



**Finanzgruppe**

Sparkassenstiftung für internationale Kooperation

# **Local Public Banks Ireland**



## **Concept Summary Paper**

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## **Local Public Banks Ireland**

### **Concept - Paper Summary \***

#### **Preliminary Remarks**

The “German Savings Banks Association” (DSGV) and its not-for-profit consulting arm, the “Savings Banks Foundation for International Cooperation” (SBFIC), have been invited to develop a proposal to establish a new **Local Public Banking System** tailored to the needs of the Irish economy and people.

Since 2014 representatives of SBFIC have had various meetings with Government representatives, politicians and Irish business associations that resulted in a feasibility study, which verified the necessary circumstances existed that a Local Public Banking System would address.

The present document sketches a proposal to establish a **Local Public Banking System** which will help to fill supply gaps, which apparently limit the access to financial services in Ireland. An improved access to finance will be vital for a continuous economic recovery and development - especially for the local Irish SME sector and the local population across the country.

The submitted concept is a preliminary draft which still allows for amendments and adjustments proposed by the stakeholders. SBFIC likes to point out that its initiative should be understood as a proposal for a specific Irish Local Public Banking System, not just an adaption or application of the German Sparkassen model, nor should it be understood as an investment proposal from a foreign investor.



To successfully establish a Local Public Banking System there will need to be a broad consensus and public support. To further this aim SBFIC has developed a working relationship with Irish Rural Link (IRL). The national network of organisations represented by IRL allows the opportunity to increase awareness of the underlying ideas being proposed and also to increase our knowledge of the local market conditions. It is hoped that this document will serve as a base for further discussions and raise interest among potential stakeholders from the Irish government and politicians.

At home, the German Sparkassen strictly act as local banks and refrain from investing outside their business region or even abroad. Nevertheless, SBFIC believes that the Irish public and its regional development might benefit from Sparkassen experience based on more than 200 years of successful public banking in Germany.

- ***The Concept – Summary Paper at hand is based on an elaborated Concept document presented at the Department of Finance. The underlying document also included main findings and conclusions from a Fact Finding Mission, which was carried out in the second half of 2014. In particular it examined critically the status of the Irish Economy, the Irish Banking Sector including its Credit Union Sector , and the present situation and the needs of the SME sector.***



## **1. Introducing a new Local Public Banking System**

**The Fact Finding Mission clearly painted a picture of an improving status of a recovered economy, yet not for all sectors and regions. The Irish Government is making efforts in supporting the Irish entrepreneurs, not only on the export sector, and not only in the Dublin, but also in the regions. Still, support could be more locally and target- oriented, and in addition, the Irish banking system which suffered heavily from its previous crisis is even more centre – driven than before. Against this background a new Local Public Banking System is proposed. The new public banks will also fill a gap between the Irish Commercial Banks and the Irish Credit Unions.**

1. The proposal suggests a nationwide network of 8 to 10 Local Public Banks which are managed independently but with an identical business model working under identical management principles. Initially 2 or 4 pilot banks are envisaged with a roll-out of the entire network developed over the next 5 years.
2. In addition a centralised service unit will provide internal services, including risk management and internal audit and will house a self-supervision unit for the new public banking system.
3. The new public banks will follow a specific business model that is different from traditional commercial banking. The new public banks will have to be economically viable but they will not pursue profit maximisation. At the same time they will be enabled to fulfil a public mandate because they will not be under pressure to make dividend payments.
4. Earnings will partly be retained to strengthen their capital base and partly distributed to social projects, also surpluses will be partly distributed to social funds to benefit the local community



## **1.1. Specific scope and main characteristics – different from commercial banks and credit unions**

### **1.1.1. Public Mandate**

The Local Public Banks follow a sustainable business philosophy which focuses on the appropriate and adequate provision of financial services to all groups of customers. This provides for financial inclusion of private customers – regardless of their personal income and financial situation – and for a sustainable commitment to the development of local businesses, particularly to very small and medium-sized enterprises in the region.

By following principles of public responsibilities the new system will help to restore trust in the Irish financial system.

The public mandate that shapes the entire business model comprises the following elements:

- Supply of financial services
- Promotion of savings
- Strengthening competition based on the competitive requirements of the business area
- Surpluses partly used to fund social commitments in the region



### 1.1.2. Regional Principle

The regional principle stipulates that the Local Public Banks are only authorised to operate within their own region and that their loan activities will focus on that region. Their business area will in principle be specified by the administrative region – the Irish counties.

The effects of the regional principle are:

- The Local Public Bank operates within its well-defined region; "cherry-picking" in more prosperous regions is not permitted, which increases the incentive to invest sustainably in the development of their original region of operation.
- This prevents the local banks from growing too quickly and inculcates responsibility in corporate governance.
- The strong focus on the home region increases customer knowledge and commitment to a long-term, stable economy.
- The bank will operate under normal market conditions. As the local banks cannot cross subsidise services from the profits of other regions, the regional principle directly increases their local focus.
- The principle of "local deposits into local loans" provides financing opportunities for economically weaker regions, preventing the economic depletion of regions.
- The new Local Public Banks are taxpayers and thus contributing to national and local budgets.



### 1.1.3. Trusteeship by Local Authorities

Depending on the final legal structure and organisational set-up, regional authorities (counties or group of counties) could be involved in the governance of the Local Public Banks and function as trustees (not necessarily as municipal owner) . Local authorities and the local banks have a common interest in regional development. The Local Public Banks support their local authorities through their obligation to economic development, regional policy, and in social and cultural areas.

Regional or local authority in the Irish context could be a group of counties, or a municipal special purpose association of a local authority for the purpose of jointly running the Local Public Bank.

- The local authorities could be stakeholders of the Local Public Banks. The legal set-up of the bank would have to ensure that a Local Public Bank once established cannot be sold to investors. This implies that involved local authorities will not be able to claim “ownership” of the Local Public Banks, i.e. that they would not be able e.g. to sell “their stake” and turn it into budget revenues.
- The supervisory board of the Local Public Bank ensures that the bank fulfils its public mandate. Local authorities could be represented on the supervisory board of the bank.
- The supervisory board’s rights of participation do not include the day-to-day business. The responsibility for this is taken by a separate management board.





#### 1.1.4. Legal Status and Ownership

In the long run, an important challenge will be to ensure that the Local Public Bank cannot be taken over by private banking groups or investors, whose principal aim is generally to increase profits. A potential takeover would – sooner or later– motivate the management and/or the owner to focus on maximisation of profits. This mission drift –even if only one out of the envisaged 10 institutions is concerned- would threaten the existence of the entire system and undermine (once again) the trust in this new system

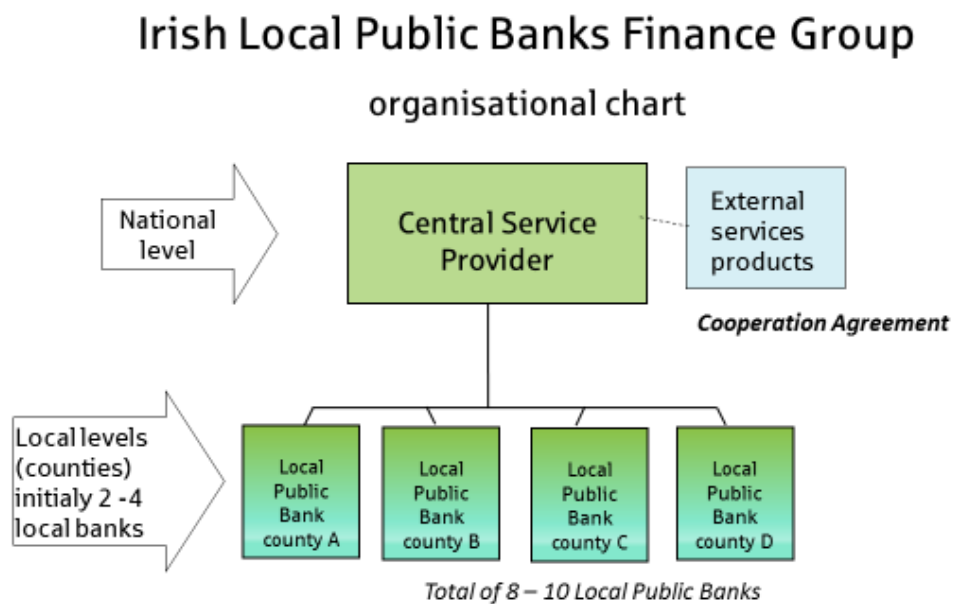
The final legal status and form of ownership still have to be decided by the stakeholders involved in close cooperation with the Central Bank of Ireland.

It is recommended that the new system of Local Public Banks will require a specific legal status, different from commercial banks, which are typically stock corporations governed under shareholder value maximisation principles. Also the legal concept of credit unions which acts under the maxim – one member one vote – will not be an exemplary concept, especially with regard to established governance principles. Obviously the specific legal set-up will have to be in line with the Irish legal framework and banking law, and there will be emphasis put on specific by-laws. In any case a number of essential points have to be ensured:

- Each Regional Savings Banks is a legally and financially independent entity.
- The legal form has to ensure that the population within the business region is adequately represented in the supervisory board.
- The day-to-day business is handled by the management board, which is comprised of banking professionals as required by the Regulator.
- Local Public Banks operate according to commercial principle but do not aim for profit maximisation . There is no pressure for dividend distribution and core capital is principally formed from retained earnings.
- Like the other financial institutions, Local Public Banks are subject to the Irish Banking Supervision.

## 2. Decentralised Group (“Network”) with a Central Service Provider

The local Public Banks are independent but comparatively small entities. Nevertheless, each bank will be managed by professional bank managers and competent teams. In order to increase efficiency and to guarantee quality standards, the Local Public Banks will be organised in a network – the **Irish Local Public Banks Finance Group**. Operational support will be provided by a **Central Service Provider (CSP)**.





The following elements constitute the Irish Local Public Banks Finance Group:

- Economies of scale will be achieved through a Central Service Provider, CSP, which will be jointly owned by the banks. They will be able to “buy” back-office services from the CSP like IT- System and - Management, Product Development, Personnel Management, Marketing, Accounting, Controlling, Auditing, etc..:
- The banks will be able to draw on special competences like start-up finance, leasing, export-finance etc. which will be available through the CSP. The CSP itself, however, will not be a seller of services in the market, i.e. the CSP will have no banking licence.
- The Irish Local Public Banks Finance Group will work under a joint liability scheme: in cases of economic difficulty, banks support each other to ensure the existence of an institution. To this end, monitoring committees of the “ joint liability scheme” are given graduated rights of information and intervention, according to the specific situation. Constant monitoring of all institutions is carried out within the Group through Self-Supervision – in addition to the Irish Supervisor. This is to be carried out by a Self-Supervision department in the CSP.
- Despite intense group interaction, decisions made by the individual bank’s management boards remain autonomous. Therefore the sole business responsibility stays with each single Local Public Bank and its management board.



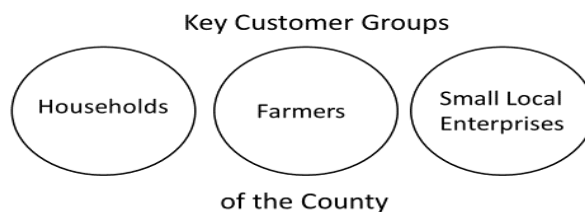
### 3. Underlying Business Model

All Local Public Banks will follow the same business model, although various regions might ask for emphasis on some specific businesses. Business philosophy and generally valid principles of the public bank's business model are as follows:

- To ensure appropriate and sufficient provision of financial services to all customers regardless of their income and financial situation in a responsible and sustainable way.
- To promote local economic development, particularly for small and medium-sized enterprises in the region.
- To promote savings and strengthen basic financial education.
- To strengthen competition according to competitive requirements of the Local Public Bank's business area.
- To retain profits and strengthen equity.

#### 3.1 Market Segments, Financial Products and Services

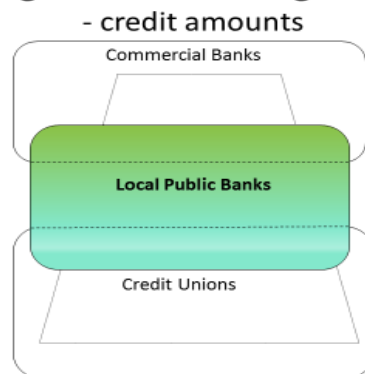
- **Private households, farmers and small enterprises will be the main clientele of the Local Public Banks which will focus on retail banking products. The public banks will not be engaged in investment banking services.**





- **The Local Public Banks' target market will be a segment in between the traditional core customer segments of credit unions and commercial banks. Typical loan amounts will be in the range of 10.000 Euro to 500.000 Euro. Commitments below or above this target range will be possible but will not be the focus.**

### Targeted Market Segments



- **The product range will encompass financial products and services for retail banking and SME finance. Focus will be on responsible and sustainable finance. Agricultural credit and finance for renewable energy will be another business area, as the Local Public Banks will be embedded into the regional economies fulfilling their public mandate and contributing to the regional development.**

#### RETAIL BANKING

- The banks will offer the typical range of retail bank services for private customers of the region. At the initial stage the number of products will be limited to 3 or 4 credit and savings products.
- The banks will propagate consumer finance in a very prudent manner only, as it is perceived to be a risky financial solution for the borrowing households as they often become overindebted .
- The banks will offer competence in on-lending finance for housing and act as mediator for public Irish housing schemes.



#### **SME FINANCE**

- Focus of corporate business will be on SME lending, especially for the segment of smallest SMEs. Finance will be available for working capital and investments.
- A special focus will be on start-up finance in the SME sector. A competence team will be established and the Local Public Banks will provide these special products and services through the Centralised Service Provider. Other specialised services will be leasing and export-finance.
- Based on the public mandate and in close connection with the regional principle, sustainable projects will be supported by Local Public Banks.
- The Local Public Banks aim for a cooperation with the new Strategic Banking Corporation as a mediator to on-lending special SME programs. The Irish Local Public Banks Finance Group will be assisted in these endeavours by a training program through the German Sparkasse as they have particular experience in this business area.
- The Local Public Banks will be engaged in renewable energy and efficient energy projects and other forms of green finance. A close cooperation with local authorities, specialised regional development agencies and specific public bodies will be established.



#### **AGRICULTURAL FINANCE**

- The Local Public Bank will offer expertise in agricultural lending, also supported by a competence centre team housed by the CSP.
- Working capital and investment credit will be offered to local farmers.
- Finance through equipment and machinery leasing will be provided by the CSP and possibly external cooperation-partners.

## **4. Regional Set-up**

2 – 4 Local Public Banks in different regions will be established during the pilot phase. This will help to get an improved and objective evaluation for the planned roll-out. Moreover it assures the necessary political transparency and public attention. Finally this relates to the regional principle and the local presence.

Criteria for the choice of location for pilot public banks

- Population
- Local banking market
- Diversification of existing economic structures
- Existing infrastructure
- Connection to bigger economic centres
- Interest of local stakeholders

Based on experience a business area with a population of 200.000 to 400.000 inhabitants will allow the development of a viable business and sufficient deposit base. In the Irish context we therefore recommend a final roll-out of a network limited to 8 to 10 regional banks.



As the business model is closely linked to the idea of municipal trusteeship, a close link to the Irish counties seems to be reasonable. In most cases a possible solution could be the combination of the neighbouring counties into one single business location. The number of inhabitants of two or three counties would thus reach the recommended level.

The final set-up is still to be discussed– also the precise location of each Local Public Bank, which should follow the above mentioned criteria. In addition to local banks there will be a Central Service Provider, which would be established in a central location of Ireland.





The final regional set-up will be preceded by an objective evaluation and will be decided in close cooperation with the local authorities. Because of the potential impact Local Public Banks will have on the regional economic development we would like to work in a close coordination with both **Departments – the DoF and the DJEI**, following key principles of the “**Framework for the Development of Regional Enterprise Strategies**”. The DJEI has worked-out a structure of sub-regional Strategic Planning Areas according to its criteria of regional development. Ultimately this will be a guide for the future network of Local Public Banks and its locations.

## **5. Competition and Cooperation**

Unavoidably the establishment of a new Local Public Banking System will cause additional competitive pressure on existing financial institutions as is the case with all new entrants to a market. Per se this must not be negative as quality, efficiency of services and acceptable price levels can only be reached in a competitive process.

Nevertheless the introduction of additional market players should not result in crowding-out existing credit unions. For that reason the business model of the new regional banks will be targeting on market segments which are less served by credit unions and the remaining commercial banks.

### **5.1 Cooperation with the Irish Credit Unions**

Credit unions and local public banks have a long history and their business models have quite some elements in common as they are not driven by the need to maximise profits or to maximise shareholder value. While Local Public Banks fulfil a public mandate on behalf of their stakeholders, credit unions primarily represent the interests of their members. Both are deeply rooted in the local population and local economy. This should be a basis for cooperation rather than the cause for additional competitive pressure.

- Besides agreements on market segments there are other potential fields for cooperation. The future Local Public Banks will develop regional competence teams and advisory capacities, e.g. in start-up finance and agricultural finance, which also could be utilised or recommended by local credit unions when they advise and serve their clients .

Also there will be more sophisticated financial products developed by the regional banks, e.g. start-up finance, leasing or export finance, which could be jointly offered by both banking channels, as these products might compliment other financial solutions of each customer group. Formal, so- called multi-channel arrangements might be feasible.

- An additional option for a cooperation with the new Local Public Banking system will be offered by the planned Central Service Provider (CSP). In addition to the Local Public Banks, credit unions will also be given the opportunity to obtain administrative services from the CSP. One important example could be the acquisition of IT services from the CSP.

## **5.2 Cooperation with other Institutions within the context of the Development of the Regional Enterprise Development Strategy**

- The Irish post office, An Post, has a branch network that currently provides certain banking services on behalf of some existing banks. Similar cooperation with the Local Public Banks could be feasible. Possibilities of cooperation will have to be elaborated on by future cooperation partners.
- Especially in the area of SME finance, housing finance and efficient energy finance the Local Public Banks will be able to act as intermediary for funds, like e.g. funds from EIB and the recently established Strategic Banking Corporation of Ireland.

In this respect the new Local Public Banks can benefit from the vast experience German Sparkassen have made over the past 50 years as they mediate more than 50% of public SME finance programs on the German market. Also in efficient energy finance and in agricultural finance Sparkassen have prominent market-shares. Due to their public mandate and due to the fact that Sparkassen are not driven by shareholders value maximisation,



Sparkassen are especially motivated to mediate public funds, which always combine a public mandate with commercial business. This experience will be made available through the regional competence teams, assisted by colleagues from their German partner Sparkasse.

- Finally through a close cooperation between Local Enterprise Offices, potentially interested municipalities and Local Public Banks it would be possible to jointly launch new regional development projects and to attract local investors and enterprises.