Co-operative Credit Institutions in Cyprus

Akis Kleanthous and Athanasios Hadjimanolis

Abstract Co-operative Credit Institutions, in Cyprus, were created in 1909 to save people from usurers and loan sharks, and have grown ever since. As a result of the financial crisis of 2013, and the subsequent lending of Cyprus by Troika, Co-operative financial institutions were forced to merge reducing their number from 100 to just 18 while 99 % of their ownership was passed to the Cypriot state as exchange for a capital injection of 1.5 billion euros and their supervision was passed from the Co-operative Societies Supervision and Development Authority to the Central Bank of Cyprus. Additionally, the Independent Commission on the Future of the Cyprus Banking Sector recommends the merge of all 18 Co-operative institutions to a single legal entity and its disposal to a foreign bank. It is the author's view that, if this happens, the true non-for-profit nature of Co-operative financial institutions will change and their members and the greater society will suffer, as the counterweight to investor owned banks that keeps them in balance will be removed.

1 The Establishment and Evolution of the Credit Cooperative System

The Co-operative movement in Cyprus was created later than in the rest of Europe because of the low education that farmers had and the lack of initial capital (Argyridou-Dimitriou and Kanaris 2012). The foundation of the Co-operative movement in the early twentieth century was the most effective reaction of the Cypriot society against the social and economic suppression of people and especially against usury (CSSDA 2014a). The long period of foreign ruling had its toll

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on the Cypriot society, which created a social system that was against any individual initiative (CSSDA 2014a). Commercial banks were not willing to lend farmers (consisting the 80 % of population in 1881) because of the difficulty in selling the mortgaged property, thus leaving farmers in the hands of usurers who charged interest rates of 30–40 % instead of the legal rate of 9 % (Argyridou-Dimitriou and Kanaris 2012). Under these difficult conditions, the anthropocentric Co-operative idea played an important role both in the economic development and the social progress of Cypriots (CSSDA 2014a).

The first Co-operative company was set up in 1909 with the founding of the "Rural Bank of Lefkoniko" (CSSDA 2014a), aiming at providing short and longer term financing for agricultural purposes (Argyridou-Dimitriou and Kanaris 2012). Its founders were Mr. Ioannis Economides, the Director of the Bank of Cyprus, and Mr. Markos Charalambous, the headmaster of the elementary school of Lefkoniko (Clerides 1947, p. 5). At the beginning, it was feared that the Raiffeisen Credit System would not be effective in Cyprus due to the spendthrift, the illiteracy and the customization of people in being over indebted. Despite this fear, Co-operatives were created according to the Raiffeisen Credit System, as it was very successful in other countries (Clerides 1947, p. 6). This is because the members of credit unions, based on the Raiffeisen model, were generally poor and they had smaller, more seasonal and thus more unpredictable income (Guinnane 1994). Commercial banks were unwilling to service people in rural areas due to the small size of the loans involved, the high cost involved in monitoring their loans and the extreme difficulty in selling the property that was used as collateral (Guinnane 1994). This, rendered the repayment of the loans on fixed loan instalments very difficult, while the Raiffeisen model relied on the strong feelings of solidarity among villagers to put pressure on borrowers to repay and reduce the information asymmetry (on villager's character, competence and on the way money was spend) (Guinnane 1994).

Despite the law of 1914 (Law no. 13 "for Co-operative Financial Institutions"), the development of the Co-operative movement was minimal due to the lack of capital and educated people (CSSDA 2014a). In 1923, a new law was passed providing for the founding of new non-financial Co-operative companies (CSSDA 2014a), but again without any significant change. During the same period, the British ruler gave a loan of UK£20,000 to facilitate the development of Co-operatives and in 1925 the Agricultural Bank was founded, by the British ruler, in an effort to ease the financial problems that the First World War had created (CSSDA 2014a). These loans were granted through the Co-operative institutions, something that led to the steady increase in the number of Co-operatives from 24 in 1924 to 273 in 1935 (CSSDA 2014a). In 1937, the Co-operative Central Bank was founded, aiming to create capital for the Co-operative movement and to become self-financed, by borrowing from the wealthy and lending to the weaker Co-operative institutions (CSSDA 2014a). In addition, the Co-operative Central Bank acted as the government representative for the financing of various developmental agricultural programmes (CSSDA 2014a).

Table 1 Evolution of number of co-operative societies and their membership for the period 1925–1960

Year	No. of societies	Membership
1925	29	500
1930	326	10,000
1935	276	15,175
1938	282	21,172
1940	264	30,950
1947	413	59,000
1950	446	69,000
1955	484	87,300
1960	588	109,800

Taken from Phylaktis (1995, p. 32)

The number of Co-operative Credit Institutions and their membership for the period 1925–1960 can be seen in Table 1:

After Cyprus' independence, in 1960, and until the withdrawal from the government of the Turkish-Cypriot community, there were two Co-operative Development Departments, one for each community (Argyridou-Dimitriou and Kanaris 2012). Up until 1974, the Co-operative movement grew rapidly and contributed enormously to the development of the society and the economy of the new state (Argyridou-Dimitriou and Kanaris 2012). The Turkish invasion, in 1974, left Cyprus in a devastating situation and Co-operatives took a leading role in raising social cohesion and in providing for the housing of the one third of the population that was displaced by the Turkish army (even though 225 Co-operative societies were directly affected as well) (CSSDA 2014a; Argyridou-Dimitriou and Kanaris 2012). As part of the effort, the Co-operative Central Bank financed the founding of new industrial and construction Co-operatives but because of the financial situation and the poverty, these went bankrupt. Therefore, the Co-operative movement was assisted financially by the Cyprus government (with a loan of CY£17.8 million) and the commercial banks (with a loan of CY£4.5 million) or combined: 3 % of Cyprus's GDP of 1980 (Phylaktis 1995). The Co-operative movement was assisted again in late 1980s by obtaining a support package of CY£67 million (or 3 % of Cyprus's GDP in 1989) which was repaid in 2006 (Argyridou-Dimitriou and Kanaris 2012). The Co-operative Societies' Supervision and Development Authority (CSSDA) was created in 1935 under the Ministry of Commerce, Industry and Tourism and, in July 2003 [Co-operative Societies Law of 1985–2011, Law 123(I)/2003], it became independent (Argyridou-Dimitriou and Kanaris 2012). Following the creation of CSSDA, the government decided for the Co-operative Societies Supervision and Development Authority (CSSDA) to supervise the Co-operative societies and, for the Central Bank of Cyprus to supervise the Co-operative Central Bank (Argyridou-Dimitriou and Kanaris 2012).

Since the Co-operatives Act of 1985(22/1985), Co-operative Credit Institutions enjoyed some privileges, i.e. exemptions from stamp duties and mortgage- registry fees, but these were abolished in 2003 [Co-operative Reform Law 124(I)/2003] (Co-operative Central Bank 2014d).

The first legal framework for Co-operatives was put in place, in 1914, with the Co-operative Companies' Law of 1914 "Law 13 regarding the Co-operative Credit Companies" (CSSDA 2014b). In 1985, the law was updated based on Law 22/1985 which subsequently changed several times to improve its effectiveness and to keep it updated (CSSDA 2014b). It is further noted that the Co-operative Special Institutions ("*Θεσμοί*") are prepared by the Council of Ministers and are approved by the Parliament (CSSDA 2014b).

Today, the Co-operative Credit Institutions are governed by the Co-operative Companies' Laws of 1985–2014, the Co-operative Companies' Special Institutions of 1985–2012, and the instructions, decrees and circulars of the Commissioner of the Co-operative Societies Supervision and Development Authority, which regulate all matters that relate to their registration and operation of Co-operative Societies (CSSDA 2014b). However, based on the "Business of Credit Institutions Law of 1997 to (No. 4) of 2013", Co-operative Credit Institutions are under the supervision of the Central Bank of Cyprus for issues such as their licensing, regulation and supervision (CSSDA 2014b).

2 The Current Model

Co-operative Credit Institutions in Cyprus offer the full range of banking products including loans (housing, student, consumer and commercial), deposits, current and overdraft accounts (with or without cheque book), debit and credit cards, internet banking, ATMs, foreign currency, wire transfers, insurance, etc. The operations of Co-operative Credit Institutions are limited within Cyprus and they have no presence abroad. Presently, there is no European Credit Institution (SCE) that operates in Cyprus.

The Co-operative Central Bank acts as the banker for all registered Co-operative companies and as the central banker for the Co-operative Credit Institutions and hence, as lender of the last resort for the Co-operative Credit Institutions, provides liquidity and general support (CSSDA 2010).

Following the accession of Cyprus in the EU in 2004, the Co-operative movement had to adopt a number of reforms in order to comply with the European acquis and be able to continue to function as Credit Institutions (Argyridou-Dimitriou and Kanaris 2012). Furthermore, in response to the EU Directive 2006/48/EC, Article 3, on 1 January 2008, all but one Co-operative Credit Institutions were permanently affiliated to the Central Body (role performed by the Co-operative Central Bank) (Argyridou-Dimitriou and Kanaris 2012). The role of the Central Body is to guarantee 100 % of the deposits and the other commitments of Co-operative Credit Institutions, to satisfy in a consolidated manner the operating requirements (liquidity and solvency ratios) in order to continue operating as Credit Institutions (CSSDA 2010) and to issue instructions to the institutions that are permanently affiliated to it.

In recent years, the adverse financial conditions that were created by the financial crisis of 2008 led the Cyprus government to apply to the *European Stability Mechanism* (*ESM*) (CSSDA 2014a). Based on the obligations that the Cyprus government undertook due to the Memorandum of Understanding, in December 2012 and April 2013, the restructuring of the Co-operative Financial Sector was necessary (CSSDA 2014a). This restructuring plan included the reduction of the number of Credit Unions to 18 (up to the 14th of March 2014), the recapitalization of the Co-operative Financial Sector by 1.5 billion euros through government bonds and further structural and other changes (CSSDA 2014a). The recapitalization of the Co-operative Financial Sector was done by transferring 99 % of the shares in the Co-operative Central Bank to the government (CSSDA 2014a). According to the restructuring plan, the Credit Unions, have the right to buy back their shares from the state by repaying the 1.5 billion euros plus 10 % interest per annum (CSSDA 2014a).

2.1 Minimum Capital Required for the Establishment and Function of a Cooperative Bank

In 2006, Cyprus aligned with the European Law regarding the creation of the European Co-operative Company (SCE) (1435/2003 of 22 July 2003) (CSSDA 2014b).

Following "The business of Credit Institutions Laws of 1997 to (No. 3) 2013", the Co-operative Special Institutions of 2000–2009 regarding the creation and operation of the "Fund for the Protection of Deposits" were abolished and the Fund itself was taken under the supervision of the "Deposit Protection and Resolution of Credit and Other Institutions Scheme"(CSSDA 2014b). It is now governed by a Committee comprised by employees of the Central Bank of Cyprus and the Ministry of Finance (CSSDA 2014b).

According to the unofficial consolidation and translation of "The business of Credit Institutions Laws of 1997 to (No. 3) 2013", the licensing, regulation and supervision of Co-operative Financial Institutions are exercised by the Central Bank of Cyprus and not by the CSSDA as was the case before 9 September 2013 (Central Bank of Cyprus 2013b). Additionally, since 2013 in order to be granted a license, the Credit Institution must have at least 5,000,000 € as its own funds (paid in share capital), in line with the "The business of Credit Institutions Laws of 1997 to (No. 3) 2013" and not only 1,000,000 € {#41.B.(1)(a)(i)} as was previously the case (based on "the Co-operative Companies' Laws of 1985–2012") (Central Bank of Cyprus 2013b).

Additionally, according to the Memorandum of Understanding, the Central Bank of Cyprus had to introduce a minimum of 4 % for the Core Tier 1 capital requirements ratio for the individual Co-operative Credit Institutions that will be affiliated to the Central Body, while on a consolidated level, the Co-operative sector has to have at least a 9 % Core Tier 1 capital requirements ratio (Ministry of Finance 2014).

2.2 *State Tax Policy and Way Credit Cooperatives Distribute Surpluses*

Types of Co-operative Institutions

According to the Law, the various types of Co-operative institutions are the following:

(a) First Level Co-operative company: members can only be physical persons (at least twelve people)
(b) Second Level Co-operative Company: its members could be (a) at least 12 physical persons and one first level Co-operative Company or (b) at least five First level Co-operative companies.
(c) Third Level Co-operative Company: its members should contain at least one Second level Co-operative Company (CSSDA 2014a).

For example, Co-operative Credit Institutions can only be first level Co-operative companies whereas, the Co-operative Central Bank is a third level Co-operative Company as at least one of its members is a second level Co-operative Company (Co-operative Central Bank 2014c). According to CSSDA (2010), the members of the Co-operative Central Bank are exclusively Co-operative Credit Institutions (286 at 31 December 2009) and each member has one vote.

Taxation

Co-operative Credit Institutions pay tax at the normal company rates on the profits that are attributable to their operations with their members (taxable profits are usually apportioned based on the value of members' activity in relation to the total activity for the year).

Maximum Percentage of Ownership

According to the Co-operative Companies' Special Institutions of 1987–2012 (#23), no physical person, can own more than 20 % of the shares of a registered Co-operative company.

Registration of Members

All physical persons can become members of any Co-operative company, as long as they fulfil the criteria of "common bond" (or "bond of association"), i.e. are older than 18 years old and are residents or are the owners of property in the area in which the specific Credit Union is operating (CSSDA 2014a).

Internal Structures

The Co-operative companies are independent organisations and are managed by the Board of Directors which is elected by the members every 3 years during the General Meeting (CSSDA 2014a). The members of the Board of Directors offer their services voluntarily, without any payment (CSSDA 2014a). The election of the members of the Board of Directors of the Credit Unions is governed by the corporate governance rules that were agreed upon during the Memorandum of Understanding between the Cypriot government and Troika (CSSDA 2014a).

Investment of Funds

According to the Co-operative Companies' Special Institutions of 1987–2012 (CSSDA 2012a), Co-operative Credit Institutions can:

(a) deposit their cash in the Co-operative Central Bank and, being granted permission by the Commissioner of CSSDA, to any other bank or registered company.
(b) to invest, being granted permission by the Commissioner of CSSDA, in shares of listed companies or any other company.
(c) to invest, being granted permission by the Commissioner of CSSDA, in Government Bonds,
(d) to buy, renovate or expand its immovable property or buy movable property

Distribution of Surpluses

According to "the Co-operative Companies' Laws of 1985–2012" [#41.(1)], at least 50 % of the surplus should be transferred to the capital reserves. Part of the surplus is returned/ distributed to the members in the form of dividends, based on the number of shares each member has or in the form of dividends according to the value of each member's transactions with the company (CSSDA 2014a). According to the Co-operative Companies' Special Institutions of 1987–2012 [#24(2)] (CSSDA 2012a), the maximum amount of dividend to be distributed is specified in the Special Articles, of the specific institution.

According to the Law, in the case of dissolution of a Co-operative institution, the members which are physical persons are not entitled to any part of the reserves (CSSDA 2014a). These reserves could be used only to create a new Co-operative institution, which will operate within the same area and which will have the same operations as the dissolved institution (CSSDA 2014a). Additionally, any remaining reserves could be used for philanthropic or public purposes (CSSDA 2014a).

In the case of dissolution of a secondary or third level company, the reserves could be distributed to the Co-operative companies that are members, in accordance to the Special Articles of the dissolved company (CSSDA 2014a). Furthermore, it is noted that, after the financial crisis of 2013, the distribution of the surplus of the Credit Unions is dealt by the Restructuring Plan of the Co-operative Financial Sector which was agreed on the Memorandum of Understanding between the Cyprus government and Troika (CSSDA 2014a).

3 The Importance of the Credit Co-operative System in the National Banking Market

The significance of the Co-operatives for the economy of Cyprus was identified even by Troika in the Memorandum of Understanding of 13 September 2013 where it is stated that: "*1.14. Cooperative credit institutions have played a significant role* *in the domestic economy and an important objective of the programme is to strengthen the regulation and supervision of the cooperative sector*" (Ministry of Finance 2014, p. 4).

Phylaktis (1995, p. 38) states that the Co-operative Credit Institutions were important for the Cyprus economy as they "*undoubtedly contributed to the economic and social improvements of the farmers on the island*" and that this was done because Co-operative Credit Institutions had good knowledge of their customers, which resulted from the "*very nature of their structure*". Additionally, Co-operative Credit Institutions encouraged farmers to save money no matter how poor they were and rendered them more self-determined to confront hardships without depending on anyone else's assistance (Phylaktis 1995, p. 38).

According to Rabobank (2008), Co-operative Credit Institutions in Cyprus play an important role in the local banking sector as they have a considerable share of local deposits and loans. Additionally, Co-operative Credit Institutions have presence almost in every town and village of the island and have a network of 500 branches and outlets (Rabobank 2008).

However, the number of Co-operative Credit Institutions has declined sharply since 2005 mainly because of the mergers among themselves following the accession of Cyprus in the EU and the need to comply with the minimum requirements imposed by the EU. More specifically, based on the common position of the European Union and Cyprus, Co-operative Credit Institutions in Cyprus needed to align with the European acquis, which meant changes in their structure and their way of operating as well as merging on a geographical or operational basis (CSSDA 2010). The mergers were necessary to bring Co-operative Credit Institutions up to date and to enable them to face the increased competition from the liberation of the financial system in Cyprus (CSSDA 2010). Additionally, the mergers would facilitate the restructuring and the strengthening of Co-operative Credit Institutions enabling them to operate more efficiently and compete more effectively (CSSDA 2010). Moreover, according to the Memorandum of Understanding, the number of Co-operative Credit Institutions had, by March 2014, to be reduced to the maximum of 18 entities (Ministry of Finance 2014) something that has been achieved. In case that recapitalized Co-operative Credit Institutions become unviable, then these would be merged even further with viable ones (Ministry of Finance 2014). Troika requested that the injection of the capital needed to recapitalize the Co-operative Credit Institutions will be done by the Co-operative Central Bank (using the 1.5 billion euros that obtained from the Cyprus government) only once the mergers are completed (Ministry of Finance 2014). Troika stated that the mergers of Co-operative Credit Institutions were designed to "*achieve viability, efficiency and profitability*" (Ministry of Finance 2014). The Independent Commission on the future of the Cyprus banking sector stated that the number of Co-operative Credit Institutions has indeed been reduced drastically from around 90 to just 18, in an attempt to consolidate the sector and to eliminate the non-viable ones (Central Bank of Cyprus 2013a). Additionally, the Independent Commission's opinion about the future of the Cyprus banking sector is that the remaining 18 remaining Co-operative Credit Institutions should be merged further, into a single entity creating a group of companies (Central Bank of Cyprus 2013a).

Table 2 Evolution of number of Co-operative Credit Institutions in period 1998–2013

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Number of Co-op Credit Institutions	361 (1)	359 (1)	360 (1)	363 (1)	363 (1)	N/A	360 (2)	347 (2)	293 (2)
	2007	2008	2009	2010	2011	2012	2013		
Number of Co-op Credit Institutions	170 (3)	118 (2)	111 (2)	110 (3)	101 (4)		18 (5)		

The table was compiled by the author using data from the Annual Reports of the Commissioner of CSSDA and the final report of the Independent Commission on the future of the Cyprus banking sector
(1): CSSDA Annual Report for 2000- 2002 (page 8, 18)
(2) CSSDA Annual Report for 2003- 2009 (page 58)
(3) CSSDA Annual Report for 2010 (page 69)
(4) CSSDA Annual Report for 2011 (page 72)
(5) Central Bank of Cyprus, 2013a

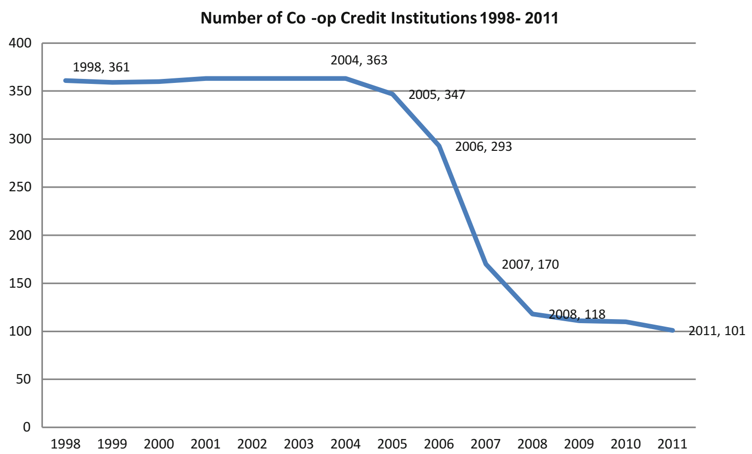


Fig. 1 Evolution of number of Co-operative Credit Institutions in period 1998–2013. *Source*: (1) CSSDA Annual Report for 2000–2002 (page 8, 18). (2) CSSDA Annual Report for 2003–2009 (page 58). (3) CSSDA Annual Report for 2010 (page 69). (4) CSSDA Annual Report for 2011 (page 72). (5) Central Bank of Cyprus (2013a)

The evolution of the number of Co-operative Credit Institutions in operation from 1998 to 2013 is shown in Table 2.

Additionally, the evolution of the number of Co-operative Credit Institutions for the period 1998–2011 is shown in Fig. 1.

Co-operative Credit Institutions are significant in the banking sector of Cyprus having about 20 % of the market share of deposits and 10 % of total assets: locally and overseas (Argyridou-Dimitriou and Kanaris 2012) (Note: Co-operatives have only local presence). Additionally, based on the Annual Reports of the

Table 3 Evolution of Co-operative Credit Institutions' market share regarding local deposits and loans for the period 2004–2012

	Deposits	Loans
	Local market share (%)	Local market share (%)
2004	26.27	26.06
2005	22.96	26.37
2006	22.81	21.70
2007	20.00	22.00
2008	19.00	16.00
2009	22.00	19.50
2010	19.34	20.35
2011	20.64	19.53
2012	21.60	19.20

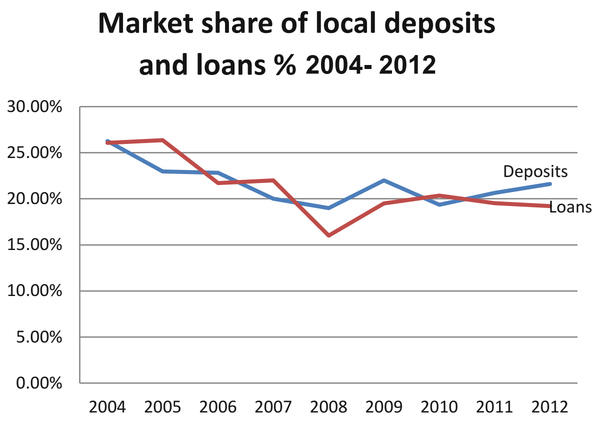


Fig. 2 Evolution of Co-operative Credit Institutions' market share regarding local deposits and loans for the period 2004–2012

Commissioner of CSSDA and the EACB, Co-operative Credit Institutions are very important for the Cyprus economy as they represent around 20 % of the deposits and the domestic loans.

Table 3 and Fig. 2 show the market share of Co-operative Credit Institutions for the years 2004–2012 (Note: data were compiled by the author using data from the EACB website and specifically "Key Figures on the Sector" tables).

The Co-operative Credit Institutions' Deposits, Loans and total assets evolution can be found in Table 4:

According to the Independent Commission on the Future of the Cyprus Banking Sector (Central Bank of Cyprus 2013a), Co-operative Credit Institutions amount to 18 % of the local market share with local commercial banks holding 72 % share and foreign banks that operate locally holding the remaining 10 % share (see Fig. 3). Currently, the banking sector in Cyprus is "*undergoing what is possibly the most severe banking crisis of any country in the EU*" (Central Bank of Cyprus 2013a). Following the collapse of the Cypriot banking sector in 2012, the local banks in Cyprus are undergoing restructuring and recapitalization with the support of the Cyprus government and "uninsured" deposits of customers, in line with a rescue plan agreed with Troika (IMF, ECB and EU) (Central Bank of Cyprus 2013a).

Table 4 Evolution of Co-operative Credit Institutions' deposits and loans in Euros and as market share for the period 1965–2012

Year	Deposits €'000	Deposits Cy market share (%)	Loans €'000	Loans Cy market share (%)	Total assets €'000
1965 (1)	19,859		18,096		
1970 (1)	48,029		41,502		
1975 (1)	84,953		63,275		
1980 (1)	212,878		164,311		
1985 (1)	573,976		492,696		
1990 (1)	1,542,630		1,346,293		
1991 (1)	1,803,955		1,600,903		
1992 (1)	2,102,118		1,893,170		2,355,649
1993 (1)	2,421,532		2,170,660		2,703,349
1994 (1)	2,748,144		2,481,439		3,034,818
1995 (1)	3,076,173		2,821,560		3,398,921
1996 (1)	3,377,796		3,137,618		3,896,466
1997 (1)	3,735,922		3,401,894		4,302,296
1998 (1)	4,128,676		3,643,951		4,500,424
1999 (1)	4,392,280		4,118,095		4,957,299
2000 (1)	4,820,921		4,244,052		5,464,998
2001 (1)	5,312,179		4,304,133		5,975,926
2002 (1)	6,002,937		4,562,393		6,665,821
2003 (2)	6,810,259		5,035,345		N/A
2004 (5)	7,231,000	26.27	5,591,000	26.06	7,849,000
2005 (6)	7,957,000	22.96	6,169,000	26.37	8,448,000
2006 (2)	9,048,075	22.81	6,755,736	21.70	9,739,000
2007 (7)	9,048,000	20.00	6,756,000	22.00	9,739,000
2008 (3)	10,699,113	19.00	10,319,125	16.00	14,773,571
2009 (3)	12,778,512	22.00	11,657,609	19.50	19,068,816
2010 (3)	13,489,794	19.34	13,045,208	20.35	19,936,298
2011 (4)	14,228,868	20.64	13,901,499	19.53	20,766,413
2012 (8)	15,165,000	21.60	13,923,000	19.20	21,169,000

(1) CSSDA Annual Report for 2000–2002 (excludes Co-op Central Bank) (page 22)
(2) CSSDA Annual Report for 2003–2009 (excludes Co-op Central Bank) (page 16)
(3) CSSDA Annual Report for 2010 (includes Co-op Central Bank and ST Lemesou) (page 12)
(4) CSSDA Annual Report for 2011 (includes Co-op Central Bank and ST Lemesou) (page 13)
(5) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_Statistics_2004.pdf
(6) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_Statistics_2005.pdf
(7) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Financial_Key_statistics_2007.pdf
(8) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/FINAL_Key_stats_2012_UPDATED-_financial_indicators.pdf

Fig. 3 Market share of total assets March 2013, taken from Central Bank of Cyprus (2013a)

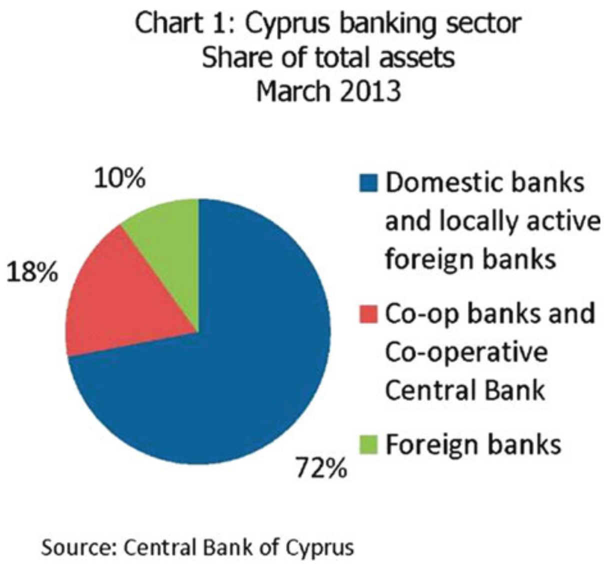
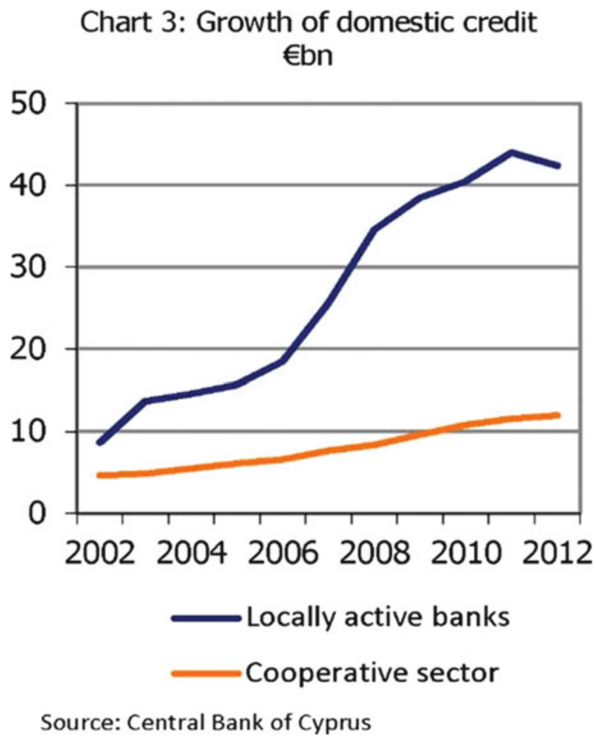


Fig. 4 Growth of domestic loans for period 2002–2012, taken from Central Bank of Cyprus (2013a)



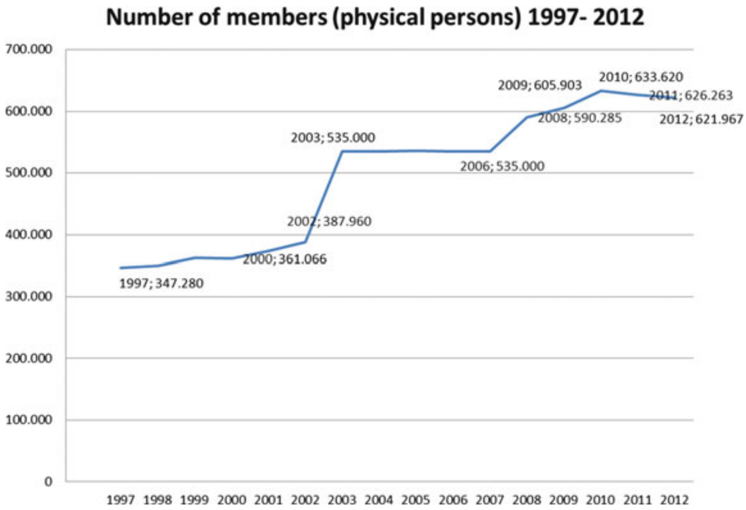


Fig. 5 Growth of membership numbers (physical persons) for the period 1997–2012, prepared by author

As can be seen in Fig. 4, Co-operative Credit Institutions, in contrast to the commercial banks, have not stopped lending even during the years 2010–2012.

The number of members (physical persons) in the Co-operative institutions, regardless of industry, in which they operate is shown (Table 4 and Fig. 5) as decreasing but this could also be due to the process of mergers through which the membership registers are verified and common members are left only once in the registry.

Table 5 shows the number of members (physical persons) in First Level Co-ops (all Co-ops not only Co-operative Credit Institutions), whereas Fig. 5 shows the growth of membership numbers (physical persons) for the period 1997–2012.

4 Crises Problems and Changes

In 2000, the Co-operative movement in Cyprus decided to align with the EU acquis and a transitional period was granted in order to comply fully with the regulatory provisions of the relevant European Union directives (Co-operative Central Bank 2014a). There were two options for the Co-operative movement: (a) each Co-operative Financial Institution would need to satisfy, on its own, the minimal criteria laid down by the relevant directives of the European Union or (b) to create a Central Body (a role that was undertaken by the Co-operative Central Bank) where all the Co-operative Financial Institutions and the Central Body together would have to meet the minimum requirements (Co-operative Central Bank 2014a). Cyprus chose the second option and thus, since 1 January 2008, all Co-operative

Table 5 Evolution of number of members for all first level co-operatives for the period 1990, 1997–2012

Year	1990	1997	1998	1999	2000
Number of members	302,330 (1)	347,280 (1)	350,500 (1)	362,000 (1)	361,066 (1)
Year	2001	2002	2003	2004	
Number of members	373,000 (1)	387,960 (1)	N/A	535 (2)	
Year	2005	2006	2007	2008	
Number of members	536 (3)	535,000 (4)	535,000 (5)	590,285 (6)	
Year	2009	2010	2011	2012	
Number of members	605,903 (7)	633,620 (8)	626,263 (9)	621,967 (10)	

The table was compiled by the author using data from the Annual Reports of the Commissioner of CSSDA (for years 1990–2002) and the EACB Key Figures on the sector tables (for years 2004–2012)

(1) CSSDA Annual Report for 2000–2002 (page 22)

(2) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_Statistics_2004.pdf

(3) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_Statistics_2005.pdf

(4) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_Statistics_2006.pdf

(5) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Financial_Key_statistics_2007.pdf

(6) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_statistics_Financial_Indicators_2008.pdf

(7) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_Financial_Statistics_2009.pdf

(8) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/Copy_of_Key_stats_2010_-_financ_indicator_revised_for_website_.pdf

(9) EACB, Accessed on 14.4.14); https://www.globalcube.net/clients/eacb/content/medias/key_figures/Key_stats_2011_-_financial_indicators_new.pdf

(10) EACB, Accessed on 14.7.14; https://www.globalcube.net/clients/eacb/content/medias/key_figures/FINAL_Key_stats_2012_UPDATED-_financial_indicators.pdf

Financial Institutions, apart from the Limassol Credit Union Ltd (which has chosen to comply independently), have joined the Central Body, signing the relevant Association and Warranty Agreement, and are now authorized Co-operative Financial Institutions by the Central Bank of Cyprus (Co-operative Central Bank 2014a).

It must be clarified that the permanent affiliation of Co-operative Credit Institutions to the Central Body does not create a parent-subsidiaries relationship or a group of companies, but merely creates a special relationship which enables the affiliated institutions to satisfy the European acquis and hence, be able to continue to provide banking services (Argyridou-Dimitriou and Kanaris 2012; Co-operative Central Bank 2014a). The affiliated Co-operative Credit Institutions continue to be autonomous and independent under their own administrative and governing bodies, as required by the cooperative societies Law administration (Argyridou-Dimitriou and Kanaris 2012; Co-operative Central Bank 2014a). In an effort to meet the EU Directives' requirements on Credit Institutions' minimum capital, Co-operatives in Cyprus have started undergoing significant consolidation (Argyridou-Dimitriou and Kanaris 2012). It is noted that Co-operative Credit Institutions are managed and owned by their members and they accept deposits (from their members and clients) and grant loans to their members only (Argyridou-Dimitriou and Kanaris 2012).

The rights and obligations of the Co-operative Central Bank as Central Body and of Co-operative Credit Institutions stem from the institutional framework which governs the operation of the Central Body (Article 3 of the EU Directive 2006/48/EC) (Co-operative Central Bank 2014b). Since 1 January 2008, when the affiliation agreement was put in place, the Central Body provides:

- coverage, through the guarantee in favour of the depositors, creditors, or other beneficiaries of Co-operative Financial Institutions and the repayment in full of all the obligations of the affiliated Co-operative Financial Institutions, including all off-balance-sheet obligations and commitments and;
- in cooperation with the Commissioner of CSSDA, the necessary technical and advisory support for affiliated Co-operative Financial Institutions is provided in order to improve their administrative and organisational structure to ensure their viability and solvency, the continuous updating, expansion and development of their activities and generally their smooth operation (Co-operative Central Bank 2014b).

The Central Body has also, certain rights which include:

- the issuance of instructions to the affiliated Co-operative Financial Institutions, regarding specific issues and sectors and, in accordance to the context of the overall regulatory framework;
- the effective monitoring of the financial situation and the operational adequacy of affiliated Co-operative Financial Institutions;
- the verification of the correctness and the full implementation of the directives issued by the affiliated Co-operative Financial Institutions;
- the obtaining of the necessary information and statements for an objective and comprehensive assessment of the organizational, economic and operational efficiency of affiliated Co-operative Financial Institutions and;
- to ensure and verify the correctness of the information submitted through carrying out visits to affiliated Co-operative Financial Institutions in collaboration with the Commissioner of CSSDA (Co-operative Central Bank 2014b).

Changes

The co-operative movement in Cyprus implemented a series of legal and structural changes in order to protect its members and the general public (CSSDA 2012b). These include the introduction of the "Deposit Protection Scheme for Cooperative Credit Institutions" in 2000 which is in line with the European Ordinance (CSSDA 2012b). Due to the transfer of the supervision of Co-operative Credit Institutions to the Central Bank of Cyprus, since 9 September 2013, the aforementioned deposit protection scheme was transferred also to the Central Bank of Cyprus and is under the "Deposit Protection and Resolution of Credit and Other Institutions Scheme (DP&RCOIS)", which is managed by a committee that comprises of representatives from the Central Bank of Cyprus and the Ministry of Finance (CSSDA 2014c). Moreover, the Co-operative movement created the "Fund for the cohesion, support and growth of the registered companies that operate as Co-operative Credit Institutions" (CSSDA 2012b).

The Independent Commission on the Future of the Cyprus Banking Sector stated that as a consequence of the support from the Cyprus government, Co-operative Credit Institutions are undergoing a fundamental restructuring in order to mitigate the effects of major losses from loans and ineffective management practice (Central Bank of Cyprus 2013a). Additionally, the Independent Commission on the Future of the Cyprus Banking Sector stated that a law was passed which demutualized Co-operative Credit Institutions by injecting new capital of 1.5 billion euros from the Cyprus state (Central Bank of Cyprus 2013a). Moreover, the supervision of Co-operative Credit Institutions was transferred from the Commissioner of Co-operative Societies' Supervision and Development Authority to the Central Bank of Cyprus (Central Bank of Cyprus 2013a). According to the Independent Commission on the Future of the Cyprus Banking Sector, all these changes were necessary because Co-operative Credit Institutions had deficiencies: the personal interests of management and the Boards, in many, cases were "*intertwined with those of their customers, particularly their borrowers*", they were influenced by political parties and were poorly supervised (Central Bank of Cyprus 2013a, p. 61). To correct these deficiencies, the Independent Commission on the Future of the Cyprus Banking Sector, suggests that the Co-operative movement must be restructured so that this culture is changed and to "*introduce governance that is strong and, above all, independent*" (Central Bank of Cyprus 2013a, p. 61).

Following the restructuring of the banking sector in Cyprus, there will be a huge commercial bank with 50 % of the market, followed by Co-operative Credit Institutions and thirdly by the second largest commercial bank and the remaining local and foreign banks (Central Bank of Cyprus 2013a). Under these conditions, the Independent Commission on the Future of the Cyprus Banking Sector believes that the Co-operative Credit Institutions could increase their market share, provided that they have a "*stronger commercial management*"(Central Bank of Cyprus 2013a, p. 46).

5 The Future of the System

With regards to the future, the author believes that many of the changes that will be imposed on the Co-operative Credit Institutions in Cyprus will be related to the findings and the recommendations contained in the final report of the Independent Commission on the Future of the Cyprus Banking Sector. To this effect, the major findings and recommendations of the aforementioned Commission will be discussed and then, counter arguments will be proposed.

Starting from the findings and recommendations, the Independent Commission on the Future of the Cyprus Banking Sector believes that even after these changes, the Co-operative sector is still fragmented, the inefficiencies of management have not yet been resolved and Co-operative Credit Institutions will still be open to outside influence through the local Board of Directors (Central Bank of Cyprus 2013a). Additionally, part of the new Co-operative Credit Institutions that will result from the mergers will be very small, averaging 1.5 % of the market (Central Bank of Cyprus 2013a), possibly rendering them unprofitable or even unviable. Furthermore, the state loan of 1.5 billion euros has "*an exceedingly high 10 per cent rate of interest*", which seems to be deliberately set at this height in order to facilitate the required changes (Central Bank of Cyprus 2013a, p. 45). The Independent Commission on the Future of the Cyprus Banking Sector suggests that the Co-operative Credit Institutions must undergo more reforms and that the crisis represents the right opportunity to implement them: the Co-operative Credit Institutions must merge into a "*single commercial entity with a joint stock structure*" enabling them to become a competitive and efficient group with an independent character and professional management at the group level (Central Bank of Cyprus 2013a, p. 45). The new Co-operative Credit entity could continue to engage in retail banking but it could also expand in business banking, where there will be shortage of funds over the next years (Central Bank of Cyprus 2013a).

Moreover, the Independent Commission on the Future of the Cyprus Banking Sector argues that the reform of the Co-operative sector is controversial and causes debate (Central Bank of Cyprus 2013a). According to the same report on the Future of the Cyprus Banking Sector the counter argument is that the Co-operative Credit Institutions offer unparalleled levels of personalized banking to consumers, something which will be lost if their anthropocentric character is altered (Central Bank of Cyprus 2013a). However, the Independent Commission does not agree with this and states that today's economy is totally different from the agrarian economy that Co-operatives used to serve and on which they grew so much (Central Bank of Cyprus 2013a). Additionally, the same Commission believes that this special character of Co-operatives is very expensive for the taxpayers (Central Bank of Cyprus 2013a) because of the 1.5 billion euros capital injected by the Cyprus Government. This argument is more or less the same with the argument that "*this will be the third time in living memories that the co-ops will have been bailed out*" by the government (Central Bank of Cyprus 2013a, p. 45). Finally, the Independent Commission believes that the present form of the Co-operatives' ownership is uncertain as, even though, the members have an option to buy it back by repaying the state loan of 1.5 billion euros plus 10 % interest per year, in reality, the cost of doing so will be so high that most probably Co-ops will be bought by another entity, e.g. a foreign bank "*8.12 We recommend that this opportunity be used to combine the co-operative credit institutions into a single entity with a joint stock structure and a commercial culture to make them a stronger competitive force on the banking market*" (Central Bank of Cyprus 2013a, p. 45).

On the other hand, the author believes that unfortunately, the present financial crisis has brought people back to the times when usurers were the only source of loans, at formidable rates, an area where Co-operatives are very effective. Additionally, Co-operative Credit Institutions have been, are and will continue to support the middle and lower classes of people offering good quality products at affordable costs (Alexopoulos and Goglio 2011). The Co-operative movement has been created by the people and for the people in response to the adverse market conditions (Spear 2000) and to combat the opportunistic behaviour of banks and usurers (Fonteyne 2007) hence, there is no match for the Co-operative financial model.

It may be true that supervision could improve even more as "*the interests of the boards and management of many of these {*Co-operative*} banks were closely intertwined with those of their customers, particularly their borrowers*" (Central Bank of Cyprus 2013a, p. 61). However, what is important is that Co-operative Credit Institutions have never taken "*the fatal step of acquiring 5.7 billion euros of Greek Government Bonds*" in an effort to increase their profits as banks have "*despite Greece's rapidly worsening economic plight and the downgrading of these bonds by the rating agencies*", which caused a "*devastating haircut*" and a huge loss of 4.5 billion euros (Central Bank of Cyprus 2013a, p. 86). Additionally, Co-operative Financial Institutions, have never spent millions of Euros in setting up subsidiaries in foreign countries and a *"surprisingly high number of branches… in the period leading up to Greece's crisis" {*from 135 branches in 2007 to 186 in 2010*},* or acquiring them, e.g. *"the acquisition by Bank of Cyprus of Uniastrum Bank in Russia in 2008"* (Central Bank of Cyprus 2013a, p. 85, 86). Moreover, Co-operative Financial Institutions have never granted loans outside Cyprus which led *"to a heavy exposure to bad debts in Greece"* and the management has never faced the "*increasingly desperate need to generate income to finance their greatly expanded operations, and meet their bonus targets"* as has happened in the case of commercial banks (Central Bank of Cyprus 2013a, p. 25).

Co-operative Credit Institutions have always borrowed and invested locally, assisting the local economy and reducing unemployment. The consolidation of Co-operative Credit Institutions and especially the move from around 100 to just 18 Institutions is welcomed as is the creation of a Co-operative group (provided that this will be for the best of members and the greater society). However, the suggestions of the Independent Commission on the Future of the Cyprus Banking Sector may not seem as helpful as intended, as, on the one hand, they seem to acknowledge that it is the commercial banks that have caused the financial crisis, but, on the other hand, it seems that they would prefer that Co-operative Credit

Institutions are punished for this; by consolidating them, changing their supervisory authority and selling them as a group to a foreign bank. The Co-operative movement in Cyprus had, has and will have a role to play in the Cypriot economy and this role is not confined to the agrarian societies of the past. Due to the reasons that were mentioned by the Independent Commission on the Future of the Cyprus Banking Sector, it is the whole financial system (and not only Co-operatives) in Cyprus that needs to change with regards to its culture and adjust to the new economic conditions (through better supervision, better governance and a new culture):

> *A.18 Culture. We believe that the introduction of fresh people, new sources of advice, international experience and different attitudes are all essential if Cyprus is to give itself a fresh start. Changes of this kind would transform the banking system in all the necessary ways, by delivering better governance, better provision of financial services, better supervision and—importantly—greater confidence on the part of its international lenders. Cultural change will involve reducing political interference in the management and supervision of the banking system, putting in place objective decision-making processes and creating incentives and sanctions to strengthen personal accountability.*
>
> Central Bank of Cyprus (2013a, p. 6).

The author does not see the reason why the commercial banks, after being rescued and strengthened, using the uninsured deposits of their customers and state money, have to remain as they were; but Co-operative Credit Institutions which are the last to blame for what has happened in the Cypriot economy, must undergo such radical transformation that will render them something completely opposite to their true nature, i.e. transform them into for-profit institutions.

Concerning the argument that "*this will be the third time in living memories that the co-ops will have been bailed out*" by the government (Central Bank of Cyprus 2013a, p. 45), the Independent Commission on the Future of the Cyprus Banking Sector seems not to have mentioned that the reason behind the second rescue was the fact that the Co-operative movement created companies in order to assist with the housing of the relocated population caused by the Turkish invasion in 1974 and that for the same reason many of the loans that it granted during this period were not recovered: "*after the Turkish invasion of 1974..., the cooperative movement, ... played a crucial role in addressing the housing and other problems, thereby supporting the government in its daunting task and at the same time fostering social cohesion. In the context of the restructuring and reconstruction ..., as well as in an effort to create new jobs, new cooperative societies were founded in the construction and industrial sectors with financing from the Co-operative Central Bank. However, as lending to those societies was often not based on proper feasibility studies, many of the loans fell overdue and, as a result, co-operative societies went bankrupt*"(Argyridou-Dimitriou and Kanaris 2012, p. 282). Also, the report of the Independent Commission on the Future of the Cyprus Banking Sector does not seem to mention that the financial support to the Co-operatives was repaid in full in 2006: "*The government and commercial banks provided financial support of CY£17.8 million and CY£4.5 million, respectively (Phylaktis 1994), which in total corresponded to 3 % of GDP in 1980. In the late 1980s, an additional support* *package was granted, totalling CY£67 million or 3 % of GDP in 1989, and was eventually repaid in 2006*" (Argyridou-Dimitriou and Kanaris 2012, p. 282).

Another suggestion by the Independent Commission on the Future of the Cyprus Banking Sector, in order to attract new entrants and to strengthen the local economy, is the introduction of Islamic Finance and microfinance (*#9.8, #11.16, #A.37*). This seems surprising somehow, as the suggestion is for the introduction of two financial models that are unknown and "totally different" from the reality in Cyprus. Islamic finance is growing but for the moment it is mainly targeting people of a certain religion and has to overcome a number of obstacles (standardization of products offered, increase awareness of possible clients, sort remaining taxation and regulation issues and speed up the introduction of "Shariah law" compliant products), before it can cater for the needs of a wider clientele (HM Treasury 2008; Alexander von Pock 2006). On the other hand, microfinance targets the developing world and its 2.8 billion of people that live on less than $60 per month, with loans in India averaging $135 in 2009 (Khavul 2010); something that seems to render microfinance unable to cater for the needs of banking clients in Cyprus: it does not provide for current accounts, overdraft facilities, debit and credit cards and all other products that are considered as "basic" for banking customers in Cyprus. Additionally, since the late 1990s, when microfinance was founded, only a few microfinance institutions managed to remain profitable and these days a big part of microfinance is handled through Credit Unions and/or other types of banking institutions (Dichter 2010).

Another suggestion of the Independent Commission on the Future of the Cyprus Banking Sector is the transformation of Co-operative Credit Institutions into commercial banks. Again, this came as a surprise as it asks for the transformation of Co-operatives, which have 20 % market share in local deposits and loans and have undoubtedly assisted the local economy for over 100 years, into something opposite to their real nature. It seems that the suggestion could have been much more meaningful and socially acceptable if the proposed restructurings were such that the problems of the past were resolved, but at the same time the anthropocentric character of Co-operatives was safe guarded or even expanded. The suggestion of the Independent Commission on the Future of the Cyprus Banking Sector sounds as if the Co-operative movement is something of the past and that its time has come to be transformed into something else. This, however is far from true as Co-operative Credit Institutions, are not only important for the Cypriot economy, but also for the European economies. Co-operative Financial Institutions in Europe rank among the top 25 financial institutions with respect to amount of equity, having 40 % of the number of branches and 30 % of total assets; (Hesse and Čihák 2007; Fonteyne 2007; Brannen and Ibrahim 2010; Stolz and Wedow 2005; Talwar 2011; Goddard and Wilson 2005). Moreover, according to Birchall (2013), in 2010, i.e. 2 years after the financial crisis of 2008, in Europe, there were 3874 Co-operative banks, serving 181.1 million customers, having 50.4 million members and 21 % market share of deposits and 19 % of loans. In 2010, Cyprus (with 19.3 %) runs seventh in terms of deposits' market share after France with 44.8 %, Netherlands with 40 %, Austria with 36.5 %, Italy with 34.2 %, Finland with 32.5 % and Germany with

19.4 % (Birchall 2013). Co-operative Credit Institutions will continue to be important because they offer products and services aiming at the increase of their members' wealth. In the UK, the government and the commercial banks are assisting Credit Unions because Co-operatives can enhance financial inclusion much more effectively than banks (Cuevas and Fischer 2006). Moreover, in 2010, the Cabinet Office in the UK having realized the possibilities that non-for-profit organizations possess, has even published a Policy paper entitled: "Building the Big Society" stating its plans to support the setting up and expansion of Co-operatives and providing assistance to public sector employees to set up their own Co-operatives (UK government 2010).

Co-operative Credit Institutions in Cyprus need to be up to date with the technology advancements, to introduce new products and services, attract younger generations, become more efficient and engage in marketing activities in order to remind older people and to educate younger people about their ideological difference in relation to commercial banks, but they should never be transformed into a commercial bank. This is simply because their role is completely different from that of commercial banks and this has been proven by the market share that Co-operative Financial Institutions have especially these days. This different role is true all over the world, including the most progressive western (North American) societies, in which, in 2011, Co-operatives had 104.5 million members, in Europe Co-operatives had 8.1 million members, whilst worldwide there were 51,013 credit unions, with a total of 196.5 million members (Birchall 2013). Finally, it is stressed that the most important distinction between Co-operative Credit Institutions and commercial banks is the non for profit maximizing objective of the former as opposed to the latter. Co-operative Credit Institutions aim at increasing the wellbeing of their members (economic, educational, and societal) and not at maximizing the profits for their shareholders/ investors. At the same time, Co-operative financial institutions effectively create a "*competitive yardstick*", forcing the rest of the financial institutions to be honest (Hogeland 2006, p. 69). In Cyprus, a 634,000 people strong membership base (Birchall 2013) should leave no doubt as to the need for Co-operative Credit Institutions alongside commercial banks, each performing its own role in society.

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