of 1%. If the NACSCU refuses to grant assistance from the stabilisation fund, the PFSA can make a decision on the acquisition of the credit union or selected property rights or selected liabilities by another credit union, with the latter's consent. In the case of the St. John of Kęty credit union, the NACSCU refused to grant assistance, arguing that there was no possibility of restructuring the entity and that the only solution was acquisition by another credit union.

If no other credit union consents to acquiring the failing entity, or if there is no possibility of such a takeover, the Article 74c, para. 1 of the *Act on Credit Unions* of 2009 stipulates that, in such a situation the PFSA may decide on the acquisition of the credit union or selected property rights or selected liabilities by a national bank (with the latter's consent), or decide on liquidation of the credit union. This is what happened in the case of the St. John of Kęty credit union, since no other credit union fulfilled the criteria for the acquisition, so the entity was acquired by Alior Bank. In this way, the potential risk for depositors was eliminated.

Last but not least, in the area of contingency planning it is worth to mention the instruments used by the BGF to enable a credit union to restructure itself. Under the terms of Article 20c of the Act of 14 December 1994 on the Bank Guarantee Fund, these include loans and guarantees. Moreover, if an entity faces insolvency risk, the BGF is entitled to purchase its receivables. This instrument is regulated by the Regulation of the Minister of Finance of 14 February 2014 on transactions performed by the Bank Guarantee Fund on receivables purchased from entities covered by the mandatory deposit insurance system or credit unions under insolvency threat.

4. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

The provisions of the Act of 14 December 1994 on the Bank Guarantee Fund allow the resolution of financial cooperatives through P&A. According to Article 4, point 1d) of the Act, as regards the restructuring of credit unions facing an insolvency threat, the tasks of the Fund include providing support to entities taking over credit unions, selected property rights and/or selected liabilities of credit unions and/or to acquirers of the business of the credit union in liquidation, organised parts thereof, and/or selected property rights.

In line with the Article 20g, point 2 of the Act, the support may be provided in the form of:

1) assumption of shares of an acquiring bank,
2) granting a loan or guarantee,
3) granting a guarantee to cover entirely or partially the loss deriving from risks connected with assumed or acquired property rights (assets) or assumed liabilities,
4) granting a subsidy to cover the difference between the value of assumed or acquired property rights (assets) or assumed liabilities and the guaranteed funds in the accounts of the credit union's depositors up to the maximum amount under guarantee in said credit union, calculated as the sum of guaranteed funds in the accounts of the depositors of the credit union, as referred to in Article 38l, point 1, in which the insolvency threat has been identified.

In line with Article 20h of the Act, the conditions for providing support by the Fund include, in particular:

1) approval by the Fund management board of the audit results of a financial statement submitted by the entity acquiring or assuming a credit union concerning its operations;
2) submission to the Fund management board by the entity assuming or acquiring a credit union, of a positive opinion from the PFSA on the expediency of the takeover and on the lack of threat to depositors' funds held in the credit union with respect to which the Polish Financial Supervision Authority has

taken a decision concerning its takeover or liquidation, as well as the lack of such danger in the bank or credit union performing the takeover or acquisition;

3) demonstration that the amount of funds allocated by the Fund for providing support to the entity performing the acquisition would not exceed the total maximum amount under guarantee in the credit union with respect to which the PFSA has taken a decision concerning its takeover or liquidation, calculated as the sum of guaranteed funds in the said credit union's depositor accounts being taken over, as referred to in Article 38l, point 1;

4) the use of the existing own funds of the acquired or taken over credit union for covering its losses.

During the resolution of the St. John of Kęty credit union, acquisition by a bank was used as a resolution method (tool) and the acquirer received support from the BGF in the form of:

A) a subsidy of PLN 15.9 million (approximately USD 4.26 million), which was granted up to the difference between the value of acquired property rights and the value of liabilities resulting from covered deposits on depositors' accounts in the credit union. The value of acquired property rights and the value of liabilities resulting from covered deposits on depositors' accounts in the credit union were determined on the basis of the credit union's audit as of the day of the acquisition. Duties and responsibilities of the acquiring entity were also determined in the agreement with the acquiring entity;

B) a guarantee to cover entirely the loss deriving from risk connected with the taken over property rights or assumed liabilities.

In the resolution process of the St. John of Kęty credit union, the process of granting financial support to the acquirer included:

- An assessment of the application submitted by the acquirer,
- The BGF council's opinion,
- The BGF management board's decision on granting the financial support,
- Signing the agreements on 18 December 2014.

The assessment of the application was based on the following criteria stipulated in Article 20 of the Act of 14 December 1994 on the Bank Guarantee Fund:

- Approval by the BGF management board of the audit results of a financial statement of CU submitted by the acquiring entity,
- Positive opinion of the PFSA on the expediency of the acquisition and on the lack of threat to depositors' funds held in the credit union with respect to which the Polish Financial Supervision Authority has taken a decision concerning its takeover, as well as the lack of such danger in the bank performing the acquisition,
- The amount of the BGF financial support for the acquirer must not be higher than the maximum total value of guaranteed (covered) deposits in the credit union,

- Utilising existing own funds of the credit union for loss coverage as a prerequisite.

The detailed terms and conditions of the financial support, along with a list of documents and information that should be submitted in conjunction with the application, are stipulated in the BGF Council Resolution.

The BGF's involvement in the restructuring process for the St. John of Kęty credit union was in accordance with the EU rules of public aid stipulated in the European Commission's decision of 1 July 2014 on the Prolongation of the Credit Unions Orderly Liquidation Scheme – H2 2014 (State aid SA.38747 (2014/N)). In addition, the BGF's public assistance was notified to the President of the Office of Competition and Consumer Protection (OCCP).

5. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

The biggest operational challenge for the BGF seemed to be simultaneously performing resolution processes for several credit unions. Application of numerous procedures along with parallel negotiations with numerous entities required BGF a coordinated operational preparedness. Moreover, it was particularly challenging given the fact, in December 2014, BGF conducted a guaranteed deposit payout with respect to another credit union.

6. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

Since November 29 2013, credit unions have been covered by the mandatory deposit insurance system of the Bank Guarantee Fund. The Bank Guarantee Fund communicates with the media and provides information/news with both education and information features in this area.

During the resolution of the St. John of Kęty credit union, the BGF performed communication actions aimed at providing the credit union's depositors with all necessary information. The Fund communicated with all potential stakeholders regularly BGF issued a communiqué on 14 August 2014, in which it announced that, with regard to the decision of the PFSA of 14 August 2014 concerning the acquisition of the St. John of Kęty credit union by Alior Bank, until the acquisition day (1 September 2014) deposits in the credit union were insured up to the coverage limit (the equivalent of EUR 100 000 in Polish zloty per depositor), and after the acquisition day the deposits are insured in Alior Bank up to the limit. Other communication channels used by the BGF included the Fund's website and a dedicated telephone line.

In addition, in the communiqué, the BGF also informed on its readiness to support Alior Bank in the acquisition process via the granting of the subsidy and the loss coverage guarantee.

Last but not least, market communication was absolutely vital for the acquiring entity, since it is listed on the Warsaw Stock Exchange.

7. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

Since the end of the resolution process, the BGF has been actively involved in the monitoring of the acquirer, as well as in the administration of the granted support. The BGF regularly assesses the fulfilment of contractual provisions resulting from the granted support, especially those of the loss coverage agreement. This is in line with Article 4, para. 1, point 1d of the Act of 14 December 1994 on the Bank Guarantee Fund, according to which, as regards the restructuring of credit unions facing insolvency threat, the tasks of the Fund include controlling the adequate use of returnable financial assistance and support to entities taking over credit unions, selected property rights and/or selected liabilities of credit unions and/or to acquirers of the enterprise of the credit union in liquidation, organised parts thereof, and/or selected property rights, as well as monitoring the economic and financial situation and management system of a credit union receiving financial assistance, and of an entity provided with support by the Fund.

8. LESSONS LEARNED[67]

The case of the resolution of the St. John of Kęty credit union has yielded the important lesson that acquisition is a far more preferable solution to insolvency and guaranteed deposit payout, since it is less costly and more effective in terms of maintaining the stability of the financial system, as well as depositors' trust. As far as the costs are concerned, the total amount of the subsidy for the acquisition of the St. John of Kęty credit union was significantly smaller than a guaranteed deposit reimbursement combined within a normal insolvency proceedings. Thus, acquisition of a credit union is more cost-effective for banks too, since the BFG's funds are not used for the payout, and therefore future contributions paid to banks for the deposit insurance system do not have to be higher in order to rebuild the deposit insurer's financial resources.

In addition, the case of the acquisition of the St. John of Kęty credit union has underpinned the BGF's expertise with respect to P&A transactions, which remain very complex in terms of the legal, accounting and financial aspects. Moreover, the BGF has also gained valuable experience in the valuation of assets and liabilities of the acquired entity, thus providing a basis for cost efficiency in financial support granted to the acquirer.

[67] These observations are based on an interview with the President of the Bank Guarantee Fund, Mr. Jerzy Pruski, which took place on 8 July 2015 and was published in the „Financial Observer". Source: http://www.obserwatorfinansowy.pl/tematyka/bankowosc/przejmowanie-skok-ow-oplaci-sie-bankom/

June 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Credit Union Deposit Guarantee Corporation, Saskatchewan, Canada

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

The Corporation has been involved in the resolution of a significant number of financial cooperatives (credit unions) throughout our nearly 65-year history. These organisations have ranged from small, single-branch, closed-bond organisations, to large, complex, multi-branch entities operating in a mix of urban and rural locations. Assets sizes have ranged from as small as CAD 310,000 to CAD 177.5 million. During a period from the mid-1980s through the early 1990s, the Corporation facilitated the recovery or resolution of approximately 50 institutions where some form of funding was necessary, incurring costs of approximately CAD 43 million.

2. ISSUES, CAUSES AND TRIGGER EVENT

There have been multiple causes/triggers that have precipitated the need to execute a recovery or resolution strategy, some of which are external factors (economic or market conditions) and some of which are related to the internal business practices of the organisation (excessive risk-taking, inappropriate credit underwriting, etc.). In our experience, challenging economic conditions, such as declining commodity prices in the agricultural sector, have placed organisations with large exposures to that sector under pressure, and when those pressures are coupled with deficiencies in the organisation's business practices, it is necessary to act to mitigate losses and protect depositors.

During a period from the mid-1980s through the early 1990s, economic conditions in our region were extremely challenging and resulted in significant problems in the agricultural sector, coupled with declining employment and extremely high interest rates. This led to multiple "failures" within our system and required both significant regulatory intervention and the use of our Deposit Guarantee Fund to maintain financial stability and depositor confidence. As the principal regulatory body and deposit protection organisation, we have both the legislative capacity and the tools to act to mitigate losses. This structure also provides us with ongoing insight into the operations of all our organisations and consequently we are able to identify negative performance trends or business practice deficiencies early on through our regular monitoring and on-site examination processes.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

Based on our extensive experience, we now have a robust crisis management and contingency planning framework. We are currently in the process of enhancing this framework to model various stress scenarios and develop more structured responses to a systemic liquidity or solvency event. In our earlier experiences, much of our response was reactive to emerging situations. Consequently, we have documented our resolution methodologies and regularly test our crisis management and contingency plans.

4. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

We have used a variety of recovery or resolution methods. In order of preference, these include:

- Early detection and intervention to prevent losses and implement corrective actions to return the organisation to financial stability. This may or may not require the use of our legislative ability to issue various types of orders.
- The use of "Supervision" or "Administration" to give effect to a recovery plan without the need for direct financial assistance from the Deposit Guarantee Fund.
- A self-directed merger where the organisation seeks to partner with a stronger entity without the financial support of the Deposit Guarantee Fund
- A financially assisted merger where the Corporation provides financial support to the "acquiring" credit union to offset financial deficiencies (e.g. capital deficiencies, non-productive assets, etc.)
- A "required amalgamation" where the Corporation issues an order to one or more organisations requiring their merger and often direct financial support. This will often necessitate some form of funding to support recovery of the merged entity.
- Assets sales and transfers of liabilities to another organisation, usually requiring the Corporation to fund any shortfalls or deficiencies.
- Implementation of a rehabilitation and recovery plan supported by financial assistance from the Deposit Guarantee Fund for an organisation where a

viable merger partner is not available. All funding provided is repayable to the fund once financial stability is restored.

- Liquidation and depositor payouts with any shortfall absorbed by the Deposit Guarantee Fund.

The Corporation has a broad range of legislative powers available to it to effect the recovery and resolution methods noted above. It also has a substantial Deposit Guarantee Fund to provide the financial resources necessary. In addition to our legislative powers, the Corporation has a wide variety of legal and contractual arrangements outlining the terms and conditions under which various types of funding arrangements can be utilised. As a fully funded credit union funded deposit protection regime, where the survivors bear the costs, our resolution strategies are based on "least-cost solutions".

In some instances, the Corporation has acquired non-productive assets from an organisation and provided offsetting funding, with the administration performed by the receiving credit union. We have also provided interest-free loans to offset the value of non-productive assets in support of a recovery strategy. In other instances we have provided funding to recapitalise institutions in a deficit position. We have also provided various forms of guarantees on loans or investments acquired by credit unions in mergers or through asset sales. These assets continue to be administered by the credit union and the level of guarantees or funding is adjusted periodically to reflect changes in valuation as assets are sold or realised in some other fashion.

In all instances where the Corporation provides funding to support the rehabilitation and recovery of a credit union, the organisation is subject to formal regulatory intervention and ongoing reporting requirements until all funds are repaid, financial stability is restored, and all regulatory requirements are met.

5. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

Resolution of a troubled credit union can present several challenges. To be effective, it is critical that the leadership of the organisation recognise and understand the problem, and are committed to taking appropriate corrective action. It is always preferable that the board take ownership of both the problem and the solution. Absent having the local leadership serving as advocates with the credit union's membership and community, executing an effective recovery or resolution strategy can be significantly more difficult.

Frequently, those responsible for creating the problem are unwilling or unable to take the necessary steps to resolve the problem. Consequently, gaining "buy-in" from the board is a critical factor in the successful resolution of a problem. More often than not, a change in the management of the organisation is needed to provide effective leadership to the organisation in executing a recovery strategy. Obtaining the necessary skills to provide this leadership can also be a challenge given the uncertainty over the future of the organisation. This requires specific

strategies (e.g. employment contracts, appropriate compensation, etc.) to recognise the unique challenges these situations present.

While gaining support from the leadership is a key challenge, it is also important that the resolution authority has the necessary legislative capacity to impose solutions if needed. While our organisation has this ability, it has been used infrequently and only as a last resort where other methods have failed to obtain the necessary commitment of local stakeholders.

6. Crisis communication issues specific to the Financial Cooperative

Related to the observations noted above, effective ongoing communication is the key to success. This includes communication with the organisation's leadership and the membership of the credit union. As publicly accountable organisations, credit unions are obliged to disclose information on their ongoing operations. Negative financial results can often impact member/depositor confidence and it is critical to have a well-developed crisis communication plan to respond to members' concerns in a timely and ongoing manner. As garnering members' support can be a key factor in the successful resolution of a problem, it is not only important that the plan provide members with assurance that their interests will be protected; it must also convey the specific actions being taken and the implications these actions may have.

As with the board of directors, ensuring the membership are engaged throughout the process contributes to more positive results. In most cases, members are required to approve fundamental changes to the organisation (e.g. amalgamation, dissolution, etc.). While our organisation can impose these solutions if necessary, it has always been our desire to respect the rights of the membership, and work with them to bring about constructive changes. It has been our experience that keeping members informed and gaining their support throughout the recovery or resolution process contributes to a more positive outcome.

7. Exit Strategy (situation after the end of the resolution process)

The Corporation conducts post-intervention reviews to evaluate effectiveness and identify areas for improvement in our processes. Our overriding objective is to ensure we have a financially viable organisation that has the capacity to provide services to its members and meet regulatory expectations on an ongoing basis. In every instance, the Corporation has achieved this objective in applying our recovery and resolution methods. In cases where we have intervened early to correct a problem, we have addressed a broad range of operating deficiencies with no disruption to the membership and no cost to the fund. Where we have provided funding to support the recovery of an organisation under stress, we have successfully rehabilitated the organisation and been fully repaid. In those cases where we have provided funding to support the merger of one or more credit unions, we have been able to create a stronger and more viable entity that is often able to offer enhanced service to its members. In the most extreme scenarios, we have resolved institutions through dissolution and liquidation while ensuring that all depositors are fully repaid.

Although it is sometimes necessary to use our Deposit Guarantee Fund to facilitate the recovery or resolution of a credit union in distress, early intervention to correct problems has resulted in our historic loss experience being considerably lower than the broader industry experience.

8. LESSONS LEARNED

Credible regulatory requirements, coupled with proactive, ongoing supervision to detect and respond to negative performance trends or business practice deficiencies, is preferable to formal regulatory intervention. Catch them early and act decisively to address problems.

Maintaining a preventive focus and constructive relationships with our regulated entities helps to ensure expectations are understood and problems are avoided.

A well-defined crisis management and crisis communication plan will contribute to enhanced coordination with other stakeholders (e.g. the liquidity support organisation or central government, other regulators, etc.).

Ensuring the resolution authority has all the necessary powers and tools to respond to a problem in a variety of ways is essential. While self-directed solutions may be preferable, it is sometimes necessary to impose a corrective action plan.

It is important that the resolution authority be sufficiently independent and empowered to act without interference from others. It should not be subject to political forces from within the credit union sector or government when exercising its mandate.

Requiring repayment of funding to support recovery of an organisation ensures accountability and mitigates moral hazard within the system.

Effective communication is essential. Ensuring all stakeholders are kept informed on an ongoing basis will avoid "surprises" and contributes to more positive outcomes.

June 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Financial Services Compensation Scheme (UK)

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

Dunfermline Building Society (DBS) was established as a mutual society in 1869 and over time developed to become the largest independent building society with its principal offices in Scotland. The core services of DBS comprised a variety of savings and investment products, secured residential mortgages and the sale of a range of insurance products which were underwritten by third-party insurers. Prior to resolution, the unaudited balance sheet of DBS, at 30 March 2009, showed approximately GBP 3,088 million of customer deposits.

DBS operated from its own principal office building in Dunfermline. In addition, there were 34 branches throughout Scotland and 37 agents with concessions within third-party establishments. A telephone banking service, Dunfermline Direct, was set up in 1999.

As DBS was a mutual society, there were no shareholders but rather members of DBS who were deposit holders, or recipients of loans. The total members' liability as at 31 December 2008 was reported as GBP 2,299 million. Under UK insolvency law at the time, members' claims were subordinate to the claims of ordinary creditors.

DBS had four wholly owned subsidiaries, all of which are limited liability companies.

In 2005, DBS had issued GBP 50 million in 6% subordinated notes due to be redeemed in 10 years, listed on the Channel Islands Stock Exchange. The notes

were subordinate to creditor claims. The failure of DBS to pay interest coupons on the notes led to an event of default declared by the notes' trustees.

2. ISSUES, CAUSES AND TRIGGER EVENT

In addition to its core retail business, DBS began lending to commercial enterprises in 2002. Initially this commercial portfolio consisted of secured loans to sole traders and small businesses for the purpose of purchasing their business premises or acquiring properties to let to third parties. Later, DBS began lending to property developers and larger businesses in the buy-to-let market. The net book value of the commercial loan portfolio in March 2009 was approximately GBP 624 million.

On 28 March, the regulator (the Financial Services Authority ("FSA")) determined that DBS was likely to fail to meet its threshold conditions for authorisation and that, having regard to timing and other circumstances, it was not reasonably likely that action could be taken by DBS to enable it to satisfy those conditions.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

Following the immediate aftermath of the 2008/09 crisis, DBS had been under heightened supervision. Due to its core lending, in particular the commercial book, DBS could not continue as an independent firm. In the absence of a private sector solution, a resolution was triggered on 28 March 2009.

The resolution was the first under the *Banking Act* 2009 (enacted in February 2009). Whilst the authorities had executed resolutions under emergency provisions in the autumn of 2008, it was the first formal resolution under the new Special Resolution Regime. It predated the current, upgraded depositor protection regime, including single customer view files, as well as recovery and resolution plans. Accordingly, whilst the authorities were familiar with resolution of institutions post-2008, the precise techniques under the Banking Act 2009 had not been tested. The authorities and the FSCS were in close collaboration prior to resolution.

4. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

The resolution was conducted by the Bank of England, as the resolution authority, acting under powers conferred on it by the Banking Act 2009, and in accordance with the code of practice issued by HM Treasury. The decisions followed explicit consultation with the FSA and HM Treasury and an evaluation of the possible resolution options against the Special Resolution Regime's objectives laid down in the *Banking Act*.

Those objectives were to:

i) protect and enhance the stability of the financial systems of the UK;

ii) protect and enhance public confidence in the stability of the banking systems of the UK;

iii) protect depositors;

iv) protect public funds;

v) avoid interfering with property rights in contravention of a convention right within the meaning of the *Human Rights Act* 1998.

The objectives were not ranked. The relative weighting and balancing of objectives will vary according to the particular circumstances of the firm, and the general circumstances in the wider financial system.

HM Treasury concluded that if the resolution had not been carried out, DBS would have been unable to satisfy depositors' claims against it.

The Special Resolution Regime tools comprised one or more of:

i) placing the whole of the building society into insolvency procedure, to facilitate rapid payout by the FSCS to eligible depositors or the transfer of their deposits;

ii) transferring all or part of the business to a private sector purchaser or a bridge bank owned by the Bank of England.

Where only part of the business is transferred, the remainder may be placed into an administration procedure, which requires the administrator to provide such services and facilities to the private sector purchaser or the bridge bank as are necessary to allow it to operate effectively;

iii) transferring the building society to temporary public ownership of the Treasury.

The transfer tools can only be exercised if their use is necessary in the public interest.

Following the FSA's determination that DBS was failing or likely to fail to satisfy the threshold conditions for operating as a deposit-taker and it was not reasonably likely that action would be taken by or in respect of DBS which would enable it to satisfy the threshold's conditions, the Bank of England was satisfied it was necessary to take action in the public interest. HM Treasury consented to the use of public funds for the resolution.

Over the weekend of 28–29 March 2009, the Bank of England conducted a sales process for DBS's assets and liabilities. The resolution comprised a transfer to Nationwide Building Society of retail and wholesale deposits, branches, head office and originated residential mortgages, other than social housing loans and related deposits. Following that sales process, the transfer to Nationwide was effected on 30 March 2009. The social housing loans and related deposits were transferred temporarily to DBS Bridge Bank Limited, a bridge bank owned and controlled by the Bank of England. The bridge bank was a 100% group undertaking of the Bank of England, incorporated in Scotland, for the purpose of facilitating the resolution. It was authorised and regulated by the FSA. This allowed the Bank of England to support the social housing portfolio, providing time to stabilise this business whilst a permanent solution was secured. The remainder of the business was placed into

the building society special administration procedure. KPMG were appointed administrators of this part of the business, comprising commercial loans, acquired residential mortgages, subordinated debt and most Treasury assets. The measures were all effected by the Bank of England as the resolution authority.

The bridge bank was run on a conservative basis to protect the value of the business and provide continuity. This included complying with obligations under existing loan agreements with housing associations. Although the bridge bank honoured its obligations under existing deposit liabilities transferred to it, it did not, with one exception, accept or roll over any new deposits. A competitive auction process was carried out to select a preferred bidder and agree a price. Four bidders carried out due diligence and subsequently two bids were received for the business, and on 17 June 2009, the Bank of England selected Nationwide as the preferred bidder. The transfer of the business was completed, together with a few residual assets transferred from the administration, on 1 July 2009.

Following distribution of the net proceeds of sale of the transferred business by the bridge bank, GBP 356 million was transferred to the Dunfermline resolution fund.

In total, the cost to HM Treasury of the DBS resolution, where it funded the transfer of deposits, only in part matched by the transfer of assets, was in the region of GBP 1.6 billion. The directors' estimated liabilities to HM Treasury under the Property Transfer Instrument in respect of the net liabilities transferred to Nationwide came to GBP 1,004 million.

HM Treasury succeeded to the claims of depositors and other creditors funded by its resolution under the Transfer Order. Due to the subordinated nature of members' claims, HM Treasury's liabilities were divided between the first liability and a second liability representing the amount equal to the amount of the aggregate liabilities owed to shareholder members. Under the creditor hierarchy, the first liability ranked pari pasu with claims for unsecured and unsubordinated creditors and the second liability ranked pari pasu with the claims that shareholding members would have had.

Under the *Banking Act* 2009, the Treasury also made three orders. Firstly, a Compensation Scheme Order because the Bank of England effected the transfer of part of the business to a private sector solution. It was determined no compensation was payable to DBS in respect of this transfer as the auction process effectively established the market price. Secondly, a Resolution Fund Order because the Bank of England transferred some of this business to a bridge bank. The proceeds of the bridge bank sale were placed in the resolution fund. The managed auction process allows for those funds, having established the price, to be released to HM Treasury. Thirdly, a third-party compensation order following the two partial property transfers where third parties' default event provisions were affected, and where any creditor is worse off as a result than would have been the case had DBS entered into insolvency. HM Treasury can be ordered by an independent valuer to make payments to ensure pre-transfer creditors receive relevant compensation. In the event, the valuer concluded that no such compensation was payable.

Since their appointment in 2009, the joint administrators have been pursuing the statutory objective to achieve a better result for creditors than would have been the case if the building society had been wound up. All employment contracts of employees were transferred to Nationwide, but the pension scheme was not transferred. Accordingly, the pension scheme was frozen with no further accrual of pension benefits. The pension scheme has entered into assessment under the Policyholder Protection Fund and the joint administrators have agreed the claims with the pension fund.

The joint administrators also operated transitional services with Nationwide following the transfer of business. This comprised day-to-day support of the business and services pending subsequent separation.

In the management of operations and assets, new lending was ceased. The joint administrators managed existing assets while investigating options for disposal. These assets included Treasury assets comprising medium-term notes and residential mortgage-backed securities, commercial loans and properties amounting to 293 loans with a net book value of GBP 624 million – reviewed on a case-by-case basis, acquired mortgage loans of approximately GBP 470 million, obligations under equity release loans valued at GBP 66 million, a small lump of social housing loans and sundry other assets including a small portfolio of subsidised staff mortgages.

The administration remains open, realising the residual mortgage assets both residential and commercial.

5. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

The Resolution provided a good, early, and successful test of the UK Special Resolution Regime. The three tools – property transfer, bridge bank and administration – were successfully implemented. In the circumstances at the time, the authorities concluded that a depositor payout in the usual course did not meet the public policy objectives. Following the initial Property Transfer Order on 30 March, an amended order was made to clarify its effect on certain assets, as understood by all parties.

HM Treasury provided public funds to back the transfer in the absence of an established resolution fund, or a prefunded FSCS. However, the FSCS is obliged to contribute to HM Treasury's costs of resolution to the extent it would otherwise have incurred those costs on an insolvency and depositor payout. An independent valuer was appointed to calculate the insolvency counterfactual, and the FSCS calculated the cost of the depositor payout in the insolvency. The FSCS and Treasury have agreed the "net" costs to the FSCS setting a cap on the FSCS's contribution to HM Treasury's costs of resolution. It is likely that the cap will leave some unrecovered costs for HM Treasury after final distributions have been made from the administration (and after the receipt of the proceeds of the bridge bank sale).

The independent valuer process indicated the complexity involved in such an exercise even for a relatively small and simple institution. FSCS has agreed a

programme with HM Treasury through which to repay its contribution of around GBP 545 million.

Following the property transfer, operational challenges for the administrators included the transitional service arrangements with Nationwide (which took some time to complete). These are clearly an important part of any resolution to ensure continuity. Further, the market at the time made quick disposal of the residual assets in the administration difficult, requiring a run-off which continues to this date. However, the smooth implementation of the Special Resolution Regime meant that the resolution would not trouble depositors of DBS or the market more widely.

6. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

In March 2009, the UK authorities were familiar with crisis communications following the 2008 crisis. As DBS was a relatively small institution, successfully and cleanly resolved, it did not cause particular communication issues. The authorities recognised the need to pre-plan communications which were effective and simple.

Further, an account of the bridge bank was published by the Bank of England, and the HM Treasury code of practice updated to refer to DBS as a case study. This provides clarity and assurance to the market and depositors, as to how these special resolution powers will be exercised.

7. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

Nationwide has absorbed Dunfermline. The rump of assets is being wound down by the administrators. Final distributions to HM Treasury will be made over the next couple of years, following which the administration will be formally completed, and the firm dissolved. The FSCS is making partial payments towards its total contribution to HM Treasury's costs of resolution.

8. LESSONS LEARNED

The Special Resolution Regime intervened successfully in this case. No private sector solution was available, and an auction process successfully managed to dispose of, firstly, much of the property and, secondly, the bridge bank. This left the relatively confined task of business wind-up to the administrators.

As noted, the independent valuation process to quantify the FSCS's contribution to costs did prove lengthy and more complicated than expected – it is important to give clear early assumptions to the valuer and to engage with the valuer on the conduct of its exercise and draft report. The process allowed for submissions for the valuer following an interim report, illustrating the need for an adequately particularised report with supporting information to enable a full assessment to be carried out.

The UK resolution regime has since been updated to add bail in, now under the Banking Recovery and Resolution Directive. This includes depositor priority, removing the two-tier position in Dunfermline – depositor members will now benefit

from depositor priority, alongside non-member depositors. This will simplify quantification of resolution and the insolvency counterfactual.

The UK regime specifically applies all recovery tools to both banks and building societies, the latter being member-owned institutions without shareholders. As such, there are technical differences in the process but the broad approach, and outcome, is the same.

October 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Financial Services Compensation Scheme (FSCS) - UK

TEMPLATE A

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE FINANCIAL COOPERATIVE

1. The Co-operative Bank Plc is a retail and commercial bank in the United Kingdom. It is Britain's seventh biggest lender and the mutual was formed in 1844 when a group of local tradesmen, including cloggers, shoemakers, joiners and cabinet makers, joined forces as the Rochdale Pioneers, with the aim of creating a better social order through mutual ownership.

2. The Bank markets itself as an ethical bank, and seeks to avoid investing in companies involved in certain elements of the arms trade, fossil fuel extraction, genetic engineering, animal testing, and use of sweated labour, as stated in its ethical policy. The ethical policy was introduced in 1992 and incorporated into the Bank's constitution in 2013.

3. In 2002, the parent company Co-operative Group Limited brought the Bank and the Co-operative Insurance Society under the control of a newly incorporated holding society, Co-operative Financial Services, which became the Co-operative Banking Group (CBG) in 2011.

4. In 2013–14, the Bank was the subject of a rescue plan to address a capital shortfall of about GBP 1.9 billion. The Bank raised equity to cover the shortfall from mainly US hedge funds which owned its debts and swapped debt for an 80% stake in the Bank (with other private investors), while the Co-operative Group became a minority shareholder, holding a 20% stake in the Bank.

2. ISSUES, CAUSES AND TRIGGER EVENT

1. The 2007–08 financial crisis threatened the collapse of large financial institutions, which was prevented largely through the bailout of banks by national governments.

2. Unlike a number of other financial institutions, before the merger, the Bank mostly obtained its funding from its own depositors. It was not, therefore, adversely affected when the wholesale markets dried up during the financial crisis. It regarded itself as having weathered the crisis well.

3. But like other banks and building societies, it was affected by the prolonged ensuing period of low interest rates, which depressed net interest margins and profitability. Because of the mutual status of its parent, retained earnings were a particularly important potential source of additional capital.

4. Further, the financial crisis prompted the Financial Services Authority (the supervisor) to require all banks to increase the quantity and quality of their capital. Between 2009, immediately after the Bank's merger with Britannia, and January 2013, the Regulator increased the Bank's total capital requirement from GBP 1.9 billion to GBP 3.4 billion. Most of the increase came towards the end of the period.

5. The timing was particularly damaging. It coincided with a reduction in the Bank's capital resources caused by the recognition of significant impairments on its commercial real estate lending and against its failed IT replatforming project, as well as significant provisions required to remedy the mis-selling of payment protection insurance (PPI). It was the interaction between an increased requirement and a reduction in the capital available to meet it that led to the Bank's capital shortfall.

6. The root causes of the Bank's crisis were subject to an independent review in 2014. Sir Christopher Kelly, appointed by the Co-operative Group, unearthed the factors that were mainly within the control of both organisations. Only two factors outside of the Co-operative Group's or Bank's control contributed to the capital shortfall of GBP 1.5 billion: the economic environment and the increasing capital requirements imposed on banks in general following the financial crisis.

7. But the ones within the control of management and the board were:

   - the merger with the Britannia Building Society in 2009;
   - a failure by the Bank after the merger to plan and manage capital adequately;
   - fundamental weaknesses in the governance and management of risk;
   - material capability gaps, leading to a serious mismatch between aspirations and ability to deliver;
   - past mis-selling of PPI;
   - a flawed culture; and
   - a system of governance which led to serious failures of oversight.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

N/A

4. IMPLEMENTATION METHOD OF THE RESOLUTION (TOOLS USED, FUNDING, ETC.)

The bail-in scheme

1. Over the weekend of 15–16 June 2013, negotiations between the Co-operative Group and its regulator, the Prudential Regulation Authority, culminated in reports that the Bank had a shortfall in its capital of about GBP 1.5 billion, and that this would be filled by a procedure known as a bail-in scheme.

2. Bail-in is the process of saving a bank by making it use up its internal resources first. A bail-in takes place before a bankruptcy and, under current arrangements, regulators have the power to impose losses on bondholders, while leaving untouched other creditors of similar stature, such as derivatives counterparties.

3. A press release issued by the Bank on 17 June 2013 explained that the scheme would compel subordinated (also known as junior) bondholders to convert some or all of their assets from debt instruments to ownership ("equity") shares of uncertain value, which would be listed on the London Stock Exchange, and a new fixed income instrument.

4. The scheme contrasted with the rescues of other British banks in 2008 and 2009, when central government introduced new capital into the failed institutions. Details of the outcome for small retail investors in the Bank were uncertain at the time of the June announcement, but there was no suggestion that ordinary deposits in the Bank would be put at any additional risk by the rescue, as they would continue to be covered by the existing deposit scheme. The bondholders had the opportunity to seek to reject the restructuring proposed, and an alternative option of the Bank of England handling the Bank under the *Banking Act* 2009 special resolution regime was considered

5. In October 2013, it was reported that the Co-operative Group had been forced to renegotiate the Bank's GBP 1.5 billion rescue with US hedge funds that owned its debt. As a result, the Group would lose majority control of its banking arm with the proportion of the Bank's equity remaining under its ownership dropping to 30%, less than the 75% proposed in the original rescue plan. The plan passed a creditor vote and, in December 2013, the UK High Court allowed the plan to move forward.

6. The shrinkage of the Group's stake follows the Bank's decision not to take up its full entitlement of the new shares being sold. Instead, the Group used a so-called "tail-swallow" process[68] to sell most of its rights to fund the purchase of a smaller number of shares, meaning that it put no new money into the Bank. Swiss investment bank UBS handled the

[68] The process of selling part of an existing shareholding to finance the purchase of new shares offered as part of a rights issue

disposal of the Group's shares through an accelerated sale process to new and existing investors.

The Bank's voting structure before and after rescue

Before:

7. Despite its name, the Bank was not itself a true cooperative as it was not owned directly by its members. Instead it was part-owned by a holding company which was itself a cooperative – the Co-operative Banking Group. Its customers could, however, choose to become Co-operative Group members and hence indirectly acquire an ownership interest in the Bank, earning dividends on their account holdings and borrowing with the Bank.

8. The Bank also had approximately 2,500 preference shareholders, which were irredeemable fixed-interest shares. These shareholders could attend the Bank's general meetings, but only had speaking and voting rights if the dividend was in arrears, or on any resolution varying their rights or winding up the Bank.

9. Unlike other cooperative banks, such as the Dutch Rabobank, the Bank did not have a federal structure of local banks, instead being a single national bank.

10. The Bank's Board of Directors comprised two executive directors (the Chief Executive Officer and the Finance Director) and nine non-executive directors.

After:

11. In anticipation of the Bank ceasing to be a wholly owned subsidiary of the Co-operative Group (after completion of the Liability Management Exercise (LME)), the Bank entered into a Relationship Agreement with the Co-operative Group and CBG on 4 November 2013, to regulate the basis of their ongoing relationship. Under the Relationship Agreement, the Co-operative Group undertook that it will conduct transactions with the Bank on arm's length terms and not seek to influence the day-to-day running of the Bank. The Relationship Agreement also contains provisions on conflicts and related party transactions.

12. The principal terms of the Relationship Agreement took effect on the LME becoming unconditional on 20 December 2013, and will continue for so long as the Co-operative Group (or any member of its group) remains a significant shareholder. For these purposes a "significant shareholder" is any person (or persons acting jointly by agreement whether formal or otherwise) who is entitled to exercise, or to control the exercise of, 20% of the rights to vote at a general meeting of the Company. Under the Relationship Agreement, provided the Co-operative Group continues to hold over 20% of the rights to vote at a general meeting of the Bank (but less than 25%), and remains a bona fide cooperative society, the Co-operative Group has the right to nominate one director to be appointed to the Board of the Bank.

13. On 11 May 2014, the Bank, the Co-operative Group and CBG entered into a Variation and Director Appointment Deed. Under the terms of this deed, even if the Co-operative Group ceases to exercise, or to control, directly or indirectly, the exercise of 20% or more of the rights to vote at general meetings of the Bank (and therefore loses its right to have a director nominated under the Relationship Agreement) but remains a bona fide cooperative society and directly or indirectly controls 15% or more of the voting rights exercisable at general meetings of the company, it has the right to appoint one Director to the Board.

14. The Relationship Agreement also provides a mechanism for the appointment of up to two persons as non-executive directors to be nominated by the purchasers of additional ordinary shares during the LME. Any directors so nominated must satisfy the criteria to be independent pursuant to the Code.

15. On 10 May 2014, the Bank entered into a Shareholder Rights Agreement with certain major shareholders ("Committed Shareholders") and the Co-operative Group, which granted rights in addition to those contained in the Relationship Agreement. Two of the company's largest shareholders are Silver Point and Perry Capital. Under the Shareholder Rights Agreement, the company has granted to each of Silver Point and Perry Capital the right to nominate a director for appointment to the Board for so long as Silver Point and Perry Capital, as the case may be, directly or indirectly controls 5% or more of the voting rights exercisable at general meetings of the company.

16. Such rights are not transferable, save that they will automatically transfer and be exercisable by another Committed Shareholder if Silver Point or Perry Capital ceases to control such level of voting rights in the company, provided that such other Committed Shareholder itself directly or indirectly controls 5% or more of such voting rights. Any such directors so nominated may, but are not required to, satisfy the criteria to be independent pursuant to the Code.

How it affected the members / how they got to the vote

17. The Co-operative Group gave 70% of the equity shares in the Bank to the senior bondholders (i.e. those with the highest priority claim – upper tier 2) in exchange for about GBP 940 million of debt plus a GBP 125 million cash injection into the Bank. The Group continued to hold the remaining 30% in return for providing GBP 462 million in a new Group bond and cash.

18. The lower-ranked bondholders, who were mainly retail investors on a smaller scale but who would have lost their whole investment if existing priorities of debt had been followed, were offered new bonds with a choice between continuing their existing annual payments for 12 years with no capital sum or a lower annual payment plus a future capital sum. The two main groups of securities (bonds or shares in the Bank) affected were:

    - 5.555% perpetual subordinated bondholders – lower tier 2 (LT2) investors – handed over their GBP 937 million of debt plus GBP 125 million of new cash plus GBP 38 million of interest (GBP 1,100

million in total) for 70% of the Bank's ordinary shares. This group, which included the hedge funds and holders of 48% of these securities, had signed up to a legal commitment to vote in favour of the scheme in their meeting.

- 9.25% preference shares and 13% perpetual subordinated bonds – both mainly held by retail investors and lower in priority for payment than the other bonds. They would have been completely wiped out in the normal course of events but were offered GBP 38 million for their GBP 60 million. They could swap for either "Instalment Repayment Notes", which received 12 years of income with no capital at the end, or "Final Repayment Notes", which gave capital at the end of the 12 years but less income from interest in the meantime. If 75% of each of the two groups agreed to swap, they would receive more than if that had not happened.

19. Their agreement to swap was taken as a vote for the Scheme. However, the whole scheme had to be agreed for every part to be effective.

Legal process – mechanics and timetable

20. This process involved a combination of legal agreement based on the common law of contract and procedures under the *Companies Ac*t 2006 to allow the imposition of what is agreed by a big enough majority on the minority.

21. To allow deals agreed through "creditor democracy", Part 26 of the *Companies Act* 2006 provides a mechanism, used for the LME, to allow majorities to impose new terms on minorities. This required court approval as well as special majorities in separate meetings of each class of creditors or members. The Act sets out the possible uses of the procedure for "a compromise or arrangement" between a company and its creditors or members or any class of them. In the case of the Bank, the bondholders are creditors and the preference shareholders are members.

22. The first step was an application to the court to order class meetings of different groups of creditors and members. That was done for this Scheme on 18 November 2013 as planned and the Court ordered that the meetings be called on 11 December 2013.

23. Under the *Companies Act* 2006, a statement explaining the effect of the compromise or arrangement had to be made available. That was done via the Co-op Group website, as referred to in the court order.

24. The scheme meeting was held on 11 December 2013. Although it is referred to as one meeting, there were separate class meetings (votes by preference shareholders, those of 13% bondholders and those for the 5.555% bonds) and the necessary majority had to vote in favour of the scheme at each of those meetings. If any meeting did not achieve the necessary majority, the whole scheme would collapse.

25. In each case the vote was on an Extraordinary Resolution. A majority in number representing 75% in value of each class of creditors or any class of members voting either in person or by proxy at the meeting

called must agree the scheme. That meant that there had to be a simple majority of votes by people present at the meeting and voting (in person or by proxy) and that this simple majority of voters had to also hold between them 75% in value of the holdings of all those present and voting (again in person or by proxy).

26. If the meetings passed the necessary resolutions by the necessary majority, the court could approve the scheme so that it became binding on all those it affected whether or not they had voted in favour of it. The court had discretion about whether or not to approve the scheme. However, the court would be unwilling to upset the scheme on its own commercial assessment, especially if there is a large majority in favour of it in each class. That is because the test applied by the court is whether no honest and intelligent person among those affected by it could reasonably approve it, and the more votes there are in favour, the less likely that is. It was also the case that the existence of an adverse situation facing the company if the scheme was failed a factor in favour of approving the scheme. The scheme document stated that:

"If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the *Banking Act* had arisen; and the Bank believes it is likely that the Bank would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject *to a resolution procedure under the Banking Act*."

27. The result of the votes at the class meetings approving the scheme was announced on 12 December 2013, and the Court hearing to sanction the scheme was on 16 December 2013.

5. DIO'S OR RA'S OPERATIONAL CHALLENGES RELATED TO THE RESOLUTION

N/A

6. CRISIS COMMUNICATION ISSUES SPECIFIC TO THE FINANCIAL COOPERATIVE

The Bank was responsible for direct communications. The restructure required certain legal formalities. But the authorities oversaw the process and would have made sure that the communication to the stakeholders, including members and depositors, was well handled, bearing in mind the risks to financial stability.

7. EXIT STRATEGY (SITUATION AFTER THE END OF THE RESOLUTION PROCESS)

1. The Co-op Group owned a 30% stake in the Bank in 2014, allowing it to appoint two directors, but post the capital raising and holding of 20%, it is only allowed to name one director of its choice.

2. The Bank's current chief executive, Niall Booker, was appointed in 2013. Since then he has been attempting to refocus the Bank's strategy as a retail and SME lender.

3. In December 2014, a Bank of England assessment measured the Bank's core capital ratio (a measure of financial strength) at minus 2.6%. As a result, the Bank appointed Bank of America Merrill Lynch to help sell GBP 6.6 billion of mortgages.

4. The Bank is not expected to make a full-year profit until 2017 at the earliest. In August 2015, Mr Booker said that he expected the Bank would be "part of the consolidation of some of the country's smaller banks", and that stock market flotation would remain an option for the future. He said that there had been "no meaningful discussions" concerning the suggestion that the hedge funds which own 80% of the Bank's equity were looking at buying up the Co-operative Group's remaining 20% holding as they look for ways to recover their investment.

8. LESSONS LEARNED

The case is interesting because the Bank, its members and the creditors proceeded with a voluntary restructuring and resolution by the LME, using the scheme of arrangement. This did not require the formal exercise of powers by the authorities. But the outcome, in which the regulator and resolution authority took a close interest, reflected the resolution powers available. The stakeholders preferred the certainty of a voluntary restructure rather than leave it for the authorities to intervene.

July 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues
for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Deposit Insurance Corporation of British Columbia, Canada

TEMPLATE B

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE LEGAL/REGULATORY FRAMEWORK FOR THE RESOLUTION

The legal framework for the resolution of credit unions operating in the province of British Columbia (BC) is included in the *Financial Institutions Act (FIA)*. The FIA was enacted in 1989 to provide the legal framework for regulating the financial institutions – trust companies, insurance companies and the credit unions operating in BC. The Credit Union Deposit Insurance Corporation of British Columbia (CUDIC), initially incorporated under the *Credit Union Act*, continued under the FIA to administer and operate the deposit insurance fund.

The Financial Institutions Commission (FICOM), an agency of the BC provincial government, is responsible for administering the FIA. FICOM was established in 1989 by combining the two offices, the Superintendent of Financial Institutions and CUDIC. FICOM's purpose is to safeguard the confidence and stability in BC's financial sector by protecting consumers from undue loss and unfair market conduct.

As the regulator of credit unions, FICOM performs regulatory and supervisory functions including ongoing monitoring and supervision. These functions are carried out to identify areas of concern and intervene at an early stage to minimise losses to the depositors and the deposit insurance fund.

FICOM administers CUDIC. CUDIC's mandate is to guarantee all deposits in BC credit unions and to promote stability in the credit union sector.

Oversight responsibilities of the BC deposit insurance programme are performed by the CUDIC Board and FICOM's oversight body – the Commission. Members of the Commission are also appointed directors of the CUDIC Board under the FIA. The Commission's responsibilities include overseeing assessment contributions and resolution planning. The Commission directs the resolution option to be implemented in the event of a credit union failure.

The CUDIC Board is responsible for overseeing the management of the deposit insurance fund.

The FIA provides CUDIC with powers to:

- draw, make, accept, endorse, execute and issue promissory notes, bills of exchange, warrants, and other negotiable and transferable security instruments;
- raise or borrow money and secure its obligations in amounts, with or without security, and pledge the assets of the fund as security;
- acquire or dispose of property;
- guarantee the obligations of a credit union;
- provide insurance or arrange for insurance for directors, committee members, officers and employees of credit unions and of subsidiaries of credit unions; and
- reinsure the liability of the fund with insurers in an amount the commission considers appropriate.

2. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

Contingency activities are planned in conjunction with FICOM's supervisory activities. FICOM assigns a supervisory rating (Low, Moderate, Above Average or High) to credit unions to reflect their risk profile and an intervention stage rating that indicates the intensity of FICOM/CUDIC's supervisory/resolution activities to be performed.

The Intervention Stage ratings are:

- Stage 0 - Normal
- Stage 1 - Early Warning
- Stage 2 - Risk to Financial Viability or Solvency
- Stage 3 - Future Financial Viability and Solvency in Serious Doubt
- Stage 4 - Non-Viability / Insolvency Imminent

FICOM's supervisory activities for credit unions with an Intervention Stage rating of 0 include periodic on-site reviews and monitoring of information on a monthly, quarterly and/or annual basis.

Supervisory activities for credit unions with an Intervention Stage rating of 1 include on-site reviews, data collection and analysis at increasing frequency, concerns communicated to credit union directors, senior management, internal and external auditors, requests for stress testing, revised business plans and risk

appetites, special examinations by external experts, and establishing or issuing expectations under an undertaking or voluntary compliance agreement.

Planning activities for possible resolution begin at Stage 2. Activities in Intervention Stage 2 include:

- requiring recovery or restructuring plans;
- revising business plans;
- increasing capital;
- issuing other orders;
- placing the credit union under statutory supervision;
- considering potential merger opportunities;
- entering into an undertaking or voluntary compliance agreement; and
- placing conditions or prohibitions on business authorisation.

Resolution activities are carried out in Intervention Stages 3 and 4, usually within a very short period of time. Actions taken in Stage 3 include:

- placing the credit union under administration;
- winding-down or merging;
- sale of assets/branch closures;
- requesting financial assistance from CUDIC; and
- preparing contingency plans.

Activities in Intervention Stage 4 include:

- withdrawing business authorisation;
- placing credit union into liquidation; and
- deposit payout by CUDIC.

There have been no credit union failures over the past 25 years. However, in the event that a credit union is deemed non-viable, the FIA allows three basic resolution methods:

- deposit payout;
- purchase and assumption ("P&A") agreement or merger; and
- open assistance agreement.

Deposit Payout

In a deposit payout, as soon as the credit union is closed, a liquidator is appointed, and all depositors are paid the guaranteed amount of their deposits. Other creditors of the failed credit union are given receivership certificates entitling them to a share of the net proceeds from the sale and liquidation of the failed credit union's assets. The FIA authorises CUDIC to pay out from the deposit insurance fund.

Procedures and systems for a deposit payout are not yet fully developed. However, at a high level the plan should consider the following:

- Implement data standards for credit unions to facilitate depositor data extraction in a standardised and timely manner;
- Compliance test data standards for balancing and reconciliation, aggregation and data quality;

- Develop a pre-planning checklist and related manual that outlines the steps and activities to be conducted prior to a payout. The manual should include a list of activities based on the number of days prior to cut-off to ensure that activities are completed substantially before credit union failure and cut-off;
- Establish standby arrangements with external parties to assist with the planning and in the event of an actual failure;
- Develop cut-off procedures providing the activities to be completed upon the date of failure and at which point the credit union is closed and moves into liquidation;
- Develop a communication plan (press release, news conference, web and social media communication updates) to coincide with the shutdown of payment/transfer channels into or out of the failed credit union;
- Develop payout procedures including a payout system to verify insured balances and reimbursement of insured deposits.

Purchase and Assumption (P&A)

The P&A agreement or merger is a transaction in which an acquiring institution purchases some or all of the assets of a failed credit union and assumes some or all of the liabilities, including all deposits. The acquirer usually pays a premium for the assumed deposits and client base, decreasing CUDIC's total resolution costs.

Open Assistance

In an open assistance agreement, the FIA provides the authority to CUDIC to provide financial assistance or guarantees to an operating credit union determined to be in danger of closing or to facilitate a P&A agreement.

3. IMPLEMENTATION METHOD OF A POTENTIAL RESOLUTION (TOOLS, FUNDING, ETC.)

1. Resolution activities begin when FICOM sends a "failing credit union letter" advising the Board of Directors of the credit union and CUDIC of the credit union's imminent failure. This would involve revoking the business authorisation for deposit taking and passing a cease and desist order.
2. The Chief Executive Officer or General Manager of the failing credit union is contacted to discuss logistics, to address senior management's involvement in the resolution activities, and to obtain asset and deposit data from the credit union.
3. An information package is prepared to enable potential bidders analysing the data collected to assign a value to all the credit union assets, estimate the amount of deposits, determine the resolution structures to be offered, and plan for closure and liquidation.
4. Control is taken of the credit union including branches and business offices. This involves managing staff and members, answering members' questions, disabling the information technology connection, and actual physical security.
5. In preparing for closure, the administrator would pass a resolution to conduct

due diligence on the credit union. An on-site analysis is performed, to prepare and plan for the closure. This estimates the number and dollar amount of other creditors, determines and analyses the extent of any contingent liabilities, and investigates whether any potential fraud is present. Upon completing the due diligence, the FICOM Commissioners are briefed and their approval must be obtained to sell the credit union.

6. The final step in the resolution process is the closure of the credit union.

   a. In a P&A, the assets that the acquirer purchased and the deposits that it assumed are transferred to the acquirer. Upon closure, a liquidator is appointed. The liquidator is responsible for settling the affairs of the credit union, which includes balancing the accounts of the credit union immediately after closure, transferring certain assets and liabilities, and determining the exact amount of payment due from the acquirer (the liabilities assumed, less the assets acquired and the premium).

      The acquirer will reopen the credit union premises, and the members of the failed credit union with insured deposits automatically become members of the acquiring credit union and can gain access to their money. The liquidator is responsible for operating the liquidation, including collecting any of the failed credit union's assets retained by the liquidator and satisfying any claims against the liquidation of the failed credit union.

   b. In a deposit payout, deposit data are analysed, balanced and reconciled, and adjustments and holds are applied and aggregated to determine insured deposit balances. Deposit insurance amounts are then paid out, either in one payment or in several tranches. Concluding activities include liquidator interactions, handling of in-transit items, and dealing with the transfer of registered products, etc.

4. DIO'S OR RA'S OPERATIONAL CHALLENGES FORESEEN FOR THE RESOLUTION OF FINANCIAL COOPERATIVES

- In the absence of depositor data standards, the credit unions will not have the capability to provide depositor data in a standardised and timely manner. This will result in operational delays for CUDIC to reimburse depositors promptly.
- CUDIC does not have a payout system in place to analyse, reconcile and determine insured deposit balances. This could lead to the determination of inaccurate insured deposit balances, particularly for credit unions with a large volume of depositor records.
- Lack of planned and tested resolution procedures results in operational delays in resolving a failed credit union efficiently.
- Staff lack the necessary expertise and the experience to resolve a failed credit union or develop a resolution plan, since there have been no recent credit union failures.

- The FIA provides the Lieutenant Governor in Council (LGIC) with the discretionary authority to direct the Minister of Finance to enter into a guarantee of indebtedness to replenish the fund if the deposit insurance fund assets and additional assessments are inadequate. The Resolution plan will need to address uncertainty and, if (for example) additional funding was not authorised, plan for tranche payments.

5. CRISIS COMMUNICATION ISSUES SPECIFIC TO FINANCIAL COOPERATIVES

Credit unions in BC are geographically dispersed within the province. There are credit unions located in rural areas servicing members with limited or no access to online communication channels. This creates challenges when attempting to notify all members about the credit union failure and providing quick access to deposits. Alternatively, the credit unions located in urban areas serve members that use a wide range of online communication networks including social media. Resolution planning should consider communication strategies that address these varying circumstances.

6. ELEMENTS OR TOOLS THAT COULD BE ENHANCED OR PUT IN PLACE IN YOUR JURISDICTION IN ORDER TO IMPROVE THE RESOLUTION PROCESS

To resolve a failed credit union effectively and efficiently, a range of resolution tools are required that can be implemented depending on the size and complexity of credit union failures under various external circumstances. The regulatory framework should provide the flexibility to adopt suitable resolution tools that are proposed and developed internationally to include in the resolution toolkit.

The resolution framework in the FIA should be amended to provide FICOM/CUDIC with legislative power to waive regulatory requirements for incorporating a new credit union in the event that a bridge institution needs to be established. This facilitates the prompt transfer of good assets and insured deposits of the failed credit union.
Enhancements to improve the legislative framework will be proposed to the FIA review which is currently underway.

- Establish criteria and identify information required to assess and select the optimal resolution option. For example, stability or least cost.
- Implement data standards for credit unions. This would enable credit unions to provide depositor data to CUDIC in a standardised format within a short period of time for quick deposit determination.
- Develop a payout system. This provides CUDIC with the operational capability to implement a depositor payout within a short period of time. Furthermore, even in the absence of a failure, having the operational capability instils confidence in depositors that their deposits can be accessed in the event of failure.
- Engage staff in credit union failure simulation exercises during the development of payout procedures to ensure the developed procedures are consistent with the realities of a potential payout.

- Develop protocols with the Ministry of Finance to initiate a request for backup funding and to access the funding.
- Develop protocols with all safety net participants to deal with failure scenarios that are beyond the capabilities of the fund.

January 2017

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Deposit Insurance and Credit Guarantee Corporation, India[69]

TEMPLATE B

2. BACKGROUND INFORMATION AND DESCRIPTION OF THE LEGAL/REGULATORY FRAMEWORK FOR THE RESOLUTION

Financial cooperatives account for a relatively small share in the bank-dominated Indian financial system; however, given their geographic and demographic outreach, they hold a key position in the system. Geographically, cooperatives have been instrumental in extending formal financial services to villages and small towns in India. Demographically, these institutions have enabled access to financial services to low and middle-income groups in both rural and urban areas. As at end-March 2017, India's cooperative banking sector comprised 1,966 insured banks eligible for deposit insurance; 1,562 urban cooperative banks (UCBs), 33 state cooperative banks and 371 district central cooperative banks (DCCBs). There were also 92,789 primary agriculture credit societies, which get funds mainly from DCCBs. As at end-March 2016, the assets of rural and urban cooperatives taken together were about 8.0% of the total assets/deposits held by the banking system.

[69] India did not fill out the case study, but the information received was appropriate to add in the template B of case studies.

3. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

Within the existing legal framework, memoranda of understanding (MoUs) have been entered into by the Reserve Bank of India (RBI) with all the state governments. A Task Force on Urban Co-operative Banks (TAFCUB) has been constituted in all states, comprising representatives from the RBI, the state government and the Federation, with a mandate to identify ways to restore the fortunes of viable urban cooperative banks and methods of non-disruptive exit for non-viable entities. These TAFCUBs have no legal backing.

4. IMPLEMENTATION METHOD OF A POTENTIAL RESOLUTION (TOOLS, FUNDING, ETC.)

Demutualisation – Demutualisation is the conversion of a cooperative, credit union or mutual into an alternative organisational form (usually one owned by investors). Demutualisation can occur through the conversion of equity into investment shares, or it can occur via a merger, takeover or buyout involving companies that are not cooperatives or mutuals. Regardless of the form it takes, demutualisation involves the transfer to private investors of the capital that has been built up over the years in the cooperative.

Regarding demutualisation, there is no explicit provision in the statutes governing the cooperative societies for converting them into new entities with a different structure from that of cooperative banks.

The RBI has the power to supersede[70] the board of multi-state urban cooperative banks (UCBs). For UCBs under the State Co-operative Societies Acts, the RBI can request the Registrar of Co-operative Societies (RCS) to supersede the board and, in view of the provisions of the Deposit Insurance and Credit Guarantee Corporation (DICGC) Act 1961, such a request by the Reserve Bank has to be honoured by the RCS. The RBI also has the power to apply to central government for the suspension of business and the issuance of an Order of Moratorium. Accordingly, the Central Registrar of Co-operative Societies has the power to prepare a merger scheme for such cooperative banks.

The RBI has the powers to restrict the activities and give directions[71] to a UCB and to a limited extent these can be considered as resolution measures not amounting to liquidation. On cancellation of the banking licence by the RBI, the liquidator is appointed by the state government to carry out liquidation under the provisions of the State Co-operative Societies Act. The payment procedure applied by the DICGC in such situations is similar to that for commercial banks.

Guidelines on the merger of UCBs and transfer of assets and liabilities to commercial banks are in place, but all such resolution strategies are voluntary and need the consent of the general meeting of the bank.

The RBI does not have any other power or tools to effectively resolve these banks.

[70] Section 36AAA of *Banking Regulation Act,* 1949 (AACS - As Applicable to Cooperative Societies).

[71] Section 35A and 36 of BR Act, 1949 (AACS).

5. DIO'S OR RA'S OPERATIONAL CHALLENGES FORESEEN FOR THE RESOLUTION OF FINANCIAL COOPERATIVES

No information.

6. CRISIS COMMUNICATION ISSUES SPECIFIC TO FINANCIAL COOPERATIVES

No information.

7. ELEMENTS OR TOOLS THAT COULD BE ENHANCED OR PUT IN PLACE IN YOUR JURISDICTION IN ORDER TO IMPROVE THE RESOLUTION PROCESS

No information.

June 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Deposit Guarantee Corporation of Manitoba, Canada

TEMPLATE B

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE LEGAL/REGULATORY FRAMEWORK FOR THE RESOLUTION

In Manitoba, the Deposit Guarantee Corporation of Manitoba (DGCM) serves as both the prudential regulator for credit unions and the caisse populaire (credit union/caisse), and the deposit insurer. The DGCM is overseen by the Registrar of Credit Unions (Superintendent of Financial Institutions), a *provincial civil servant.* (Both the DGCM and the Registrar are given specific roles and powers under the Credit Unions and Caisses Populaires Act (the "Act").

Manitoba's legislative and regulatory framework allows for increasing resolution authority that is proportionate to the financial condition of a credit union/caisse and the risk to the guarantee fund which is managed by the DGCM.

The DGCM operates under an intervention policy that is similar to the Office of the Superintendent of Financial Institutions (OSFI), and ramps up intervention activity as required. Under the intervention policy and the Act, the DGCM can direct a credit union/caisse to take a number of actions including divestment of assets, cessation of business activity, etc. These latter measures would be taken in cases of high distress.

If early intervention activity is unable to mitigate risks of a credit union/caisse failure, the Act sets out provision for placing a credit union/caisse under supervision. Under the Act, the Registrar has the authority to place a credit union/caisse under the supervision of the DGCM. The regulatory framework envisions that the DGCM would, through its intervention policy process, recommend supervision to the Registrar.

The criteria for supervision are broad and enumerated in the Act to include scenarios such as credit union/caisse non-compliance with legislation (including capital and liquidity requirements) and general solvency or liquidity concerns. The Registrar may also place a credit union/caisse under supervision if they "carry on business in a manner … that is financially unsound".

The powers of the supervisor (DGCM) are also enumerated in the Act and are broad. The DGCM may "exercise … any or all powers of the credit union/caisse" and may replace board and management. If necessary, the supervisor has the power to liquidate a failed credit union/caisse. But in that event, it must follow federal and provincial insolvency law and "ensure that the interests of all creditors are properly and lawfully provided for". The DGCM, as deposit insurer, would likely end up being an unsecured creditor. The intention of the framework is to make all depositors whole, regardless of the outcome of that process.

Manitoba's legal/regulatory framework is compliant with the IADI Core Principles, particularly Principles 13 and 14. However, ongoing work is required, to prepare for potential failure scenarios (see below).

2. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

Using IADI Principle 6 as guidance, Manitoba is not compliant in terms of having in place effective contingency planning and crisis management policies. The DGCM is currently working in this area under its 2015–2016 tactical plan.

The DGCM has some advantages. First, it is part of a system-wide group of safety-net participants that meets regularly to discuss policy, latest developments and plan for crises. The group includes the Registrar of Credit Unions, DGCM, and Credit Union Central of Manitoba (CUCM). Second, this group has prepared draft emergency liquidity protocols in the event of systemic liquidity problems.

The DGCM foresees working with the emergency liquidity protocols and this working group to further develop contingency planning documents (including communication strategies) that would address solvency crises and individual or systemic failure resolution.

3. IMPLEMENTATION METHOD OF A POTENTIAL RESOLUTION (TOOLS, FUNDING, ETC.)

Using IADI Principle 9 as guidance, the DGCM has many of the elements in place to resolve a distressed credit union/caisse. The DGCM maintains a Guarantee Fund with a set target of 95 to 115 basis points of system deposits. The target is similar to those in other Canadian jurisdictions. The DGCM conducts regular actuarial assessments on the adequacy of its guarantee fund. The fund is maintained

through regular credit union/caisse levies. Where required, the DGCM has the power under the Act to impose a special assessment.

The Act gives the DGCM borrowing authority and the power to request further assistance from the province. While Manitoba has no express obligation to provide assistance, it lists credit union/caisse deposit guarantees from the DGCM as a contingent liability in its financial statements.

A description of the DGCM's resolution tools (e.g. supervision/liquidation) was provided in answer to Question 1. In the event of a liquidation, a clear legal process for resolving creditor claims to a failed institution is provided in federal and provincial insolvency law.

4. DIO'S OR RA'S OPERATIONAL CHALLENGES FORESEEN FOR THE RESOLUTION OF FINANCIAL COOPERATIVES

The last time Manitoba's regulators faced individual and system crises that involved formal resolutions (including dissolutions and forced mergers) was in the 1980s. The DGCM does not have personnel with experience in dealing with credit union/caisse failures. Lack of experience is a key challenge that can only be overcome by establishing processes and protocols and identifying resources that can be called upon in a crisis.

To that end, another key operational challenge is that the DGCM has not formally identified, through established processes, the resources required to resolve a failed credit union/caisse (e.g. legal, accounting, managerial and funding). This challenge is mitigated by the fact that the DGCM has access to funding sources (system levies) and other system resources to assist with supervision or liquidation.

Over the course of many years, Manitoba credit unions/caisses have seen a rise in the number and size of large credit unions/caisses, due to mergers and significant growth. Resolution of large institutions may pose a challenge to the DGCM, particularly if key management needs to be replaced or supported to overhaul operations and manage an orderly transition.

5. CRISIS COMMUNICATION ISSUES SPECIFIC TO FINANCIAL COOPERATIVES

Failure or potential failure of any one credit union/caisse poses a unique systemic-risk challenge and may adversely affect other credit unions/caisses. Credit unions may be viewed by the public as a highly interrelated system and the failure of one credit union/caisse could lead to deposit flight. Crisis communication must take into account stability of the system as a whole.

Financial cooperatives are member-run institutions that typically are integral to their community. Placing a credit union/caisse under supervision may pose a communication challenge for regulators. Communications would be different from, although not necessarily more challenging than, the case of a bank with shareholders and bondholders.

6. ELEMENTS OR TOOLS THAT COULD BE ENHANCED OR PUT IN PLACE IN YOUR JURISDICTION IN ORDER TO IMPROVE THE RESOLUTION PROCESS

As mentioned above, the DGCM is working on finalising the emergency liquidity protocols. The DGCM needs to continue to work with its stakeholders on a communication strategy for these protocols. In addition, in 2015–16 the DGCM will be developing new contingency plans related to the resolution of a credit union/caisse. With those measures in place, the DGCM would be more closely aligned to the IADI Core Principles.

July 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Autorité des marchés financiers, Quebec, Canada

TEMPLATE B

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE LEGAL/REGULATORY FRAMEWORK FOR THE RESOLUTION

The Quebec DIO (Régie de l'assurance-dépôts du Québec) was established in 1967 by the Quebec government in order to improve trust in the financial system.[72] In 2004, the Quebec DIO was subsumed into the Autorité des marchés financiers (AMF), a newly created body which is mandated by the Quebec government to regulate the province's financial markets and provide assistance to consumers of financial products and services. The AMF, which is regulated by the *Act respecting the Autorité des marchés financiers*, is an integrated regulator for the Quebec financial sector, notably in the areas of insurance, securities, deposit institutions (other than banks), and the distribution of financial products and services.

The Quebec legislative framework includes the *Deposit Insurance Act* (1967) and the *Regulation respecting the application of the Deposit Insurance Act* (1970), which are the cornerstones of our DIO. The purpose of the *Deposit Insurance Act* is to foster the stability of Quebec's financial system by guaranteeing deposits in the event of a financial institution's real or anticipated failure. Also, there is the *Act respecting financial services cooperatives* (2001). This governs, in particular, the cooperative components of the largest cooperative financial group in Canada, the

[72] The Quebec DIO is one of the founding members of IADI.

Desjardins Group, with 360 caisses,[73] more than 7 million members and clients (individuals and businesses), and total assets exceeding CAD 229 billion (USD 197 billion) as at December 2014.[74]

The AMF's roles as deposit insurer are as follows:

- protection of deposits;
- ensuring that all deposit-taking institutions are registered and comply with the conditions of the permit;
- determining the adequate level of funding for its deposit insurance fund;
- assessment of the risk of registered institutions;
- intervention and resolution;
- communication and awareness.

In June 2013, the AMF officially designated the Desjardins Group as a domestic systemically important financial institution (D-SIFI). Thus, as a systemically important institution, the Desjardins Group is now subject to stricter requirements such as a 100 basis point capital surcharge, enhanced regulatory disclosure requirements, the implementation of a recovery plan, and the development, by the AMF, of a resolution plan. Consequently, the Quebec government is updating the legislative framework applicable to financial cooperatives. In this review, the AMF, as deposit insurer, would be designated as the resolution authority for provincially chartered deposit-taking institutions in Quebec. The AMF would thereby have the necessary powers to impose the implementation of the Desjardins recovery plan, assess its effectiveness, and develop a resolution plan. If the Desjardins Group is no longer viable, or is likely to become non-viable, the legislative framework would stipulate the instruments and powers available to restructure this financial institution before bankruptcy.

2. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

The AMF continues to work on a fully operational intervention framework applicable to registered institutions.

In October 2013, our DIO wrote an action plan in order to put in place intervention guidelines for Quebec-chartered deposit institutions. This action plan is articulated around three steps: risk monitoring of deposit institutions, planning of an intervention, and simulations.

Concerning the risk monitoring of deposit institutions, the DIO has improved its early detection model based on the risk profile of the Quebec-chartered deposit institutions.

[73] As at December 2014, the Desjardins Group included 346 caisses in the province of Quebec and 14 caisses in the province of Ontario.

[74] The exchange rate was USD 1 = CAD 1.1601 on 31 December 2014.

Regarding the planning of intervention, in February 2014, the AMF published the *Intervention Guidelines for Quebec-chartered Deposit Institutions registered under the Deposit Insurance Act*. The Guidelines provide an overview of the actions likely to be undertaken at each intervention stage. These are:

- Stage 1 : No Significant Problems
- Stage 2 : Early Warning-Viability or Solvency at Risk
- Stage 3 : Watch Condition-Viability or Solvency Threatened
- Stage 4 : Imminent Non-Viability or Solvency Seriously Compromised
- Stage 5 : Non-Viability Ascertained or Insolvent

At Stages 1 and 2, the supervisory function predominates, while, generally speaking, the exercise of the deposit insurance function does not result in direct interventions with the institution. At Stage 3, the deposit insurer's responsibilities increase and converge with the supervisory responsibilities. At Stages 4 and 5, the deposit insurance function becomes predominant. It should be noted, however, that these two functions are exercised in concert at every stage.

Regarding the simulations, our DIO held its last payout simulation in August 2014, assisted by a consultant with vast experience in this field. Using this three-day simulation, our DIO aimed to gain more expertise on the entire operational process in order to revisit its intervention plan and to better communicate its needs to the team in charge of the development of a new payout system.

During the simulation, our DIO was able to process overall steps for a payout such as failure announcement and payout kick-off, communication strategy, data extraction, transformation and load (ETL), balancing and reconciliation, interest calculations, aggregation, adjustments, holds, payments (including tranches), as well as final memos, sign-offs and documentation.

The next step for our DIO is to review its intervention framework to take into account the implementation of the recovery plan and the resolution plan for the Desjardins Group. Developed side by side, both of these projects are very closely linked.

Due to the fact that the last case failure of financial cooperatives in Quebec happened more than three decades ago, we have decided not to fill out template A. However, some lessons learned are always useful for our DIO.[75] These are:

- The crisis spread quickly over the whole group, even if it originated in a few caisses which were legal entities separate from the group.
- The difficulty for a financial cooperative is to have capital which has loss-absorbing and recapitalisation capacity (Total Loss-Absorbing Capacity). In fact, some members of financial cooperatives are both depositors and investors by purchasing their "capital shares" ("parts de capital"). So,

[75] In the 1980s, during a difficult economic environment, some caisses of the *Société des caisses d'entraide économique du Québec* suffered a liquidity crisis. The broadcast of a report on this matter by a French-language television network in Canada created a crisis of confidence among depositors, with a serious run on deposits.

ultimately, these members will absorb part of the losses, while the DIO's aim is to protect them.[76]

- The complexity of resolving the crisis due to the fact that the structure of financial cooperatives is an inverse pyramid (the top ownership level is made up of caisses which are all different legal entities). It might be necessary to request a special legal framework in order to resolve the crisis.

3. IMPLEMENTATION METHOD OF A POTENTIAL RESOLUTION (TOOLS, FUNDING, ETC.)

As mentioned earlier, the Quebec government is updating the legislative framework applicable to financial cooperatives, and the AMF is transitioning towards a resolution authority mandate. Currently, the AMF has some resolution powers under the *Deposit Insurance Act*, but this act may not really be adapted for the resolution of an integrated financial group and a D-SIFI such as Desjardins Group. Under this Act, the AMF may:

- make advances of money, with or without security, to a registered institution or an institution whose licence has been suspended or cancelled, or guarantee payment of the debts of such an institution;
- acquire the assets of a registered institution or an institution whose licence has been suspended or cancelled;
- make a deposit or guarantee a deposit made with a registered institution;
- guarantee a registered institution against any loss it may incur following an amalgamation with a registered institution or with an institution whose licence has been suspended or cancelled, or following the acquisition of the assets together with the takeover of the liabilities of such an institution;
- with the authorisation of the Minister, enter, with any body or agency which, in the opinion of the AMF, administers an equivalent scheme, into an agreement concerning an institution whose deposits are guaranteed or partly insured by the AMF and partly by such body or agency;
- obtain the authorisation of the Minister to:

  (i) constitute a legal person or a partnership under an *Act of Quebec* to carry out the winding-up of the assets acquired from a registered institution;

  (ii) acquire any security issued by a registered institution;

  (iii) apply to the Superior Court for an order to force the sale or amalgamation of a registered institution whose licence has been suspended or cancelled;

[76] However, Desjardins Group as a whole is a very sound financial institution. Its core capital is made up of a large amount of reserves and its CET1 capital ratio is higher than that of Canadian systemically important banks and many systemically important financial institutions worldwide. Desjardins Group has also recently been working closely with the AMF to be able issue contingent capital to non-members. Currently, the members of Desjardins Group hold approximatively 12% of instruments that could be changed into bail-inable debt.

- act as liquidator of an institution whose licence has been cancelled, or act as receiver of a registered institution or an institution whose licence has been suspended or cancelled.

Moreover, under the *Act respecting the Autorité des marchés financiers*, the AMF has the power to ask the Superior Court of Quebec to order the appointment of a receiver, and also to recommend a party to act as receiver.

As mentioned, our DIO is actively working on the resolution planning, which is based on these four principles:

- to preserve the stability of Quebec's financial system and the continuity of operations;
- to protect consumers;
- to reduce risks for taxpayers; and
- to minimise the costs of the resolution.

The following steps are part of the resolution process:

- set the strategy of the resolution (high level);
- identify the critical functions and key entities whose failure would have a serious impact on financial stability;
- analyse the needs and the sources of financing;
- choose between single or multiple point-of-entry approaches;
- determine the point of entry, the triggers and the possible crisis scenarios;
- set the options for the resolution;
- identify obstacles;
- readjust the strategy of the resolution;
- find solutions in order to remove obstacles; and
- develop a contingency operational plan.

As the resolution planning is an ongoing and iterative process, each of these steps will be followed in order to redraft the resolution plan until we obtain an iteration that is satisfactory. Then, it will be a matter of updating the resolution plan, either yearly or following a significant change to the institution.

Concerning funding, the AMF has put in place, as requested by the *Deposit Insurance Act*, a Deposit Insurance Fund (DIF), which had a market value of CAD 641 million (USD 529 million) as of April 2015,[77] or DIF capitalisation of 79

[77] The exchange rate was USD 1 = CAD 1.2119 on 30 April 2015.

basis points.[78] It may also be possible to obtain cash advances from the Quebec government if the resources of the AMF are insufficient for the payment of its obligations. Funding is one of the elements of our DIO's work on the resolution plan for the Desjardins Group. It is worth noting that the AMF does not perceive an imminent risk of payout regarding Desjardins Group, as the institution has a strong capital ratio and has currently assets largely above liabilities. Moreover, Desjardins Group has a financial security fund which aim is to ensure that no Desjardins caisse is insolvable.

4. DIO'S OR RA'S OPERATIONAL CHALLENGES FORESEEN FOR THE RESOLUTION OF FINANCIAL COOPERATIVES

Most of the AMF's resolution challenges are related to the uniqueness of the Quebec financial landscape in terms of market concentration and the nature of its deposit-taking institutions.

First, market concentration in Quebec is very high with the Desjardins Group, having deposit and lending market shares higher than 40%. Moreover, as mentioned earlier, deposits guaranteed by the AMF are overwhelmingly linked to the Desjardins Group. This creates challenges that include a limited number of potential acquirers for the entirety or part of the institution in resolution, and the difficulty in obtaining adequate funding in resolution (due to the size of the core business to protect, and the potential inability to have ex post funding mechanisms).

For the caisses, regional concentration may present challenges such as the lack of potential acquirers within the same region, their importance for a region, community or group of workers, and the fact that some caisses are the only financial institutions in many remote areas. In addition, there is a relatively high risk of contagion as the failure of one local caisse carrying the Desjardins' name would entail significant reputational risk and could lead to spillover effects to other caisses or, possibly, the entire group.[79]

Second, deposit-taking institutions in Quebec (especially those under the jurisdiction of the AMF) are largely dominated by the 346 financial services cooperatives belonging to the Desjardins Group.[80] As the fifth largest financial cooperative in the world and the largest in Canada, the Desjardins Group remains one of the world's very few institutions of that size to not have a share capital

[78] The DIF capitalisation is calculated from the total covered deposits held by provincially chartered deposit-taking institutions in Quebec (excluding those held by federally chartered deposit-taking institutions in Quebec).

[79] However, The Desjardins financial security fund tries to come to the rescue of any Desjardins caisse that is in financial difficulty. Moreover the solidarity between member caisses of the Desjardins Group is reinforced in a new bill introduced the Quebec's parliament.

[80] In Canada, banks are federally regulated (e.g. Canada Deposit Insurance Corporation, Office of the Superintendent of Financial Institutions), whereas credit unions and financial cooperatives are provincially regulated. It is worth noting, however, that the federal government has recently introduced a framework allowing credit unions to become federally regulated.

structure like that of banks.[81] For this reason, some adjustments were needed before the international resolution standards can be applied to Desjardins Group. To overcome potential challenges, the AMF has been working closely with Desjardins Group to find the best way to adapt these standards developed for traditional banks to the financial cooperative.

Resolution challenges inherent to the nature of the Desjardins Group as a financial cooperative include the fact that it is a "virtual" entity[82] whose top ownership level is made up of 360 caisses which are all different legal entities. So, the governance structure is more complex and the single point of entry approach in resolution may not apply or may need to be adapted. Moreover, there are unique separability concerns as these caisses are dependent upon many key entities (other cooperatives) for day-to-day operations and enjoy competitive advantages over banks from their ability to sell Desjardins insurance products in their branches. In addition, both for the resolution of the group and for the early intervention actions over small caisses, the Desjardins cooperative structure presents some limitations in terms of recapitalisation.[83]

5. CRISIS COMMUNICATION ISSUES SPECIFIC TO FINANCIAL COOPERATIVES

The main challenges seen in terms of crisis communication relate to the ownership structure of financial cooperatives. The "one-member-one-vote" nature of financial cooperatives implies that, when communicating to depositors, the deposit insurer and/or the resolution authority has to keep in mind that, in the vast majority of cases, the depositor is also an owner.

As many resolution options could interfere with the ownership rights of depositors, communication tools need to ensure that the message strikes the right balance between the understanding of such ownership rights and the need to protect depositors and to act for the benefit of financial stability.

For financial cooperatives, this is especially meaningful if resolution options must first require demutualisation, in which case members could lose, albeit temporarily, a significant portion of their ownership rights.

In addition, with regards to the concentration issues described above, the communication strategy has to make sure that the message is one of reassurance in order to minimise reputational risk for the institution and to avoid spillover effects to other caisses or to the group[84]. This may also mean isolating the source of the problem in the communication strategy.

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[81] Most of the larger financial cooperatives do have some form of share capital structure (e.g. France's *Crédit Agricole*).

[82] "Desjardins Group" does not exist per se, it is rather the name given to the group resulting from the regulatory consolidation of all of its entities. A new bill submitted to the Quebec's parliament, which is expected to be adopted in 2018, will help resolve this situation.

[83] Having said that, Desjardins' ability to maintain an adequate level of common equity tier 1 capital remains important for the AMF (its CET1 ratio was 15.7% as at Q1 2015). Moreover, Desjardins Group has also recently been working closely with the AMF to be able issue contingent capital and bail-inable debt to non-members.

[84] In a new bill to be adopted in 2018, it is expected that it will not be possible for a caisse to become unaffiliated of the group. In addition, the bill indicates that in case of resolution, the whole group will be treated as one entity.

6. ELEMENTS OR TOOLS THAT COULD BE ENHANCED OR PUT IN PLACE IN YOUR JURISDICTION IN ORDER TO IMPROVE THE RESOLUTION PROCESS

As mentioned earlier, the AMF already has some resolution powers but, for the resolution of an integrated financial group and a D-SIFI such as Desjardins Group, more resolution powers need to be obtained. For example, the ability to implement bail-in, bridge bank, and a "goodco/badco" model requires resolution powers to be put in place in order to improve the resolution process. But as the Desjardins Group is a financial cooperative, we have to find how these can be applied and adjusted if necessary, and develop the tools allowing their application. These reflections will be part of our work for the next months.

In addition, we will be performing resolvability assessments and will be looking at possible measures that could help improve resolvability.

As the claims structure in resolution differs from the one in liquidation, we are studying the possibility to include a depositor preference framework in our legislation, which would assign a priority claim to depositors.

Moreover, our DIO is working on the funding necessary for the resolution of the Desjardins Group. Until now, we have the DIF but, as mentioned earlier, its capitalisation is likely to not be enough. Whether we use the DIF or, possibly, a new fund exclusively for the resolution such as a resolution fund, we have to find the adequate way to capitalise it. Considering that the Desjardins Group is the major deposit-taking institution in the province of Quebec, it is difficult to consider ex post funding.

We also have to work on having a better knowledge of our safety-net partners and strengthening our relationship with them. Also, a crisis management group (CMG) for the resolution of the Desjardins Group has to be put in place. Therefore, more formal processes with our safety-net partners and a CMG would be detailed in our resolution plan (including the funding implications) and in our intervention framework.

June 2015

IADI Research and Guidance Committee
Case Study of Resolution Issues for Financial Cooperatives

CONTACT

Name of Deposit Insurance Organisation (DIO) or Resolution Authority (RA):
Deposit Guarantee Fund, Ukraine

TEMPLATE B

1. BACKGROUND INFORMATION AND DESCRIPTION OF THE LEGAL/REGULATORY FRAMEWORK FOR THE RESOLUTION

According to the Ukrainian Law on banks and banking activity, it is possible to create a cooperative bank, but there are currently none in Ukraine.

There is, however, another type of financial cooperative – the credit union.

Main CU data

	31.12.2012	31.12.2013	31.12.2014
No. of CUs	617	624	589
No. of members of CU	1 095,9	980,9	821,6
No. of depositors	44,9	40,3	31,5
No. of borrowers	254,0	233,6	186,6
Assets (million USD)	332,5	325,3	148,4
Equity (million USD)	136,3	132,1	66,5
Loans (million USD)	316,8	294,0	126,5
Deposits (million USD)	161,1	166,5	62,8
Exchange rate USD/UAH	**7,99**	**7,99**	**15,76**

According to the Law, deposits in cooperative banks are insured by the Deposit Guarantee Fund. The Law on credit unions contains no requirements about

guarantees for depositors. Forty-five credit unions are members of the Deposit Protection Programme, a non-governmental organisation which is responsible for on-site and off-site monitoring of CUs, and for accumulating funds for payouts in the event of CU bankruptcy.

Our legislation also entitles the regulatory authority to appoint provisional administrators and liquidators for credit unions.

2. CONTINGENCY PLANS (EXISTENCE, TESTING AND LESSONS LEARNED)

Banks are supervised by the National Bank of Ukraine (NBU). Credit unions are supervised by the National Supervisory Commission for Financial Markets. A law is being drafted on the reorganisation of financial market supervision. As of 1 January 2016, Cus would be supervised by the NBU.

We think the when the NBU becomes the supervisor for credit unions, this will start a discussion on the participation of credit unions in the Deposit Guarantee Fund.

12. ANNEX 3 - LEGAL DEFINITIONS OF FCS

Alberta (Canada)

Canada credit unions are defined in Part 4 "Essential Features of a Credit Union", Section 26 of the *Credit Union Act*, Revised Statutes of Alberta 2000, Chapter C-32, as follows:

(1) The purposes of a credit union are, subject to the restrictions set out in this Act and the regulations, to provide on a co-operative basis financial services wholly or primarily for its members, and its principal purposes are to receive deposits from, and to make loans to, its members.

(2) A credit union shall operate on a co-operative basis such that:

a. Subject to section 60, a member has no more than one vote at its general meetings or in respect of elections of its directors and officers,

b. There is no provision for proxy voting,

c. Membership in it is:

i. Voluntary, and

ii. Open to individuals resident in Alberta, except to the extent that, in the case of a credit union with a bond of association, it is restricted by that bond,

d. Its business is carried on wholly or primarily for the benefit of its members, and

e. Net income accruing from its business is:

i. Distributed to members,

ii. Used to develop its business,

iii. Used to provide services for its customers,

iv. Used for the enhancement of its reserves or retained earnings, or

v. Used for another purpose approved by the members.

British Columbia (Canada)

"**Credit union"** means a corporation incorporated as a credit union under this Act [*Credit Union Incorporation Act*], the *Credit Union Act*, RSBC, 1979, c. 79, or a former *Credit Unions Act*, and includes a central credit union and a credit union continued in British Columbia under section 15.1, but does not include a credit union continued under the laws of another jurisdiction under section 15.2;

In the above definition, section 15.1 refers to an extra-provincial credit union entering the BC jurisdiction and continuing their business within BC, while section 15.2 refers to a CU that is leaving the BC jurisdiction to continue business in another jurisdiction.

Chinese Taipei

Credit cooperative means a cooperative that is organised and registered under the *Credit Cooperatives Act of the Republic of China*, and that the institution has been approved by the Central Competent Authority to carry on the business of providing banking services.

Colombia

Savings and credit cooperatives: Article 41º of Law 454 of 1998

Savings and credit cooperatives are specialised cooperative organisations whose main function is to offer financial services exclusively to their members.

Multi-active cooperatives with savings and credit Section: There is no specific definition. The general definition of multi-active cooperatives is in Article 62 of Law 79 of 1988:

Multi-active cooperatives are organised to meet different needs through concurrent services provided through a single legal entity.

Services must be organised into separate sections, according to the characteristics of each specialised type of cooperative.

Czech Republic

Financial cooperatives are (under Act No. 87/1995 Coll., on savings and credit cooperatives) institutions that are not banks, but are licensed by the Czech National Bank to receive deposits from their members and provide loans to their members.

Greece

A civil cooperative is a voluntary union of persons with an economic interest, which, without engaging in activities of the rural economy, aims mainly at the economic, social and cultural development of its members, and the improvement of their quality of life in general within a common undertaking. The main types of cooperatives are producers' cooperatives, consumers' cooperatives, suppliers' cooperatives, credit cooperatives, transportation cooperatives and tourism cooperatives. Credit cooperatives are an alternative form under which credit institutions may be established and operated in Greece.

Japan (DICJ)

Each type of financial cooperative in Japan has a different legal basis, as below:

- Shinkin banks (a type of cooperative bank):
  - *Shinkin Bank Act*
- Credit union (credit cooperatives/ Shinkumi banks):
  - *Small and Medium-Sized Enterprise Cooperatives Act*
  - *Act on Financial Business by Cooperatives*
- Labour banks (a type of cooperative bank):
  - *Labour Bank Act*

The term "financial cooperatives" is defined slightly differently, and for different purposes, in each different law, such as the *Act on Preferred Equity Investment by Cooperative Structured Financial Institutions,* the *Act on Special Measures for Strengthening Financial Functions* and the *Act on Financial Institutions' Merger and Conversion*.

Currently, there is no common legal scheme for financial cooperatives in Japan. Common characteristics of financial cooperatives (excluding that of central/umbrella organisation) are implied in the *Act on Prohibition of Private Monopolization and Maintenance of Fair Trade*, Article 22, as a case exempted from the Act in the following way using the term partnership (in the definition below, the word partnership is used as term to refer cooperatives):

(i) The purpose of the partnership is mutual support among small-scale entrepreneurs or consumers.

(ii) The partnership is voluntarily formed and the partners may voluntarily participate in and withdraw from the partnership.

(iii) Each partner possesses equal voting rights.

(iv) If distribution of profits among partners is contemplated, the limits of the distributions are stipulated by laws and regulations or in the articles of partnership.

Japan (SIC)

The definitions of "financial cooperatives" differ slightly in the relevant legislative texts in Japan, as the Deposit Insurance Corporation of Japan has explained in the preceding paragraph. Agricultural and fishery cooperatives are defined in the *Agricultural and Fishery Cooperative Savings Insurance Act*.

Mexico

In Mexico, there are three DIAs for deposit-taking institutions; one for banks (IPAB), one for "people's savings & loans microfinance institutions" (PROSOFIPO)[85] and one for savings & loan cooperatives (FOCOOP).

By law, these kinds of institution can only take deposits if they are licensed by the financial authority (National Banking and Securities Commission). Only those that are licensed can be members of one of the three DIAs, according to the kind of institution.

Savings & loan cooperatives are deposit-taking institutions, licensed by the National Banking and Securities Commission, that can only offer financial services to members, who have paid-in an equity contribution; they have a cooperative organisational structure.

People's savings & loan microfinance institutions are private societies that can offer financial services to non-members, and their organisation is private.

Ontario (Canada)

Financial cooperatives include credit unions and caisses populaires – all of which are deposit-taking institutions as defined under the *Credit Unions and Caisses Populaires Act*, 1994.

Poland

1. Credit Unions are financial cooperatives, set up with the purpose of providing financial services to their members, based on a pre-existing social connection. Only persons connected by a common professional or organisational bond, such as employees of one or several companies or members of the same social or professional organisation, may become members of a credit union.

2. Cooperative banks are cooperatives – i.e. "voluntary associations of an unlimited number of persons, of variable composition and share fund, which conducts a common business activity in the interest of its members", on the basis of an authorisation from the Polish Financial Supervision Authority, which can provide financial services such as loans, credit, guarantees and securities only to natural or legal persons domiciled in the area in which the bank is licensed.

[85] PROSOFIPO responded to the survey. However, their microfinance institutions are not considered by law as financial cooperatives, so their responses were omitted in this research paper.

Quebec (Canada)

1. Credit unions and federations of credit unions are financial services cooperatives.

   A financial services cooperative is a legal entity in which persons having economic and social needs in common unite to form a deposit and financial services institution whose objects and rules of cooperative action are set out in the *Act respecting financial services cooperatives*.

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