

Co-operative Banks and the Role of Supervision

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Co-operative Banks and the Role of Supervision

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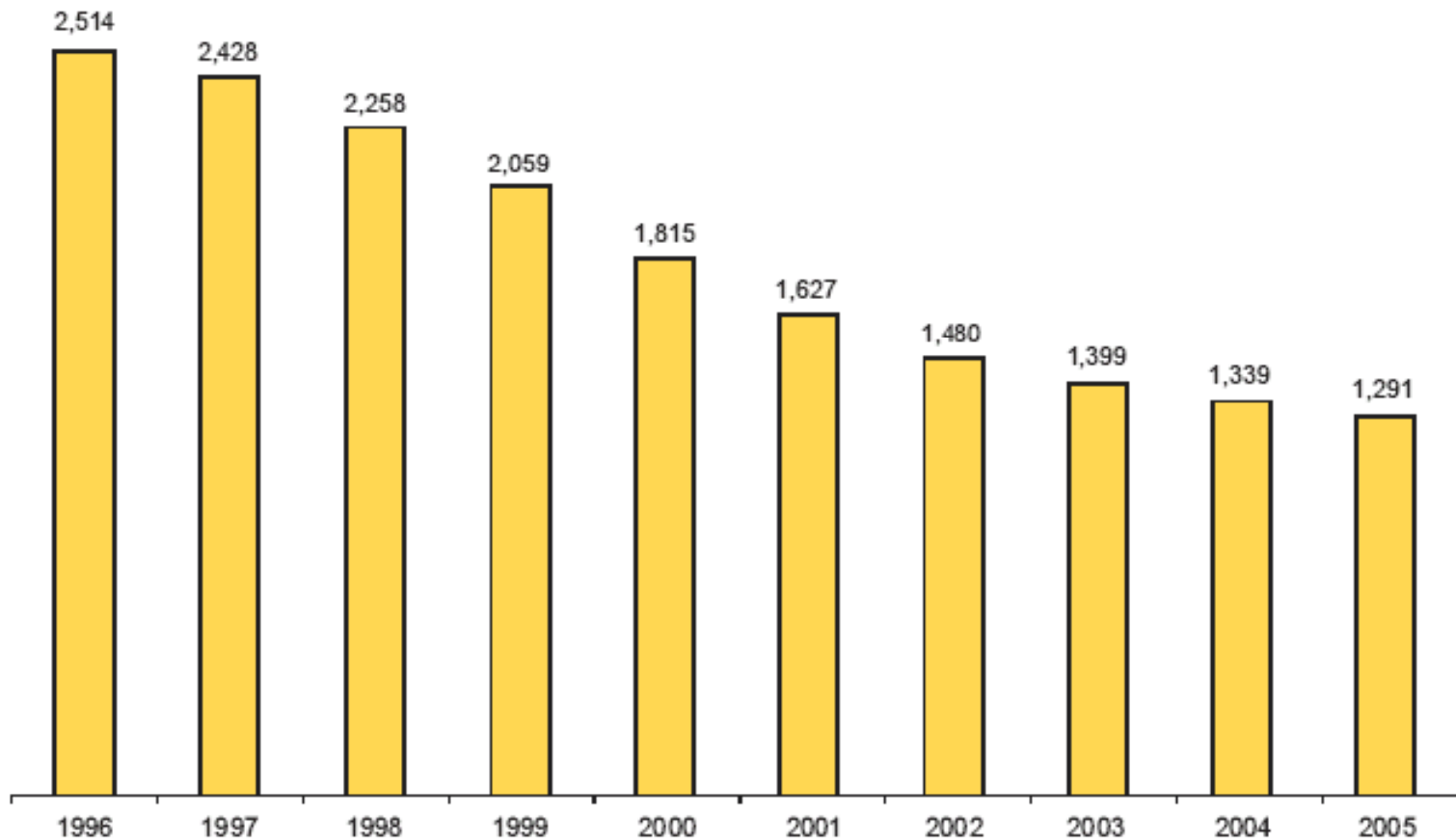
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Number of cooperative primary banks



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Number of banks by type of institution*

Type of institution	2005	2004
Lending banks	208	216
Institutions belonging to the savings bank sector	475	489
Institutions belonging to the cooperative sector	1,337	1,382
Other institutions	132	132
Total	2,152	2,219

* As at 31 December in all cases.

Co-operative Banks and the Role of Supervision

The most important difference between co-operative banks and private banks is that co-operative banks' annual accounts are not inspected by a private auditing company, but by a regional auditing association, to which all co-operative banks must belong. This obligatory membership of regional auditing associations was introduced in 1934 for all co-operatives for reasons that were not specific to banks. The regional auditing associations are not only responsible for the co-operative banks, but also for all other co-operatives. The associations of co-operative societies also have further duties, such as offering advice to and providing supervision for their member co-operatives as well as representing their interests in the public domain, in particular with respect to government agencies.

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Besides the solvency regulations, which are based on the standards of the Basel Committee and which in Germany are summarized in what is known as Principle I, weighted risk assets are to be covered with 8 % liable equity capital. Risk assets are essentially all balance sheet assets, i.e. in particular loans that have been issued.

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Like all banks, co-operative banks must also show sufficient liquidity. A liquid asset ratio must be calculated every month as well as observation ratios for the next 3, 6 and 12 months. This involves comparing the payment commitments with the funds available for payment for each particular period. This procedure is relatively new in Germany and was first adopted by the banks in the mid of 2000.

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The regulations regarding large loans serve to spread the risks. In Germany the classification large-scale lending is defined depending on liable equity capital. A large-scale loan is a loan that amounts to 10 % of the liable equity capital. No single large-scale loan may exceed 25 % of the liable equity capital, and all large-scale loans together must not exceed eight times the value of the liable equity capital.

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Since 1998 banks have - in accordance with the German Banking Law - been obliged to have suitable instruments in place for management, monitoring and control of risks, as well as suitable instruments with which to determine the financial position of the institution with sufficient accuracy at any time. These organizational obligations were adopted in German Banking Law in order to implement EC directives concerning the harmonization of regulations in the laws governing banking and securities supervision. Of course, prior to that co-operative banks already had - depending on their business activities - a risk management and a risk control systems, as well as an accounting and a management information system. However, these management instruments were all clearly improved after the introduction of statutory organizational obligations. Worthy of particular mention here are the new instruments for measuring interest rate fluctuation risks and address loss risks.

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Every bank and therefore every co-operative bank must have at least two members of its board of directors, who are not just active for the bank in an honorary capacity. (This is known as the Four Eyes Principle.) This principle is in the interest of mutual control and allows for representation in case of absence.

Co-operative Banks and the Role of Supervision

Besides the annual accounts that are submitted, the main sources of information for the Federal Financial Supervisory Authority are the auditors' report on the annual accounts, which the associations of co-operative societies produce each year. The Federal Financial Supervisory Authority does not receive these audit reports automatically, but only when requested. The Federal Supervisory Authority aims to request the auditors' reports for all co-operative banks, but is unable to meet this goal because of the current size of its staff. The auditors' reports for all larger co-operative banks are always requested, as are those for problem banks, while the others are requested on an alternating basis. The evaluation of the auditors' reports is generally carried out by the Deutsche Bundesbank; that is a valuable service to the Federal Financial Supervisory Authority.

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Findings of supervisory law violations and sanctions imposed

Type of institutions	Serious findings	Actions against managers	Administrative fines	Measures in cases of danger (pursuant to section 46 KWG)
Lending banks	26	0	0	1
Institutions belonging to the saving bank sector	33	12	0	0
Institutions belonging to the cooperative bank sector	116	25	0	3
Other Institutions	20	2	0	4
Total	195	39	0	8

Co-operative Banks and the Role of Supervision

According to the German Banking Law, a credit institution can only make a loan totaling more than 750,000 Euros if the borrower has disclosed its financial position, in particular by presenting its annual accounts. In the practice of bank supervision, great attention is given to the observation of this requirement, since from our experience in the past loans have been made too often without sufficient checks on the borrower's financial circumstances. This has led to banks having to make large valuation adjustments. It is an important goal in bank supervision to cultivate and maintain a high level of risk awareness in the banks when they make loans. I should point out that banks are not prevented from making loans that do have a risk attached to them. However, the banks must be quite clear about this and have the necessary resources to cover the risk.