A Co-op bank for Malta

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Excellency, Hon Minister, Distinguished guests,

Whilst thanking the organisers of this conference I must state by way of an introduction that I am delighted to participate in this conference not only in my own right, as an academic and economist, but as a Labour Member of the European Parliament. The implication, implicit or not, is that in Malta issues related to the our financial services sector have always enjoyed the support of both sides of the political spectrum, and have sought continuity between one administration and another. The subject of cooperative banks is no exception. The Leader of the Opposition Dr Joseph Muscat has in fact spoken openly about the support we are ready to give to the setting up a Maltese coop bank. The Labour Party believes in the cooperative movement's ideals and principles and it would be desirable that the movement went through another step in its evolution.

We are convinced that the active participation of a local cooperative bank, would by its nature encourage entrepreneurship, creating and sustaining social and cooperative networkds, introducing know-how and other information at the grass-root level, where it matters.

This year has been proclaimed by the United Nations as the Year of the Cooperatives with the motto "cooperative enterprises build a better world". Coops are not new to our island though ones has to admit that this process, at least to my knowledge, did not cross-over into the banking sector and only tiptoed in the voluntary insurance and pensions sector.

This is not the only oddity of its kind. Way back in the early eighties during the second oil crises the Mediterranean was inundated with solar water heaters on one's rooftop, Greece, Cyprus, Turkey, Israel. Yet not one in sight in Malta. We were as Mediterranean as they were. We had the same amount of sunshine. Hit by the same international oil prices. And yet no demand. Try to explain that.

I do not want to deviate from the subject but it is ask that a thought need to be given to explain why such idyosynchronies happen. What are the real ingredients which help an idea take hold, convince and grow. And which are those factors which are harmful and hostile.

Like many colleagues of mine here I have come to learn from the experts in the field and listen to their own country experiences.

What I can share with you are my own experiences in the European Parliament and in particular the Committee on Economic and Monetary Affairs with respect to how I think our legislative work may be assisting or hindering the growth of cooperative banking and mutual societies in the financial sector.

The first question which needs to be addressed is this. What impact did the financial crisis have on co-operative banks compared to the rest of the sector?

Perhaps before we answer this question we need to say that the financial crises which resulted from all the excesses imaginable has provoked us to rethink the whole system of providing credit to the development of an economic activity. We were so sure of the rocket science to which the financial industry was turning into, the efficiency of the markets with full faith in the principle of self-regulation. Hype brings more hype and I remember clearly what our attitude as regulators both at the Central Bank and the MFSA was in those days and how wrong we all were.

On one side we have the prevalence of the Anglo-Saxon banking model aimed at profit and shareholder value maximization of the last decades. On the other we have the cooperative institutions which, let us face it, in most of our universities are given the impression that they are not considered the most efficient, vibrant, or innovative institutions. For us quantitative academics the lack of empirical data or absence of time series data for basic financial indicators on coop banks, has not helped the cause for us to make an objective evaluation of their specific business model. Added to this their organizational structures and various goals are generally more difficult to understand for outsiders. Even in micro-theory profit maximizing models are text-book stuff for many students. Models which maximise consumer surplus, as is the case with coop banks, are covered by a select few of advanced students, Having said all this co-operative banks fared better than the banking sector as a whole. According to Groeneveld, European co-operative banks with an average market shares of around 20 percent were responsible for 8% of all direct losses and write downs of the entire European banking sector as a result of the credit crisis (Groeneveld, 2011). By comparison with European Shareholder Value banks, European Cooperative banking groups (ECBGs) appear to have been dealt only a glancing blow by the immediate effects of the credit crisis. Financial indicators show that they escaped relatively unscathed from the crisis and did not need large-scale government support.

In reality thanks to their ownership model, where the depositors also own a stake of the company, co-operatives adopt a more conservative and local lending model. A 2009 study by the Bundesbank - (Germany has the largest co-operative banking sector in the EU) - found that co-operative banks were much less likely to fail than privately owned institutions. Germany has 1,200 local mutual banks, serving 16 million members, 30 million customers, and holding just over €1 trillion in assets. A report by rating agency Standard and Poor's noted that no mutual banks in Germany have gone bust in 75 years.

Co-operative banks in Europe strengthened their position in the loan and deposit markets between 2000 and 2010, and particularly in 2007 and 2008.

I now come to the second question. What are the effects of EU financial regulation on the co-operative sector?

Since my election to the European Parliament in 2009 we have been inundated with massive number of regulatory legislative reports. Our aim is to reform the financial system in order to mitigate systemic risks. Not only did we set up a European Systemic Risk Board (ESRB). We also set up three European Regulatory Bodies, one for banking, one for insurance and one for securities. The main elements in our legislation have been the strengthening of transparency and accountability, enhancing sound regulation, promoting integrity in financial markets and reinforcing international cooperation among regulators and supervisors.

EU financial regulation has been radically overhauled since the start of the current parliamentary term in 2009. The main item on the table at the moment is the Capital

Requirements Directive (CRD IV) which regulates the proportion of core capital that a bank must hold on its banks to prevent excessive leverage. The Basel III rules will require a minimum ratio of 3%.

Co-operatives may be somewhat disadvantaged by CRD IV as the capital requirements will not be risk adjusted. They also are less able to access capital markets to issue stock and raise capital like listed banks. This could drive up interest rates. However, the higher level of capitalisation of co-operatives should allow them access to cheaper capital market funding.

A single EU rule-book for financial regulation should reduce complexity in the financial services market but, if done on a one-size-fits-all basis, it can add to the compliance burden. EU regulation has not been aimed at the co-operative sector but imposes unintentional costs on them. The evidence is that compliance costs impose a disproportionately high burden on co-op banks largely because they are relatively small and thus have fewer staff.

What about the implications of an EU banking union?

The European Commission's ambitious blueprint for a banking union is now being negotiated by ministers and MEPs. It has three main features: a single supervisor, an EU-wide deposit guarantee scheme, and a resolution mechanism for insolvent institutions.

Under the Commission's plans, the ECB would assume supervisory authority over the eurozone's biggest banks from July 2013, with the rest of the eurozone banking sector coming under ECB supervision from January 2014. The Commission proposal would allow the ECB to: award or withdraw banking licenses; conduct on-site spot checks; issue financial sanctions for non-compliance; rule on all bank takeovers and mergers; and impose rules on capital requirements.

It is difficult to assess the precise effects that this new supervisory structure will have especially as the Commission wants to maintain the role of national supervisors. What we know is that Germany is fighting tooth and nail to have their network of small banks outside this central banking supervision. On this both the Commission and the European Parliament seem contrary.

I did not mention to whole array of new schemes which we want to throw at the problem with the hope of finding a lasting crises resolution and crises prevention system for the future. They range from all sorts of bank taxes including the FTT to resolution funds, and on to living wills. But the basic question remains. Would these remedies prevent a systemic risk? Unfortunately to date we have no proper agreed idea of which financial institution constitutes a systemic risk. Is it just the big to fail banks or could it be a big number of smaller banks synchronise to the same shock? Would not a deposit guarantee scheme invite moral hazard, since its nature is the provision of a safety net?

As we are seeing from the proposal of "living wills" we prefer that excessive risk taking by financial institutions is best prevented when the banks' shareholders and bond holders are exposed to financial risks if a bank gets into trouble.

Conclusion

The financial crisis has demonstrated the value of the co-operative banking model to a diverse financial services market. In a post-crash environment co-operatives should in principle find it easy to adapt to corporate governance and ethics rules. In practice this is not the case.

Policy makers need to be kept aware of the specifics of co-operative banks. It would be unfair if the co-operative sector became the victim of new regulation aimed at the listed Shareholder Value banks. Resolution funds are not relevant to coop banks and are an added burden.

One should not go to the other extreme where one claims that cooperative banking is superior to other banking models, but it should be considered as a viable alternative to conventions shareholders value model. Competition demands diversification. Let us hope that this would apply to Malta too in the near future.