World Council of Credit Unions, Inc.

Cooperative Banks, Credit Unions and the Financial Crisis

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Introduction

World Council of Credit Unions (WOCCU) is the leading trade association and development organization for the international credit union movement, representing more than 49,000 cooperative owned not-for-profit credit unions in 96 countries. The global credit union movement holds aggregate assets of more than US$1.1 trillion in the retail financial services market. Worldwide, cooperatives financial institutions of all types serve an estimated 857 million people.

This paper addresses three key areas that will be discussed at the Expert Group Meeting on Cooperatives panel discussion on credit unions and cooperative banks in the financial crisis. These areas include: 1) how credit unions and cooperative banks have been affected by the global financial crisis; 2) the cooperative institutions' response to the provision of financial services; and 3) challenges that restrict cooperative banks' and credit unions' ability to broaden their access. Most germane to this topic is the fact that not a single credit union, anywhere in the world, has received government recapitalization as a result of the financial crisis and they remain well capitalized.

1. How are credit unions and cooperative banks affected by liquidity issues and financial constraints and what strategies are being deployed to meet these challenges?

Credit unions and financial cooperatives contribute significantly to ensuring access to affordable financial services, access that is especially critical given the current economic crisis. Credit unions often provide savings, credit and related financial services to communities that otherwise may not have access due to geographical, cultural or financial challenges facing individuals. Credit unions are best able to accomplish these goals and achieve their intended social and financial missions within a supervisory structure that understands and takes into account the nature, risks and methodologies of credit unions.

Although the causes of the current economic crisis are complex, few doubt that the skyrocketing number of mortgage loan defaults and foreclosures during the past few years were a primary catalyst, with the resulting drop in housing values serving to exacerbate the problem. The primary culprits included subprime mortgage loans characterized by high interest rates with large interest-rate re-sets, negative amortization, lack of sufficient underwriting and other indicators of fraud.

Unlike other types of financial institutions, credit unions originated few if any subprime mortgage loans with these characteristics and have not otherwise been the cause of the current economic circumstances. Credit unions' generally conservative lending practices and philosophical mandate to place member needs ahead of institutional profits have, in effect, restricted financial cooperatives from engaging in careless lending practices and distinguished them from institutions responsible for making unscrupulous loans in recent years.

The table below provides a sampling of how credit unions have been impacted by the financial crisis in several major markets.

Sampling of the Impact of the Financial Crisis

Country	How have CUs been included or excluded from recent financial rescue programs?	What changes have been made to deposit insurance in the banking and CU sectors?	Have CUs been positively, negatively, or not at all affected by the recent market disruptions?
Australia	The regulator has urged higher liquidity standards and may require higher capital levels. Credit Unions (CUs) are currently at 14% risk-weighted capital. The regulator originally increased liquidity requirements to 15%. They are being dropped down to 12%.	On Oct. 13, 2008, the government announced an unlimited guarantee on deposits in banks, CUs and building societies for the next three years. There has never been explicit deposit insurance until this point. The government is still identifying details and funding. It is also codifying the limits and will cap the base guarantee at US$750,000 per account holder. (New Zealand has followed Australia, also announcing a deposit guarantee system for the first	Property values, in general have not declined and delinquencies have remained low. The securitization market has ceased functioning, causing big banks to seek retail deposits. This has increased the rates on deposits and tightened margins for CUs. Deposit insurance coverage seems to be helping mobilize deposits.

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		time. CUs may opt-in.)	
Brazil	Small banks are struggling and their solution is to sell loan portfolios to big banks especially to government - owned banks. The government has enacted a law allowing government-owned banks to acquire private banks with financial difficulties. The exporters are having difficulty obtaining external financing. Many investment projects are being postponed.	There have been no changes.	CUs are not yet feeling the effects of crisis. They have high liquidity and are financed with their short- and medium-term resources. Long-term financing also is available with the government's development bank.
Canada	The government has offered a guarantee facility for federally regulated financial institutions, which includes some credit union organizations. This is a guarantee of inter-banking lending that could be purchased at high rates of interest. There have been no changes to the deposit insurance for banks.	CU deposits are insured at the provincial level. In British Columbia the government has removed the limit on the value of deposits that will be guaranteed in CUs.	To date, the impact of the global financial crisis has been relatively mild in Canada. Canadian CUs have been able to manage the downturn and continue to lend to their members. In 2008, the CU system experienced healthy loan growth of 7.3%. Some stresses are emerging in the consumer credit and mortgage markets, but these appear manageable and are normal in recessionary conditions.
Caribbean	There have not been any	Jamaica and Trinidad &	Some CUs have been

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	rescue programs announced in the region. They are seeing a decrease in tourism, remittances and foreign direct investment.	Tobago CU Leagues have stabilization funds. Central banks in the region are warming up to deposit insurance for CUs, in part due to the crisis, but credit unions do not yet have access.	directly affected by the global financial crisis but tourism has held up better than anticipate in the region. Credit unions closely associated with tourism, shipping and sugar have been most severely affected. These industries have suffered from employee layoffs, salary cuts, reduced workweeks or imminent closure. CUs with high dependencies on remittance inflows as part of their operations have also been affected.
Great Britain	CUs have been included in the government's Financial Services Compensation Scheme since July 2002, when they came under the Financial Service Authority's regulatory regime. CUs are treated the same as other deposit takers in this regard. The government is not planning capital infusions into CUs.	Since the guarantee level has risen to £50,000 from £35,000, CUs are treated like other deposit-taking institutions. In 2008, regulators eliminated the co-insurance concept through which 100% of the first £2,000 on deposit and 90% of the remaining £33,000 was covered. Now 100% of the full amount on deposit is insured.	Credit unions attract more savings as depositors look for safer locations for their money. Consumers also are spreading their deposits around to multiple institutions to assure they are fully covered by the compensation scheme. Some CUs also report increased loan demand. A few also have reported increased delinquency.
Ireland	CUs have not been included in the recent financial sector rescue program. The government has established a two-year	On Sept. 20, 2008, Ireland became the first country facing the current crisis to increase its deposit insurance levels, raising the amount	There seems to be a positive impact with a) the government's deposit guarantee in CUs which is 10 times higher

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	unlimited guarantee on liabilities incurred by Irish banks and building societies. The government will raise €1bn over two years from the banks covered by the state guarantee. A new committee will oversee directors' and executives' salaries and bonuses. Bonuses will be linked to a risk reduction and each bank's long-term sustainability.	covered from €20,000 to €100,000. This is a two-year increase. For the first time CUs in the Republic of Ireland will be covered by the government's Deposit Protection Scheme. The details of how CUs will pay for this coverage are still being finalized. There has been no modification for Northern Ireland's CUs, so a disparity now exists between the coverage levels for members' savings in the two countries.	than the previous CU-run deposit insurance system; and b) with banks lending less, people are borrowing more from CUs. For the first time in a number of years, the movement's loan-to- asset ratio is above 50%. CU investments, while risk averse and well diversified, have been badly affected by the global financial crisis throughout 2008, and in particular the second half of the year. This continues to be an issue in 2009.
India	There has been limited impact and the government still plays a large role in banking through tight restrictions and ownership of several large retail banks.	There have been no changes. Cooperative banks and commercial banks have the same coverage levels.	Publicly traded banks have been affected by large decreases in the stock market values. Interbank lending markets have become extremely expensive. Some coop banks are lending excess liquidity. The Reserve Bank of India has decreased required statutory liquidity reserves.
Poland	CUs have not been included in government legislative packages related to the current	On Oct. 16, 2008, the CU movement's deposit insurance company increased coverage from €22,500 to €50,000 per	There has been substantial growth, both in deposits and CU credibility. Both CUs and

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	financial crisis.	account. Banks have not yet increased their coverage levels but are expected to do so in May, 2009.	their insurance company were included in state anti-crisis legislation. We expect further turbulence connected with state budget deficit, a decrease of productivity and construction activity. Mass layoffs may influence credit union members. Fluctuations in the Polish currency exchange rate results in serious problems for companies and, to some extent, for consumers.
United States	CUs are not part of the government's plan to infuse capital into banks by purchasing up to 3% of their capital in non-voting preference-preferred shares which would return set levels of dividends. CUs are discussing whether to access this fund. The federal CU regulator's central liquidity facility has received approval for increased activity.	On Sept. 30, 2008, the government passed legislation increasing deposit insurance levels for the bank, thrift and CU deposit insurance funds from $100,000 to $250,000 per account. This took affect Dec. 31, 2008 and remains in place for one year. All federally-insured credit unions are facing an aggregate $5.9 billion in insurance costs related to the National Credit Union Administration's conservatorships and related measures for U.S. Central Federal CU and Western Corporate Federal CU.	CUs have experienced positive and negative impacts from the financial crisis. Fixed deposits have increased $52 billion in recent months and CUs are experiencing unprecedented positive press coverage as a safe haven in the economic storm. CUs in certain states, such as California and Florida, are suffering from weakened regional economies.

2. What is the cooperative response to the provision of financial services?

According to a March 15, 2009 *Wall Street Journal* article, in 2008 American banks cut back on lending, while loans by American credit unions rose 7% to more than $575 billion, an amount up by $35 billion compared to the previous year. The article also noted that U.S. bank loans declined about $31 billion during this time. As indicated above, credit unions in many countries have also realized an increase in savings during the crisis as consumers have attempted to de-leverage their family finances.

As an active participant in the United Nations' Year of Microcredit and the broader microfinance community, WOCCU has continuously stressed the importance of not-for-profit financial cooperatives that take a savings-led approach to development. This approach proved successful for credit unions during Ecuador's financial crisis of 1999, when the largest banks collapsed while credit unions continued to operate. Similarly, during Jamaica's banking crisis of the late 1990s, credit unions on the island weathered the storm in much better shape than the four largest banks that were consolidated with assistance from the International Monetary Fund. These isolated national-level experiences are now being replicated at the global level.

For more than 150 years, credit unions and financial cooperatives have provided affordable financial services to millions of people around the globe. They serve members of all income levels, ethnic backgrounds, political beliefs and religions, in even the most challenging environments. Whether rural or urban, located in communities struggling with political unrest or confronting economic depression, credit unions serve people otherwise excluded from the financial system by offering them access to high quality and affordable financial services.

Credit unions help overcome the financial market imperfections that perpetuate poverty by expanding and deepening access to financial services. For many of the world's poor access to finance marks the difference between simply surviving and thriving. People without access to financial services have less opportunity to generate income, accumulate assets or build human capital.

For more than 35 years, World Council of Credit Unions (WOCCU) has worked with credit unions worldwide to expand access to financial services in a sustainable manner. WOCCU currently has 17 programs in 15 developing countries. One such program is the credit union growth program in partnership with credit unions in Colombia, Kenya and Rwanda, with funding from the Bill & Melinda Gates Foundation. During the three-year program, WOCCU is working with participating credit unions to double their membership and expand outreach to very poor members.

Below is a snapshot of credit union membership in Colombia, Kenya and Rwanda to demonstrate how credit unions are serving the poor and providing an entry to the formal financial system. The survey findings are based on interviews with 6,300 walk-in members at 31 credit unions in 2007. These 31 credit unions serve more than 600,000 members. Survey results have been used to create detailed member profiles so that the credit unions can better tailor their services to the unique demands of their members.

Key Findings of Credit Union Membership Surveys in Colombia, Kenya & Rwanda:

- **Half live below the national poverty lines and 24% of respondents live on less than $2/day.**
- **Nearly half are first-time users of formal financial services.**
- **One-third live in rural areas.**
- **Nearly one-third include a microentrepreneur or small business owner in their household.**
- **37% of respondents are women.**
- **One in four have a primary school education or less.**
- **One in five households farm crops.**
- **Nearly 90% have recommended their credit union to friends or family.**

However, credit unions do not focus on serving just the poor. In fact, a credit union with mixed outreach to the poor, working poor, working class and middle class has the capacity to reach greater numbers of people living in poverty than an institution that exists to serve only the poor. A diverse membership base also gives credit unions a competitive advantage in operations. The loans and deposits of the relatively wealthier members drive growth, profitability and sustainability of the institutions, enabling them to provide a range of affordable financial services to poor members while keeping costs low. Additionally, higher income members who own farms or small businesses provide important sources of local employment for low-income individuals. Most importantly from a macroeconomic perspective, credit unions that are able to help ***create*** middle classes in societies. The existence of a broad middle class greatly contributes to political and economic stability – including development indicators.

Like people of higher income levels, the poor need convenient access to an array of financial services beyond credit, such as savings, insurance, money transfers and card services. Credit unions provide these services. In dozens of countries credit unions offer remittance service to their members to help capture savings and provided a needed service. Based on a 2005 survey of 502 credit union members in Guatemala, the survey revealed that the credit unions' remittance services reach populations that are largely unbanked. Key characteristics that stand out:

• Women receive the vast majority (73%) of remittances.
• The average age of recipients is 40, and male recipients tend to be older (average 46 years old) than female recipients (average 38 years old).
• Education levels are very low–only 20% of the remittance recipients surveyed have more than primary school education.
• Ethnic backgrounds are diverse. In some regions, 55% of the recipients have an indigenous dialect as their first language.
• Without remittances 62% of households would have a per capita cash income of less than $1 per day.

Since WOCCU began its International Remittance Network (IR*net*) product in 2001 over US$2 billion has been transferred through the system.

3. What challenges do cooperative banks and credit unions face to broaden their outreach?

To increase credit unions' ability to create a middle class, aid in the economic recovery and support financial sector stability, five principle restrictions that exist in many jurisdictions must be lifted:

1) Provide credit unions with direct access to payment, clearing and settlement systems. This includes direct access and membership in card networks, which are often owned and operated by commercial banks to the exclusion of other depository institutions as a mechanism to limit competition. A 2008 survey of 60 countries indicates that credit union systems in 41 countries do not have direct access to national clearing and settlement systems (see Attachment A for details).

2) Provide direct access to the central bank's liquidity window. This is largely correlated to the point above.

3) Lift restrictions on small business lending.

4) Assure that access to deposit insurance systems is on par with that of commercial banks in places like Barbados, Jamaica and Mexico so as to not dissuade consumers from saving with financial cooperatives.

5) Provide credit unions the ability to access and issue alternative forms of capital in markets where credit unions and/or cooperative banks exhibit the ability to issue and manage such capital.

We recognize that in addition to these regulatory barriers, financial cooperatives themselves must exhibit the capacity, skills and vision to achieve change. Many of the services and resources identified above will require credit unions to be subject to prudential supervision – this would be a welcomed development for most markets. However, some of the barriers above are legislative in nature. The most advanced credit union systems around the globe are built upon legislative frameworks that recognize the unique nature of financial cooperatives. One of the surest ways to develop such a framework has been for countries to enact credit union-specific legislation. This can ensure an appropriate set of financial management disciplines, creates avenues for building and distributing capital, establishes governance controls and sets up a prudential supervisory framework for a large number of small institutions (see Attachment B).

Conclusion

In comparison to other financial institutions, credit unions and cooperative banks have performed exceptionally well during the current economic crisis notwithstanding the problems that have occurred. This is due in part to the relatively straight-forward operations of most credit unions, their commitment to member service rather than short-term profit maximization, and reasonable executive pay packages and incentives structures that do not incent excess risk-taking similar to that offered by many commercial banks.

WOCCU is committed to assisting its members at a national level and working at the global level to ensure the interests of mutual institutions are considered as we go through this process of regulatory reform.

Attachment A

Survey Results: **Do credit unions have direct access to payment and settlement systems?**

Total responses: **60**
YES: **19** countries; NO: **41** countries

YES	NO	NO
Australia	Azerbaijan	Lesotho
Bahamas	Barbados	Macedonia
Brazil	Belize	Moldova
Canada	Bolivia	New Zealand
Colombia	Cameroon	Nicaragua
Costa Rica	Cayman Islands	Panama
Ecuador	Chile	Peru
Gambia	Dominica	Romania
Great Britain	Dominican Republic	Russia
Honduras	El Salvador	South Africa
India	Estonia	Sri Lanka
Kenya	Ghana	St. Vincent
Lithuania	Grenada	St. Kitts
Paraguay	Guatemala	Taiwan
Philippines	Guyana	Tanzania
Poland	Hong Kong	Thailand
Seychelles	Indonesia	Trinidad & Tobago
Tonga	Ireland	Uganda
USA	Jamaica	Ukraine
	Latvia	Uzbekistan
		Zimbabwe

Source: WOCCU Internal Survey 2008

Attachment B

Jurisdictions with Credit Union/Cooperative Bank Specific Legislation*

Africa Democratic Republic of Congo Kenya Senegal South Africa **Asia** Hong Kong Korea Taiwan Uzbekistan Caribbean Belize Bermuda **Europe** Czech Republic Estonia Great Britain Ireland Latvia Lithuania Netherlands Northern Ireland Poland Romania Russia Ukraine	**Latin America** Bolivia Ecuador Mexico Uruguay **South Pacific** Fiji New Zealand Papua New Guinea Solomon Islands Tonga **North America** Canada Alberta British Columbia Manitoba New Brunswick Newfoundland Nova Scotia Ontario Prince Edward Island Quebec Saskatchewan United States

*Source: WOCCU's Guide to International Credit Union Legislation.