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THE IMPACT OF POST-CRISIS REGULATORY ARCHITECTURE ON POLISH COOPERATIVE BANKS

1. INTRODUCTION

Before the 2008 crisis, financial deregulation and market efficiency were the pillars for constructing bank regulatory architecture [Kroszner and Shiller 2013]. The 2008 crisis forced regulators to adopt a new attitude of strengthening and tightening regulatory rules and bank supervision [Beck 2010]. However, the complexity of post-crisis banking regulations and overlapping prerogatives of newly created supervisory institutions increased considerably the regulatory costs and burden for banks [KPMG 2013]. Moreover, in the EU the new institutional safety net was not consistently implemented, but constantly rearranged, following changes in macroeconomic priorities from financial stabilisation towards financial growth, which increased the organisational uncertainty and chaos.

The post-crisis bank restructuring has concentrated on stabilizing large banks and preventing systemic risk. In this respect, market competitive conditions and the strengthening local, mutual banks have been of marginal importance to the regulators. However, retail banking carried out by locally-based small institutions has always played an important role in many countries. The global financial crisis of 2008 has changed the complete position of small banks. On the one hand, their healthy business model was emphasized. On the other hand, they have to fulfil regulatory requirements designed for large global banks. Hence, the aim of this paper is to look at the challenges stemming from the post-crisis regulatory architecture to small banks, using as an example the Polish cooperative sector.

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2. THE CHALLENGES TO BUILDING POST-CRISIS REGULATORY ARCHITECTURE

The deregulation of financial markets over the last two decades has dramatically influenced the scale and complexity of banks. The changes in bank scale and scope of activities were facilitated by new regulatory philosophy, exemplified by moving from the Basel 1 to Basel 2 regulatory framework, where market discipline and bank self-regulation were to replace tight supervision. The increasing complexity of banks and the expansion of conglomerate structures generated synergies between banking (regulated) business and relatively unregulated investment activities and offered both new sources of income and new areas of risk [Allen et al. 2011].

However, the 2008 crisis demonstrated that Basel 2 was built on many optimistic assumptions, looked at isolated areas of risk and focused on partially recognized threats to financial stability. Consequently, banks, which for decades had been leaders in global efficiency or expansion, turned out to be most affected, requiring massive public stabilization funds and in some cases rescue by direct government intervention [Demirgüç-Kunt and Huizinga 2011]. Necessity to stabilize large banks in post-crisis period have contributed to inflated budget deficits and escalated public debts in major countries.

Table 1

Basel agreements and financial stability: survey results

Question: How would stability be best served?	Survey results (% of answers)
▪ Implementing Basel 3	34
▪ Implementing Basel 3, with a higher leverage ratio	27
▪ Scrapping Basel 3 – just raise the leverage ratio	12
▪ Keeping Basel 2, but enforcing it more effectively	8
▪ They got it right the first time – go back to Basel 1	19

Source: Centralbanking.com: 28 Jan 2013 [accessed 10.03.2013].

The financial community (e.g. the respondents to a *Centralbanking.com* poll in tab. 1) support the post crisis tightening of regulations, epitomized by Basel 3 capital accord, although many want to see a higher leverage ratio than the minimum of 3% it prescribes (the leverage ratio was defined as a result of dividing Tier 1 capital by the bank's average total consolidated assets). However, almost one-fifth of the respondents of the poll (19%) voted for a return to the simplicity of Basel 1.

In the post-crisis period, there was also a growing consensus that global financial stability and cross-border banking cannot be supported by nationally based supervision. The „financial trilemma” stated that financial stability, financial integration and national financial policies are incompatible [Schoenmaker 2011: 57–59], and hence the single supervisory power and lender of last resort function should be centralised in ECB. Moreover, there was a growing recognition that the supervisory system focusing predominantly on bank safety may produce less economic growth.

Based on OECD estimates, the post-crisis financial regulatory framework permanently reduces annual GDP by 0.15% [de Larosière 2013] and the Global Financial Stability Report estimated that the UE large banks reduced their assets [IMF 2012]. Consequently, the ECB seemed better equipped to prevent banking contractions and to stimulate growth with cheaper loans and investment programmes to generate growth. ECB had already been instrumental in slowing down bank deleveraging, by relieving funding pressures on euro area banks [EU Commission 2012]. Those arguments were crucial for a decision of the European Council and the Euro area summit in June 2012 to move from coordination of national banking supervision to an integrated system, where the EU countries within the euro zone will start to come under the direct supervision of the ECB, planned initially on January 2014, later moved to March 2014 [EU Commission 2012]. The Banking Union will consist of three parts: a common banking supervisor (Single Supervisory Mechanism, SSM), a common resolution framework (the final proposal of Bank Recovery and Resolution Directive was presented on 22 December 2013 by the Council of the EU) and a common deposit guarantee scheme, which will be constructed at a later date. Initially there was a proposal that the ECB should be directly responsible for all 6,000 eurozone banks, arguing that during the financial crisis, even relatively small banks can threaten the entire financial system. Under the compromise with some national regulators, the ECB will oversee large banks with more than 30 bn euros in assets or with 20% of national GDP (around 200 of the biggest European banks). Single Supervisory Mechanism is also a precondition for the possibility of direct recapitalization of banks by the European Stability Mechanism (ESM) – the eurozone’s permanent bailout fund.

Banking Union confers strong powers on the ECB, with an option for non-euro countries to join on a voluntary basis. In contrast to the European Banking Authority, which sets the rules under which all banks in the EU must work within, the ECB would be able to impose its will on the national banking regulators. National supervisors outside the euro zone will continue to behave as before and the European Banking Authority will remain the common banking regulator for them [The Economist 2012]. The ECB will cooperate with the EBA within the framework of the European System of Financial Supervision. EBA will continue developing the single rulebook applicable to all 27 Member States

and make sure that supervisory practices are consistent across the whole Union. The EU states outside the euro area can sign up to the banking union, although most non-euro based countries hesitates.

The complex regulatory structure, based on a number of regulatory agencies with overlapping prerogatives, will most probably produce more stable, but not necessary more efficient financial system. Regulatory complexity and uncertainty are particularly harmful for small banks for whom the regulatory requirements are overwhelming [KPMG 2013].

3. BANKING SECTOR IN POLAND: THE IMPORTANCE OF COMPETITIVE FRAMEWORK

Poland has a relatively low concentrated banking sector, based on traditional bank business model. Foreign capital dominates, constituting 61% of banking assets of fully capitalised subsidiaries and 4% of branches of foreign institutions, but the Treasury is also an important shareholder (22% of total assets). Polish private capital dominates in small, niche oriented banks (6% of total assets) and the cooperative sector plays important role in the local markets (6% of total assets). Overall, the Polish banking sector in the post-crisis period is characterized by good performance as well as by solid and sound fundamentals, as indicated by table 2.

Table 2

Cooperative and commercial banks' selected performance indicators (%)

Types of banks:	ROA				ROE				CI			
	2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
Total sector	0.81	1.03	1.26	1.22	8.37	10.21	12.64	11.19	54	52	51	51
Commercial	0.83	1.10	1.27	1.23	8.22	10.19	12.71	11.19	53	51	49	49
Cooperative	1.18	1.12	1.21	1.19	10.46	10.46	11.59	11.23	72	69	67	66

Source: UKNF [2012 and 2013].

Cooperative banks represent 90% of total number of banks, 25% of bank branches and 20% of employment (table 3), but only 6% of total assets. They are small, locally based institutions: majority (around 350 banks) have assets below 20 millions of Euro, and only 66 are relatively large, with assets above 50 million euro [BFG 2010]. Consequently, they have excess capacity and considerable growth potential.

Table 3

Cooperative sector in Poland: basic statistics

Basic data:	1995	1997	1999	2001	2003	2005	2007	2009	2011
No. of banks	1510	1295	781	642	600	588	581	576	574
No. of branches	n.a.	2550	2619	2878	3151	3598	4014	4374	4600
Employment (000)	n.a.	14,6	14,4	16,0	18,0	28,6	30,1	31,7	32,8
Capital adequacy (%)	8,4	11,1	12,8	13,9	14,2	14,7	14,0	13,4	13,4
Assets (bil. PLN)	n.a.	11,3	15,4	21,5	25,7	36,4	48,9	61,7	78,4
Loans (bil. PLN)	n.a.	5,5	8,1	11,3	14,8	18,0	27,9	36,2	44,3
Deposits (bil. PLN)	n.a.	7,6	11,1	16,1	19,1	25,0	32,2	45,7	60,0
<i>ROE</i>	n.a.	14,3	30,8	18,0	19,4	12,2	17,3	10,5	11,9
<i>C/I</i>	n.a.	71,5	74,2	69,4	75,1	72,2	70,0	73,0	68,7

Source: based on NBP Summary evaluation of the financial situation of Polish Banks (various years).

The main objective of the Polish banking sector restructuring since the 1990s has been a creation of a competitive market structure. That's why at the beginning of this process in 1989, the NBP branches were divided into nine independent banks, to foster competition. Also later on, there were frequently a pro-competitive regulatory interventions. Today, the level of concentration of the Polish banking sector remains low in comparison with other EU countries. At the end of 2009, the share of the five largest banks in total banking assets in was 44%. At the same time, the CR5 concentration ratio was 72% in Slovakia, 93% in Estonia, and 62% in Czech Republic [Pawłowska 2012]. This characteristics of the Polish banking markets – a competitive banking environment – was a dominant feature attracting new players in a post-crisis period, such as the re-entry of Spanish Santander. In the financial literature, there are inconclusive evidence on the role of competition for bank stability and efficiency, and recent papers stress the role of individual country's regulatory framework [e.g. Beck et al. 2013]. The Polish banking market presents an empirical evidence that competitive market structure and adequate regulation perform well both in a pre-crisis and in a post-crisis environment.

The cooperative sector follows a two-level model and in 2013 there were two cooperative associations, one headed by BPS SA (Bank Polskiej Spółdzielczości SA) with 366 banks; another by SGB-Bank (Spółdzielcza Grupa Bankowa) with 207 banks, and one cooperative bank which operates independently (Krakowski Bank Spółdzielczy). Cooperative banks' mission is to support their customers as well as members of local communities, as opposed to profit-maximizing objectives of commercial banks [Siudek 2010]. Among a number of locally active financial institutions, banking activities are conducted also by

unregulated (till recently) credit unions (SKOKs). Although SKOKs represent only 1.4% of total banking sector's assets, they have grown at a remarkable rate since their implementation in 1992. SKOKs operate among low income individuals, especially those who do not have account with other banks. In 2010, there were 61 SKOKs with 1800 branches, serving over 2 million customers (15% of Polish households). Their assets in June 2010 were over 4 billion US\$ (WB 2012). The Credit Union Act of 1995 defined SKOKs as self-regulatory organizations, which gave them flexibility and low-cost advantage. The new Credit Union Act of 2009, implemented in October 2012, provided for external supervision and depositors' protection, similarly like for the rest of the regulated banking institution, commercial and cooperative. This was a move in a right direction, as many surveys have indicated that customers cannot differentiate between self-regulated SKOKs and fully regulated cooperative and commercial banks, while SKOK's possessed in 2011 deposits equal to 27% of that in cooperative banks [UKNF 2013].

Poland's cooperative banks have a limited scale and scope of operations. At the end of 2011, loans constituted 55% of their assets: 40% for the households and micro enterprises and 15% for the firms, mostly SMEs, followed by interbank loans (30%) placed in the associating banks. They financed their assets in 77% by deposits, mostly from households. The crisis changed their strategies, giving incentives for moving into more risky enterprise financing (table 4), the area less attractive for commercial banks.

Table 4

Changes in loan structure of commercial and cooperative banks (%)

Loan structure:	Commercial banks			Cooperative banks		
	2008	2010	2011	2008	2010	2011
Households	55.7	62.0	61.8	74.7	70.5	67.1
Firms	40.2	31.3	30.0	19.8	22.1	24.1
Local and central governments	3.8	6.2	7.8	4.9	6.7	8.0
Others	0.3	0.5	0.4	0.6	0.7	0.8

Source: BFG [2011].

The cooperative model has performed well in the post 2008 crisis period in a number of countries. In Poland, the cooperative banks, although less profitable in the pre-crisis booming years, have a similar post-crisis performance to that of commercial banks (table 2). For some cooperative banks the crisis years were the most profitable, thanks to retaking some businesses and customers from commercial banks, which were contracting some activities. Overall, the Polish cooperative sector in the post-crisis period is characterized by good performance and important role in local SME financing.

4. THE CASE STUDY OF THE POLISH COOPERATIVE BANKS: THE RESULTS OF A SURVEY

The report by Oliver Wyman, based on cooperative banks' global survey [Oliver Wyman Report 2012], indicated key success factors for cooperative banks, such as efficiency, customer satisfaction and proper handling of regulations. A similar cooperative bank survey was run by the author in early months of 2013, with the aim to analyze how the cooperative banks understand the challenges ahead¹. The key question/answers are analyzed below, for the whole cooperative sector and for subsections of small and large cooperative banks.

- Regulatory challenges

Both for the Polish cooperative banks, and globally, the implementation of post-crisis regulations will impose new considerable costs, concerning the quality of capital, higher capital requirements, introduction of leverage ratio and new liquidity standards [McKinsey 2011]. According to cooperative bank forecasts, with a stricter definition of tier 1 capital, many smaller banks may have a short-term problem with adequate capital. In Poland, the biggest problem seems to be the implementation of CRD IV liquidity requirements (fig. 1).

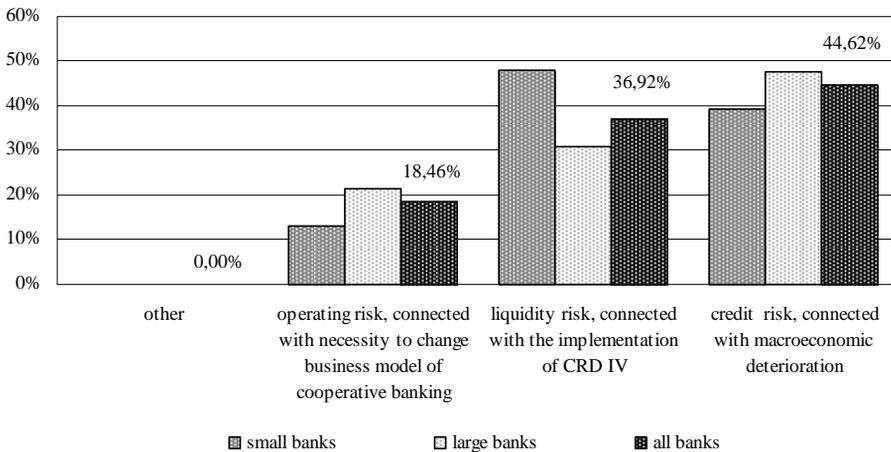


Fig. 1. Major risks for the cooperative banks: the result of bank survey

Source: own research, 2013.

In the Polish two level cooperative sector model, the subordinated cooperative banks have excess liquidity from local deposits, which they place in the association banks. However, those transactions are treated as interbank transac-

¹ The survey was conducted with the help of Krzysztof Kil from Dept. of Finance, UEK.

ctions and do not count as required liquidity for associating banks. If associating banks start to take deposits directly from the market, it will be in direct competition with the subordinated banks, thereby risking problems with their owners. In the Polish model, associating banks coordinate and control subordinated banks, but at the same time are owned by them, which sometimes create a stalemate.

The regulatory body (KNF) have suggested a compromise by implementing the Individual Protection Scheme (IPS), which was used by some cooperative groups, e.g. in Spain. This organisational innovation is intended to ensure the solvency and liquidity of a group of affiliated institutions (BIS, 2010). It entails all participants relinquishing to the central body of the IPS the capacity to determine and implement business strategies and internal risk control. The second pillar comprises the mutual liquidity and solvency pacts between the participating cooperative banks and the third pillar is a commitment to the stability of the agreements. Thus the IPS results in much tighter cooperation within a group of affiliating banks than in the past. However, there is a considerable resistance among most Polish cooperative banks to giving up their independence and the scheme is immensely unpopular (fig. 2).

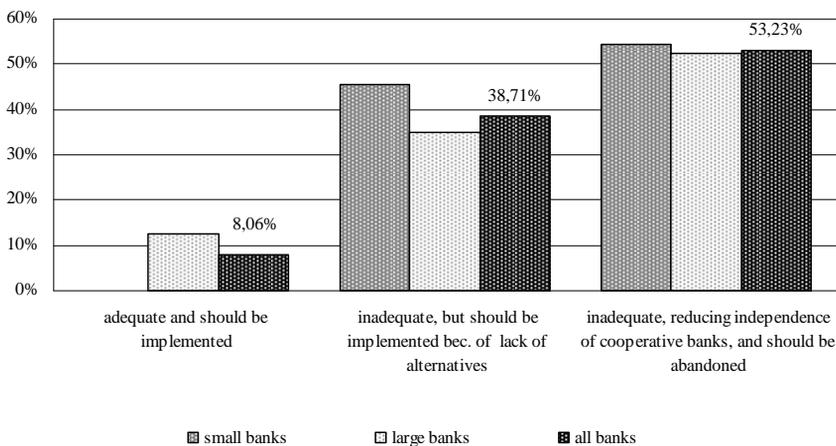


Fig. 2. The cooperative banks' attitude to the IPS proposal: the result of bank survey
Source: own research, 2013.

- Strategic challenges for the cooperative banks

So far, it has not been the intention of the regulatory authorities to interfere directly with the cooperative banking structure, as it was done in the 1994 and 2000. However, some actions may be advisable, considering the regulatory challenges ahead. Regulatory intervention may be aimed either at strengthening the position of „mother banks” for cooperative groups, or at encouraging

the strongest cooperative banks to demutualise. However, this option was immensely unpopular in the bank survey: only 3% of surveyed banks accepted this notion, while the majority (77%) suggested that the large cooperative banks should operate independently within the cooperative structure. Another solution is to split the sector, making IPS obligatory only for small cooperative banks. This solution will result in a considerable weakening of the cooperative associations, but may be most acceptable.

In the survey, the cooperative banks indicated many regulatory threats ahead, the dominant one connected with the implementation of CRD IV directive, as was analyzed above. As for strategic priorities, cooperative banks seem to be ready to gain from post-crisis favourable environment, indicating a need of expansion and increase in operational efficiency as major long-term goals. On the other hand, they do not sense any long-term fundamental change in their competitive position, as according to the survey, cooperative banking share will increase in the future only marginally, to 10%.

5. CONCLUSIONS

Economic theory provides contrasting evidence as to the impact of bank regulation and supervision on bank performance. In the post-crisis period, most research in this area has concentrated on the regulatory impact on large global banks. However, the post-crisis overregulation has created an immense burden particularly for smaller banks. The data presented in the empirical part of the paper, when analysing the Polish cooperative banks, is a case in the point.

The Polish banking sector underwent a comprehensive and painful restructuring in the 1990s, resulting in an efficient regulatory and institutional framework. However, the post-crisis regulatory architecture creates a new environment, forcing commercial banks to be oriented towards owners' markets rather than the Polish one (particularly in the Banking Union scheme). Banking Union is giving strong supervisory powers to ECB and creates a mechanism of shared bank rescue burden for the eurozone members. Instead of deleveraging big banks, it will create another rescue vehicle for them, increasing moral hazard behaviour.

The cooperative banks, with their traditional business model, have come out from 2008 crisis stable and with satisfactory profitability. However, those were short-term advantages. Today they face many new regulations and new institutions to comply with and their long term success will depend on efficient accommodating to new regulations and market opportunities.

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Cooperative banking – retail banking, carried out by locally-based small institutions, for years has played an important role in their local environments, enhancing bank reputation and trust. However, pre-crisis deregulation and the growing size and complexity of banking firms and post-crisis restructuring based on massive public assistance aimed at stabilizing the largest banks, create a hostile environment for locally based, small banks. Despite many declarations, the competitive, customer-friendly banking market is no longer a regulatory priority in the post-crisis era.

Consequently, this paper analyses the relative position and future prospect of small banks, based on the example of Polish cooperative banking. It concentrates on the question of whether those banks are indirectly discriminated against and in which way the sector could be aided.

WPLYW POKRYZYSOWEJ ARCHITEKTURY REGULACYJNEJ NA POLSKI SEKTOR BANKOWOŚCI SPÓŁDZIELCZEJ

Bankowość spółdzielcza, prowadzona przez małe instytucje dobrze osadzone w lokalnych społecznościach, odgrywa ważną rolę w kreowaniu konkurencyjnego środowiska bankowego oraz budowaniu zaufania do instytucji bankowych. Jednak zarówno przedkryzysowa deregulacja i globalizacja rynku finansowego, jak i pokryzysowa restrukturyzacja, oparta na konieczności stabilizacji dużych banków poprzez ogromną pomoc publiczną, stworzyły nieprzyjazne otoczenie dla długookresowego rozwoju tych instytucji. Pomimo wielu deklaracji, konkurencyjny i przyjazny dla klienta rynek bankowy nie jest priorytetem regulacyjnym w okresie pokryzysowym.

Dlatego w artykule poddano analizie pozycję konkurencyjną i wyzwania strategiczne stojące przed polskimi bankami spółdzielczymi, koncentrując się na pytaniu, czy banki te są pośrednio dyskryminowane przez pokryzysowy porządek regulacyjny.