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Legal Determinants of Accountability of Credit Union Members

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Abstract: The financial crisis of 2007-2009 has triggered the development of legal solutions aimed at reducing economic turmoil by, in particular, increasing the responsibility of shareholders of financial institutions for the failure of the latter. The solutions in question include, inter alia, procedures of forced restructuring of financial institutions and establishment of the level of the so-called MREL for them. Counted among these institutions are also credit unions, the legal situation of which entities shows a number of peculiarities. They operate not for profit, have a highly dispersed ownership structure and limited opportunities to raise capital and, above all, members of the credit union as a cooperative society play a dual role in it - both that of shareholders and one of service users (consumers). The Polish lawgiver has made national credit unions subject to the rules of forced restructuring and MREL despite their exclusion from the European law regulations in force in that respect and placed them within as many as two separate legal regimes under which the solutions can potentially be applied. The aim of the paper is to consider whether - taking into account the legal structure of Polish credit unions - the solutions adopted under the aforementioned regimes may actually serve to increase the responsibility of credit union members for the institutions they co-own, and looking in a broader perspective - whether and to what extent they can generally contribute to successful operation of credit unions. In pursuit of the goal, attempts were made to combine dogmatic research (with the employment of the verbal logic method) with an analysis of the functions of the legal norms aimed at achieving the desired economic effects, taking into account the values the credit unions adhere to - on a global scale - as cooperatives run "not for profit, not for charity, but to serve", as their motto reads. Thanks to the considerations done it was ascertained that burdening Polish credit unions with MREL requirements has been, in fact, an inappropriate solution, inadequate both to the structure of their ownership funds and the goals for which these requirements were established, since the goals include, at the outmost, protection of union members as consumers, and not burdening them - as small shareholders – with the risk of the business conducted by the members to satisfy their own needs.

Keywords: Cooperative Savings and Credit Union, Resolution, MREL, Consumer, Cooperative

1. Introduction

In connection with the financial crisis of 2007-2009, a discussion was revived, mainly in economic sciences, but also in jurisprudence, on what shape the legal framework for the operation of financial institutions should take to protect the economy against violent shocks caused (at least to some extent) by the activities of financial institutions and, above all, to safeguard natural persons as depositors and small shareholders (e.g. the holders of small amounts of shares purchased on the stock exchange) against a loss of their savings [1]. Counteracting the occurrence of the crisis and then its negative effects took place with a heavy involvement of public funds, which in turn has led to the formulation of such principles of the new legal environment for the operation of financial institutions that have been aimed at burdening the shareholders (owners) of financial institutions, to the greatest possible extent, with liability for a failure, if any, of the institutions' operation. Such increased accountability is intended to enhance prudence in the management of private financial institutions and limit the attempts to maximize their current profits at the expense of long-term sustainability. In the European Union countries, legal solutions developed to meet these ideas include, among other prudential and supervisory regulations, the regulation

of forced restructuring of financial institutions and the minimum level of own funds and liabilities subject to redemption or conversion for such institutions (MREL), determined by the resolution authority[1] [2].

The aim of the article is to analyse the legitimacy and purposefulness of applying certain solutions from the field of resolution and MREL to credit unions from the perspective of the specific legal structure of the entities in question. Putting it more precisely, the issues will be discussed on the example of Polish savings and credit unions, as a type of credit unions in general, and examining them must take into account the specific way in which the European Union regulations on the matters have been implemented against the Polish entities.

Such an assumption being adopted, the article starts with presentation of the way in which the Polish lawgiver has extended onto the domestic credit union sector the European provisions on (orderly) resolution and MREL and attempts at taking a critical look on the justification for such a move, juxtaposing it with the elements of the legal structure of Polish credit unions. That step inevitably leads to the consideration of the specificity of the legal situation of credit unions (both in Poland and other parts of the world), which are treated as entrepreneurs even though members of the unions, constituting the latter's human fabric are, in fact, consumers (recipients of the services of the entity formed by themselves). Finally, the key issue of credit unions' ability to build up their own funds is addressed and discussed in the context of possible enhancement of the accountability of the members of the union for its results. Only against such a background is it possible to answer the research question posed at the beginning and to formulate the conclusions closing the article.

2. Implementation of Resolution and MREL Against Polish Savings and Credit Unions

The specificity of the implementation of resolution and MREL against Poland's credit unions lies mainly in two factors. First, despite the direct exemption of credit unions operating in individual European Union countries, including Polish credit unions, from the regulations contained in banking directives and regulations (both as regards the so-called capital regulations and the regulations concerning resolution), the Polish lawgiver decided to subject the credit unions to (orderly) resolution and establish the MREL for them[2]. Secondly, it made them subject to two separate regimes of forced restructuring, initially in 2013 through the amendments to the Act of November 5, 2009 on Cooperative Savings and Credit Unions[3], and for the second time in provisions of the Act of 10 June, 2016 on the Bank Guarantee Fund, the Deposit Guarantee Fund and Resolution[4]. The measures provided for in the first piece of legislation are applied by the authority exercising supervision over the financial market (in this country – the Polish Financial Supervision Authority) [3], the instruments listed in the other Act of Parliament may be wielded by the Bank Guarantee Fund (which is the deposit guarantee body within the Polish safety net) in cooperation with the Polish Financial Supervision Authority. As the Act on BGF provides, the resolution instruments described in it can only be applied if the intended objectives of forced restructuring cannot be achieved using the measures available to the supervision authority (although available to the latter are, in fact, equally effective instruments, regulated by the Credit Union Act). The establishment of such logical equivalence means that, both in theoretical and practical terms, the application of the resolution instruments described in the BGF Act to a cooperative savings and credit union is virtually excluded. In addition, the plan for compulsory restructuring of cooperative savings and credit unions, developed by the Polish government in 2013 to serve as a basis for winning the European Commission's approval of public aid for the unions, was drawn up based on the rules contained in the Credit Union Act providing for the instruments available to the Polish Financial Supervision Authority [4]. Such aid was, in fact, extended, using those very instruments. Unlike them, the resolution measures described in the BFG Act have never been applied to credit unions [5].

Quoted as a justification for maintaining, within the Polish legal system, the superfluous regulation on credit union resolution with the instruments used by the Bank Guarantee Fund is the relationship between a given group of institutions being subjected to such measures and the fact that the deposits pooled in the entities in question are covered by public guarantees. It appears, however, that should such a legal tie between the guarantees and the (orderly) resolution (wielded by the deposit guarantee authority) be missing, no logical or praxiological necessity could be quoted to serve as a rationale for it [6, 7]. Rather, it seems that subordinating an entity covered by deposit guarantees to public supervision,

[1] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (BRRD).

[2] As indicated in the preamble to the BRRD, in order to ensure consistency with the existing Union legislation in the area of financial services as well as the highest possible level of financial stability across the spectrum of institutions, the resolution regime should apply to institutions subject to the prudential requirements laid down in Regulation (EU) No 575/2013 of the European Parliament and of the Council and Directive 2013/36/EU of the European Parliament and of the Council. The regime should also apply to financial holding companies, mixed financial holding companies provided for in Directive 2002/87/EC of the European Parliament and of the Council, mixed-activity holding companies and financial institutions, when the latter are subsidiaries of an institution or of a financial holding company, a mixed financial holding company or a mixed-activity holding company and are covered by the supervision of the parent undertaking on a consolidated basis. Credit unions are exempt from the provisions of the above-said directives and, consequently, do not fall within the scope of operation of the BRR Directive.

[3] The Act of 19 April, 2013 Amending the Act on Cooperative Savings and Credit Unions and Certain Other Laws, Journal of Laws 2013, item 613.

[4] Consolidated text: Journal of Laws 2000, item 842.

especially if the supervisory authority is also equipped with instruments allowing for the restructuring of the supervised entity and the achievement of resolution objectives, is entirely sufficient. The actual problem resulting from the double regulation is that although the resolution measures described in the BGF Act are simply not applicable in practice, the credit unions – when made subject to the Act - are obliged to meet a number of requirements ancillary to the instruments of resolution. Meanwhile, the Bank Guarantee Fund has to prepare a resolution plan for each of the credit unions, is vested in the powers to indicate obstacles to the implementation of such plans and has the powers to set up MREL, including the so-called intermediate goals related to the latter, i.e. the levels of the ownership funds and liabilities subject to redemption or conversion in subsequent years of the period through which the target level of MREL is to be achieved. The credit unions' obligation to reach the intermediate goals, and ultimately the target MREL level, is definitely out of character with the cooperatives in question.

3. Polish Savings and Credit Unions as Entrepreneurs and Its Members as Consumers

A most important feature of Poland's savings and credit unions (and credit unions in general) is the fact that the profit generated by a credit union is not divided among its members, but is entirely allocated to supplement the credit union's own funds, in fact the resource fund. As the adage of credit unions reads, they conduct their activities "not for profit, not for charity, but for service". The benefit enjoyed by the members of the credit union (being, at the same time, the union's owners), does not lie in their participation in profit distribution, but rather in access to credit union services provided on fair terms (that is, based on economic reasoning, so as to allow the credit union to be financially sustainable, the revenues from the activities covering the costs of the operation and the credit union being able to meet the regulatory requirements; moreover, the prices of credit and payment services provided by the credit union should not exceed the level necessary to meet this assumption and the interest rate on the deposits accepted by the credit union should be as high as possible under such conditions) [8].

The essence of orderly resolution, the establishment of a minimum level of own funds and liabilities subject to redemption or conversion (MREL) for financial institutions made subject to such a scheme in particular, lies in the link between profits derived from the activities of a financial institution and the accountability for possible failure of the activities. It is aimed at preventing a situation in which the owners of a financial entity could reap, for years, profits from its operations but in the event of a failure the burden of financing the corrective actions, and ultimately the burden of the payment of deposit guarantees would be borne solely by public institutions (being effected either from the state budget or through contributions made by all financial institutions), not the owners. The scheme is, in fact, supposed to make the owners (since it is themselves that derive profits from the activities of a credit institution) build funds from at least a portion of the profits, to be used, in the event of a business failure, as a source of compensation for the losses occurred [9].

No such indirect coercion is actually necessary in the case of cooperative savings and credit unions, since the Credit Union Act explicitly obliges the unions to allocate the entire profit to capital (non-returnable one, as such is the nature of the resource fund).

By the very nature of credit unions, their shareholding is highly dispersed. Not only are credit unions cooperatives (the latter being defined as the organisations of people, not of capital) but they can boast the largest membership in the entire cooperative sector. In Poland, where the biggest cooperative societies are housing cooperatives and cooperative savings and credit unions, the largest housing cooperative has 30,000 members (those next in line having membership below 10 thousand), while the largest credit union (the Franciszek Stefczyk CU with the registered office in Gdynia) counts almost 900,000 members. At the same time, Poland's savings and credit unions, as cooperatives with participation of natural persons, are subject to the rule granting each member only one vote, regardless of the number of the shares held. Due to the statutory prohibition of payment of interest on the shares, most of credit union members have one mandatory share each. Instances of holding non-mandatory shares are mainly related to the situation where the credit union has reduced the value of the mandatory share and the members did not demand the return of the payments exceeding the thus determined, new amount (as is the case with the largest Polish credit union). A factor significantly inhibiting the acquisition of non-mandatory shares by credit union members is regulations providing for a possibility to introduce, in credit unions' articles of incorporation, additional membership liability [10], which became the basis for receivers in bankruptcy to demand additional payments from members of credit unions having gone bankrupt [11]. Eventually, by a resolution of December 12, 2019, III CZP 42/19[5], the Supreme Court ruled that the receivers are not entitled to pursue such claims, and that for the origination of the latter it is necessary that the general assembly of the cooperative savings and savings union should take, during its normal operation, a resolution providing for the coverage of losses from the resource fund and share fund and through additional membership liability [12].

An important feature distinguishing credit unions from other types of cooperatives is that they can provide services only to their members, and therefore the circle of recipients of the services overlaps with that of the shareholders. A similar feature is also characteristic of housing co-operatives [13], although their legal situation under Polish law is different in that membership in such a co-operative is, under the law in force, entirely secondary to member's right to premises being part of the housing cooperative stock (Art. 3

[5] Orzecznictwo Sądu Najwyższego. Izba Cywilna [The Supreme Court Jurisprudence. The Civil Law Division], 2020, No. 9.

of the Act of December 15, 2000 on Housing Cooperatives) [14]. Provisions of the Act of September 16, 1982 - the Cooperative Law regarding membership declaration, and those concerning the withdrawal, exclusion, deletion from the cooperative and payment of shares and the entry fee (Art. 1 paras. 8 and 9 of the Act) do not apply to housing cooperatives, either [15]. In the case of cooperative savings and credit unions, the provisions on membership in a cooperative, arising as a result of an accession/admission agreement concluded on the basis of a membership declaration submitted by the person willing to join the credit union (and entailing the obligation to pay an entry fee and mandatory share) [16], as well as provisions on termination of membership relationship fully apply [17]. The specificity of Poland's cooperative savings and credit unions (and credit unions in general) is that in order to become a member of a credit union, one needs to share a common bond with other members of the union's community (under Polish law, this may be a professional or organizational bond, and currently in a majority of credit unions membership results from a common bond of an organizational nature). Members of a cooperative savings and credit union, who are natural persons, are consumers within the meaning of Polish law and the law of the European Union [18]. The Polish lawgiver extends onto credit unions, to a full extent, all duties of the entrepreneur providing financial services to consumers and all solutions, ever more extensive in contemporary EU law, intended to counterbalance the weaker position of the consumer vis-à-vis the entrepreneur, even though this entails a deterioration of the entity's financial result (and a reduction in the balance sheet surplus from which the credit union's own funds are supplied). An example is the relations between a cooperative savings and credit union and its members, having been made subject to the provisions of the Consumer Credit Act. These, inter alia, limit the amount of non-interest loan costs and establish a wide range of disclosure obligations on the part of the lender (sanctioned with what is termed a free credit) while imposing on credit unions the obligation to consider claims submitted by members following the procedure applicable to consumer complaints (a delay in doing so being liable to a fine). In addition, the EU Court of Justice has ruled that credit union members - as consumers - are entitled to a refund of part of the commission in instances of an early loan repayment. And, finally, the national authorities competent to protect consumer interests (in Poland - the Office for Competition and Consumer Protection and Financial Ombudsman), making a decision on how to implement the CJEU judgment ruled that the refund of part of the commission to credit union members should be done on the same terms as those observed by other lenders operating in the open market.

Even discerning the fact that each member of a credit union plays a double role – that of a depositor or consumer of the services and, at the same time, one of the credit union's shareholders - the person in question always belongs to the group whose protection is the objective of the resolution-related measures (as the measures are supposed to protect also small shareholders who do not have – everybody for himself - a significant influence on the activities of the financial institution). Its purpose is not to increase the liability of such shareholders – if liability can be spoken of at all - since it is only credit union members acting jointly, and not each of them taken separately, that can exert impact on the activities of the credit union, on the way in which its affairs are managed or on the (risky) decisions made.

As mentioned in the introduction, the members' benefit from the activities of the credit union lies in their access to services the cooperative society provides. Should the members of a credit union be held more accountable for its bottom line or, more generally, for the success of the entity's operations, the services of the credit union, provided exclusively to its members, would have to become more expensive or less consumer-friendly. This is, actually, ruled out, as restrictions on the prices of services provided by credit unions, primarily the lending, as well as the factors that make the provision of consumer-friendly services costly for the service provider, result from the mandatory provisions of law. The credit union cannot decide to increase the profitability of its activity by raising the prices of services or changing the rules for their provision to ones less consumer-friendly. Increasing the price of services or reducing their quality would not only defeat the objective of the legislator's financial services policy, but is prohibited by law. On the other hand, improving the profitability of a credit union's operations by increasing the number of services provided and expansion of the membership base is bound to cause a growth of the credit union's assets, and thus an increase in the denominator of the solvency ratio or the MREL requirement (moreover, when lending, credit unions are obliged to respect a number of requirements significantly limiting the access to their credit services).

It is therefore at least a praxiological, if not a thetic contradiction within the legal system that is at stake. The lawgiver (both domestic and European) forbids the cooperative savings and credit unions to increase the profitability of their enterprise by raising the prices of services or limiting the costs incurred in their provision (at this point it is also worth emphasizing the growing statutory and supervisory requirements regarding the assessment of creditworthiness and credit risk, anti-fraud security, and quality requirements for the provision of payment services).

An important aspect of the issue is that allocation of the annual profit to the resource fund is gratuitous and irreversible in nature and is not limited in time. Within the equity of business entities, distinction should be made between the self-funding capital (the retained earnings in question) and the entrusted equity (i.e. shares or stock purchased by shareholders, instruments acquired by them, such as bonds, in particular subordinated bonds or subordinated loans granted by shareholders or external investors, if the legal regulations concerning a specific entity allow). A characteristic feature of the latter type of equity (or liabilities subject to redemption or conversion, using the orderly resolution terminology) is that it consists of funds

made available to the cooperative for a certain period of time, subject to repayment. In the case of shares which, in the credit union, do not bear interest, the acquisition of the entrusted capital from members does not generate any costs to the credit union (regarding non-mandatory shares, credit unions usually offer the purchasing members only some benefits indicated on the service price list). However, as mentioned earlier, building the equity by encouraging members to acquire non-mandatory shares is not likely to result in a significant growth of such funds. Acquiring non-mandatory shares is not attractive to members, not only due to the lack of interest on them, but - in the case of Polish credit unions - mainly due to the reputational problems occurred as a result of credit unions' receivers in bankruptcy seeking additional payments (up to double the share amount) from members of bankrupt credit unions. As a result of those events and due to the treatment of credit union members, being natural persons, strictly as consumers, the body exercising supervision of credit unions does not recommend the latter to entice their members to purchase additional shares through a more attractive product offer (especially that concerning deposits), it being feared that the members, irrespective of the information provided to them by the credit union may still not be fully aware of the difference between the savings guaranteed by the Bank Guarantee Fund and the shares that can be used to cover a loss.

4. Cooperative Savings and Credit Union Capital

In the case of Polish savings and credit unions, non-mandatory shares are contributed primarily by the National Association of Cooperative Savings and Credit Unions being the central body of the Polish credit union sector - a cooperative of legal persons associating all credit unions, exercising control over them, representing their interests on the outside, acting as an intermediary in making cash settlements by credit unions, issuing payment cards for the benefit of credit union members, managing credit unions' liquid reserve, and above all running a stabilisation fund arising from contributions made by credit unions and from the annual balance-sheet surplus generated by NACSCU. The National Association joins credit unions as a member [19], not in order to use their financial services, however, but with the sole purpose of providing credit union with stabilisation aid by taking up non-mandatory shares[6]. That method of stabilisation leads to a direct, immediate increase in the own funds of the supported credit union by the entire amount of the granted aid, which makes the assistance particularly effective. It should be remembered that the main problem created for credit unions after the changes occurred in their legal environment (the new Credit Union Act coming into force on October 27, 2012 and the subsequent implementing acts on new, specific accounting principles for credit unions and the method of calculation of their solvency ratio, having been enacted - without a reasonable vacatio legis - during the fiscal year), was the insufficient level of own funds. Even where the credit union's membership includes – in addition to the natural - legal persons, the entity is still subject to the principle of "one member, one vote" (regardless of the number of shares held), characteristic of cooperatives with the participation of natural persons. Consequently, also NACSCU, when the shares it has acquired, make up a majority of the credit union's share fund, is entitled to just one vote. In the period following the Credit Union Act's entry into force, all the resources of the stabilisation fund of the National Association were employed in stabilisation aid for the credit unions (along with the funds obtained from the liabilities incurred for the same purpose). It is thus no longer possible to fund the increase in the equity of cooperative unions on such a scale from the stabilisation fund as the internal source of the aid (the current balance-sheet surpluses of the National Association must be allocated primarily to the intervention aid, especially to supporting internal consolidation).

Therefore, for credit unions, the main source of equity or liabilities to be written down or converted would have to be subordinated liabilities (especially bonds) taken by external investors. Finding buyers for the instruments issued for capital building requires giving the instrument the character of investment vehicles purchased for commercial purposes. However, since after the change of the legal environment in 2012 credit unions underwent a turbulent restructuring process, the investment vehicles issued by them are bound to be viewed as risky, the buyers expecting a higher rate of return on them. Credit unions' striving to meet the MREL requirement by issuing investment instruments dedicated to an external investor would not mean increasing the responsibility of the shareholders of credit unions for the result of their activities, but a decrease in this result and, consequently, a reduction of the credit unions' capacity to build their own resources in the form of the resource fund supplied with retained profit indefinitely and in a non-refundable way. And where the credit union would be unable to generate, through its activity (being, by law and by nature, a non-profit one), income sufficiently increased to cover the debt servicing costs, the latter could lead to an increase of the credit union's loss instead of the entity's capital reinforcement.

5. The Legal Opportunity for Cooperative Savings and Credit Unions – Investment Shares

Legislative work is currently underway, aimed at enabling Polish credit unions to accept the investing members. These could make investment contributions, bearing interest

[6] Pursuant to Art. 10 para. 2 of the Credit Union Act, membership of Poland's cooperative savings and credit unions, besides natural persons, can also include non-governmental organisations operating among credit union members, trade unions, organisational units of churches and religious denominations, cooperative societies, condominia.

covered from the balance-sheet surplus. The assumption is that such shares would only be acquired by legal entities (so as to eliminate the risk for consumers), and law would limit the part of the balance-sheet surplus allocated to payment of the interest. The investment shares of the type would have a significant advantage over bonds as a source of capital for credit unions, since in their case the payment of interest would depend on performance of the credit union in a given financial year; the risk of occurrence, on the investing member's side, a claim for the payment of interest, would rest with the member himself/herself. Such a form of capital building, appropriate for the cooperative movement, including the credit union sector where the interest on shares covered from the balance sheet surplus (even if limited) is a rule, while prohibition of payment of interest on shares (particularly as categorical as in the case of the existing regulations on Polish savings and savings unions credit unions) forms an exception, would create a significant impulse for the development of credit unions [20]. The solution seems to have the greatest potential significance for those credit unions that cooperate with large enterprises, provided that the enterprises would venture to support (share the risk of) credit unions, associating the entities' employees, in such a way.

6. Conclusions

The analysis of the legal framework established for the operation of credit unions, and in particular of the cooperative savings and credit unions existing in Poland, leads to the conclusion that introducing a requirement for a minimum level of own funds and liabilities subject to redemption or conversion (MREL) is an inappropriate legislative measure. The requirement is, in fact, inadequate to the structure of the own funds of a credit union belonging to thousands (or even hundreds of thousands) of members holding small equal shares. In the case of Polish credit unions, a prohibition of the distribution of profit among members and the rule that the entity's entire profit is allocated to equity is also of essence. In that situation, a contradiction arises between the credit union's aspiration to meet the MREL requirement by issuing debt instruments and paying the interest due to their buyers, and building the resource fund as a permanent component of the credit union's own funds. In addition, 99% of members of Polish credit unions (being the sole users of their services) are consumers, and credit unions, in relations with their members, have to observe the strict regulations to which an entrepreneur providing financial services to the consumers has to adhere. This is one of the most important factors determining the shape of the services provided by the credit unions and the operating expenditures the unions bear. Therefore, the costs of meeting the MREL requirements by credit unions would, in practical terms, have to permanently interfere with constant improvement of the level of services provided to the consumers.

Also an analysis of the EU regulations, the implementation of which into Poland's legal system lay at the bottom of the MREL requirements established for Polish financial institutions proves that the regulations were not intended to be applicable to credit unions operating in varied EU Member States and do not, in fact, concern credit unions in countries other than Poland, as the aim of the regulations is not to burden consumers with the risk of the operation of the financial institution the services of which they enjoy, but just the opposite – to protect the consumers.

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