

Exploring the Sparkassen Model of Local Savings Bank in Ireland with the Savings Bank Foundation for International Cooperation (SBFIC)

October 2014

Introduction

The Public Banking Forum of Ireland (PBFi) is an open forum for public debate and education on banking reform with particular emphasis on the role that public banking can take in reforming banking in Ireland.

The forum was set up following the invitation and visit of Dr. Ellen Brown, author of “The Public Bank Solution”. During her visit public meetings took place in Dublin, Athlone and Cork at which she made presentations looking at the present banking/money system and outlined alternative models which have allowed some countries to avoid the worst of the recent banking crises. She also examined how future crashes could be mitigated and evaluated different options. A seminar was subsequently organized which included Dr. Thomas Keidel, Director of the Financial Market Relations Department at the Deutscher Sparkassen- und Giroverband (DSGV), who spoke about the 200 year old Sparkassen group of public banks that has been central to the German economy, particularly in financing of Small and Medium Enterprises (SMEs). Christopher Simpson was also a contributor, speaking on his “Commentary and Case Study of German Public Banks” and how a similar system might benefit the UK.

Following this seminar, the PBFi have engaged with the Sparkassen group in Germany to identify the key contributions that such a system could make to the Irish banking situation. This has resulted in two fact-finding visits earlier this year by Dr. Juergen Engel, European Project Manager of the Savings Banks Foundation for International Cooperation (SBFIC), to assess the current situation in Ireland and meet some of the key stakeholders. This was followed by a well-attended workshop in the Pearse Centre in June this year at which Dr. Engel and his colleague Niclaus Bergmann (MD SBFIC) made detailed presentations of their findings on how the Sparkassen model could fit into the Irish situation and set out a road map to follow to explore this option.

This report outlines the key aspects of the Sparkassen model and the role of the SBFIC in helping Ireland to set up a similar system suitable to the Irish situation. It will also look at the interest expressed to date by some of the key stakeholders and what support there is for the concept. Finally the next steps that should be taken on the road map and the required support are explored.

The Sparkassen Model

The three pillars of the German banking system are made up of the Private commercial banks, the Cooperative banks and the Sparkassen (Fig 1 below). The Sparkassen are most notable for the public welfare mandate they have whereby stakeholder value is the key objective not shareholder value. The Sparkassen have the lion's share of the market for SME financing in Germany at 70% with an overall 42% market share of business financing generally. The 423 Sparkassen have 15,300 branch offices with 245,000 staff and a business volume of €1,106 bn.

The key to the success of the Sparkassen is down to the unique features of their set up:

- They are public-law institutions under the responsibility (but not ownership) of the local authorities. They are not entities with shareholders and thus cannot be bought or sold.
- They operate on a principle of strict regionality so each Sparkassen must restrict its activities to a specific geographic area.
- Audit and control is achieved through the Sparkassen centralized supervision entities.
- There is close cooperation within the group "family" the Sparkassen-Finanzgruppe.
- There is a comprehensive Sparkassen Joint Liability Scheme.

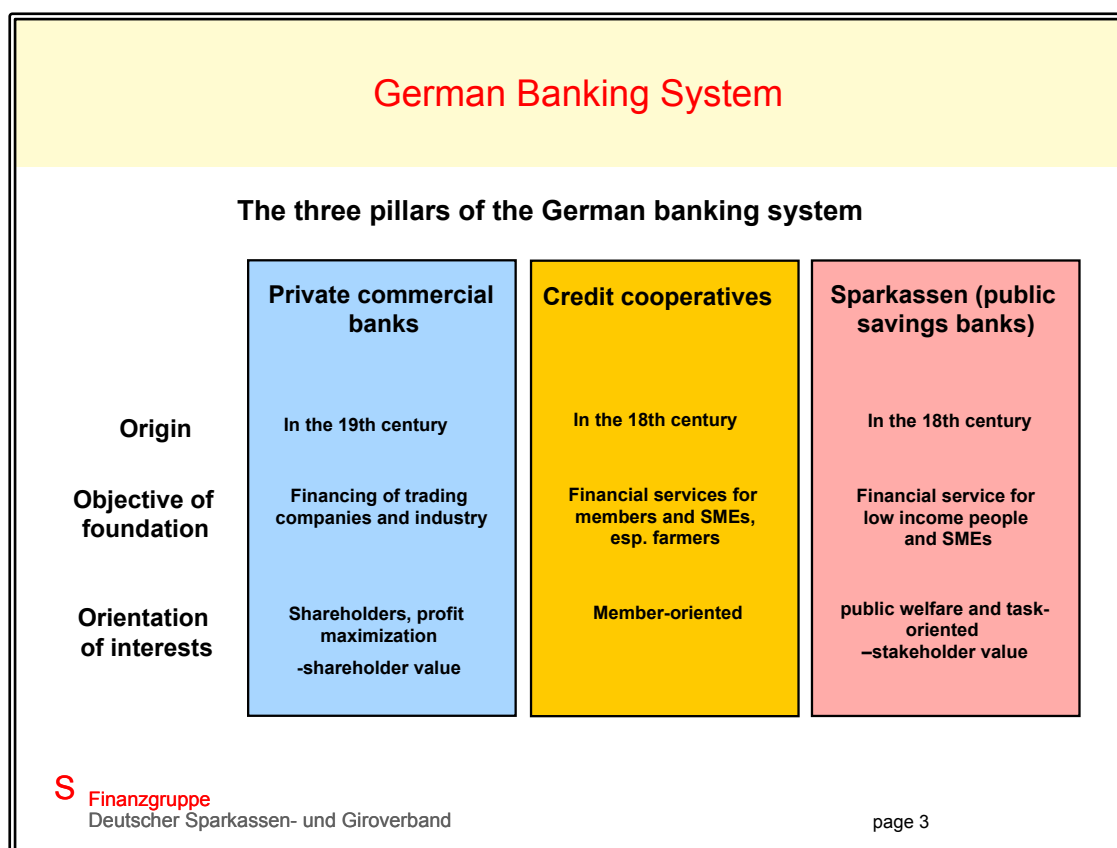


Figure 1 The three pillars of the German Banking System

This format of banking creates a virtuous cycle within communities and leads to balanced regional economic structures as it is guaranteed that local deposits are transformed into local loans. The regional principle establishes a strong link with the local economy where local staff uses local knowledge as a basis for risk management. Furthermore the public mandate ensures non-discriminatory provision of financial services with appropriate conditions to all citizens (especially SMEs) and reinvestment of profits for local social developments.

Role of the Savings Banks Foundation for International Cooperation (SBFIC)

The Sparkassen, as previously outlined, have a strict regional focus with no international banking activities and no plans to do so. However, having been repeatedly asked by various countries for access to the expertise and experience of the Sparkassen group, the SBFIC was set up in 1992 as a non-profit organisation to achieve that accessibility for developing and transitional countries. Since then the SBFIC have participated in over 150 projects in more than 60 countries. Currently they have 5 projects in the EU in countries such as Greece, Macedonia and the UK (Bank Of England) as well as 32 projects in 31 other countries worldwide (See Figure 2).

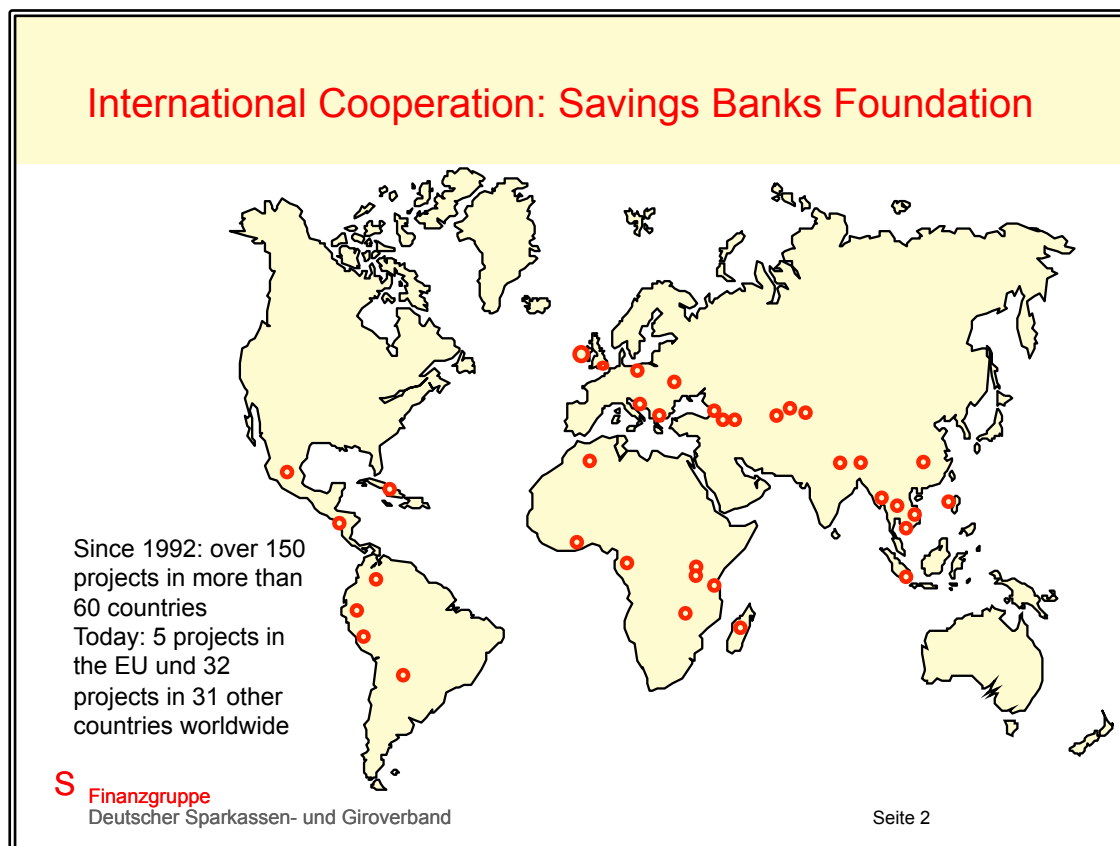


Figure 2 SBFIC projects worldwide

Dr. Engel (European coordinator) of the SBFIC travelled to Ireland on two fact-finding missions which included meeting many of the potential stakeholders. From this feedback, Dr. Engel developed a preliminary outline of how the Sparkassen bank model might be adapted to the Irish context while maintaining its essential characteristics.

- **Regional Principle:** Savings Banks could be established as independent regional Savings Banks across Ireland with one bank per province as a starting point. The banks would limit their services to residents and businesses within their geographical region, keeping credit and savings local.
- **Public Ownership:** The sustainability of the new regional Savings Bank should be secured by a suitable legal structure. The SBFIC recommends a 'foundation' model whereby the foundation capital cannot be moved nor the bank sold at a later date.
- **Public Mandate:** In the Irish context, the new regional Savings Banks should focus on providing priority services for the segment comprising the smallest companies of the SME sector and include mentoring for start-ups. The new banks could also provide finance for permanently affordable housing provision and finance for community owned renewable energy and energy conservation projects. The retained earnings and profits would be invested in local community social and cultural services.
- **Business Model:** The new regional Savings banks would not aim for profit maximization but general stakeholder welfare with particular emphasis on SMEs in the local economy. Lending to SMEs would be based on their potential cash-flow as assessed by in-house experts with competencies in start-up finance, farming, housing finance, renewable energy etc. as appropriate.
- **Centres of competence and cooperation:** The SBFIC are in the position to provide specialized training and mentoring to develop the necessary competencies to the new regional Savings Banks. The banks would then have the capacity to share these competencies with other social finance providers and to become centres of cooperation with the Post Offices and the Credit Unions (Figure 3 outlines how the PO and CU could benefit from the new regional bank system).
- **Decentralized Services supported by centralized unit.** While the regional Savings Banks will be completely independent of each other, centralized support provides economies of scale, ensures supervision on the product level and provides oversight of the risk management practice of the individual Savings Banks. The SBFIC also advises the central support unit should provide internal services such as IT, Product Development, Processes, Risk Management, Internal Audit, Accounting, Taxation, Legal Advice etc. to the independent banks (See Figure 3). This centre could be set up in Dublin and become the first core centre of competence with training and coaching provided for by the SBFIC.

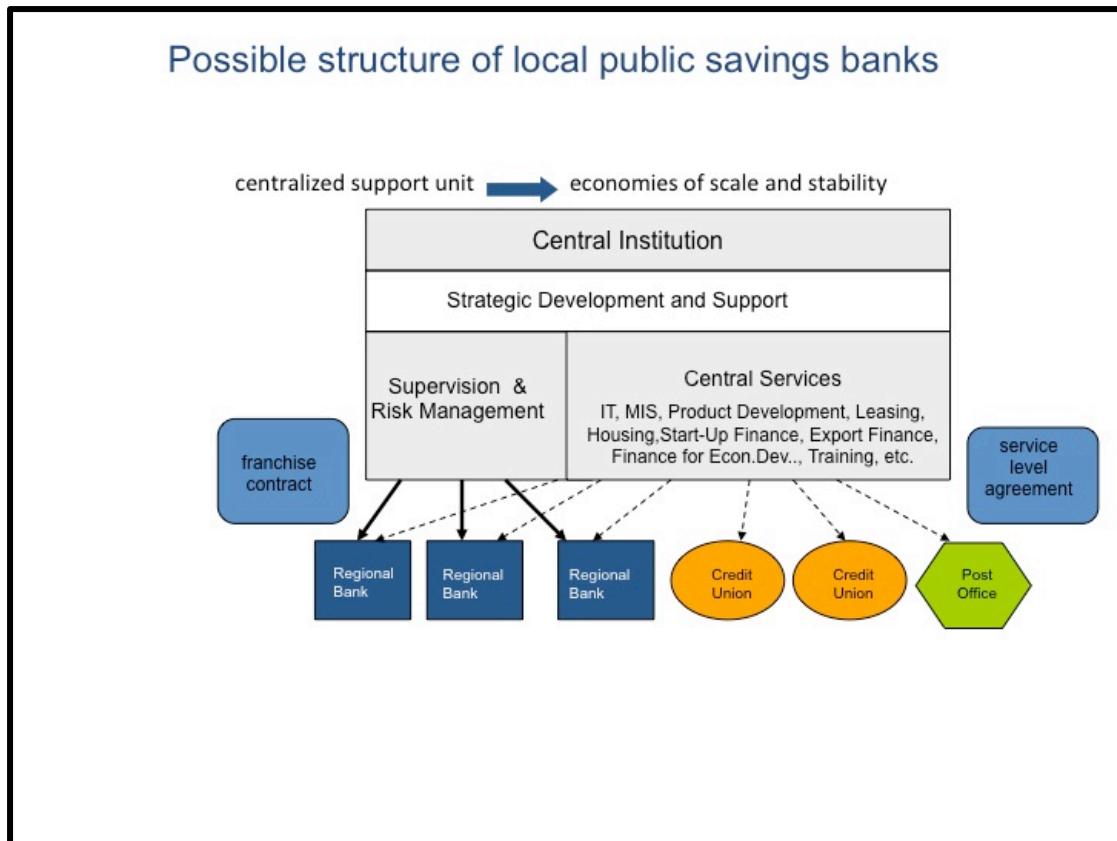


Figure 3 Outline of possible structure of local public savings banks in Ireland

Potential stakeholders and partners

A number of potential stakeholders have engaged with the process to date and are interested in taking this project forward as participants. It is important that all existing and future benefiting stakeholders are fully included in any working group set up to take the project forward under the road map as outlined by SBFIC (see The Way Forward below).

- **Small & Medium Enterprises:** SME representative organisations ISME and the SFA were contacted and consulted. The SFA were not fully convinced of the need for another type of bank, as they remain confident that their members can access funding from existing banks. The ISME membership experience was very different however, and they were fully behind the concept for a new kind of banking service for smaller SMEs. ISME included a debate on “Banking – Are there options?” as part of their 2014 Conference in October, which included a presentation by Niclaus Bergmann of SBFIC.
- **Credit Unions:** While there was some initial support for exploring the new banking model amongst Credit Unions individually, The Irish League of Credit Unions (ILCU) and the Credit Union Development Association (CUDA) have been reluctant to engage formally with the project. The

difficulties facing the sector are such that there is little space for considering new initiatives and some may perceive a potential threat from competing local Savings Banks.

- **Post Offices:** The Post offices have been approached on two fronts: **The Postmasters Union**, which represents 90% of the Postmasters running individual post offices around the country, is very positive about the Sparkassen banking model and has actively contributed to the process.
An Post were also positive about the idea of local Savings banks recognizing the enhanced services post offices could offer their communities in partnership with regional public banks. The failure of their partnership with Fortis to provide Post Bank services has made them cautious about actively participating in any similar initiatives without substantial political support.
- **Politicians:** The establishment of any alternative banking system will require political support and goodwill to implement and we are in the process of building cross-party consensus for the project that is yielding positive results.
- **City Councils & County Councils:** There has been limited contact with local authorities because of the lack of a single forum of engagement. While Irish local authorities cannot act as a financial backstop to local banks in the same way the German Municipalities do for the Sparkassen, they could form part of the local representation on the local Saving Bank boards and work closely with the banks to identify the local community services and amenities to support with the bank's profits/surplus funds.
- **Other Social Partners and NESC:** A representative from NESC, the policy research development agency of Irish Social Partnership, attended the Pearse Centre Workshop and was impressed by their potential to deliver key social and environmental objectives. Local public banks could play a key role in providing new methods of financing projects in the high priority areas of social housing and wind energy, facilitating community ownership for example. The Environmental Pillar is actively considering proposing that NESC facilitate the process to research an appropriate local banking model for Ireland.

The Way Forward

Dr. Engel presented an outline of the road map to deliver local public banks in Ireland at the Pearse Centre Workshop as follows:

- Define partners and stakeholders
- Establish a Working Group
- Secure finance
- Agree on principles
- Work out business model
- Work out and present business plan
- Establish links with authorities, Department of Finance, Central Bank
- Prepare for Foundation
- Roll out

Considerable progress has been made in the initial step of defining and engaging partners and stakeholders, as has been outlined before. The next crucial stage is the establishment of a representative and credible working group to input the Irish context and perspective to the SBFIC while they work on adjusting their business model to Irish economic conditions and on identifying the most appropriate legal structure for Irish Local Public Banks. This in turn requires that funding is made available to SBFIC to cover the costs of allocating two or three Sparkassen experts for the 6-9 month project duration. A “ballpark” figure has been tentatively suggested of €250,000.

No new bank can be established in Ireland without meeting the exacting requirements of the Central Bank and the Department of Finance, which is as it should be. The SBFIC are fully confident that their 200 years banking experience and their proven training and mentoring systems can satisfy all criteria that the Irish and European Central Banks will demand. Once this process is fully examined and understood, Ireland can seize this opportunity to allow banking to work in the public’s interest as one alternative to our current private system.