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## **CORPORATE GOVERNANCE IN THE COOPERATIVE BANKING SECTOR IN POLAND**

**Abstract.** The corporate governance principles in the cooperative banking play crucial role in complementing institutional supervision and supporting internal controls. This paper discusses the selected issues of corporate governance in the cooperative banking sector in Poland. It outlines the contemporary challenges of corporate governance principles in the Polish cooperative banking sector related to external and internal supervision of banking activity. In addition, this paper aims to answer the question whether and to what extent the Polish cooperative banks have adopted the recommendation of the Polish Financial Supervisory Authority with regard to corporate governance in the banking sector and the extent to which internal rules for the organization of these banks affect the efficiency and effectiveness of the market. As a result, the following hypothesis was put forward: implementation of the corporate governance principles in the Polish cooperative banks has not contributed significantly to the improvement of their efficiency and has not enhanced the institutional supervision and internal controls in the cooperative banks. According to the authors, despite the existence of corporate governance principles in all Polish cooperative banks, there is still problem with the effectiveness of these institutions. Cooperative banks in Poland have experienced the phase of lethargy since 2013 and reported weaker and weaker financial results. Having in mind the fact that in 2015, that is after 14 years of stability in the sector, one of the Polish largest cooperative banks, SK-Bank, got bankruptcy, nobody predicted this event. It concludes that when it comes to the corporate governance principles the management bodies, regulators as well as supervisors require more effectively cooperation. The results in this paper confirmed that the model of credit cooperative movement adopted in Poland requires implementation of a couple of basic changes that are directly related to the utilization of the principles of a good corporate governance. The current corporate governance rules in Polish cooperative banks lead to having standardised governance without any substantial improvements and promoting better governance.

**Keywords:** corporate governance, cooperative banks, bank ownership structure.

**GEL Classification** G21, G3, M1

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## **КОРПОРАТИВНЕ УПРАВЛІННЯ В КООПЕРАТИВНОМУ БАНКІВСЬКОМУ СЕКТОРІ ПОЛЬЩІ**

**Анотація.** Принципи корпоративного управління в кооперативному банківському секторі відіграють вирішальну роль у доповненні інституційного нагляду та підтримки

внутрішнього контролю. У статті розглядаються окремі питання корпоративного управління в кооперативному банківському секторі Польщі. Висвітлено сучасні виклики принципам корпоративного управління в польському кооперативному банківському секторі, пов'язані з зовнішнім та внутрішнім наглядом за банківською діяльністю. Крім того, ця стаття має на меті відповісти на запитання, чи прийняли польські кооперативні банки рекомендацію Польського органу фінансового нагляду щодо корпоративного управління в банківському секторі та в якій мірі внутрішні правила організації цих польських банків були прийняті, як банки впливають на ефективність ринку. Внаслідок цього було висунуто наступну гіпотезу: впровадження принципів корпоративного управління в польських кооперативних банках не сприяло суттєвому підвищенню їх ефективності та не посилює інституційного нагляду та внутрішнього контролю в кооперативних банках. На думку авторів, незважаючи на існування корпоративних принципів управління в усіх польських кооперативних банках, все ще існує проблема ефективності цих установ. Кооперативні банки в Польщі пережили етап пасивності з 2013 року і повідомили про слабкі фінансові результати. Маючи на увазі той факт що в 2015 році, тобто після 14 років стабільності в секторі, один з найбільших польських кооперативів банків СК-Банк, потрапив до банкрутства, і цю подію ніхто не передбачав. Зроблено висновок, що коли доходить до принципів корпоративного управління, органів управління, регуляторів, а також органів нагляду потрібно вимагати більш ефективної співпраці. Результати в цій роботі підтвердили, що модель кредиту Кооперативний рух, прийнята у Польщі, вимагає виконання декількох основних змін які безпосередньо пов'язані з використанням принципів гарного корпоративного управління. Поточні правила корпоративного управління в польських кооперативних банках призводять до стандартизації управління без будь-яких істотних покращень та розвитку управління.

**Ключові слова:** корпоративне управління, кооперативні банки, структура управління банками

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## **КОРПОРАТИВНОЕ УПРАВЛЕНИЕ В КООПЕРАТИВНОМ БАНКОВСКОМ СЕКТОРЕ ПОЛЬШИ**

**Аннотация.** Принципы корпоративного управления в кооперативном банковском секторе играют решающую роль в дополнении институционального надзора и поддержки внутреннего контроля. В статье рассматриваются отдельные вопросы корпоративного управления в кооперативном банковском секторе Польши. Освещены современные вызовы принципам корпоративного управления в польском кооперативном банковском секторе, связанные с внешним и внутренним надзором за банковской деятельностью. Кроме того, эта статья имеет целью ответить на вопрос, приняли польские кооперативные банки рекомендацию Польского органа финансового надзора по корпоративному управлению в банковском секторе и в какой степени внутренние правила организации этих польских банков были приняты, как банки влияют на эффективность рынка. В результате было выдвинуто следующее гипотезу: внедрение принципов корпоративного управления в польских кооперативных банках не способствовало существенному повышению их эффективности но и не усилило институционального надзора и внутреннего контроля в кооперативных банках. По мнению авторов, несмотря на существование корпоративных

принципов управления во всех польских кооперативных банках, все еще существует проблема эффективности этих учреждений. Кооперативные банки в Польше пережили этап пассивности с 2013 года и сообщили о слабых финансовых результатах. Имея в виду тот факт, что в 2015 году, то есть после 14 лет стабильности в секторе, один из крупнейших польских кооперативов банков СК-Банк, попал к банкротству, и это событие никто не предполагал. Сделан вывод, что когда доходит к принципам корпоративного управления, органов управления, регуляторов, а также органов надзора нужно требовать более эффективного сотрудничества. Результаты в этой работе подтвердили, что модель кредита Кооперативное движение, принятая в Польше, требует выполнения нескольких основных изменений непосредственно связанных с использованием принципов хорошего корпоративного управления. Текущие правила корпоративного управления в польских кооперативных банках приводят к стандартизации управления без каких-либо существенных улучшений и развития управления.

**Ключевые слова:** корпоративное управление, кооперативные банки, структура управления банками

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## 1. Introduction

The World financial crisis has revealed many imperfections and inefficiencies of the banking supervision and the banking sector corporate governance, which, in consequence, has contributed to the loss of public trust in the financial market institutions, including banks. The experience gained over the last years forced supervisory bodies to undertake some measures aiming at the improvement of the banking sector operational standards, its internal organization and corporate governance. One of the main assumptions behind such changes was to increase capital requirements for banks and to strengthen responsibility of bank owners for activities undertaken by the bank governing authorities.

The Polish cooperative banking sector was only slightly affected by the financial crisis. This may be explained by some very specific features of the sector such as a long history of operating on the market, its local nature and restricted market reach, the absence of sophisticated investment products in cooperative banks' offers, extensive knowledge of their customers, owners' commitment and a one member-one vote principle. However, despite those advantages beneficial during the financial crisis, it was necessary to introduce some solutions strengthening corporate governance in the entire EU banking sector. The key document regulating the corporate governance issues at the international level was prepared by the Basel Committee on Banking Supervision "*Enhancing corporate governance for banking organizations*" [Basel Committee on Banking Supervision 2006] and *Green Paper: Corporate governance in financial institutions and remuneration policies* [European Commission 2010]. The CRD IV<sup>1</sup> package was significant interest for banks. The package had very general nature and did not take into consideration any specific features of the cooperative banking sector. Cooperative bank owners and supervisory authorities in particular state authorities were given wide latitude in decision making.

The Polish Financial Supervisory Authority (the body supervising financial market institutions) published "*The Corporate Governance Principles for Supervised Institutions*" on 22 of July 2014. The document became effective for the banks from 1<sup>st</sup> of January 2015. Previously, the banks had been voluntarily implementing codes of good banking practice and codes of bank management. The mandatory introduction of the corporate governance principles into the Polish banks resulted in greater transparency, stronger position of the supervisory authorities and improved

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<sup>1</sup> CRD IV includes Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance (Official Journal of the European Union No L 176/338) and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (text with EEA relevance).

bank-customer relationships. Unfortunately, this document (like the one at the EU level) did not take into consideration the special nature of cooperative banks, treating them like any other commercial banks. Two years after introducing "*The Corporate Governance Principles for Supervised Institutions*" by the Polish Financial Supervisory Authority, all cooperative banks developed and offered the modification of the principles adapting them to the scope and scale of their operations. They also provided the explanations for reasons not to comply with some of the recommended principles.

Taking the above into consideration, the Authors would like to review the following thesis: the implementation of the corporate governance principles in the Polish cooperative banks has not significantly influenced their efficiency and has not strengthened their institutional supervision and internal controls.

Similarly to local financial market institutions, cooperative banks carry out their business in accordance with such values as self-support, democracy, equality, fairness and solidarity. The banks are the significant element of the social market economy. However, a business model adopted by the Polish cooperative banking sector is less and less based on self-support and reciprocity but it comes closer and closer to a business model typical for commercial banks. Cooperative banks have been operating in Poland for almost 160 years and belong to the leading banking groups in local communities. They play a substantial role in the regional development. Their competitive advantage over the remaining types of banks operating in Poland primarily consists of:

- their long history and rich experience,
- their identity and the established position with the market share of 8-10%,
- no significant impact of the World financial crisis on performance of the cooperative banking sector in Poland,
- close relationships and extensive knowledge about local customers,
- excellent identification of customers' financial needs,
- operation in collective structures, what strengthen market position,
- well-developed network of the local entities, facilitating direct contact with customers, providing opportunities for cooperation based on relationship banking,
- implementation of additional legal and organisational solutions such as e.g. IPS (Institutional Protection Scheme), which contribute to the increase of the cooperative banks' internal safety,
- tax preferences — cooperative banks are not subject to the regulations on taxation of certain financial institutions (under the Act of 15 January 2016 on *taxation of certain financial institutions*, Government Journal of Laws of 2016, item 68).

## **2. Literature review and the problem statement**

The majority of cooperative banks are small, rural credit institutions. Cooperative banks follow the principle of one member-one vote, regardless of the amount of capital retained, however, this principle depends on the capacity and size of the banking system [Maroua 2015, p. 714]. The main competitive advantage of the cooperative bank is the ability to raise and hold on local deposits [Fonteyne 2007, p. 13, Ferri 2012, p. 13]. For that reason, members cannot accumulate votes by purchasing shares on the market. Membership is one of the main distinguishing traits of cooperative banks and it can be said that it is the foundation of such an institution. Cooperative banks are characterized by a "multi-stakeholders" model of governance. It is a model of governance that takes into account the different views, such as customers, shareholders, the employees [Groeneveld, Llewellyn 2011, p. 10]. The main difference between cooperative banks and commercial banks (aiming at maximum profit) is that the latter are formed primarily to earn profit and bring benefits for their owners. The competitive advantage and special nature of cooperative banks are described by the fact that their main objective is to achieve basic expectations of cooperative bank stakeholders. Cooperative banks being public trust institutions demonstrate responsibility towards shareholders and their customers as well.

From the European perspective, no single business model for cooperative banks can be found. As emphasized by J.M. Groeneveld, we may differentiate between banking groups driven

by bank stakeholders' interests and banks driven by bank shareholders' interests (cooperative bank shareholders) [Groeneveld 2015, p. 10]. Bonds for members can be considered as an important factor counting for service price differences charged to members by cooperative banks. Economic motivation becomes a decisive factor with regard to membership in credit cooperatives, i.e. cooperative banks. Most local and/or regional cooperative banks are funded predominantly by retail deposits raised locally and do not have external shareholders, i.e. equity/capital providers with voting rights. As a consequence, cooperative banks have a different governance structure and their business orientation is not focused on achieving shareholders' goals. The cooperative bank ownership structure appears to have a profound effect on the priorities and performance of these institutions. Customer ownership places incentives on managers to maximize the long-term customer value [Groeneveld 2011, p. 13]. Their decisions concerning the business strategy depend on many internal and external factors.

The role and significance of cooperative banks as local financial market institutions do not leave any doubt that these are the institutions which, thanks to their assets, have played and may, in the future, play a very important role on the financial services market. In Poland, their role and significance are being reviewed in detail since a target business model for cooperative banks is being searched for on account of their financial and economic problems.

Cooperative banks in Poland play a major role providing access to credit, promoting financial inclusion and supporting the local economy. Cooperative banks are the largest group of monetary financial institutions in Poland: at the end of 2016, there were 559 cooperative banks, 36 commercial banks and 27 branches of credit institutions. The share of the cooperative banking sector in the entire banking system is a stable element of the Polish financial system but since 2015, it has been suffering of some symptoms of instability; moreover, since the transformation of the political system it cannot exceed the level of 10% market share [Alińska, Szelągowska 2016, p. 117-131]. Polish cooperative banks, as customer-owned banks, were much more stable and more efficient during the financial crisis than commercial banks and provided an alternative to commercial banks. In Poland, cooperative banks performed better than commercial banks during the financial crisis [Szelągowska 2011, p. 291]. Cooperatives banks stopped money outflows to protect their assets in the event of financial destabilization in the global banking [Solarz 1998, p. 26]. Cooperative banks also play a special role in fostering local and regional development by mobilizing savings and granting loans in their own region and in the process, limit the extent of "capital drain" from a region [Llewellyn 2014, p. 5].

Financial cooperatives grow mainly through networking: local financial cooperatives group themselves in networks with a central apex to benefit from economy of scale, liquidity in management facilities, additional supervision ensured by the network, etc. The structure of those networks is heterogeneous. In Poland, there are very strong tiers at the regional or local levels. Such situation results predominantly from an organisational structure adopted in Poland - initially a three-tier organisational structure based on the regionality factor and currently, a two-tier structure without any division into regions. Their level of integration also varies a lot: in highly integrated networks, many tasks and policies are centralized, whereas in decentralized networks, major tasks such as human resources management, and policies, such as the setting of interest rate on loans, continue to be carried out by the local cooperatives [Desrochers, Fischer 2005, p. 307].

The purpose of the article is to review the scope of the corporate governance principles applied in the Polish cooperative banks and to evaluate efficiency and effectiveness of their implementation. In this study, the Authors have used the method of analysing literature and bank materials related to the applied corporate governance principles and the source critical method.

### **3. Research results**

The essence of corporate governance in the financial system is to deliver the development conducive balance between interests of all entities involved in operations of financial market institutions (shareholders, investors, borrowers, depositors, managers, employees and other investor groups), with special reference to interests of public institutions responsible for stability and continuity of the financial system [Sablik 2014, p. 232].

Corporate governance is an area of interdisciplinary research combining such issues as corporate finance, strategic management or the organization and management theory. At the same time, in order to apply corporate governance in an efficient and effective manner, it is indispensable to possess the skill of designing, organizing and supervising decision making processes [Jeżak 2013, p. 21].

The issue of corporate governance is not a very vital area of analyses, solutions and activities of cooperative banks. The rules of internal organization of the cooperative banking sector adopted in Poland reflect primarily regulatory requirements and prudential standards imposed by the supervisory authorities. The scope of decision making and activity of such banks' owners/customers directed at achieving objectives resulting from corporate governance seem to be less important in practice. It is, however, systemically essential element of management and stability maintenance, not only in the cooperative banking sector but the entire financial system. In this context, corporate governance may be defined as a set of rules describing internal and external cooperative banks' relationships, including relationships with shareholders and customers, organization, internal controls, key systems and internal functions including also statutory bodies and the rules for interactions between them. Under the corporate governance principles mandatory for the Polish cooperative banks, the cooperative banks organization should enable them to achieve long-term targets. On the other hand, an organizational structure of the cooperative bank is to be adjusted to its specific business, its scale and complexity and its risk profile. The organizational structure comprises all management levels grouped into different divisions covering all crucial processes of the bank. The division of responsibilities, the issues of reporting and control are defined clearly and explicitly in internal rules and job descriptions. The cooperative bank's organizational structure is reflected in supervision rules for divisions, departments and organizational units, internal controls rules concerning the internal controls organization and internal audit.

As far as relationships with shareholders are concerned, cooperative banks should operate in the interests of all shareholders (regardless of the amount and value of shares held by them) respecting customers' interests and providing them access to information. Within the framework of corporate governance, cooperative bank shareholders may influence the supervised institution solely through decisions of the bank authorities, i.e. General Shareholders' Meeting, Supervisory Board and the Bank's Management Board. Under Article 18 § 2 (2) of the Cooperative Law Act of 16 September 1982) consolidated text in Government Journal of Laws of 2016, Item 21), members of a cooperative have the right to be elected to the governing bodies of the cooperative. The management board of a cooperative bank is the sole governing body and is entitled to and responsible for managing the cooperative bank, including running its affairs, planning, organizing, decision making, directing and controlling the bank. The second essential body authorized to act as a governing body is a supervisory board and its members who are expected to follow their objective judgment and assessment while performing their supervisory duties. The provision on the composition of a cooperative bank's supervisory board (Art. 11 (2) of the Act of 7 December 2000 *on the functioning of cooperative banks, their associations and affiliating banks*; consolidated text in Government Journal of Laws of 2016, item 1826) stipulates that a supervisory board of a cooperative bank must consist of at least 5 persons who are also members of the cooperative. The same provision provides that bank employees may be members of the supervisory board on condition their number is not greater than 1/5 of the members. The adopted approach may significantly diminish the effectiveness of owner supervision. Supervisory board members should have appropriate education, guarantee safety of the bank functioning and perform their professional tasks without detriment to their performance as members of the supervisory board, respecting the conflict of interest rules. Individual competences of particular supervisory board members should complement each other so as to enable them to perform adequate supervision over all bank's activities. What is more, the crucial role play assessing the suitability of the shareholders and the fit and proper requirements of all persons who effectively run the business or have other key functions involved in the management of another entity of the same group. The fit and proper requirements

are not well-known in Poland and they are practically not observed. The reason may come from fact that the provision principles were stipulated in the cooperative bank corporate governance principles. According to these principles shareholders are not allowed to take advantage of their position to take decisions on transfer of assets from a cooperative bank to other entities. Nevertheless there were some instances of embezzlement and failure, which caused bankruptcies and serious financial problems of some large Polish cooperative banks over the last years.

In 2015, that is after 14 years of stability in the sector, one of the largest cooperative banks, SK-Bank, declared bankruptcy. One year after implementing the corporate governance principles, that is at the end of 2015, the cooperative banking sector suffered a financial loss of over PLN 1 billion (ca. EUR 232 mln) for the first time in the last decade. The consequences of lowering financial results were the deterioration of basic measures of effectiveness, i.e., increase in the costs index (from 50.5% in 2014 to 76.5% in 2015), decrease in the ROA index (from 1.7% in 2008 to 0.4% at the end of 2015) and decrease in the ROE index (from 19.3% in 2008 to 4.4% at the end of 2015). In October 2016, the Polish Financial Supervisory Authority announced the bankruptcy the second Cooperative Bank in Nadarzyn. At the same time the Cooperative Bank in Ciechanów announced its problem with the financial liquidity. At the end of September 2016 there were procedures pending in 42 consecutive cooperative banks [Komisja Nadzoru Finansowego 2016, p. 13]. All these banks were supervised by the BPS Association or SGB-Bank Association as well as by the Polish Financial Supervisory Authority.

Despite the fact that one of the corporate governance principles adopted in Poland is a provision that a transaction with an affiliated entity should be performed in the interest of the bank and in a transparent manner in compliance with the internal rules of the bank. However the bank bankruptcy was the example of inefficient, incomprehensive or ineffective supervision of owners and public supervisory institutions (Financial Supervisory Authorities). The key problem with the functioning of cooperative banks is information asymmetry between cooperative bank authorities, i.e. the board, and shareholders what could increase a risk of fraud and negative selection related to it.

### **Third-party supervision over cooperative banks**

In 2014, pursuant to the Resolution No. 218/2014 of the Financial Supervision Authority (KNF) entitled “*Corporate governance principles in supervised institutions*”, the basic requirements and expectations of the financial market supervisory authorities towards the supervised institutions were determined. The critical opinions on the aforementioned document, as well as the corporate governance principles defined therein for the financial sector, were presented by A. Hajos-Iwańska, who paid attention to, among other things, lack of unequivocal legal bases for the KNF’s presentation of the corporate governance code to the financial services market, in the form of a summary of expectations that have not taken a form of a legal decree, provision, recommendation or warning [Hajos-Iwańska 2016, p. 243]. The applied method of presenting the corporate governance principles raises doubts not only to the legal regulation formula, but also questions about the KNF’s legal capacity to enforce them. Failure by the banks to comply with the corporate governance principles suggested by KNF may lead to an ascertainment. The Authority is not empowered by the legislator to enforce this kind of requirements. However, it seems that the KNF’s publication of the corporate governance principles can be permitted, as an activity aimed at improving the correctness of market functioning.

In regard to the general guidelines of the Financial Supervision Authority for corporate governance, Polish cooperative banks implemented the corporate governance principles defined as “*Compliance policy in a cooperative bank*” as of January 1, 2015. The prepared corporate governance principles in the sector of cooperative banks cover the following fields of their operation:

- organization,
- organizational structure,
- relations with shareholders,
- executive body,
- supervisory body.

- remuneration policy for employees on managerial positions,
- information policy,
- promotional activities and relations with clients,
- identification and management of key systems and internal functions.

In the context of the current assessment of stability of the sector of cooperative banks, one of the most important aspects seems to be the one concerning the possession of an adequate, effective and efficient internal control system. Due to a small number of employees of cooperative banks, the control job is combined with other duties, and its effectiveness is significantly limited. Furthermore, pursuant to art. 9D sec. 1 and art. 10 of the *Banking Law Act* (consolidated text Journal of Laws of 2016, item 1988), there is no obligation to establish an internal audit unit in those cooperative banks which are associated in the apex bank (BPS Association or SGB-Bank Association). This means a greater responsibility of the apex bank for any irregularities arising on the local bank level.

Apart from internal control conducted on the level of local bank and audit conducted by the apex bank, cooperative banks, as cooperatives, are subordinate to unions of cooperatives and are subject to inspection process. The primary tasks of the unions of cooperatives are conducting inspections and examining financial statements. In Poland, the unions of cooperatives are not obligated to conduct inspections. Cooperative banks enjoy a freedom of action in this field and can have their financial statements examined by an auditing company chosen by them. Some of the banks take advantage of such an option, and the decisive factor when choosing the method of verification of compliance and correctness of functioning of cooperative banks is the financial matter (amount of fee). The legislator, through the provisions of the Act on functioning of cooperative banks, does not impose a specific form of integration, leaving the cooperative banks free to decide on association, rules of cooperation inside the group or number of associated banks. Similar rules are applied in relation to the choice of union of cooperatives and rules of cooperation in this field. The confirmation of the fair share of freedom in executing corporate governance is also the abolition of the obligation of affiliation in unions of cooperatives (art. 15 sec. 1 of the Act *on functioning of cooperative banks*). Pursuant to art. 240 § 2 of the *Cooperative Law Act*, the goal of a union of cooperatives is to provide assistance to the associated cooperatives with their statutory activity, above all in terms of conducting inspections in cooperatives, but also: tutorial, advisory, training and publishing activity, representing the interests of the associated cooperatives before state administration bodies and local government bodies, as well as representing the associated cooperatives abroad. Inspections of cooperatives takes place obligatorily at least once every three years (art. 91 § 1 of the *Cooperative Law Act*) and consists in examining the legality, economy and reliability of the actions taken by cooperatives. Inspections of cooperatives, including cooperative banks, can be conducted by a union of cooperatives in which the cooperative bank is associated, and in case the cooperative bank is not associated in a union of cooperatives, the inspection process can be conducted either by the National Cooperative Council or another union of cooperatives or auditing company chosen by the cooperative bank.

As of the end of December 2016, the following unions of cooperatives were active in Poland:

- Franciszek Stefczyk Union of Cooperatives of Cooperative Banks (approx. 70% of cooperative banks associated)
- Union of Cooperatives of Cooperative Banks in Poznań (12%)
- Beskidzki Union of Cooperatives (7% )

Also the National Association of Cooperative Banks (267 cooperative banks) has review rights; the association serves at the same time as the chamber of commerce associating cooperative banks on a voluntary basis.

### **Characteristics, privileges and requirements towards the members of cooperative banks**

The premises inspiring one to become a member of a cooperative bank result from a number of determinants (economic, social, organizational, prestige-related, etc.). One may identify the positive ones, such as the capability to participate in the bank's decision-making and management

process, as well as the negative ones (responsibility for the functioning of the bank). Yet membership in a cooperative bank also involves responsibility, obligations and costs. A shareholder of a cooperative bank cannot take advantage of any preferences when contracting credits or loans, such possibility is excluded by the provisions of the *Banking Law*. At the same time, shareholders should effectively utilize the tools of ownership supervision, in order to ensure proper functioning of the Management Board and Supervisory Board of the Bank. The Bank's bodies operate in such way to ensure separation of the ownership and management functions. The presence of a shareholder in the management board requires her/his affiliates' (especially in terms of family and business relations, except for the shares in the bank). The role in the bank's Supervisory Body is limited, in order to avoid reduction of effectiveness of the internal supervision. Cooperative banks are an example of distributed shareholding what, in the opinion of M. Aluchna [Aluchna 2015, p. 182] has a lot of advantages and is often seen as an element of the economic system. The primary advantage of such situation is the possibility of collecting significant funds and spreading of risk. However, the distributed ownership structure may create difficulties in executing managerial control and supervision over the institution by investors. Low share makes it more difficult to influence the managerial staff.

In Poland, legal enterprises as well as private people with full legal capacity can become members of a cooperative bank, proving that they meet the requirements determined in the Act and the statute of the cooperative bank. However, legal enterprises (e.g. apex banks) as members of cooperative bank can have a varied number of votes. Members of a cooperative bank may have the legal status of: (1) founding members, (2) members who have been admitted (3) members who have been admitted through reorganization of a cooperative bank [Cioch 2011, p. 161]. Each member of a cooperative bank is obligated to bring at least one share, as well as contributions, if such obligation is provided in the statute. The entity responsible for passing a resolution for accepting anyone as a member of cooperative bank is the management board who keeps the register of members. In case of refusal, a cooperative bank member candidate shall have the right to appeal to the supervisory body. This means that in Poland it is possible to be a customer of a cooperative bank without being its member. Pursuant to art. 10 sec. 1 of the Act on *functioning of cooperative banks*, every member of a cooperative bank is obligated to have at least one declared and paid-in share. The minimum amount of membership share is specified in the statute of cooperative bank. Currently the provisions for financial services in cooperative banks are not determined by having shares in the same bank.

Taking into account the Polish conditions, membership in a cooperative bank involves the following benefits, privileges and possibilities:

- share in excess balance — payment of dividends,
- participation in the Meeting of Representatives and the Meeting of Membership Group of a cooperative bank,
- electing and being elected to the cooperative bank authorities,
- obtaining information on the bank's operations from the cooperative bank authorities,
- familiarizing oneself with the contents of annual financial statements of a cooperative bank and the protocols of the Meeting of Representatives and the Meeting of Membership Group,
- submitting applications regarding the operations of cooperative bank and demanding information on the manner of resolving them.

The effectiveness of cooperative banks' encouragement to membership in cooperative banks is strongly limited. That is mainly due to the fact that the scope of privileges and benefits is strictly defined and not very favorable. Furthermore, in the situation of a cooperative bank's increase of demand for additional equities, it might involve a decision not to pay dividends. Additionally, if a bank paying its members dividends from profit on after tax basis, creates a situation allowing re-taxation of a member of the cooperative bank, the cooperative member will pay the income tax for the second time. Moreover, each member of a cooperative bank is liable up to the double amount of

his shares. To withdraw one's shares, a notice of termination must be submitted, and the receivables can be recovered only after the Meeting of Representatives, provided that the bank does not suffer a loss. Therefore, urgent withdrawal of shares is strongly limited procedurally. At the same time, attention should be paid to the fact that the following principles are indicated as the reasons for reduction of the members fund: regulatory changes implemented on the EU level, regarding the lack of possibility to credit the members fund towards equities, the anticipated possibility of prohibiting the payment of shares credited towards own funds, or the limitations resulting from the dividend policy. These elements efficiently restrict the development of the cooperative banking sector through the rise of the value of equities.

Additionally, the applicable law do not allow the possibility of crediting the members fund towards banks' own funds, the so-called CET I, which means that there is no possibility to capitalize them effectively. In the case of cooperative banks which have a large number of shareholders being private people, imposing on them an additional obligation of providing financial support is unenforceable and irrational. Therefore, cooperative banks have decided not to apply the principles specified in those regulations. However, the Polish legislator has been obligated to comply with the regulation of the European Parliament and Council (EU) No. 575/2013 dated June 26, 2013 (CRDIV/CRR). Being aware that cooperative banks might have problems with the fulfillment of the requirements regarding own funds and to maintain the stability of the financial system, limits on return of shares in banks experiencing problems were introduced. The factor supporting the security of the cooperative banking sector is the establishment of institutional protection systems (IPS) at associations, which has allowed to increase the effectiveness of internal control systems and uniform systems of credit risk management, as well as implementation of mechanisms of mutual control and support in the field of solvency and liquidity. The value of the funds available for the participants of both protection systems is PLN 5.36 billion for liquidity support and PLN 567 million for capital support. The number of participants of the protection systems is constantly rising — from among 559 cooperative banks, 470 already participate in IPS.

#### **4. Conclusions**

The model of credit cooperative movement adopted in Poland requires implementation of a couple of basic changes [Alińska, Szelągowska 2016, p.117—131], that are directly related to the utilization of the principles of a good *corporate governance*. One should underline here the limitations and barriers resulting from the prevailing rules of cooperation and co-creation of the market power of cooperative banks. At the same time, one should remember that further development of contemporary cooperative banking depends on elimination of the current disadvantages, which include:

- ineffective and mismatched supervision over the sector of cooperative banks. This requirement pertains to both the ownership supervision and the supervision executed by unions of cooperatives and regional banks towards local banks, as well as by financial supervision institutions;
- failure to apply the principle of proportionality in the regulatory practice. Organizational, legal and financial requirements are often badly adapted to the possibilities of small, local banks. Not all groups of cooperative banking in EU (including cooperative banks in Poland) are based on a business model aiming at creating bank holding companies;
- the attitude of members of supervisory boards, making them poorly engaged in the development of the cooperatives they own. One can identify an attitude of members of cooperative banks who, due to lack of privileges and real benefits resulting from the membership in a cooperative bank, escalate the discrepancy in terms of goals between owners, supervisory boards and management boards of cooperative banks. Moreover, a low value of shares does not encourage the owners of cooperative banks to become engaged in the execution of ownership supervision;
- the increasing tendency of cooperative banks to abandon the cooperative principles and missions in their daily activities in favor of increase of commercialization, which in turn causes alteration of the business model of these banks;

- limited conditions for a close and subjective cooperation between cooperative banks and apex banks, as well as inside the group. Lack of internal integration also manifests itself in the level of cooperation with unions of cooperatives and other entities from the environment of the sector of cooperative banks.

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