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PRINCIPLE OF PROPORTIONALITY OF REGULATION IN COOPERATIVE SAVINGS & CREDIT UNION SECTOR

Summary: The reform of cooperative savings & credit union sector which introduced new organizational and regulatory solutions has been facing severe criticism due to the significant increase in the sector's regulation, especially with respect to the smallest credit unions. The purpose of the following paper is to assess the implementation of the Principle of Proportionality of Regulation in the sector of Polish credit unions and to do research into the perception of regulation changes in the sector among the employees of selected cooperative savings & credit unions in the Wielkopolska province. In the majority of implemented changes, the Principle of Proportionality has not been taken into account. It is only the Polish Financial Supervision Authority which considers in its recommendations the necessity to differentiate the obligations imposed with respect to the particular cooperative savings & credit union's scope of activity. The employees of the institutions in question have assessed the reform of the sector negatively, however, their opinion on proportionality is equivocal.

Keywords: Principle of Proportionality, regulations, cooperative savings & credit unions.

JEL Classification: G21, G28, L38.

Introduction

In the past few years significant regulatory changes have been introduced to the financial services market of cooperative savings & credit unions which have existed in Poland for over 25 years. These reforms, despite the fact that they increased the service quality and the customers' safety, have resulted in the un-

ions' financial problems¹. On the other hand, it is the lack of sufficient regulation in the past that is considered to be the key reason for the current problems of the sector [Orzeszko, 2014, p. 153].

More restrictive safety regulations together with the decisions made by financial supervision apparatus and the irregularities in management have led to halting market activity of a quarter of all cooperative savings & credit unions on the Polish market². The introduced changes of legislation premises were seen as controversial mainly due to a large degree of the state's interference in the credit unions' activity (deflection of so-called regulatory pendulum) often without the sufficient adjustment period. Although the changes implemented in the sector partially resulted from political decisions and constituted the regulator's answer to the financial crisis, the range of use of the principle of proportionality commonly applied in regulations is worth considering. Thus, the purpose of the following study is the assessment of the application of the Principle of Proportionality of Regulation in the sector of Polish cooperative savings & credit unions and investigating the perception of regulatory changes in the sector among the employees of the selected credit unions in the Wielkopolska province. The analysis is conducted on the basis of the subject literature, interviews with the board members of several cooperative savings & credit unions in the Wielkopolska province and the conducted survey.

1. The Principle of Proportionality of Regulation in credit cooperatives

The principle of proportionality is used in many areas of law³. It is usually propounded that the regulations should be adequate to the established objectives and the state's interference into the rights and freedom of individuals should not be excessive [Kasiewicz, Kurkliński and Springer, 2013, p. 2; Kasiewicz, Kurkliński and Springer, 2014, p. 13]. This principle results from the Constitution of

¹ Increase in expenses due to the obligations of creating provisions leads to losses, which – because of the lack of the adequate level of own capital – can result in insolvency.

² Until July 2016 the number of cooperative savings and credit unions decreased by 14: the activity of 7 institutions was either suspended or they were partially announced bankrupt (SKOK Wspólnota, SKOK Wołomin, SKOK Kujawiak, SKOK Polska, SKOK Jowisz, SKOK Arka and SKOK Skarbiec), five were taken over by banks, one was taken over by another credit union and two other merged.

³ For example in election, administrative, criminal and constitutional law. In 2009 the Office of the Constitutional Tribunal published a document comprising the Tribunal's statements with reference to public law which use the principle of proportionality. These statements referred to such regulation areas as: commercial law, freedom of assembly, functioning of territorial self-government, security and order regulations, financial law, labor law [*Zasada proporcjonalności*, 2009].

the Republic of Poland (article 31, section 3) and the European Union Law [Stepkowski, 2010, p. 211-260; Kasiewicz, Kurkliński and Springer, 2014, p. 30]. Three significant elements can be distinguished within the principle [Balina, 2015, p. 591]: appropriateness, necessity and proportionality in the strict sense (the principle requiring to maintain the appropriate balance between the expenses incurred by the addressees of the regulation and the benefit attained by the society). It is the third element of the principle of proportionality referring to the selection of the golden mean that is mostly desired but, at the same time, the least often implemented in the legislative practice [Srokosz, 2011, p. 494-495; Kasiewicz, Kurkliński and Springer, 2014, p. 32]. For example, due to limited risk, the smallest cooperative savings and credit unions could function on the basis of simpler and less strict security regulations and the range and frequency of reporting obligations could also be limited.

The essential requirements of regulating the financial market which are considered public interest are: pursuit of eliminating financial system crises, which means maintaining the stability of the whole economy of a given country, and the necessity to protect the market participants who use the services rendered by financial subjects [Golędzinowski, 2009, p. 23; Gup, 2011, p. 42; Zalciewicz, 2013, p. 175-180]. Administrative interventions on the financial market assume the existence of an authority whose main goal is to supervise and intervene in the market institutions activity and the implementation of legal norms limiting the undertaken risk in the financial sector [Ancyparowicz, 2015, p. 11; Golec, 2016, p. 52].

However, the institutions operating on the financial market are characterized by high diversity and their possible financial difficulties or the bankruptcies of smaller market participants do not necessarily result in a financial crisis. Microfinance organizations include, among others, credit unions, and in Poland, mostly cooperative banks and cooperative savings & credit unions. These subjects due to, for example, the restrictions on the services that they can offer, do not take such considerable risks as commercial institutions. Cooperative banks have been postulating the increase in the regulator's use of the Principle of Proportionality, which is reflected in numerous scientific publications [Fontaine, 2007, p. 51; Stefański (red.), 2008, p. 13; Żółtowski, 2011, p. 47-50; Balina, 2015] and is widely discussed by the market practitioners⁴.

⁴ For example, in 2016 the Proportionality Board was created in the National Association of Cooperative Banks and its main goal is to work out detailed conclusions and recommendations for appropriate authorities with regard to the Principle of Proportionality.

The range of activity of most cooperative savings & credit unions when compared to cooperative banks is usually even more limited. Moreover, credit unions, the example of which are cooperative savings & credit unions, are mutual cooperatives. Thus, although in other banks the regulations in question are supposed to protect the depositors against excessive risks taken by the management, in cooperative savings & credit unions the depositors, being the owners, can influence the management decisions.

All the mentioned above arguments lead to a wide diversity of regulations in the credit union sectors. The World Council of Credit Unions, which associates credit unions, on one hand postulates the supervision of these organizations by a public agency, while on the other hand, describes in its publications various supervision models, ranging from no supervision through indirect supervision (corporate supervision) and supervision over the largest credit unions, up to full finance supervision [Branch and Grance, 2008, p. 13-15]. One should take into consideration the fact that in the EU countries mutual credit unions are exempt from the obligation of complying with a number of requirements which are listed in **Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms** [UE Directive, 2013].

2. Credit union sector regulations after 2012 versus the Principle of Proportionality

Until 2012 credit unions in Poland functioned on the basis of very characteristic of this sector legal regulations. Most prudential norms were in most cases created by the superior authority, namely the National Association of Cooperative Savings & Credit Unions [Act of 1995]. The supervision was of corporate character and was handled by the National Association as well. The key prerequisites of the introduced sector reform was, first of all the increase in the activity range and inefficiency of the National Association in terms of executing the prudential regulations⁵. Together with the introduction of the new Act on Credit Unions in October 2012 the rules of their activity were reformed (for example,

⁵ In 2014 this sector rendered financial services for over 2.6 million members. On the basis of the World Bank's report, it can be stated that enforcing adequate capital security was not sufficient. According to this report the capital adequacy ratio for cooperative savings & credit unions was 3% in 2009, while the requirements of the National Association were at the level of 5% and the recommendations of the World Council of Credit Unions stated that it should be at the level of at least 10%.

credit unions' activity went under the supervision of the Polish Financial Supervision Authority [Act of 2009]. Various regulative solutions have been gradually implemented since then – similar to those imposed on the institutions of the banking sector, for example: capital adequacy ratio, guaranteed deposits of Bank Guarantee Fund, obligation of keeping mandatory financial provisions according to the Accountancy Principles, obligation of checking creditworthiness and the Polish Financial Supervision Authority recommendations regarding risk management, licensing activity, acknowledging by the Polish Financial Supervision Authority changes in statutes and appointing presidents with the consent of the Polish Financial Supervision Authority [Pelc, 2013, p. 126-140].

The Principle of Proportionality of Regulation in cooperative savings & credit unions needs to be considered on two different levels: on one hand, the sector needs to be considered as a whole, and on the other hand, its internal diversity also needs to be taken into account from the point of view of the sector these norms resulted in the credit unions resemblance to banks disregarding the specificity of their activity (apart from the mentioned above mutuality, the social aspect of the credit unions activity and the limited membership should also be noted). It might be just the enhanced efficiency in the National Association regulations enforcement that would provide sufficient stability of the sector. While implementing new solutions intermediary supervision models were not taken into account. These models could comprise: introducing supervision only over the largest institutions, or supervising only the National Association whose competences would include supervising other credit unions, the latter of which was rejected during the proceedings in the Parliament [Grabal, 2015, p. 72]. When it comes to the prudential regulations the increasing resemblance to banking regulations can be observed⁶. This widening of the scope of the sector's regulations is commonly criticized, mainly due to disregarding the Principle of Proportionality [Herbert et al., 2014, p. 199-251; Ancyparowicz, 2015, p. 9; Fundacja Warsaw Enterprise, 2015, p. 14].

Considering the individual institutions of the sector can also give grounds for making remarks on the introduced reforms. The segment of cooperative savings and credit unions is internally diversified. Its image is mainly shaped by the largest institutions of the sector. At the end of March 2016 72% of the sector assets belonged to three credit unions with the assets of over 500 million PLN

⁶ In practice the norms regarding the required reserve are almost identical, in the construction of the capital adequacy ratio the risk of assets was taken into consideration, however, the ratio is calculated in a different way, namely the amount of write-downs is identical with those required in the banking sector.

(the biggest institution of the sector Stefczyk's Cooperative Savings and Credit Union comprised up to 56% of the sector's assets and almost 50% of all the members), while almost 40% of all the institutions accounted for the credit unions with the member number below 10 thousand [www 1, p. 6]. Moreover, according to the President of Polish Financial Supervision Authority – A. Jakubiak, who presented his opinion at the Senate Sitting in 2014: “It is the small, conservatively managed credit unions whose financial condition is best” [www 2]. The Constitutional Tribunal indicated the internal diversity of the cooperative savings & credit union sector in its resolution (K 41/12) of 31 July 2015 stating that the regulations introducing the supervision of Polish Financial Supervision Authority over small credit unions are non-compliant with the Polish Constitution. The state's supervision is permitted, however “the legislator is obliged by the Constitution to differentiate the legal supervisory means according to the diversified size of cooperative savings & credit unions and the range of their credit and depository activity” [Judgment of the Constitutional Tribunal, 2015]⁷.

On the other hand, Polish Financial Supervision Authority has begun to apply the Principle of Proportionality with respect to the recommendations intended for cooperative savings & credit unions (four of them were published before September 2016) [www 3]. In its recommendation “A-SKOK” concerning good practices of credit exposure risk management, the Polish Financial Supervision Authority for the first time distinguished three groups of cooperative savings & credit unions (group I comprises credit unions that comply with the following two criteria: balance sheet total is less than 50 million PLN and the number of members is smaller than 10 thousand; group II comprises credit unions with the balance sheet total of at least 50 million PLN but not more than 200 million PLN, regardless of the number of members, and credit unions with the balance sheet total of below 50 million PLN and at least 10 thousand members, and finally, group III – credit unions with the balance sheet total of over 200 million PLN regardless of the number of the members). The scope of recommendations made by the Polish Financial Supervision Authority depends on the size of the cooperative savings & credit union, for example smaller subjects were recommended to comply only with the main points of the recommendation, and when it comes to details – to use their own solutions. References to the Principle of Proportionality and the exemption from complying with some regulations regarding the smallest credit unions can also be found in other recommendations of the supervision.

⁷ The legislator was granted 18 months to adapt the appealed article of the law to the requirements of the Constitution.

Similarly to banks the smallest credit unions are not obliged to keep required reserves due to the applied in both sectors lump deduction amount from the reserves at the level of 500 thousand euro, however, they are not exempt from the reporting obligations with this respect [Resolution of the National Banks of Poland, 2015].

3. Regulations assessment by the employees of selected cooperative savings & credit unions

The reflection concerning the differentiation of regulations among the employees of cooperative savings & credit unions is worth considering. To what extent are these possibilities noticed by those who are mostly interested in the credit unions functioning and who, while in contact with customers, encourage them to use the services of the organizations being alternative to banks?

The purpose of the conducted study was the diagnosis of subjective assessments of the sector reform and the scope of proportionality of introduced regulations among the workers of the selected cooperative savings & credit unions. The study was conducted in the form of a direct sample survey among the workers of credit unions which have their branches within the boundaries of the Wielkopolska province in February 2016. 120 of filled questionnaires were collected from five different cooperative savings & credit unions that conduct their operational activity in 32 different places.

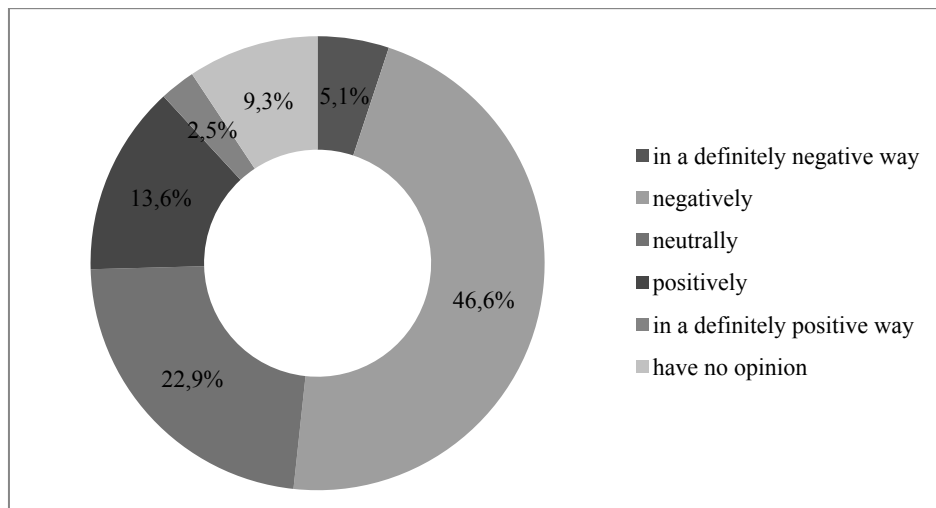


Fig. 1. Assessment of influence in legal regulation changes on cooperative savings & credit union activity according to respondents

Source: Own work on the basis of survey results.

The respondents quite unambiguously assessed the introduced regulations as influencing the institution in which they work in a negative way (Fig. 1). Over 50% of the respondents expressed such an opinion (5,1% of them assessed the changes as definitely negative). One should take into consideration, however, that some of the new legal solutions have influenced cooperative savings & credit unions in a positive way, for example, Bank Guarantee Fund (BGF) deposits or removal of the time limit on their credit activity. Therefore, 16% of the respondents perceive the changes introduced to the sector as positive ones

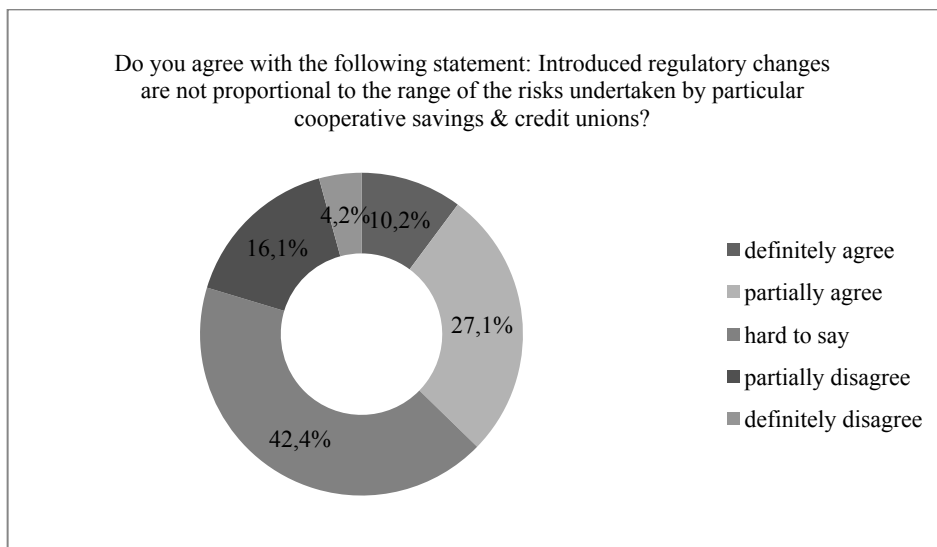


Fig. 2. Assessment of proportionality degree of introduced regulations versus degree of undertaken risk according to respondents

Source: Own work on the basis of survey results.

The assessment of the scope of proportionality of regulations is not unambiguous as up to 42% of the respondents do not want or cannot take a particular position (Fig. 2). Within the group of the remaining respondents more agree completely or partially that the Principle of Proportionality is in use. The investigated workers perceive the activity of credit unions as risky, that is why they consent to regulations. However, they might not have sufficient knowledge on the real risk involved as the information which they receive is mainly delivered by the management. As it is indicated by various practices in the credit union sector, the risk involved is often reduced by the sales of the selected types of assets.

Conclusion

The universal principle of law that takes into account protection of individual freedom gains special meaning in the sector of mutual credit unions. These organizations except for functioning almost like banks, are not banks as they operate within the limited range and scope and they offer services only to their owners.

In Poland many “mechanically transferred” regulations from the banking sector have been imposed onto credit unions, which resulted in disproportional interference into their activity disregarding the Principle of Proportionality. One should pay particular attention to the very smallest credit unions as in their case the legislator was obliged to revise the introduced regulations. The very first symptoms of taking the Principle of Proportionality into consideration have appeared in the recommendations of the Polish Financial Supervision Authority. However, it is the verdict of the Constitutional Tribunal that will certainly contribute to further legislative changes. The distinction between large and small cooperative savings & credit unions can comprise not only the scope of their activity but also the services which they offer. Such solutions are in use, for example, in Great Britain.

The higher degree of regulation is perceived by the workers of credit unions negatively, which is probably due to their current view on the reforms. The increase in regulations, in time, will definitely enhance the stability of the sector, but at present it inhibits sales. It can also be noted that in the past the main objective of credit unions was just to grow disregarding the safety precautions (if each person in need is granted a loan, some of them definitely will not be able to settle their debts).

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ZASADA PROPORCJONALNOŚCI REGULACJI W SEKTORZE SPÓŁDZIELCZYCH KAS OSZCZĘDNOŚCIOWO-KREDYTOWYCH

Streszczenie: Reforma sektora spółdzielczych kas oszczędnościowo-kredytowych wprowadzająca nowe rozwiązania organizacyjne i regulacyjne jest poddawana krytyce ze względu na znaczny wzrost skali uregulowania tego sektora, szczególnie w odniesieniu do najmniejszych kas. Celem opracowania stała się ocena stosowania zasady proporcjonalności regulacji w sektorze polskich unii kredytowych, a także zbadanie postrzegania zmian regulacyjnych w sektorze kas wśród pracowników wybranych kas w Wielkopolsce. W większości wprowadzanych zmian regulacyjnych nie uwzględniono zasady proporcjonalności, jedynie w rekomendacjach KNF zauważa się różnicowanie obowiązków, biorąc pod uwagę skalę działalności kasy. Kadra kas negatywnie ocenia reformy sektora, zaś ich opinia dotycząca proporcjonalności nie jest jednoznaczna.

Słowa kluczowe: zasada proporcjonalności, regulacje, spółdzielcze kasy oszczędnościowo-kredytowe.