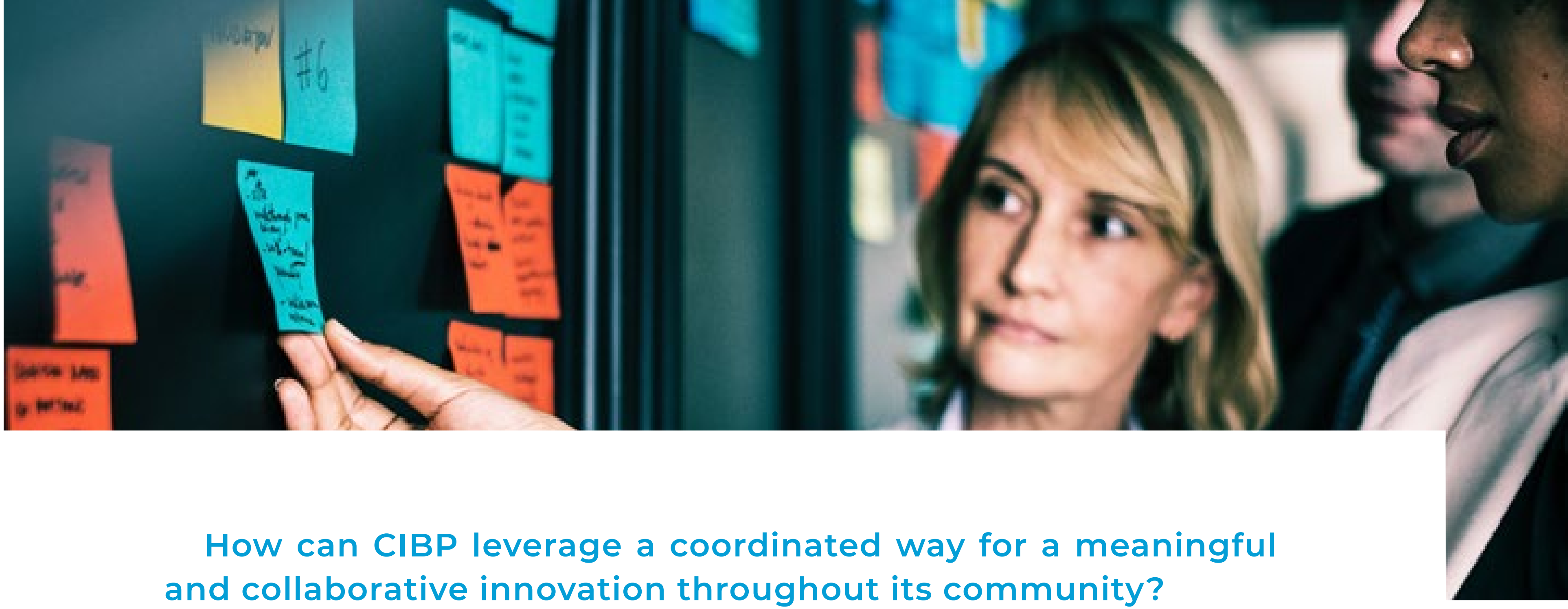
CIBP SPRINT

COCREATING VALUABLE CONTENT AND INSIGHTS FOR OUR MEMBERS

GOVERNANCE COOP MODEL AND OPPORTUNITIES OF DIGITALIZATION



How can CIBP leverage a coordinated way for a meaningful and collaborative innovation throughout its community?

Taking on this challenge, the CIBP team designed a solution: the SPRINT.

The SPRINT connects and engages specialists and seniors in an international approach of innovation and technology. This is a collaboration from inside and outside CIBP members to generate knowledge, tools and experiences to be used by all members. Based on a methodology of innovation sprints, our focus is to produce relevant material from within the community to serve real challenges.

How does this work?

After selecting a theme of innovation and technology that has multiple implications in banking and financial services, in coop models or product trends, the SPRINT team will deep dive in the matter with data and cases and share same report drafts to encourage CIBP members to share their own experience. After that, an insightful and practical report will be produced.

Community engagement is the backbone of a successful SPRINT. Reach out to the CIBP team to co-create the next one.

Executive Summary

This report provides an analysis of cooperative governance, discussing the uniqueness elements of cooperative model that shape policies and practices in the relations with customers, members and the board. This report also puts a light on the impacts and opportunities of technologies in governance models.

Three specialists collaborated with the discussions in this report, contributing with their researches and outlook. Mr. Eric Lamarque, author of several articles and books on the management of banks, shares his findings in building a framework to assess different governance models, considering important aspects such as number of decision-making levels and the influence and authority of each level. Mr. Pedro Andrade, a blockchain enthusiast entrepreneur, points out the opportunities towards innovation and technology, in which blockchain and digital tools can foster trust, transparency and participation in decision-making processes. Mr. Raymond Oliger, former President of Banque Populaire Lorraine Champagne and of the Fédération Nationale des Banques Populaires, draws attention to the importance of assessing coop governance model in the face of principles of cooperative governance, highlighting criteria like balance, transparency, credibility, independence and sustainability.

The report gathers different references to help financial coop institutions to rethink their governance model, making possible to evaluate how their practices are leveraging coop values and to evaluate their readiness to adopt technology trends.

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Introduction

"We design therefore we become". This quote from Jason Silva, one of the most influential futurists of our time, sums up the changes we are facing in this digital era.

Based on a set of principles and values we design the best tools to match our needs, to solve the problems we want; at that time. The way we get educated, the way we collaborate, the way we make our organizations last. All these tools, in the end, shape the way we think, we act and interact. We have designed the cellphone to overcome a communication gap and now our devices shape the way we interact with each other and with the world through data.

How are we taking opportunities in this dynamic era to change old systems and models?

In this challenging scenario, this report brings us content about how building a successful model for cooperative governance, regarding the organization of decision making processes and in the light of technological trends that may reshape our models.

This is an opportunity to rethink current models and design new approaches to innovate in our organizations. From voting systems that ensures that every single voice is heard to decentralized control to foster trust. All based on and leveraging coop values. What we design shapes us and our environment back. In the end, we design therefore we become.

Coop Governance Model

Financial cooperative institutions stand for responsibility and social cohesion since their creation in the 19th century. Supporting their operations, unique in the principle-based services and ownership model, innovative governance models are designed as the fundamental structure to add value to their customers and members. And now, the pace of technology transformation is pushing forward their evolution.

Deloitte, the largest professional services network in the world, defines Governance Model as: "the mechanism used by the board and management to translate the elements of the governance framework and policies into practices, procedures, and job responsibilities within the corporate governance infrastructure."

Coop governance is oriented by a set of principles that also establish the constraints and challenges in designing its model.

Proximity to customers: *coop banks are part of their communities, having a deep connection with their customers. The local support stems from a dense network of branches.*

Democratic Structure: *members and customers have a role in the coop governance model. The "one member one vote" principle shapes the governance structure.*

Trust in relations: *coop banks are relationship banks. Therefore, trust and credibility are key. Governance model builds trust by reducing misinformation often seen in the relation between clients, members, managers and directors.*

Resilience: *proximity to communities help coop banks to anticipate and adapt to new circumstances. Being able to change their objectives and design services in advance may be essential to a faster decision-making process.*

Solidarity: *coop banks are deep-seated in real economy, providing credit to households and small and medium enterprises. They promote entrepreneurship at the individual level, fostering the common good of society.*

Sustainability: *positive social impact comes with environmental responsibility: Coop banks promote services and investments that enables a sustainable development.*

Traditional governance model is characterized by top down decisions: setting objectives, defining managerial activities, committing to results for shareholders. A central body owns local branches and subsidiaries. Coop governance shifts this established model: bottom-up decisions set the protagonism of local branches that own the central institution. Customers become members due to ownership, being active in the definition of strategies and having their voice heard equally.

Besides this common and shared structure, cooperative institutions work with a wide range of governance models. Local needs, national regulation, banking background and future interests create different identities for the institutions. As presented further in this report, a framework is needed to build more than a "one size fits all" model, and to create a path that will constantly help rethink a governance structure rooted in the coop values and flexible in order to adapt to our changing environment.

Technology and Governance

The constant changes in technology in the banking sector impacts the business models, from the traditional banks to smaller cooperative financial institutions.

Digitalization brings well-known opportunities over product and service development. Accounts, credits and mortgage loans are easily offered online, replacing the face-to-face services at bank's branches. But technology also opened the market to fintechs that offer customer-oriented products. The focus on customer experience and digital interface is attracting an increasing number of customers, shifting from old "brick only" models. At last, digitalization is an opportunity for scaling up with a small investment.

Governance has an impact in the rapid adoption, or not, of trending technologies for the transformation of traditional services into e-banking profile. Openness to innovation, risk taking, fast decision-making and agile product and service development are elements shaped by the governance model.

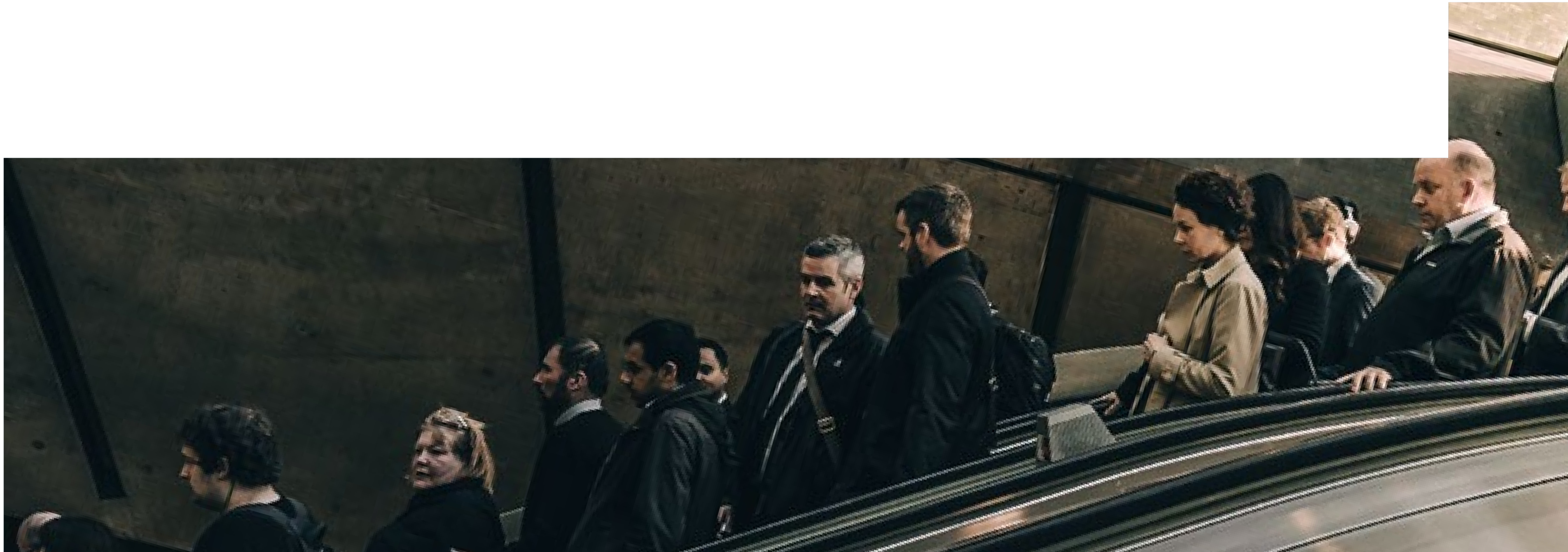
Which technological trends may impact the governance structure of coop financial institutions?

big data and predictive analytics: *the ability to collect massive amount of data and predict events. This technology can improve the efficiency on monitoring and tracking the usage of resources, making possible to prepare for future effects like economic crisis or regulation change. The use of information can empower groups, making decision processes faster and based on data. Therefore, data governance, data security, compliance risk and privacy are new board issues implicating different processes, operations and strategies.*

digital governance: *online voting, open virtual discussions and information access; these are some opportunities that increase the influence and involvement of people in governance processes. Adopting these technologies can decentralize dominant voices, leveraging participation of all and improve trust.*

blockchain: *decentralized storage of data and transactions between links. Thanks to this fundamental element in the building of blockchains (blocks of information identical across the network) a blockchain can not be controlled by a single entity and has no point* *of failure. Everyone is accountable in a distributed system where everybody register via a secure validation mechanism. Governance can become fully transparent and verifiable when elections and decision-making are run through blockchains.*

artificial intelligence: *autonomous decisions in specific tasks within certain programmed parameters. This technology autonomously solves complex problems, giving faster responses than humans on credit applications or insurance pricing, based on gathered data. Virtual assistants chatbots and automated personalized review summaries are already the implementation of artificial intelligence in banking services and products. AI brings questions to managerial structure on accountability for decisions made by algorithms.*



OPINION FROM EXPERTS

We heard experts from different areas of study, from coop governance model to blockchain, to collect perspectives and insights that help to deep dive in understanding governance model and digitalization opportunities.

Governance Models

ERIC LAMARQUE

Eric Lamarque is a professor at the University Paris 1 Panthéon Sorbonne within the IAE of Paris where he directs the Master of Finance. His research focuses on issues of strategy, governance, organization, and performance in financial institutions. Author of several articles and books on the management of banks, he works with the general management of financial institutions to assist them in restructuring and their development strategy, carrying out expertise and study strategic assignments. He is also a member of the Supervisory Board of Caisse d'Epargne Aquitaine Poitou Charente, Member of the Risk Committee, and Director of foundations and training organizations.

We had a conversation with Mr. Lamarque about his experience with governance models and the impact he sees with adoption of technology. Also, this article gathers inputs from two of his papers and a book, all references are presented at the end of this report.

Although coop financial institutions share the same coop principles, they may diverge in a spectrum of governance models. In-depth understanding of the processes that govern the model is key for transparency and trust.

In his article "Identification and valuation of cooperative banking Models", published in 2014, Mr. Lamarque conducts a study using a framework for analyzing coop governance and then assigning performance profiles, highlighting the different coop governance models. The analyses were based on two dimensions:

1. the number of decision-making levels, split in three levels (local, regional and national or central);
2. the influence and decision-making authority of each level, evaluated by three criteria: the type of decision at each level, the effective level of autonomy and the influence of governance structure on the management.

Adding to this framework, four different interactions were investigated that contribute to the decision-making process in coop organizations: interactions between levels of management, interactions between governance and management structures, interactions between different levels of the governance structure, and interactions with members/customers.

In order to collect data and validate the identification of the governance models, Mr. Lamarque conducted 15 interviews with 8 financial cooperatives and received answers from 50 banks to a survey questionnaire.

First highlights from the respondents were a common set of principles. Although they are implemented differently in each coop bank, they are what distinguish them from traditional banks. 4 principles were detailed:

1 Unique practices for allocating earnings

Members vote to determine the returns paid on ownership shares and evaluate the performance of general managers at the local and regional levels. Every member votes regardless of their equity share or in the amounts of their deposits.

2 Autonomy

Local boards have a role and an importance in the management. There is a common strategic alignment between local, regional and national levels and the autonomy of local manager depends on the degree of oversight provided by the upper level.

3 Accountability

General managers play a role of building relationship with customers and members that participate in the activities. Accountability, therefore, is an exercise of listening, providing support to members and respecting the relationships.

4 Recognition

freedom and autonomy to make decisions are primary incentives to elected officers, giving meaning to the work. In the same way, customers contributions as members are valued.

In the end, three main governance model were identified by the cases studied:

1 Centralized governance model

In this case, the organization counts on a central body with strong influence in the decision-making processes and able to push its authority across all levels. Elected members, general assemblies and boards provide assistance for management decisions made at the regional and local levels.

2 Shared decision-making model

In this model, decision-making authority appears to be relatively significant at both national and regional levels. It's a harder model to pin down given that the distribution of decision-making between levels tends to vary from one period to the next. Decisions are often built in common. In recent years regional entities have increased their level of influence on group decisions. Elected assemblies are consulted at the regional and local levels but do not set objectives.

3 Decentralized governance model

local and regional level have significant authority over all key functions. The central body's job is to monitor the performance of local entities, centralize financial data, support implementation of development strategies, and manage liquidity. This model can be broken down into two types, with decision-making authority being concentrated at either the local or regional level. Elected assemblies at the regional and local levels are consulted and may participate in making strategic decisions and defining objectives.

Based on all this experience, when asked about how governance models are adapting to digitalization opportunities, Mr. Lamarque points out the better circulation of information inside the organization. Virtual tools and technologies may improve participation of members, promoting virtual proximity to general assembly, organizing voting, even remote voting to elect board members. This brings more people to discuss, increasing diversity and enabling more communities to engage in the decision-making. Digitalization when applied to these processes improve transparency, make representation more legit and strengthen relationships.

Blockchain Opportunities and Challenges

PEDRO ANDRADE

Pedro Andrade is an entrepreneur, full stack developer, emerging technologies consultant, decentralized solutions architect and instructor. He has worked as innovation and digital transformation consultant in the retail market. More recently, he has been given blockchain and smart contract trainings in Latin America and worked in a mobility ICO (Initial Coin Offering) in Austria. He uses his software development skills to bring ideas to life, mainly about positive social impact. Pedro helps organizations to understand emerging technology, mainly Blockchain and decentralized technologies, and its impacts in their businesses.

We did an interview with Pedro and talked about the changes and opportunities that organizations may find in this (still) underexplored technology of blockchain.

1. Blockchain may threaten some of the current governance systems. What aspects of governance may be impacted by blockchain technology?

The biggest impact in my opinion is allowing people who don't know or trust each other to collaborate on decision-making. One very known example is called DAO (Decentralized Autonomous Organization) which is basically a set of smart contracts that, among other things, allow participants to submit, fund and vote for projects. Because the source code is public, run by many computers worldwide which are not under control by any particular peer and can't be frauded, participants can trust the system and work together.

Other key aspect of blockchain technology that could inspire the creation of new models of governance is how incentivization is used over restrictions to obtain certain desired outcomes. The idea is to add a charge for an action instead of forbidding it because the latter would require more control over the network.

2. Participation in a traditional governance model is proportional to the company share. Coop model is based on 'one member one vote' for electing representatives. How may digitalization and blockchain technologies foster this coop principle and which changes may it implicate?

I believe that the digitalization is a great opportunity to rethink organization's processes to ensure that things are being done in the most efficient way. In the case of voting, we could start by asking ourselves: when voting is the best approach to decision-making and when it is not? What could we do instead of voting? Who should be allowed to vote? What are the fairest voting mechanisms?

A couple of examples:

We may wish to always vote for ourselves in themes A and B but, because we trust a peer X on the matter C, we can leave to X all the decisions regarding this matter. This delegation mechanism can make voting process faster and increase the quality of decisions.

Quadratic voting is a procedure that allows voters to express the intensity of their desires by buying voting power. So, instead of each participant having one vote, they could have many according to how much they care about certain issues. Besides the price increasing exponentially we could also place other restrictions to ensure the procedure is fair and is not monopolized by richest voters.

3. What are the biggest challenges and gains of adopting a decentralized model in decision making processes? Does it have different implications comparing a big, nationwide company and a small, local one?

I think biggest companies have more to gain as they are more likely to have complex governance processes that could be simplified and broadened at the same time. The biggest gains are exactly this: allowing more participation even from outside the organization if desired.

The biggest challenges are understanding the decentralized mindset and the consequences of it, like: having to spread the control to participants, respecting the outcome of decisions, being mindful of all the possible interactions from participants, correctly align the incentives to reward actors who contribute to the network and disincentivize bad actions, etc.

4. In financial institutions, auditing plays a center role in creating trust in processes. How do you see this changing in the face of blockchain?

First generation blockchains like Bitcoin can be seen as a public, decentralized, distributed and append-only databases. Although these characteristics - along with some cryptographic mechanisms, make conventional auditing virtually unnecessary, it would be troublesome for a financial institution to adopt a blockchain like that due to privacy, law requirements and many other factors.

What I imagine as an initial step is incorporating some of blockchain's features to improve the systems that are in place. For example, having an append-only shared ledger between financial institutions could make consolidation an automatic process.

5. How can an organization evaluate its readiness to these trends in blockchain?

For conventional organizations it may be a challenge to adopt blockchain as it would imply to decentralize at least part of the control the organization holds. It is most likely to be easier in cooperatives as they are by nature more decentralized as decisions are made collectively.

My suggestion is always having a budget to experiment and pilot a few ideas and technologies every year. It doesn't need to be much. In the book "Innovator's hypothesis" Michael Schrage suggest a framework called "5 x 5 x 5" where proof-of-concepts are restricted to a maximum cost of US$ 5000, carried out in maximum 5 weeks by maximum 5 persons. The main goal is gathering information about assumptions which will lead to better decisions when choosing the next projects.

6. Interesting references (links, sites, articles, books) about blockchain and digital governance that you'd like to share:

- Blockchain Governance: Programming Our Future: https://medium.com/@FEhrsam/blockchain-governance-programming-our-future-c3bfe30f2d74

- Quadratic Voting: http://ericposner.com/quadratic-voting/

- Colony project: https://colony.io

Coop Governance Principles

RAYMOND OLIGER

Raymond Oliger holds a degree in philosophy and psychology. He is the former President of Banque Populaire Lorraine Champagne and of the Fédération Nationale des Banques Populaires. He served as Vice President chair of CIBP and is a former member of BPCE Supervisory Board

Mr. Oliger led a working group on governance model in CIBP in 2014. The output was a series of documents comparing models from CIBP members and other key findings regarding the interaction of coop values and governance.

The group did a survey within the CIBP community that confirmed the range of governance models, shaped by their respective environment. Besides the advantage of flexibility in different models, this may bring a lack of consistency, opening an opportunity for regulators to apply the same rules as traditional financial institutions.

The study brings five important perspectives that should be considered for assessing a coop governance model:

1 Balance on the Boards

Representation is key on the elected board and the appointed executive structure. Considering geographic representation favours proximity, diminishing the gap of local concerns and strategy. Socio-professional balance enables cross-over between economic activities. Age and gender balance should also be considered. A balanced representation avoids keeping influence of the same groups

2 Credibility

Representation is key on the elected board and the appointed executive structure. Considering geographic representation favours proximity, diminishing the gap of local concerns and strategy. Socio-professional balance enables cross-over between economic activities. Age and gender balance should also be considered. A balanced representation avoids keeping influence of the same groups

3 Transparency

access to reliable information is a responsibility towards shareholders. This is fundamental for general meetings, that should be complemented by meetings held in the different locations, engaging more shareholders in discussing relevant issues to the bank.

4 Independence

the independence of the deliberative and executive structures should not be a challenge for coop governance. Limiting the number of mandates of elected board and making the "one member one vote" model an universally principle are options to guarantee the independence.

5 Long-term outlook

the sustainability of the model, carrying for the long-term coop principles, can be achieved by management strategies. Focus on management performance in the mid and long-term, disconnect remuneration from share and results and make impossible to share reserves are options investigated in the study.

But, from five to ten years ago, digital revolution shifted the analyses over the fundamental aspects of cooperative governance model. As highlighted by Mr. Oliger, they are three: participation, representation and information. Physical distance that separated members, local organizations and the central decision body shrank with the virtual boundaries of internet. The high costs for sharing information and the logistics of correspondence to voting in assemblies were replaced by accessible tools for participation and for transparency.

Technology disrupts practices on the above governance perspectives and therefore may have a crucial role in nowadays assessments. Digitalization can leverage the balance on the boards reaching a wider panel not only of electors but also of candidates. Direct participation of members via digital tools and also leads to direct democracy, strengthening transparency. No organization would refuse to give access to open information to its members and regulators. Therefore, it is necessary to adopt and improve new communication channels.

The challenge to adapt coop governance models are not only to the technological evolution but also to new mentalities. Mr. Oliger states then: "This revolution-evolution will prevail only if we have the ability to keep a clear vision of our fundamentals and to stay faithful to them".

CONCLUSION AND OUTLOOK

Conclusion and outlook

Governance requires a high level of commitment and a deep understanding of the process. For coop organizations, we must add a tight connection to principles and values.

The governance structure for a coop financial institution does not have a standardized model. Expert Eric Lamarque described a framework used in assessing different models, considering important aspects such as the number of decision-making levels and the influence and authority of each level. Also, it is important to consider the relationship between different parts of the structure, such as different levels of management, governance and members. Expert Raymond Oliger also described the importance of assessing coop governance model in the face of principles of cooperative governance, highlighting criteria like balance, transparency, credibility, independence and sustainability.

Rethinking governance is an opportunity to take a step towards innovation. Digital technologies leverage the chance to reinforce tools to make processes faster, more transparent and reliable to all stakeholders. Expert Pedro Andrade points out the collaboration in decision-making process that blockchain technology can foster.

Values are the cornerstone that differentiate cooperative governance from traditional models. Management activities, deliberation processes and ownership are shaped by these values. Relevant cases of bigger autonomy to local branches and cases of centralized goals setting should be explored in further work, adding value to this governance discussion.

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