Creating an Enabling Environment for Financial Cooperatives

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I. Executive Summary

Apex organizations of financial cooperatives play a critical, albeit evolving, role in ensuring an enabling environment for their members.[1] Historically, apex organizations have played a key role in setting up new, independently run financial cooperatives and then served them as both technical service provider and supervisor. The presence of a large number of small financial cooperatives in an increasingly digitally connected world makes the seting up of new financial cooperatives less important for apex organizations. At the same time, advocating before regulatory authorities, that are dual-focused on financial sector stability and facilitating financial inclusion, provides financial cooperative apexes with new challenges to confront.

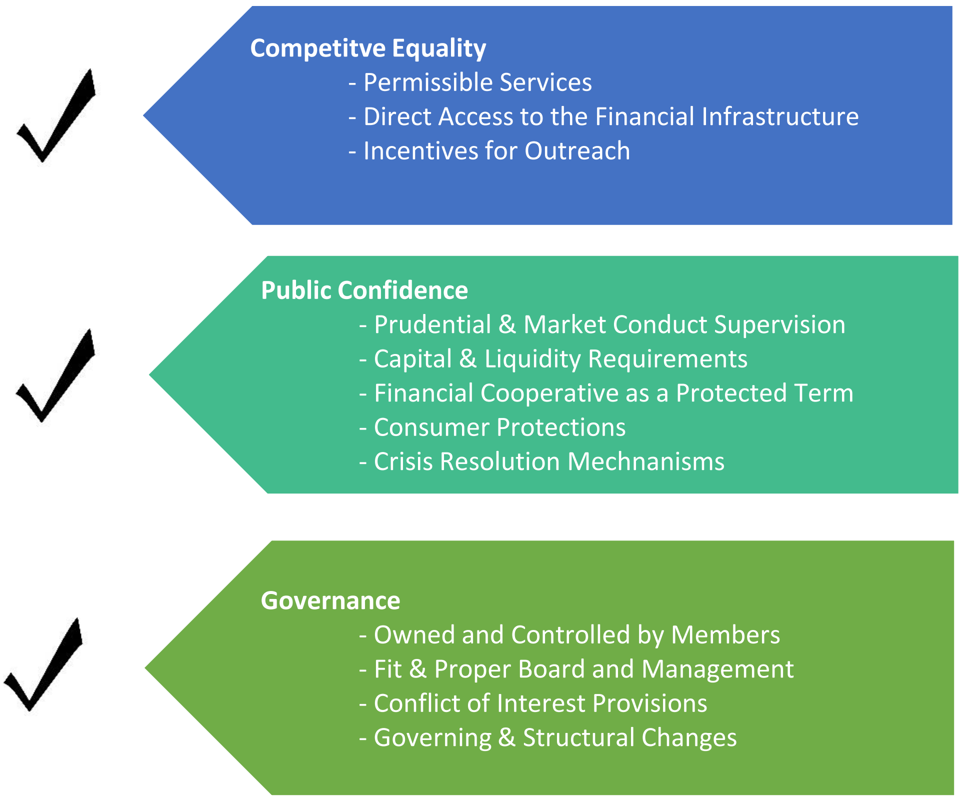
This paper identifies international, national and regional and organizations and issues for apexes to engage with, describes the process of enacting legislations, and the rationale and key components for an enabling legislative and regulatory environment for financial cooperatives. The information is supported with in-depth and practical case studies from an apex in Kenya that helped usher in ground-breaking legislation for financial cooperatives and a Brazilian case study where apex organizations work with partners to participate in public credit guarantee schemes supporting agriculture.

A high-level overview of key legislative provisions for enabling legislation and regulation of financial cooperatives can be broken down into ensuring competitive equality for financial cooperatives, supporting public confidence, and ensuring good governance. Legislation must recognize that financial cooperatives need to compete in a marketplace with banks, microfinance institutions and mobile money. This requires that financial cooperatives, as deposit-takers, be prudentially supervised to ensure the safety of members' money and public confidence in these institutions.

[1] Throughout this module the term "financial cooperatives" is used to refer to savings and credit cooperatives, credit unions, credit cooperatives, cooperative banks, building societies and savings and credit associations as they are commonly known in various jurisdictions.

A summary of these provisions is provided below in Figure 1 with additional details provided later in the module.

Figure 1: Key Provisions of Enabling Legislation for Financial Cooperatives



II. Introduction

There is growing awareness in emerging and developing countries of the importance of appropriate and prudential supervision for financial cooperatives. While there are instances of overly restrictive and too-permissive oversight of finance cooperatives, the broad arc is heading in the right direction for most jurisdictions. This paper is intended to help financial cooperatives in those jurisdictions where changes are needed in legal, regulatory, supervisory or market structure to allow financial cooperatives to better compete and serve their members.

Based on the *United Nations 2014 Global Census on Cooperatives*,[2] banking/financial cooperatives are the largest segment of the cooperative system in terms of clients/members served and total assets. However, there are few instances outside of Western Europe where

[2] *Measuring the Size and Scope of the Cooperative Economy: Results of the 2014 Global Census on Cooperatives*, Dave Grace & Associates, April 2014

financial cooperatives have more than 15-20% market share of a country's domestic loan or savings market. Yet, financial cooperatives have been shown to be less counter-cyclical than commercial banks and have greater capacity to help low-income consumers reduce the effects of poverty than credit-only microfinance institutions, and they generally treat consumers better than moneylenders.

Apex associations of financial cooperatives (and/or general cooperative) associations play a critical role in unifying the positions and needs of financial cooperatives before policymakers. As such, this module can help apex associations become better advocates for financial cooperatives.

III. Assessing the Broader Policy Environment for Financial Cooperatives

A. Financial Inclusion

Over 30 developing countries have adopted or are in the process of developing National Financial Inclusion Strategies. These national policy documents generally provide a list of policy and market actions to make financial sectors more inclusive. These national strategies are often spearheaded by the Ministry of Finance and/or Central Bank and developed in a consultative process with feedback from the private sector.

However, because financial cooperatives may not be supervised by the Central Bank and their supervisor may not be under the Ministry of Finance, it is critical for apexes to insert themselves into the process of national consultation – *and as early as possible in the process*. Once the strategies have been issued by government it is often too late to ensure that the views and needs of financial cooperatives are sufficiently reflected. Rather, financial cooperatives should provide data and written policy positions, and engage in dialogue in the early diagnostic stages of strategy development.

If early agreements can be reached through this process to allow financial cooperatives to offer more competitive services (e.g., mobile money, agent banking, access to the payment system, deposit insurance, etc.) as an avenue to make the financial sector more inclusive, it will make later-stage engagements with policymakers much easier, as the changes will have already been agreed to by technical and senior staff in financial sector authorities.

B. Agricultural Finance

Financial cooperatives are often important financers of the private sector for agricultural small and medium enterprises. However, financial cooperatives are not always included in public credit-risk-sharing guarantee schemes. Section V below highlights the successful experiences of credit cooperatives in Brazil working with intermediaries to participate in public credit guarantee schemes for agriculture.

Some of the additional services that financial cooperatives could benefit from offering (e.g., participating in the credit bureau, agent banking, partial credit guarantee schemes) may also be supported by government or development partner programs. Liaising with such partners can help financial cooperatives and farmers.

C. Gender Equity

The important role that women often play in effectively managing household finances is generally acknowledged by researchers and increasingly by policymakers. However, women are disproportionally excluded from formal financial services and are often more avid users of informal financial services where there are few legal or regulatory protections available to them should problems occur. Unlike many microfinance institutions (MFI), which have traditionally targeted female clients, many financial cooperatives have a balanced gender representation in their memberships, but boards and management remain dominated by men.

Ensuring greater gender representation in apex associations and their boards will be critical to improving the situation in financial cooperatives, and ensuring diversity in representation should also be considered when crafting regulations.

D. Financial Stability

No topic is nearer and dearer to a central banker's heart than financial stability. Many policy makers have failed to put in place appropriate supervision, crisis preparedness, lender-of-last-resort, and deposit insurance mechanisms for financial cooperatives for two reasons. First, is the view that financial cooperatives are only mobilizing "members' deposits", not public deposits. Of course, financial cooperative members are part of the public and working with authorities to balance the trade-off between greater financial inclusion and stability is a critical roles of the apex association. Second, policy makers have not wanted to invest the resources for smaller deposit-takers. However, in nearly every developed and many developing markets where financial cooperatives have grown to serve a sizable portion of consumers (often around 10% of adults), these mechanisms are eventually adopted. The energy around financial inclusion initiatives could help apexes move more quickly to bring about enabling environments.

IV. Apex Participation in the Right National or Regional Forums

A. Gathering the Support and Data on Financial Cooperatives

Over the years, a primary difference that has emerged between financial cooperative and other MFIs is that MFIs in most markets in Latin America, Africa and Asia are better at telling their stories of their outreach and impact. This has naturally occurred as many MFIs rely on borrowing from outside investors to fund the operations and they need to become adept at measuring and communicating their impact. In contrast, financial cooperatives rely on member deposits, have focused more on developing and marketing saving products to members and less focused on collecting sector-wide data to share their impact.

Aside from many people in financial cooperatives being frustrated to see MFIs garner more attention when financial cooperatives in the market serve more people (as has been documented by the Consultative Group to Assist the Poor (CGAP)), the relative lack of attention to SACCOs affects the policymaking process. For example, legislation for microfinance institutions in Kenya, Uganda, Rwanda and Lesotho advanced or catered to MFIs over financial cooperatives, despite the larger outreach of the financial cooperatives in these markets.

As such, its incumbent upon apex organizations to collect impact and outreach data and stories about the work of financial cooperatives to be able to effectively communicate with policymakers. once this information is available and communicated apexes can begin to clearly demonstrate the current impact and how favorable legislation could make a positive difference.

B. Engaging Financial Sector Policymakers: Ministry of Finance & Central Bank

With data at hand, apexes need to begin building a strategy and coalition of support for regulatory reform. Too often financial cooperatives approach coalition building by only considering who may be their current regulator or members of parliament as opposed to recognizing who influences financial sector regulations/legislation. While financial cooperatives may be supervised by an independent agency or department of cooperatives, the Ministry of Finance and Central Bank are often formally, or informally, consulted on financial sector legislation/regulations even if they are not directly responsible for supervising a sector.

> "The best time to lobby is when you *don't* need anything."

Even in jurisdictions where financial cooperatives are supervised by the central bank, they are a small part of its overall supervisory responsibilities. As a result, it is advisable that apex organizations of financial cooperatives meet with the senior management (i.e., governor or deputy governor) and supervision department of the central bank annually to keep them apprised of developments. Similar meetings should be held with the secretary responsible for financial sector policy within the Ministry of Finance. Building such relationships when a specific regulatory or legislative change is not needed is the best way to ensure that relationship capital exists when changes are needed.

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C. Engaging Cooperative, Agriculture and SME Authorities

The historical supervisors of financial cooperatives in many emerging markets have been the Departments of Cooperatives. As financial cooperatives specialize in the intermediation of funds among its members they have been increasingly overseen by more specialized financial sector supervisors. However, the Department of Cooperatives may still play a supportive, or lead, role in moving forward regulatory and legal changes in the Parliament, making them an important audience for apexes to engage.

While not involved in the oversight of financial cooperatives, agricultural and small and medium enterprise (SME) support and/or guarantee schemes can be additional allies and opportunities for financial cooperatives to expand their scope. While financial cooperatives may be important sources of finance for farmers and SMEs, they are at times excluded from participating in such guarantees schemes which were set up to encourage banks to lend to these groups. Section V below provides a case study from Brazil of how financial cooperatives have been able to engage such guarantee schemes through an apex.

D. Participating in National Financial Inclusion Working Groups

As mentioned earlier, more than 30 countries have developed or are in the process of developing national financial inclusion strategies. These strategies[3] are often undertaken by the Central Bank and Ministry of Finance. They lay out multi-year legislative and regulatory reform programs which can help improve the enabling environment for financial inclusion. These strategies are generally approved at the cabinet, or in some cases, presidential level before they are published. With such high-level approval, their content can influence the legislative/regulatory agenda for years. Ensuring that the needs of financial cooperatives are appropriately reflected in these strategies can help move forward an enabling environment. At the same time, if financial cooperatives are excluded, either intentionally or by accident, because they did not engage in the process, it can stall their progress.

There are multiple ways and opportunities for apexes to engage in the development and implementation of financial inclusion strategies. First and foremost is to engage the Ministry of Finance/Central Bank and any consultants that they have brought in to assist with the early diagnostic phase. It is at this stage, before any of the formal strategy has been written, that an apex which is armed with good impact data on its members can affect the process. This will likely include meeting multiple times with the consultants/facilitators and providing timely and accurate information. Engaging policymakers at the Ministry of Finance/Central Bank to

[3] A broader version of a financial inclusion strategy is a financial sector development strategy. These latter strategies may include other aspects of financial sector development (i.e., housing finance, capital markets, pensions, etc.) which are not always found in a financial inclusion strategy. Financial sector development strategies are equally important for financial cooperative apexes to engage in.

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describe the desired enabling environment and rationale (see Section VI below) will also be important. The apex and its members should:

- Participate in any diagnostic studies,
- Participate in stakeholder workshops,
- Provide detailed written comments on the draft strategy and where possible suggest alternative language to ensure their points are adopted, and
- Ensure that financial cooperatives are represented in any and all of the implementation working groups which emanate from the national strategy.

E. Getting on the Radar of Development Partners/Donors

Donor and development partners can be important allies (or nemeses) of apexes that are seeking regulatory reforms. Development partners are often perceived as provide=ing policymakers with an impartial, international perspective on potential reforms and can provide funding to support such reforms. Therefore, these can also be critical relationships for apexes to foster. Within the financial sector, key development partners include the World Bank, Food and Agriculture Organization, United Nations Capital Development Fund, International Monetary Fund, Alliance for Financial Inclusion, the Department for International Development of the United Kingdom and the Consultative Group to Assist the Poor (CGAP).

F. Engaging with Global or Regional Networks

In addition to working with development partners to promote an enabling environment for financial cooperatives, there are multiple regional and international networks of cooperatives. These include the International Cooperative Alliance, which is the global association for all types of cooperatives, the European Association of Cooperative Banks, which increasingly has a global remit to support financial cooperatives, the SEEP Network, which is an international association of microfinance and financial cooperatives, Canadian Cooperative Association, which is a global development agency, the Irish Credit Union League Foundation, which is a global development agency, the Credit Union Foundation of Australia, which is a regional development agency, World Council of Credit Unions, which is a network of financial cooperative associations, and the International Credit Union Regulators Network (ICURN), which is the global association and technical assistance provider for financial cooperative supervisors. Regional associations include the African Confederation of Cooperatives Savings and Credit Associations (ACCOSCA), Association of Asian Confederation of Credit Unions (AACCU), Caribbean Confederation of Credit Unions (CCCU), and the Latin American Confederation of Credit Union (COLAC).

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G. Case Study: A Kenyan Apex Advocating for Enabling Legislation

An example of how an apex organization, government and development partners worked together in Kenya to create an enabling environment for the country's financial cooperatives is provided below.

Savings and Credit Cooperatives, or SACCOs, as credit unions are known in Kenya, are among Africa's largest and fastest growing financial cooperatives. According to the Kenya Union of Savings and Credit Cooperatives (KUSCCO), the SACCOs' trade association which was established in 1973, there are 5,700 registered credit unions serving 5.4 million members as of December 2015. The movement's US$3.5 billion in mobilized domestic savings represent 35% of the national savings and make SACCOs a vital component of Kenya's economic and social landscape. In addition, the 2016 Financial Access survey of Kenya reveals that getting a loan from a SACCO is the second most common way that consumers obtain loans – with mobile money being the most commo.

Background on the Creation of SACCO Societies Act & Regulator

Kenyan SACCOs were not always in such a strong position, however. The journey of developing specific laws that govern financial cooperatives started with the apex in the year 2003 as SACCOs were looking to expand their scope of services and were weighing whether to stay under the more generic Cooperatives Societies Act or pursue specialized legislation for SACCOs. The revision of the Cooperative Societies Act in 2004 realized the unique role of savings and credit cooperatives compared to other types of cooperatives and recognized that some SACCOs had begun offering fully-withdrawable savings in addition to mobilizing their traditional shares, which served as cash collateral against loans. In 2005, an analysis of financial practices in 148 SACCOs revealed that only 10 SACCOs would meet international standards. Some of the leadership of KUSSCO and SACCOs saw that in the long-run they could have a bigger impact if SACCOs had stronger financial operations and more confidence from consumers. Lobbying by the apex KUSSCO, and a supportive government given the size of the sector and its political clout, made it possible to pursue specialized legislation for SACCOs, and the SACCO Societies Act was passed in 2008.

By 2008 the SACCO sector had experienced tremendous growth, serving nearly 10% of the adult population. The sector was, and still is, critical for larger financial inclusion goals and there was a recognized need to bring the SACCOs that were doing banking business of accepting withdrawable savings under prudential and market conduct supervision. The Central Bank of Kenya felt that supervising these smaller and numerous institutions (there were 214 SACCOs offering demand deposits with a total of US$1billion in deposits) would distract it from supervising banks.

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Prior to 2008, all SACCOs were overseen by the Commissioner for Cooperatives under the Cooperative Societies Act and what was the Ministry of Cooperatives. However, as the sector had grown beyond the capacity, the Commissioner's office and the central bank were not interested in diverting attention to supervise SACCOs. As such, Kenya chose the path of creating the SACCO Societies Regulatory Authority (SASRA), a specialized supervisory agency focused solely on SACCOs that mobilize withdrawable savings. SACCOs that just mobilize non-withdrawable shares remain registered by the Commissioner of Cooperatives and do not have prudential oversight.

The SACCO Societies Regulatory Authority (SASRA), responsible to the Ministry of Industry, Trade and Cooperatives[4], was established in the SACCO Societies Act of 2008, and began its operations in 2010 to oversee *deposit-taking* SACCOs. SASRA, which is separate from the Central Bank of Kenya, received significant training for its 70 staff and technical support team from development partners. However, the Department of Cooperatives which registers all types of cooperatives in the country and was left to oversee the remaining 5,500 registered SACCOs (of which an estimated 3,000 SACCOs are active), has received little training and support. This two-tier regulatory system has furthered the bifurcation of SACCOs between the largest SACCOs which increasingly offer modern banking services, and more traditional and smaller SACCOs.

Tiered Regulatory Approach

The tiered regulatory approach of having a small number of very large SACCOs, which have 70% of the sector's assets, supervised by SASRA, while a larger number of smaller SACCOs are still under the Department of Cooperatives, has predictably led to challenges for the KUSCCO – the SACCO apex organization. As the needs of its members have become more diverse regarding regulatory requirements, support services, and training needs, As deposit-taking SACCOs these entities are subject to different regulations and need training in compliance matters and asset liability management, marketing of deposits, deposit pricing, and how to provide competitive delivery channels.

The establishment of SASRA in 2010 fell within the Government-reform process which has the objectives of protecting the interests of depositors, ensuring public confidence in the financial sector and spurring Kenya's economic growth through the mobilization of domestic savings.

Branding Challenges and Signs of a Split

[4] In 2012 the Ministry of Cooperatives was absorbed into the Ministry of Industry, Trade and Cooperatives, which includes the Department of Cooperatives and is headed by a Commissioner of Cooperatives. SASRA now reports to the Ministry of Industry, Trade and Cooperatives.

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Enabling legislation for financial cooperatives should ensure that the name SACCO in Kenya is a protected term that would be illegal to utilize unless licensed as a SACCO and the clause needsto be enforced. Kenya provides an example of why this seemingly innocuous issue is important.

To complicate further the branding around SACCOs, mini-bus taxis have started to use the term "SACCO". The government of Kenya sought to improve the driving practices of thousands of mini-bus taxis in Kenya by requiring them to be part of a self-regulating cooperative. To self-regulate, rules were established whereby all of the drivers in a mini-bus taxi cooperative could have their license suspended if any driver of the cooperative was caught violating the traffic laws thus creating social pressure. The mini-bus taxi cooperatives were also required to display the name of the cooperative they had formed and were part of on their mini-bus. However, instead of using the word "cooperative" the mini-bus taxis used the word "SACCO". As their poor driving and customer service practices have not improved much, this has denigrated the meaning of a savings and credit cooperative (SACCO). Amendments to the SACCO Societies Act were proposed in 2017 requiring SACCOs which accept withdrawable deposits to use the words "deposit-taking SACCO" in their names and to make these words a protected term of SASRA-licensed SACCOs only.

Role of the Regulatory Authority

SASRA has seven board members, three of which are from Government bodies: the Ministry of Finance, the Central Bank of Kenya, and the Commissioner of Cooperatives. The other four are independent board members from the private sector and may not actively serve as employees or board members of a SACCO. The figure below depicts the legal and regulatory evolution of SACCOs since 2008.

Source: Dave Grace & Associates, 2016

SASRA currently oversees the 170 largest SACCOs that offer fully withdrawable savings products and which hold nearly 70% of all SACCO deposits. SASRA is funded from the National Treasury as well as a levy of .05% of deposits charged to SACCOs to support the cost of supervision. However, early on development partners provided significant funding to aid with the establishment of the authority. Support for the training of staff has continued with support from development partners. Since regulations came into effect in 2010, the sector has been growing its assets at an average of 13% per year. Deposit-taking (DT) SACCOs have grown considerably and their financial picture has improved, except their liquidity, as demonstrated by the figures below.

Indicator	DT SACCOs Dec. 2011	DT SACCOs Dec. 2016	SASRA Standards
Non-performing Loans to Gross Loans	9.6%	4.7%	5%
Core Capital to Total Non-Risk Weighted Assets	8.3%	14.8%	10%
Return on Assets	1.98%	2.6%	NA
Liquid Assets / Deposits	17%	13.2%	15%
Loans / Deposits	102%	107%	70%-80%
Total Deposits	US$1.7 Billion	US$2.7Billion	NA
Total Assets	US$2.4 Billion	US$4 Billion	NA

This improvement in the financial health of SACCOs has been the result of setting clear rules, expectations and demonstrating to SACCO leaders how stronger institutions enable SACCOs individually and as a group, to have a larger impact. This “clean-up” of the sector has been a combined effort with training activities of KUSCCO and SASRA supported by development partners. In some instances this has meant that SACCOs that were not licensed by SASRA could not mobilize voluntary deposits as they had done in the past. In a few other cases, SACCOs were placed under administration by SASRA. Where KUSCCO trained the SACCOs, it was provided for free in some instances where donor support was provided, and in other instances, as a fee-for-service activity.

Role of the Apex for SACCOs

KUSCCO as a trade association is not supervised by SASRA and has no formal role in the supervision of SACCOs, as being both the supervisor and representative body creates conflicts of interest. KUSCCO, and the smaller apex called the Kenya Rural Savings and Credit Cooperatives Societies Union (KERUSSU), were actively involved in advocating for a SACCO-specific Act, and supporting the creation of SASRA and the development of regulations. SASRA's first CEO came from KUSCCO. This support from the apexes included hosting and co-chairing the task force working on draft regulations and lending logistical support to SASRA early on.

SASRA's development of regulations in 2010 for deposit-taking SACCOs sought to balance rules that the Central Bank had put in place in 2007 for microfinance banks, with international best practices for SACCOs and what had been in place for Kenyan SACCOs prior to the 2008 passage of the SACCO Societies Act. During this regulatory transition, KUSCCO had to adjust itself to a new environment in multiple ways. First, it had to shift from supporting the regulatory development to ensuring regulatory enforcement did not go too fast in the "cleaning-up process" so SACCOs were not forced to close. At the same time, propping up weak SACCOs puts member's money at risk and hurts the reputation of the entire sector.

Secondly, it had to understand the new needs of its members that now have two different regulatory regimes and increasingly different training and advocacy needs. For example, the deposit-taking SACCOs supervised by SASRA are moving into payment products, must manage more volatile liquidity, and must develop back-up lines of liquidity. Lastly, as greater regulatory scrutiny has entered the marketplace, KUSCCO's small central finance facility cannot meet the needs of larger SACCOs and its intermediating funds among SACCOs is coming under additional scrutiny because it is not supervised by SASRA yet it is providing intermediating funds among SACCOs.

Because of the large number of deposit taking SACCOs in Kenya, the model of having a separate financial sector regulator just for deposit-taking SACCOs has worked well there and in the United States, but in few other countries. At the global level, it is more common to see a central bank supervise financial cooperatives or a broader non-bank financial regulator which may supervise insurance companies, mobile money services, pensions, microfinance institutions and credit unions/SACCOs. This is also the direction that Kenya could be heading with the potential consolidation of the pension, insurance, securities, and SACCO supervisors into a newly anticipated Financial Services Authority. As SACCOs develop and become prudentially regulated, as is now the case in Kenya, it is common for SACCOs to then become part of the financial infrastructure including directly accessing the payment system, card networks, credit bureaus, emergency liquidity assistance vehicles and deposit insurance – all of which are on the horizon for Kenyan SACCOs and could be new business area for the apex, or a related company, to evolve along with the sector.

H. Resources for Shaping Legislation, Regulation and Supervisory Practices

There is a growing list of resources to help apex organizations and policymakers move toward unique and appropriate supervision of financial cooperatives. These include the Guiding Principles on Effective Credit Union Supervision by the International Credit Union Regulators' Network (ICURN), Model Financial Consumer Protection Law by the Microfinance CEO Working Group, the Model Law and Model Regulations for Credit Unions by WOCCU, the

Basel Committee's 2016 Guidance on the Application of the Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion. Together these documents can provide useful inputs to apex organizations seeking to improve the legislative or regulatory environment for financial cooperatives.

V. Keys Attributes of an Enabling Environment

This section describes the typical process of developing and passing legislative and regulatory changes for financial cooperatives in emerging markets and what apex organizations can do to facilitate the process. In addition to highlighting the process, a description of key attributes for an enabling environment for financial cooperatives is also provided.

A. Unique Legislation for Financial Cooperatives

The cornerstone of an enabling environment for financial cooperatives is to have their own specific legislation because of their differences from other financial institutions and cooperatives. Financial cooperatives are unique in the following ways: 1) governance and skill requirements for board members that are distinct from other cooperatives, but also have greater constraints than banks in terms of whom they can attract; 2) financial cooperatives liquidity requirements are more closely aligned with banks, but they often do not have back-up facilities at a central bank, 3) financial cooperative start-up capital requirements should be more than other types of cooperatives, but investors are not present as in banks and financial cooperatives generally cannot meet bank guidelines given their intention to help financially vulnerable groups, 4) on-going capital adequacy needs in financial cooperatives are distinct from other forms of cooperatives, but they cannot access capital markets as easily as banks, 5) financial cooperatives mobilize deposits like banks, but only from members, 6) unlike banks, financial cooperatives engage in retail lending and a significant portion of their resources are lent to low and moderate income people for productive purposes — similar to MFIs, 7) financial cooperatives often have a mission to create social justice through economic justice, most similar to MFIs, but via a cooperative structure.

Because of this inability to pigeon-hole financial cooperatives as either a cooperative, commercial bank or MFI, many governments globally and more recently in sub-Sahara Africa (i.e., Kenya, South Africa, Lesotho, Malawi, Rwanda) have chosen to create unique legislation for financial cooperatives.

With specific legislation, financial cooperatives can best ensure that their needs are met regarding governance, capital, liquidity, supervisory, deposit insurance and the range of permissible services. In addition to having a framework that caters to the needs of financial cooperatives, having their own legislation can make it easier to make (or avoid changes) without

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having to involve the broader cooperative community, MFIs or banks if they are part of these legislative frameworks. Importantly, regulations specific to financial cooperatives should flow from having a specific act for the sector and can be better calibrated on a proportional basis.

Apexes have a significant role to play in advocating for specific legislation and describing how society and consumers will benefit from a stronger financial cooperative sector. Generally the larger the financial cooperative system is the more weight it will have in effecting legislative change since there will be broader awareness of financial cooperatives. However, even smaller systems have been able to demonstrate the impact that they could have on creating competition to the high fees/rates in banks and MFIs, expanding access to finance for SMEs and farmers and making safe savings facilities available to women, youth and low-income consumers.

B. The Policy Process

In many jurisdictions, before a law can be passed a government policy related to the sector or issue is needed. Such a policy includes information about the sector, why it is important to national development or other government goals, and provides a policy statement on the sector or issue. There is ample opportunity for an apex to assist in crafting and participating in this non-technical policy. The need for accurate and up-to-date information on the financial cooperatives and their impact is critical for inclusion in the policy.

The policy framework could be broad-based to cover the entire financial sector, focused on financial inclusion, payments, microfinance or financial cooperatives. Any of these policy frameworks could create a sufficient avenue for financial cooperatives to establish an enabling environment.

C. The Legislative Process

Introducing items that are needed for financial cooperatives (i.e., liquidity requirements, capital, provisioning), even under a separate section in the law, can create unintended consequences for other marketing, agriculture cooperatives or supply cooperatives. For example, this has been the case in the Eastern Caribbean. While it may make sense to have a minimum of 10 members to start an agriculture supply cooperative, such small numbers in financial cooperative institutions are unsustainable. These unintended consequences for other cooperatives may create divisions within the cooperative sector. In addition, the type and amount of monitoring needed for other cooperatives is very different than in a financial cooperative which mobilize deposits.

To better understand how to achieve unique legislation for financial cooperatives, a typical legislative development process is provided below. The exact steps may vary depending on the country and legal system.

1. Passage of a related policy on financial cooperatives, if none exists
2. Approval from Cabinet that a law can be drafted

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3. A regulatory impact assessment to determine if a law is needed. This includes: a statement of problem; cost-benefit analysis; review of other laws in place; assessment of whether a new law would solve the stated problem; and an analysis of whether another vehicle exists to accomplish the task.
4. If the assessment shows that a new law is the best option then a layman's draft can proceed
5. Developing a layman's draft of the bill
6. Stakeholder consultation on the layman's draft
7. The layman's draft goes to the Parliamentary Committee or legislative draft team for review
8. There is a need to get concurrences from affected ministries
9. The Attorney General needs to review the Bill
10. Approval sought in Cabinet
11. The appropriate Parliamentary Cluster Committee (e.g., Economic & Development) needs to be briefed and to review the Bill
12. Sensitization needed of members of Parliament
13. Approval sought in Parliament
14. Approval sought in Senate
15. Signature by the President
16. Final gazetting of the Act

D. Key Aspects of Enabling Legislation

Enabling legislation must recognize the unique aspects of financial cooperatives while ensuring they can provide services in a competitively equal, not necessarily the same, manner as banks. Legislation should support public confidence in financial cooperatives and ensure good governance provisions. Legislation must recognize that financial cooperatives need to compete in a marketplace with banks, microfinance institutions and mobile money. This requires that financial cooperatives, as deposit-takers, be prudentially supervised to ensure the safety of members' money and public confidence in these institutions. This section describes the high-level items that should be included in enabling legislation. Prior to each section, a summary listing of the key provisions is provided.

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1. Competitve Equality Provisions

<u>Permissible Services</u>
- Mobilize deposits from members, loans to members, payment services to members and non-members, related financial services to members
- Members can include persons, businesses, not for profits and local governments. Ability to conduct necesary affairs as a business such as entering into contracts, acquiring and selling assets, hiring staff, using the legal system and investing funds

<u>Direct Access to the Financial Infrastructure</u>
- Direct access to the national clearing and settlement systems, credit bureaus, securitization markets, modern delivery channels of agent banking, digital/mobile financial services and card services
- May require ability to hold a reserve account at the central bank directly or via a wholesale financial cooperative

<u>Incentives for Outreach</u>
- Income tax exemption, recognition of cooperative shares as tier one capital, special supervision of financial cooperatives, deposit insurance systems, powers to broker insurance
- Participating in public partial credit guarantee schemes for agriculture or SMEs

Permissible Services: Enabling legislation must ensure that financial cooperatives can mobilize deposits from their members, provide loans to their members and offer related payment and financial services to members and non-members.[5] This should include service to consumers, business, not-for-profits, local governments and other entities needing financial services. The intermediation of funds among members is at the core of financial cooperatives, but it also must be able to conduct the typical affairs of business such as entering into contracts, buying or selling property, employing staff and utilizing the legal system. Financial cooperatives should also be allowed to invest in a range of non-speculative and conservative investment options.

[5] Offering payment or other fee-based services to non-members can be a requirement of providing some network-based services such as remittances or mobile money. Providing such service to non-members can also help attract new members in the financial cooperative

Direct Access to the Financial Infrastructure: Financial cooperatives operate in a competitive financial sector and can perform best when they have direct access to the national clearing and settlement systems, participate in credit bureaus, participate in securitization markets, and are able to utilize secure and modern delivery channels of agent banking, digital financial services and card services. Participating in these facilities on an individual, or group basis through a wholesale[6] financial cooperative, can have important implications for both the supervisory arrangements and oversight by the central bank. For example, being direct participants in the payments system will require financial cooperatives to hold settlement/reserve accounts at the central bank. To hold a reserve account an institution must also hold reserves at the Central Bank. In some jurisdictions the only firms that can hold a reserve account at the central bank are those that are directly supervised by the central bank. Holding a reserve account at the central bank is also generally a requirement to be eligible to borrow from the central bank's emergency liquid assistance facility. As such, the issues of who supervises financial cooperatives can be tied to the services they can offer.

Incentives for Outreach: Many advanced jurisdictions have some form of differentiated standards to help governments advance financial inclusion objectives through financial cooperatives. Common incentives included in enabling legislation are to provide financial cooperatives an income tax exemption, recognition of cooperative shares as tier one capital, allowing for special supervision of financial cooperatives, specialized deposit insurance systems, and/or powers to broker insurance.

Outreach to target groups such as SMEs and farmers can be achieved by ensuring that legislation allows financial cooperatives to participate directly in partial credit guarantee schemes for these group as in the case study below on Brazil.

[6] A wholesale financial cooperative is a second-tier financial cooperative for financial cooperatives that is restricted from providing services directly to consumers.

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2. Public Confidence Provisions

Prudential & Market Conduct Supervision
- Supervised by well-resourced financial sector supervisor

Capital & Liquidity Requirements
- Requirements for minimum start-up capital, capital adequacy and holding liquid assets relative to deposits

Financial Cooperative as a Protected Term
- Limit usage of the commonly used terms for financial cooperatives (SACCO, credit union, caisse populaire, etc.) to licensed instituitons

Consumer Protections
- Disclosures, fair treatment of members, data privacy, capacity to repay and redress mechanisms

Crisis Resolution Mechnanisms
- Deposit Insurance & Emerency liquidity assistance

Prudential & Market Conduct Supervision: Financial cooperatives should be supervised by a financial sector supervisor that has sufficient capacity and resources. Having good oversight can help ensure that members and the broader public have confidence to utilize financial cooperatives. As part of this framework, supervisors need the necessary powers to issue regulations, the autonomy to take corrective actions that are free from political interference, and the ability to assess fines and to protect depositors.

Capital, and Liquidity Requirements: While the details and required amounts of minimum start-up capital, capital adequacy and liquidity ratios should be laid out in regulations, the broad framework for them should be enshrined in legislation. More explicit guidance on these areas is provided below in Section E on regulations.

Protected Term: As the term “bank” is a protected term in most countries so that only licensed banks can use the name, it is equally important that the term for financial cooperatives (e.g., SACCO, credit

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cooperative, savings and credit association, credit union, *caisse populaire*, *caja popular*, etc.) in the jurisdiction also be considered a protected term by law.

Consumer protection: Consumer protection abuses are much less frequent in financial cooperatives compared to other institutions, but having these legal protections helps consumers know that they will be treated fairly and respectfully. Similar to other financial institutions, financial cooperatives should be required to adhere to consumer protection practices requiring disclosures, fair treatment of members and collection practices, data privacy, conducting capacity to repay assessments and providing internal and external redress options to members.

Crisis Resolution Mechanisms: Ensuring smooth resolution of problem institutions can help prevent hysteria and runs on deposit-taking institutions. Many financial cooperative systems in emerging markets still lack the two fundamental crisis resolution systems that have been proven beneficial for banks. These are deposit insurance and access to emergency liquidity assistance from the central bank. While separate systems, they are essential for the smooth functioning of deposit-taking institutions and should be included in enabling legislation.

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3. Governance Provisions

Owned and Controlled by Members
- One vote, one member
- Limit barriers to membership

Fit & Proper Board and Management
- Proportional vetting criteria
- Ability of a supervisor to remove officials for breaking the law or putting members money at undue risk

Conflict of Interest
- Require disclosure of potential conflicts of interest and reclusion
- Require external and internal audits

Governing & Structure Changes
- Regular and special AGMs, members can stand for election
- Merger, acquisition or voluntary liquidation require notice, disclosures and special voting majorities

Owned and controlled by Members: At the core of financial cooperatives and any enabling legislation should be the ownership and control of cooperatives by their members via the seven cooperative principles, notwithstanding supervision by a financial regulator. Legislation should ensure one-member, one-vote structure is maintained. Legislation should not create barriers making it difficult for consumers or business to become members of financial cooperatives.

Fit and Proper Board & Management: The fit and proper requirements for board members and management of financial cooperatives should be proportional to the risks that the organization presents to its members and the broader finance sector. This section should also allow the supervisor to remove board members or management if they are operating outside the law, have been convicted of crimes or are putting members' deposits at undue risk. Striving for gender, age, tribal, political, religious, net savers versus net borrowers on the board can also be considered within the realm of fit and proper requirements. They nonetheless should not circumvent the democratic process of financial cooperatives.

Conflict of Interest Provisions: Financial cooperatives can be especially susceptible to conflicts of interests as the lack of a single dominant shareholder with his/her funds at risk can instill a degree of oversight. In contrast, where there is weak external supervision and weak internal governance, the prospect for conflict of interest is present. Legislative requirements for external and internal audits should exist.

Governing & Structure Change: Ensuring the proper notification and conduct of regular and special annual general meetings and that members have the chance to stand for election to the board is at the heart of financial cooperatives. This ensures that the institution is responsive to its members in its operations. This aspect of democratic governance especially should be included in legislation as it relates to mergers or voluntary dissolution of the cooperatives which simple and three-fourths of members voting should be required to change the structure of the organization. In any mergers, acquisitions or voluntary dissolutions, disclosures should be required of any board or staff compensation, or conflicts of interest.

E. Enabling Regulation

Following from legislation are regulations, which help interpret and implement the law. Regulations are easier to modify than laws and therefore generally contain much more detailed provisions. Similar to the section on legislation, this section provides the high-level outline of key aspects that should be included in regulations.

1. Developing Proportional Rules, Supporting Innovation and Outreach

As defined in guidance from the Basel Committee on Banking Supervision, the International Credit Union Regulators' Network (ICURN), International Accounting Standards Board and other international entities/standard setters it is important that regulations within the financial sector be established on a proportional basis. This aids in both understanding and compliance by firms and can help promote financial inclusion.

In the process of developing regulations, authorities should ensure that sufficient space for early-stage innovation can be provided to financial cooperatives and their partners. Innovation and traditional activities by financial cooperatives have shown to reach rural residents, women, youth, low-income and other vulnerable populations.

2. Key Regulatory Provisions

Licensing: To legally operate as a financial cooperative it is a requirement that the institution receive a license from its supervisory authority. The potential revocation of a license also provides financial cooperatives an incentive to continue to follow laws and regulations.

Liquid Asset Requirement: As deposit-takers financial cooperatives must have sufficient liquidity to meet depositor demands for funds. Having cash available to meet deposit demands can have seasonable fluctuations and be impacted by the location of an institution. At a minimum, financial cooperatives should have liquid assets that are in cash or investments of three-month duration or less which are equal to at least 15% of the total deposits that the institution holds.

Minimum Start-up and Capital Adequacy: To ensure that groups wishing to start financial cooperatives are genuinely interested and have some likelihood of succeeding they should be required to have a minimum amount of start-up capital prior to being licensed (e.g., US$1,000). However, a much better indicator of the financial health of a financial cooperative is its capital base relative to its total assets. The capital base in financial cooperatives should serve as a buffer for the organization to absorb losses and invest in future projects. This capital can be comprised of retained earnings, year-to-date profits, non-withdrawable member shares and donations. There are also alternative sources of capital such as preferred shares, subordinated debt, member equity shares that financial cooperatives have also issued in various jurisdictions. The total capital base of financial cooperatives at a minimum should equal 10% of its total assets.

Conflict of Interest: Any board or committee member or member of staff that has a potential conflict of interest must declare such interest and should not be present when items affecting them are being discussed or voted upon. Failure to do so should result in potential fines and/or removal from office.

Loan Concentration: Loan concentration limits are needed to protect the financial cooperative from exposures to a single or closely related group of loans becoming

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non-performing. Specifically, no single loan or loans to a closely tied group of borrowers should be more than 15% of the total capital base of the financial cooperative.

Loan Loss Provision: An inevitable part of providing loans is that the borrowers will occasionally not be able to pay back the loan. To prepare for potential loan losses financial cooperatives should be required to set aside an allowance for loan losses. While the exact schedule for loan losses vary, as do acceptable accounting practices for making such provisions, at a minimum, financial cooperatives should provision 10% of the total outstanding loan balance for loans over 30 days past due to an allowance for loan losses, 30% provision for loans 90 days past due, 50% provision for loans 180 days past due and 100% provision for loans over 365 days past due. Any loan that has been reschedule for two or more times should have a 100% allowance regardless of its current status. All loans over 365 past due should be written off so that the loan portfolio reflects the accurate status of assets of the institution.

Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT): The general laws and regulations for AML/CFT, including the reporting of suspicious transactions and customer due diligence processes should also apply to financial cooperatives so that they are not utilized by persons with ill intentions.

Investments: Financial cooperatives should focus on utilizing their funds in their loan portfolio. Where excess funds are available financial cooperatives should prudently invest them in other licensed financial institutions, government debts, real estate that they own and occupy. Financial cooperatives should not invest in speculative areas such as stock markets, commodities, real estate development or non-financial businesses.

Consumer Protection: Financial cooperatives should disclose in writing all fees, interest rates and potential penalties to a member prior to concluding a transaction or contract. The disclosures should also include how consumers can lodge a complaint to the institution or an external party (i.e., ombudsman or supervisor) should they encounter problems. Financial cooperatives should also be prohibited from sharing members' financial or personal information with any entity, except law enforcement or a credit bureau, without first receiving written consent from the member. Financial cooperatives should be required to conduct a capacity to repay assessment for all loans prior to issuing the loans and must not over-indebt their members. Lastly, financial cooperatives must treat their members fairly and not directly, or through entities acting on the financial cooperative's behalf, threaten, degrade, discriminate or use physical forces against their members/clients.

Deposit Insurance: Consumers generally have a higher aversion to losses than their orientation toward gains. Recognizing the significant and long-lasting effects on consumers who have lost their savings in institutions that have been liquidated, financial cooperatives should be required to participate in a deposit insurance system which provides coverage on par, or better, than the coverage afforded to clients of other deposit-taking institutions.

Independent Supervisors & Enforcement Powers: Supervisors of financial cooperatives need to have political independence to take the necessary actions to protect consumers' funds where a financial cooperative itself has put the funds at risk. In addition, to have the independence, supervisors need to have the legal and regulatory powers to take corrective actions, assess fines, remove boards or management, issue cease and desist orders, place an organization under administration and order the liquidation of a financial cooperatives. There should be avenues to appeal such decisions by the supervisor.

F. Potential Role of Apex Organizations in Supervision of Financial Cooperatives

CGAP's *Guide to the Regulation and Supervision of Microfinance: Consensus Guidelines* concludes that "true self-regulation and self-supervision is almost always a gamble against very long odds." This consensus view has been developed over decades of mainly abandoned practices of having an apex organization responsible for the supervision of its members financial cooperatives. Possibly with the exception of the early stages from some very young systems, the conflict of interest, skill and resource challenges of apexes supervising their members have not been addressed and repeated with success in nearly any market in the world.

As such, the consensus view today is that financial cooperatives should be prudentially supervised by a well-resourced financial sector supervisor with the requisite knowledge of the sector, skills and powers to act. However, this does not mean there is no role for apex organizations in the oversight of their members. To the contrary, apex organization can play an important role in adopting internal codes of conduct, such as those promoted by the Smart Campaign, gathering data on financial cooperatives, providing members with peer comparison information, advocating on behalf of members with the supervisory authority and providing training to members to understand and comply with laws and regulations.

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Apex organizations themselves should not be supervised unless they are intermediating funds among financial cooperatives or consumers. In cases where apexes do operate a “wholesale” financial cooperative for financial cooperatives, this activity should be legally and financially separated from the apex organization and the wholesale financial cooperative should have unique capital, liquidity, investment and permissible service regulations. The separation of financial intermediation activities from an apex organization are especially critical as they can be a point of concentration risk for the financial cooperative sector.

G. Public Schemes for Agricultural Finance – Brazil case study

Financial cooperatives themselves and the members they finance are often involved in small and medium enterprises in the agricultural sector. To highlight how financial cooperatives can effectively work with public credit schemes to finance farmers, this case study from Brazil explores the role of Credit Cooperatives in channeling public funds and providing guarantees for SMEs.

Credit cooperatives were first formed a century ago in the southern states of Brazil, and are today a mature alternative to banks. As of June 2016 Central Bank of Brazil reports over a thousand existing credit cooperatives organized in regional “central” associations and apex national confederations of associations.

Confederations	4
Central Credit Cooperatives	35
Single Credit Cooperatives	1045
Total	**1084**

The four national credit cooperative confederations are Sicredi with 121 cooperatives, Sicoob with 482 cooperatives, Unired with 43 cooperatives and Confesol with 152 cooperatives. The role of the national confederation is to establish a common brand for the network, organize operational activities and coordinate the system-wide actions of their members while the centrals organize/standardize financial services and procedures, centralize operational activities and perform auxiliary supervision. The entire credit cooperative system holds $130 billion in assets which represent 2% of the total Brazilian financial system. Credit cooperatives in Brazil have a strong and stable presence in the regions and rural areas and as this case study shows, the trust they have in the rural communities and their increased efficiencies and innovations has allowed them to become one of the most important partners in channeling public funds and providing guarantees for micro and small enterprises (MSEs).

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Despite the fact that MSEs, including producer organizations and family farming cooperatives, account for 95% of Brazilian firms, and generate some 16.6 million formal sector jobs, Brazil has been facing a chronic deficit in terms of financial support to MSEs, especially in the rural areas. Research done by the World Bank (2010)[7], showed that 52% of MSE lacked access to credit, 46% noted the absence of collateral guarantee and 40% the high interest rates charged as significant barriers for access to credit. In addition, banks find it difficult to evaluate the creditworthiness of MSEs in remote areas, combined with higher cost of processing smaller loans, and the complexities of enforcing loan contracts.

As a response to these challenges, the government has been using public banks such as Banco do Brasil to increase the supply of loans. Banco do Brasil is a first-tier universal bank predominantly owned by the central government. As the largest provider of rural credit in Brazil, it operates nationwide and is an important bank for small businesses. To grow MSE's and small farmer's access to affordable finance Banco do Brazil initiated a public policy initiative called PRONAF (Programa Nacional de Fortalecimento da Agricultura Familial). PRONAF's main goal is to strengthen family farming and provide income support. It benefits agricultural producers who rely on family labor by allowing them to borrow at subsidized interest rates. Banco do Brasil partners with the credit cooperative network to extend PRONAF's funds to farmers.

Role of Credit Cooperatives and Apex Institutions

One of the most important partners of Banco do Brazil is the credit cooperatives network which extends working capital and investment loans funded by public programs such as PRONAF. Credit cooperatives have been known for their essential role in financing rural producer organizations and family farms , including disbursing government lines of credit to rural entities. By their nature, cooperatives can reach remote rural clients more easily than banks. Some financial cooperatives have a presence in areas where there are virtually no commercial banks or microfinance companies. The southern region of Brazil includes three states (Santa Catarina, Parana, Rio Grande do Sul) that account for close to 50% of the agricultural GDP, and has at the same time the longest tradition of cooperative organizations.

Credit cooperatives have become an important segment of the National Financial System, having undergone growth and many changes since the passing of the Cooperative Law (5,763 / 1971). They reorganized in the 1980s under their current model, as provided for in Resolution nº 2.788/2000. The Central Bank has been working since the 1990s to strengthen this sector, focusing particularly on measures to prioritize the growth of the cooperatives in a safe environment. These efforts have resulted in their improved outreach and credit cooperatives remaining the main providers of

[7] World Bank Enterprise Surveys https://finances.worldbank.org

microfinance in Brazil. The Brazilian credit cooperative system has made important advances since the 1995 permission to establish cooperative banks, (also known as banks for cooperatives) which are banks that hold deposits, make loans and provide other financial services to cooperatives and member-owned organizations. Cooperative banks have lent to their member cooperatives and have allowed for a rapid expansion of credit cooperatives, combined with growing professionalism and a broader range of services. For example, members of SICOOB and SICREDI, the largest financial cooperative national confederations, can issue credit cards, offer internet banking, issue trade credits including letters of credit, and provide insurance (life, nonlife, and rural) through the cooperative bank they own.

New legislative measures introduced in 2003 have led to expanding membership in remote areas by allowing 'open-admission'[8] credit cooperatives to be established, and by creating a more level playing field with banks through the harmonization of capital requirements. As a result, between 2000 and 2010, the number of credit cooperative service points increased from 2.6 to 6.4 thousand and the number of credit cooperative members rose from 1.5 to 5.1 million nationwide. Credit cooperatives are now present in 40% of Brazil's municipalities and in 25% of municipalities without a bank branch.

The National Monetary Council is the main body issuing financial sector regulation, while the Central Bank of Brazil is in charge of supervising all the credit cooperative systems including their confederations, central credit cooperatives or single credit cooperatives. The monitoring activities done by the centrals of their affiliated cooperatives represent an additional auxiliary supervision which was established by Resolution nº 4.434/2015. Overall, financial cooperative legislation has become increasingly aligned with that of Brazil's financial sector. The government's interest in developing this sector largely stems from the fact that most of these cooperatives improve financial inclusion[9] in the country as they operate outside the large metropolitan areas to collect deposits and extend credit within their area of operation in the community while serving the interests of their members.

Guarantors for Agricultural Finance

The lack of MSE collateral has led to the creation of several public-funded guarantee schemes. Most of these credit guarantee schemes can be interpreted as risk-sharing tools to supplement the guarantees provided by credit cooperatives and other financial institutions. In order to use additional guarantee schemes, credit cooperatives have worked with a number of public funds[10] managed by Banco do Brasil.

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[8] Resolution No. 3,106 of 2003 allows the formation of "open-admission" credit cooperatives in localities with less than 100 thousand inhabitants, as well as the conversion of existing credit cooperatives into "open-admission" in locations with population under 750 thousand inhabitants. After the resolution was passed, credit cooperatives were no longer limited to membership groups (e.g. employees of companies, farmers or entrepreneurs) and allowed open admission of members of different groups and diverse origins and economic activities.

[9] Financial inclusion is defined in this context as the provision of savings, loans, payments and insurance services to low-income or unbanked individuals or enterprises.

[10] FCO (Fundos Constitucional de Financiamento do Centro-Oeste), FUNPROGER (the Guarantee Fund to Create Jobs and Income) and FGO (Operations Guarantee Fund). FUNPROGER was only directed to guarantee finance to private borrowers, small businesses (including start-ups and informal businesses), microfinance institutions and credit cooperatives.

As mentioned earlier, credit cooperatives play an important role in channeling public funds such as PRONAF and catalyzing efforts by providing guarantees to credit agents, selecting applicants and assisting in the design and monitoring of projects. It has contributed to the significant increase in the number of farmers benefiting from rural credit, as well as providing a set of other business training elements necessary for the process of development and consolidation of farms.

In 2016 the SICREDI confederation's rural credit portfolio accounts for 34% of the total funds disbursed PRONAF, of which 23% is made up of the SICREDI confederation's own resources and 77% comes from subsidized funds. The SICREDI confederation channels public funding to its member financial cooperatives, and its primary source of subsidized funds is from PRONAF which targets credit for family farmers. The loan terms for rural credit ranges from 1 up to 12 years, with an average of 5-year loans. The maximum loan amounts allowed under this program are R$5,000 (US$1,600) for working capital and R$15,000 (US$4,800) for investments in fixed assets.

Among private banks, Bradesco claims to be the main lender to small farmers. It lends in amounts not exceeding R$30,000 to R$40,000 (US$9,600-12,900) per farmer, and its agricultural loan portfolio accounts for about 10% of its total loan portfolio. Bradesco also on-lends a substantial part of its agricultural lending to cooperatives, which on-lend to their members.

Another player in the southern region is the BRDE (Banco Regional de Desarrollo del Extremo Sur). BRDE is also working in collaboration with the SICOOB and Cresol confederations to provide rural credit through on-lending to small rural producers and micro entrepreneurs.

BRDE has made approximately 6,000 fixed investment loans per year with funds from BNDES (National Bank of Economic and Social Development). These loans are made through and guaranteed by rural credit cooperatives in the three southern states of Brazil. For operations of up to R$10,000 (US$3,200), the guarantee is provided directly by the credit cooperatives, without the need for collateral. Value chain financing is utilized for larger loans between R$10,000 (US$3,200), and R$100,000 (US$32,000). In these instances the credit cooperative provides a local endorsement from the processing cooperatives or integrated company of which the rural producer is a member. In the Santa Catarina region the SICOOB confederation created a guarantee fund, for situations when it is not possible to provide the endorsement of the production cooperative or integrating company.

The Cresol Confederation is another example of a cooperative network with local family farmers as members of individual cooperatives. The family farms are linked by a service center responsible for accounting and standardization of the operations carried out by the cooperatives that are part of the Cresol confederation. The Cresol confederation covers a large part of the southern region of the country, serving more than 25,000 members in 192 municipalities, operating with 69 individual cooperatives. Cresol system is channeling municipal, state, and federal resources to its member credit cooperatives by facilitating access to rural credit and support the development of regions in which they operate. Cooperatives often function as intermediaries between farmers and government officials, taking care of information gathering and guaranteeing activities, forming groups of farmers who provide a cross-guarantee, or endorsing transactions, especially for investment operations. In addition to guarantees, cooperatives provide analysis, inspection, collection and monitoring services for fixed investment financing. The cooperative also drafts the contract and collects the signatures of the agreeing parties.

The performance of credit cooperatives explains the success of the public policy initiatives described above as cooperatives take responsibility for the risks and operational activities involved in credit contracts, while receiving a percentage of what is charged by the official agents. The PRONAF partnerships with credit cooperatives in the role of guarantor and also in channeling public funds is considered one of the most successful experiences in Brazil and one of the fastest way to implement access to financial services for MSEs and small farmers.

H. Check List for Well-Functioning Public Credit Guarantee Schemes

In 2015, the World Bank convened an international task force to develop Principles for the operation of Public Credit Guarantee Schemes for small and medium enterprises. The expectation is that with well-functioning schemes the approximately $1 trillion credit gap for SMEs in emerging markets could be at least partially closed. The scope of application of these principles recognize that many SMEs also operate in agricultural markets and as such these principles are applicable for agricultural credit schemes. Below are the World Bank's 16 principles for Public Credit Guarantee Schemes (CGS).

Legal and regulatory framework

1. Establish the CGS as an independent legal entity.

2. Provide adequate funding and keep sources transparent.

3. Promote mixed ownership and treat minority shareholders fairly.

4. Supervise the CGS independently and effectively.

Corporate governance and risk management

5. Clearly define the CGS mandate.

6. Set a sound corporate governance structure with an independent board of directors.

7. Design a sound internal control framework to safeguard the operational integrity.

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8. Adopt an effective and comprehensive enterprise risk management framework.

Operational framework

9. Clearly define eligibility and qualification criteria for SMEs, lenders, and credit instruments.

10. Ensure the guarantee delivery approach balances outreach, additionality, and financial sustainability.

11. Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders.

12. Set a transparent and consistent risk-based pricing policy.

13. Design an efficient, clearly documented, and transparent claim management process.

Monitoring and evaluation

14. Set rigorous financial reporting requirements and externally audit financial statements.

15. Publicly disclose non-financial information periodically.

16. Systematically evaluate the CGS' performance and publicly disclose the findings.

VI. Conclusion & Recommendations

This paper has identified how apex organization can work to ensure an enabling legal and regulatory environment for financial cooperatives. This has included the identification of international, national and regional organizations, issues to engage in the process of enacting legislation, and the rationale and key content of enabling legislation and regulation for financial cooperatives. This information was supported with in-depth and practical case studies of how an apex of financial cooperatives in Kenya helped bring about one of the first independent laws for financial cooperatives in Africa and how apex organizations in Brazil work with partners to participate in public credit guarantee schemes supporting agriculture.

Apex organizations can also play an important role in adopting internal codes of conduct, gathering data on the sector to aid advocacy work, monitoring the health of the sector, providing members with peer comparison data, providing training to members to better understand and comply with laws and regulations, and, of course, serving as the champion in creating an enabling environment for financial cooperatives.

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