

11th Strasbourg European Meeting – European Parliament

**Cooperatives values and economic and monetary integration:
the case of banking regulation**

**The regulation of French financial co-operatives:
From local co-operatives to global banking groups
subject to the Post-Crisis regime for banking
resolution**

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- 1. Resolution: a new cycle of global and EU banking regulation**
- 2. Characteristics of the French banking co-operative groups**
- 3. Bail-in and co-operative groups**

1. Resolution: a new cycle of global and EU banking regulation

I – Resolution: a new cycle of global and EU banking regulation

□ Main objectives of banking resolution:

- Preserve financial stability
- Ensure the continuity of critical functions (to the real economy)
- Protect depositors
- Prevent or at least limit the use of public funds –
- many EU banks are still under State control (e.g. Royal Bank of Scotland Group, still under State control after being rescued by the U.K. government at a cost of £45 billion in 2008).

I – Resolution: a new cycle of global and EU banking regulation

- A new life cycle of banking regulation as a response to the Great Financial Crisis

Oct.2011

- FSB's Key Attributes of Effective resolution regimes for Financial Institutions

04.11.2014

- Single Supervisory Mechanism (ECB) is fully operational

01.01.2015

- Banking recovery and resolution Directive enters into force (except for the bail-in tool)
- Resolution plans established by NRAs in application of BRRD
- Resolution schemes adopted by NRAs

01.01.2016

- Single Resolution Mechanism fully applicable
- Full resolution powers may be used by SRB (inc. Bail-in)
- MREL to be fixed by SRB/NRAs

01.01.2019

- TLAC 1

01.01.2022

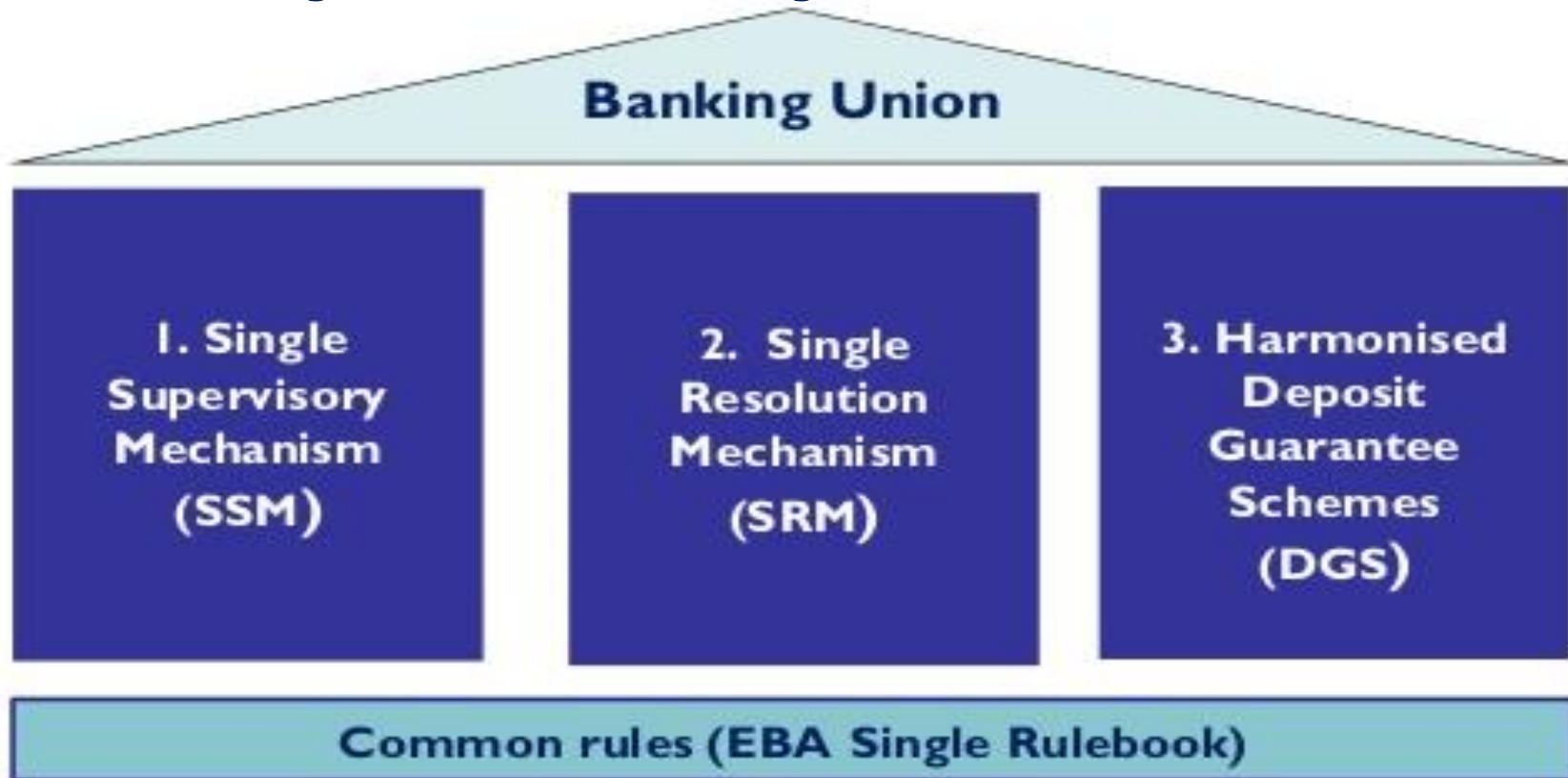
- TLAC 2

01.01.2024

- Full mutualisation of the Single Resolution Fund

I – Resolution: a new cycle of global and EU banking regulation

- In Europe, within the framework of another life cycle of regulation, the Banking Union



I- New resolution tools and resolution powers

- ❑ Resolution authorities are now able to exercise several **resolution powers** and to apply **4 resolution tools**.

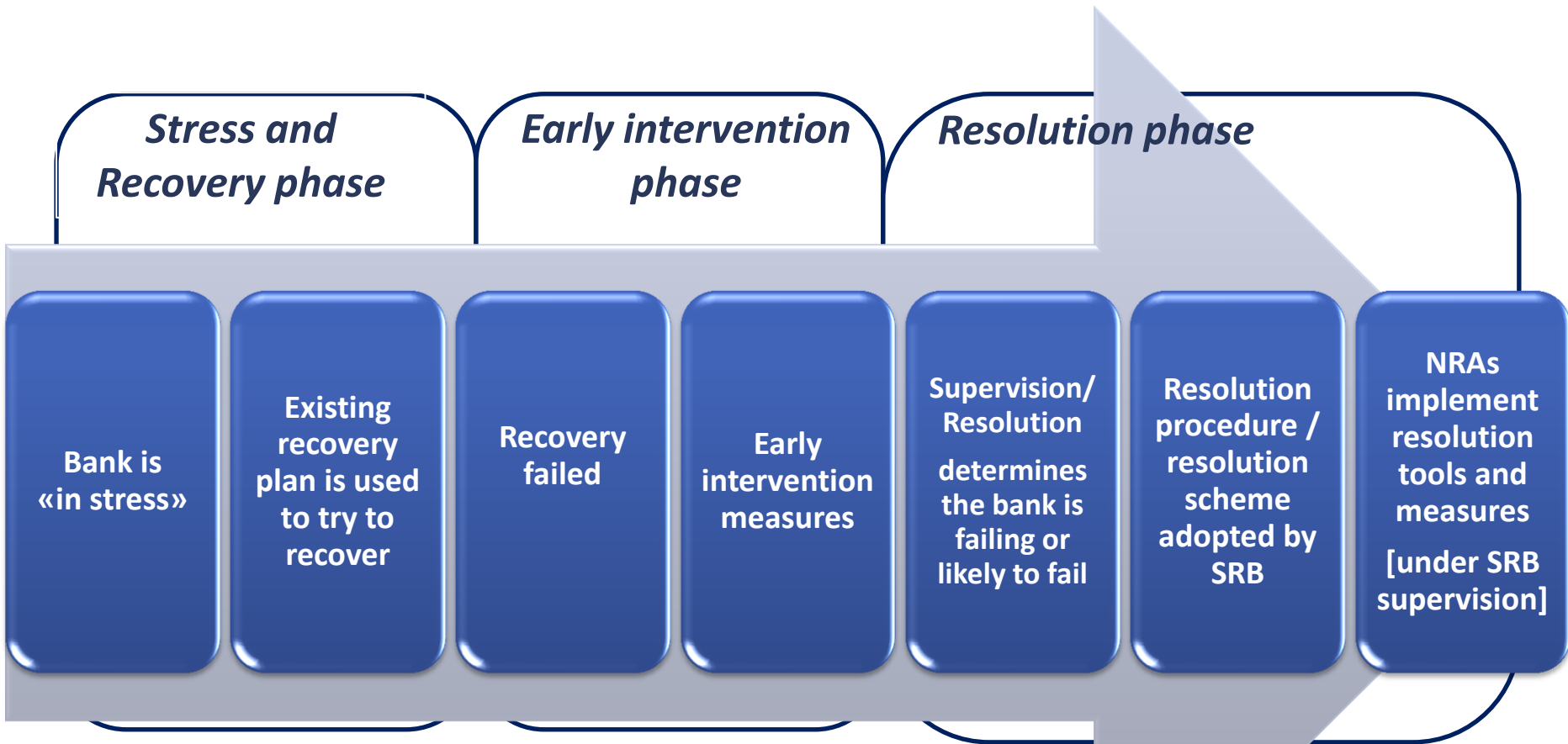
4 Resolution tools

- Sale of business
- Bridge institution
- **Asset separation** (this tool will be applied only together with another resolution tool)
- Bail-in

Resolution powers (among others)

- Take control of the institution under resolution
- Transfer shares and other instruments of ownership
- Remove or replace the management body and senior management

I – Stress, recovery, early intervention... resolution



Who is in charge of each phase?

Bank

Supervisory Authority

Resolution Authority

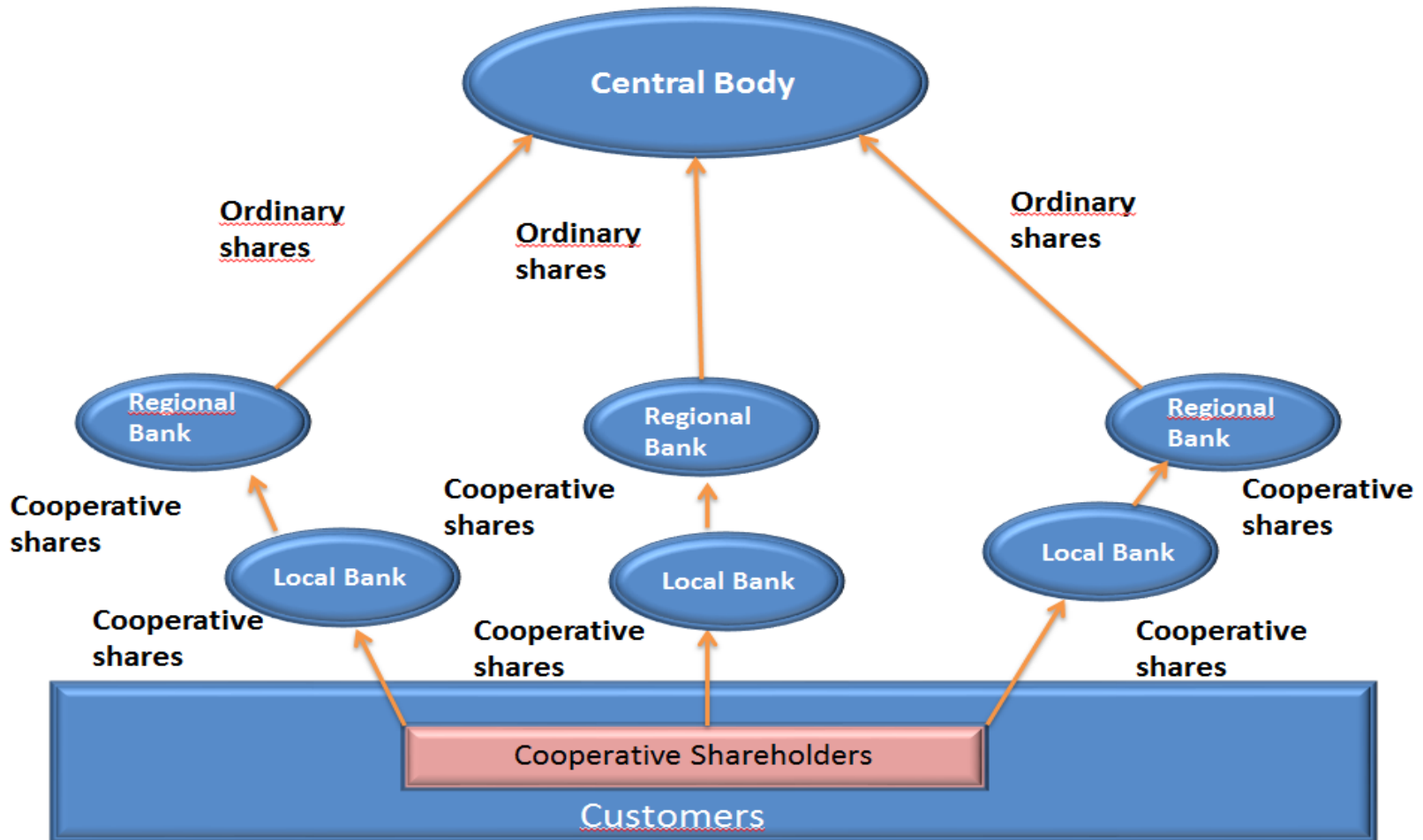
2. Characteristics of the French banking co-operative groups

II – French co-operative banking groups: main common characteristics

- ❑ Financial co-operatives share common values but they also present very different legal and financial structures:
 - IPS (Institutional Protection Schemes) in some Member States (e.g. Germany, Austria)
 - France: no IPS but ‘solidarity mechanisms’, based on statute, complemented by agreements and/or regulations, and recognized by banking regulation (Art. 10 CRR)
- ❑ French financial co-operatives: from local co-operatives («*caisses locales*») to global SIBs

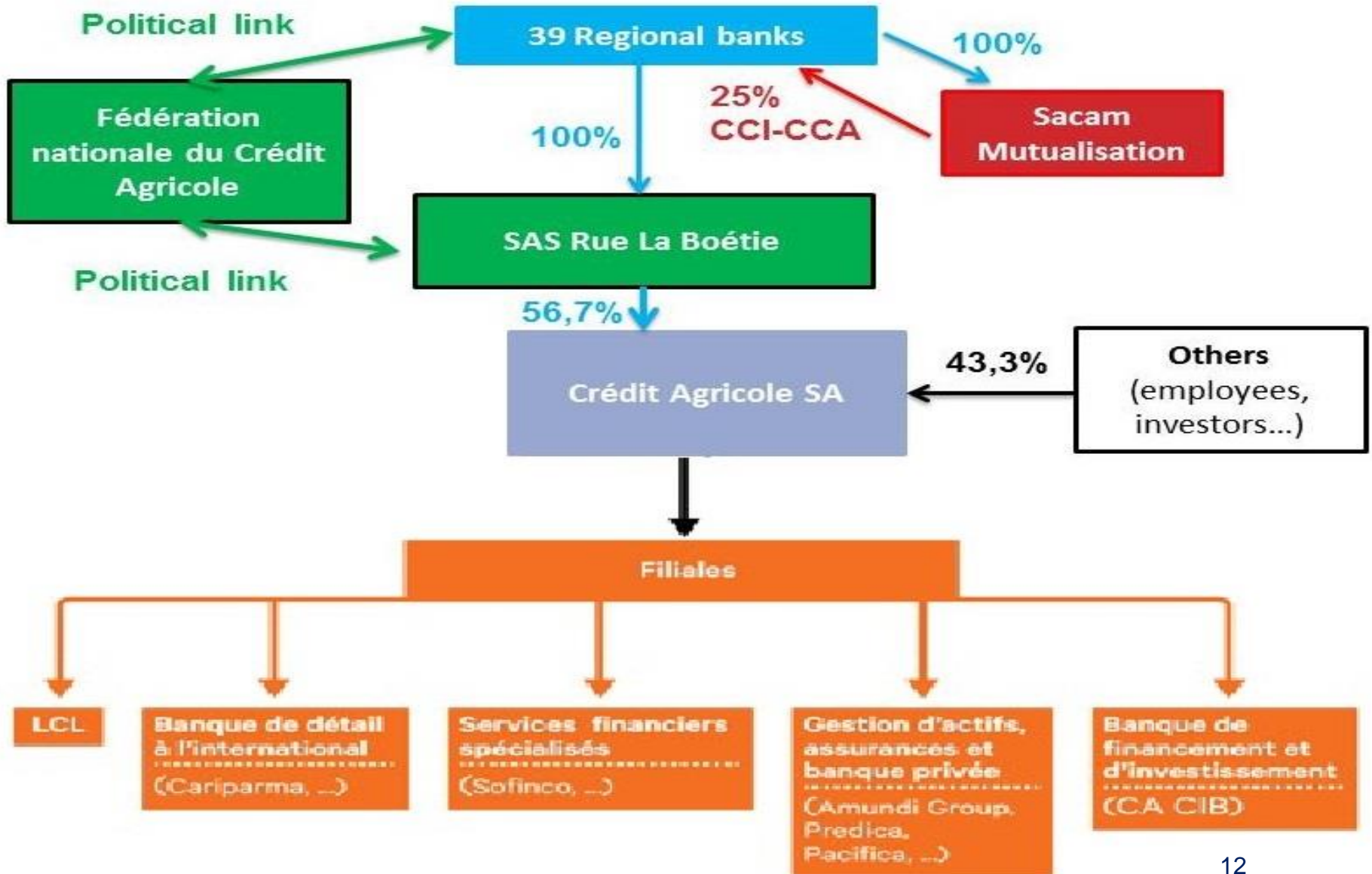
II – French co-operative banking groups: main common characteristics

- ‘Inverted pyramid’ networks composed of separate legal entities



Stylized diagram of a typical structure of a cooperative banking group

II – French co-operative banking groups:



II – French co-operative banking groups: systemic institutions/groups



Bucket ¹⁰	G-SIBs in alphabetical order within each bucket
5 (3.5%)	(Empty)
4 (2.5%)	Citigroup JP Morgan Chase
3 (2.0%)	Bank of America BNP Paribas Deutsche Bank HSBC
2 (1.5%)	Barclays Credit Suisse Goldman Sachs Industrial and Commercial Bank of China Limited Mitsubishi UFJ FG Wells Fargo
1 (1.0%)	Agricultural Bank of China Bank of China Bank of New York Mellon China Construction Bank Groupe BPCE Groupe Crédit Agricole ING Bank Mizuho FG Morgan Stanley Nordea Royal Bank of Scotland Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG UBS Unicredit Group

Source: FSB, 21 November 2016

II – French co-operative banking groups:

- CRR recognises the specific capital instruments of co-operatives (mutual shares) as CET1 capital instruments.
- FSB document of November 2015 on TLAC (Total Loss-Absorbing Capacity) refers explicitly to IPS and **'co-operative mutual solidarity system' (Principles 6, 8)**
- Co-operative banks often appear to be well-capitalized, in particular the French.
- However, the co-operatives capacity to issue CET1 instruments is limited due to their limited access to financial markets.
- Consequently, co-operatives are highly dependent on retained earnings. Their main challenge is to generate sufficient profits.
Need to pay attention to the risk of mis-selling practices for mutual shares and negotiable debt issuances.
- Some co-operatives **have created listed entities** that bring advantage in their ability to quickly raise bigger amounts of shareholder capital, and negotiable debt.
- But such investment vehicle creates additional complexity in the capital structure and is a source of additional market risks.
- The structure of co-operative banks and their “One man, one vote principle” may impair their ability to quickly re-allocate capital across entities and activities.

=> Need for strong solidarity mechanisms

II – French co-operative banking groups: The French ‘statutory solidarity mechanism’

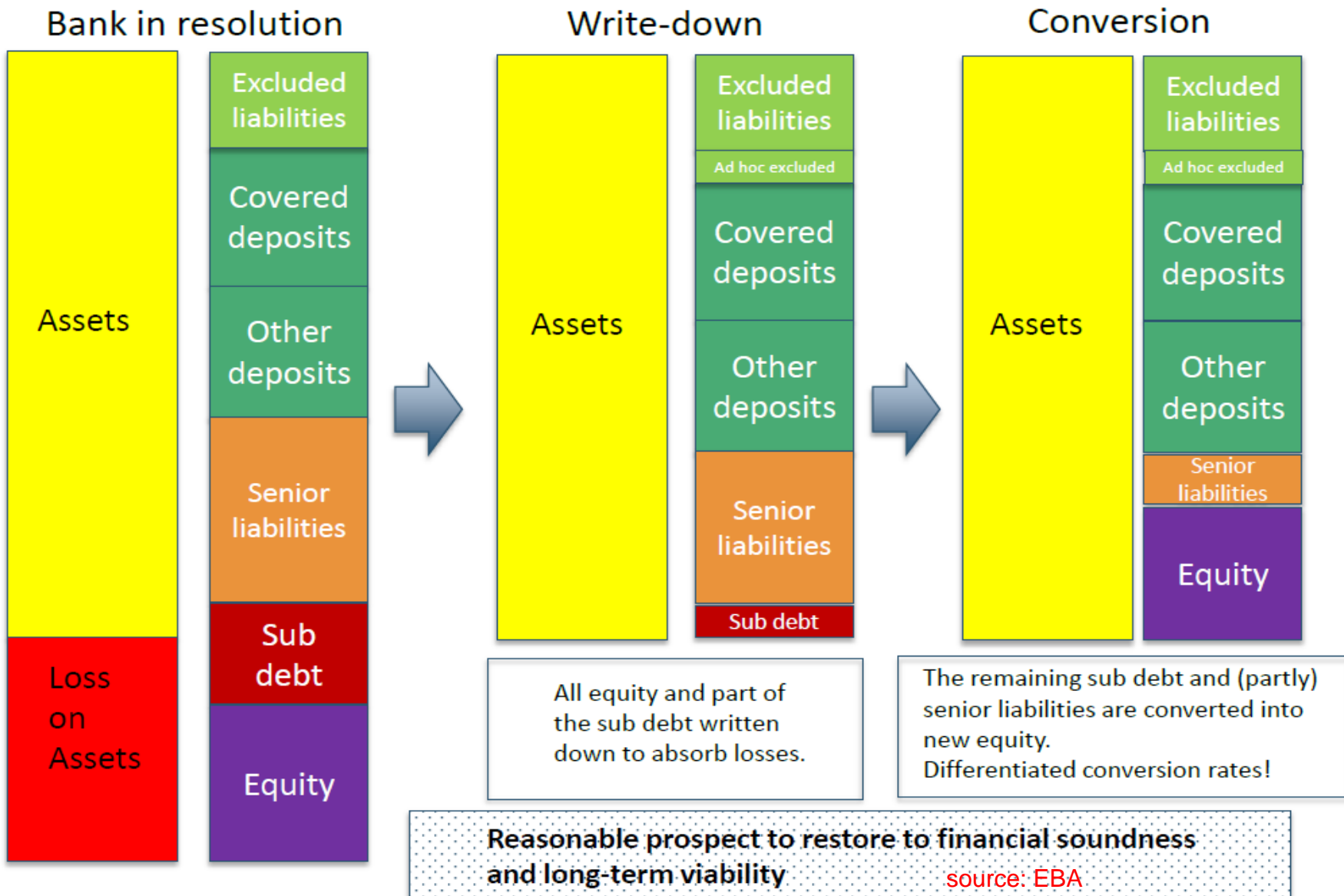
- **Article L. 511-31, French Monetary and Financial Code:**
 - any central body of a French co-operative banking network “shall be responsible for ensuring the cohesiveness [of its] network and the correct functioning of the institutions affiliated with [it]. To this end, [it] shall take all necessary measures, notably to ensure the liquidity and solvency of each of the [affiliated] institutions and of the network as a whole”,
 - the central body shall oversee the application of the laws and regulations specific to the said institutions and it shall exercise administrative, technical and financial control over the organisation and management thereof,
 - the central body may decide to merge two or more of the affiliated legal entities, with a total or partial sale of their assets and resulting in their dissolution.

II – French co-operative banking groups: Main features of the solidarity mechanism

- ❑ **One common statute, but different financial instruments for its implementation:**
 - Generally, solidarity is enforced through liquidity and solvency funds and the mutualization of losses through contributions
 - Different forms: Internal regulations of the central body (BPCE) Vs. Joint contractual guarantee made public (CASA)
 - The scope of affiliated entities may include entities which are not co-operative banks but commercial subsidiaries of the central body or of regional banks

3. Bail in and co-operative groups

III – Resolution strategy: bail-in

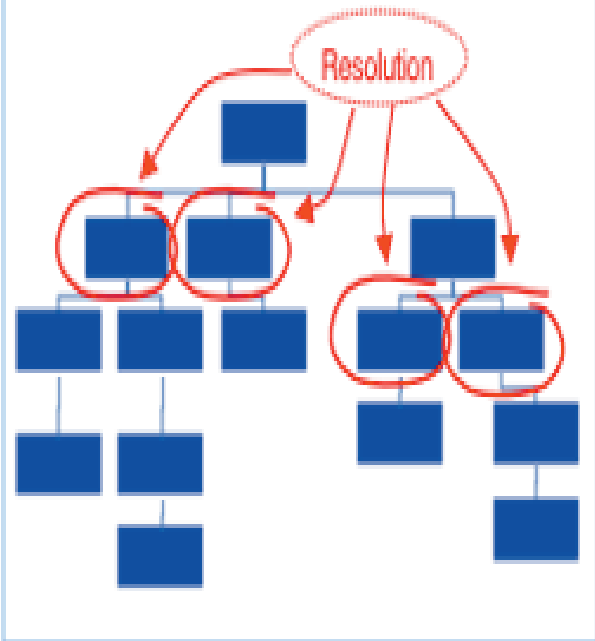


III – Bail-in and co-operative groups

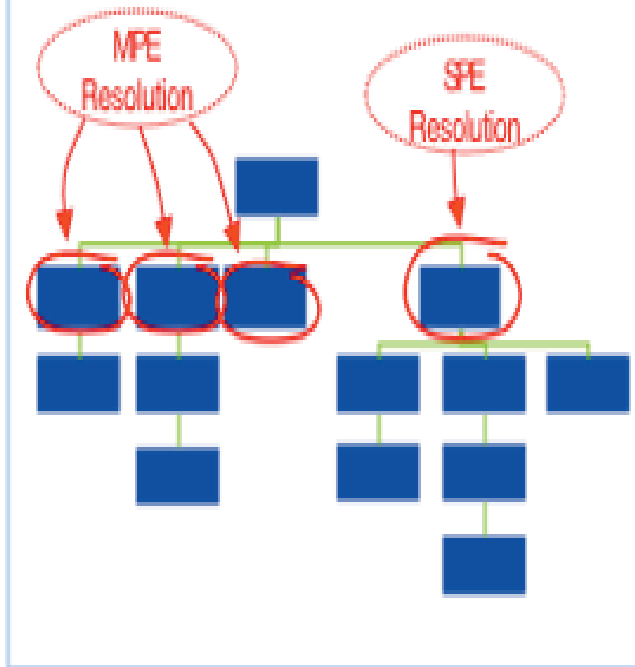
- ❑ **Application of bail-in (Art. 43 and 44 BRRD, Art. L.613-55 III French Monetary and Financial Code) :**
 - Bail-in also covers co-operative banks, whatever their legal form.
 - Bail-in will result in writing down existing shareholders and replacing them with creditors converted to shareholders
 - Therefore, resolution may result in changing the legal form of the entity (from co-operative form to ‘regular’ corporation)
 - But the resolution authority may also leave open the possibility of a re-mutualization, once the crisis has been addressed

III. Bail-in: strategies for groups: SPE or MPE ?

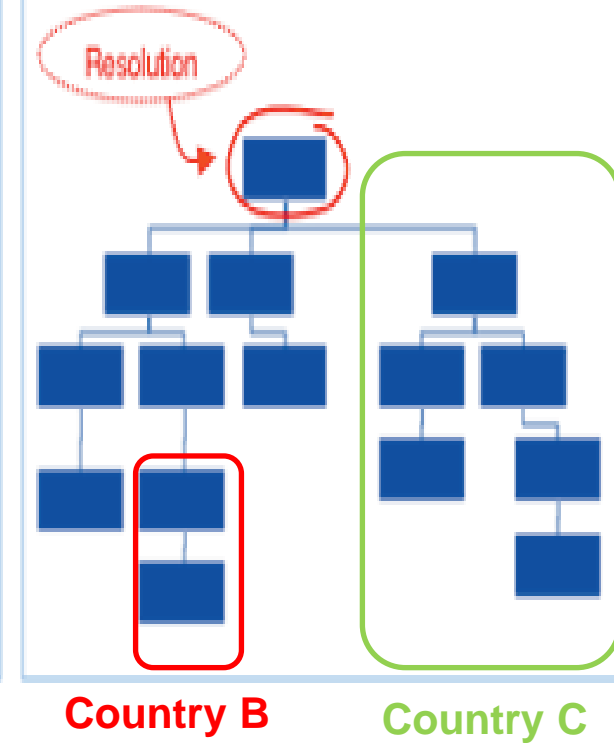
MPE resolution strategy



Hybrid model



SPE resolution strategy



Source: BBVA Research + ACPR

III – Bail-in and co-operative groups: questions

- ❑ **Solvency : How to take into account the inverted pyramid structure and the fact that own funds are located in the regional banks?**
 - Loss-absorbing capacity is based on: 1/ equity (mostly in regional banks), and 2/ bail-inable debt (usually a centralized vehicle)
 - The effect of bail-in is that the members of the network will lose their shares/control in the central body
 - BRRD grants to the Resolution Authority resolution powers to restructure a group/network

- ❑ **Liquidity: The difficult issue of liquidity in resolution:**
 - Trust => market funding
 - Centralisation of liquidity at the level of the central body? Pros and cons.

III – Bail-in and co-operative groups

The implementation of bail-in will protect depositors and financial stability: **Is it credible to apply bail-in to a co-operative group?**

- ❑ **1/ Bail-in takes place, by definition, after the writing down of shareholders :**
 - in co-operative groups : around 8M of holders of co-operative shares (in each network)

- ❑ **2/ Bail-in of debt instruments:**
 - senior bonds Vs. ‘non-preferred senior bonds’ («Loi Sapin2»)
 - selling to investors with adequate information/warning

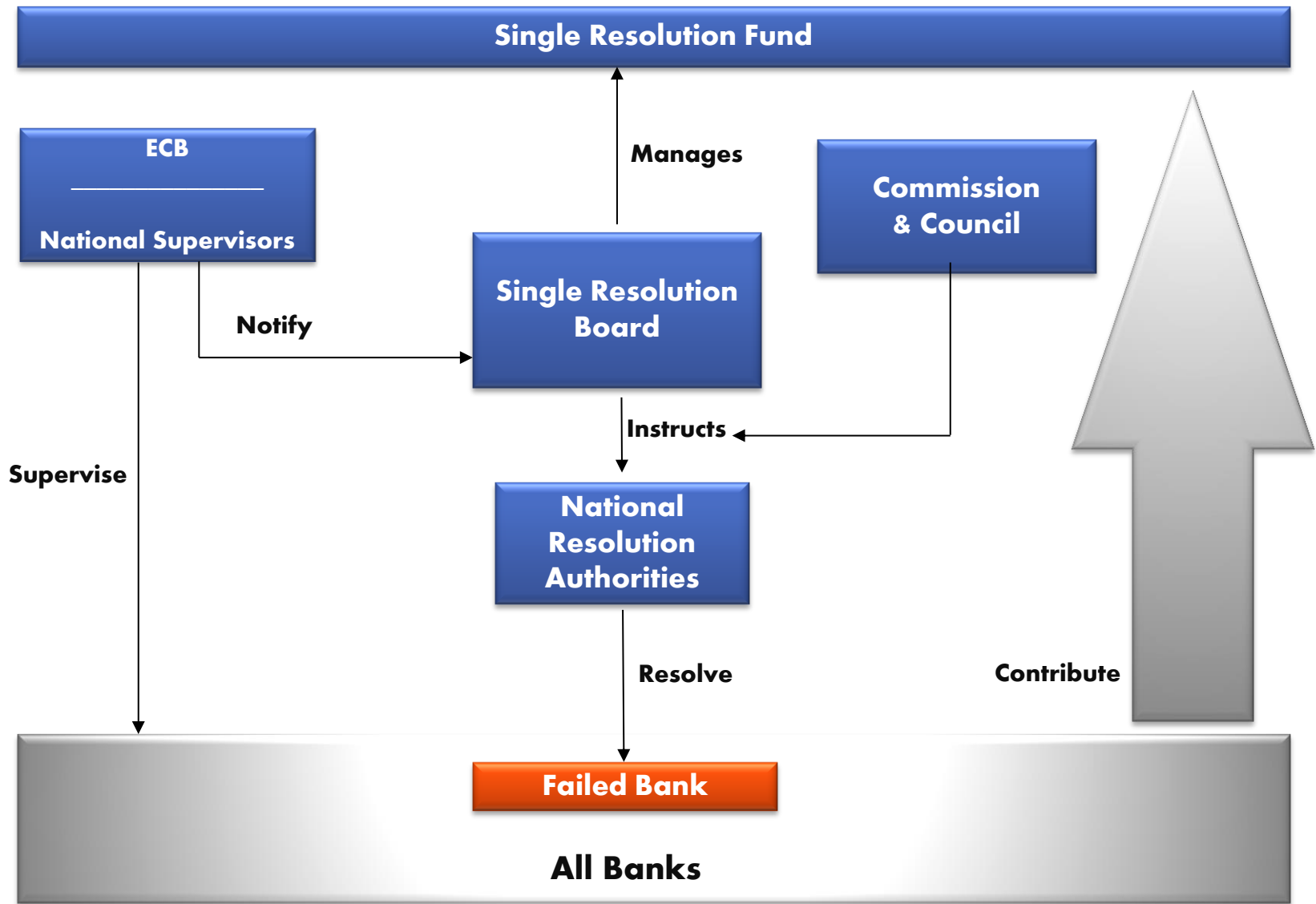
- ❑ **3/ Protection of depositors (deposits up to EUR 100,000):**
 - EU harmonised deposit guarantee schemes
 - fundamental objective of resolution
 - in addition, in France, for regulated savings account with a social purpose (« épargne réglementée »): State guarantee – these deposits are largely collected by co-operative banks

Thanks for your attention

<https://www.labex-refi.com/event/11th-strasbourg-european-meeting-european-parliament-workshop-cooperatives-values-and-economic-and-monetary-integration-the-case-of-banking-regulation/>

Annexes

I – A new legal and institutional framework:



III – Bail-in and co-operative groups

❑ Bail-in and « No Creditor Worse Off » (NCWO):

❑ What would have been the situation if normal insolvency had been applied to a co-operative bank?

- co-operative shareholders are as junior as ordinary shares in the creditors' hierarchy

❑ Bail-in and the creditors' hierarchy:

- the ranking of co-operative shares in the creditors' hierarchy should be taken into account when implementing the bail-in tool.
- which implies that the « no creditor worse off » constraint for cooperative shareholders is exactly the same as for ordinary shareholders.