
# LOCAL BANKS FOR LOCAL BUSINESS

Sinn Féin

## A SINN FÉIN DISCUSSION PAPER

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## 'STARVED OF CREDIT'

This, more than any other sentence, was the description of the key problem facing small and medium enterprises (SMEs) during the recession in the south of Ireland.

While banks were bailed out with over €64 billion of taxpayers' money, on top of the €30 billion for NAMA to acquire distressed loans, SMEs and small agricultural enterprises, the backbone of the economy, saw their credit lines dry up.

Despite not having caused the recession, these businesses, along with ordinary citizens, bore the brunt of it, as banks sought to correct their mistakes and stabilise their balance sheets.

While there are signs of a fledgling recovery in some aspects of the financial world, it is crucial that we take this period to reflect on the crisis caused by the banks withdrawing credit and consider proposals to try to prevent this happening in the future.

## SME FACTS

- The Irish economy is dominated by SMEs, which employ approximately 70% of Ireland's non-public/self-employed workforce, above the European average. The vast majority of Irish enterprises are micro firms, employing less than 10 persons
- Between 2008 and 2012 the sector lost about 17% of its employees
- During the crisis, reports commissioned by the Department of Finance, the Central Bank, the Irish Small and Medium Enterprises representative body (ISME) and InterTrade Ireland, among others, established a pattern in the refusal of credit to SMEs
- The percentage of declined loan applications over the period was above the European level. At the end of August 2014, ISME recorded a loan refusal rate of 42%, with increasing delays in bank decisions. In addition, smaller loans are offered at far more expensive rates than larger loan amounts

From 2011 – 2013, the southern government attempted to impose SME lending targets on the two domestic pillar banks, Allied Irish Bank and Bank of Ireland. Both banks received State capitalisation and each was required to sanction lending of at least €3 billion in 2011, €3.5 billion in 2012 and €4 billion in 2013 for new or increased credit facilities to SMEs.

The banks claimed they were meeting their targets. However, unlike the mortgage arrears resolution targets, the SME targets are not published.

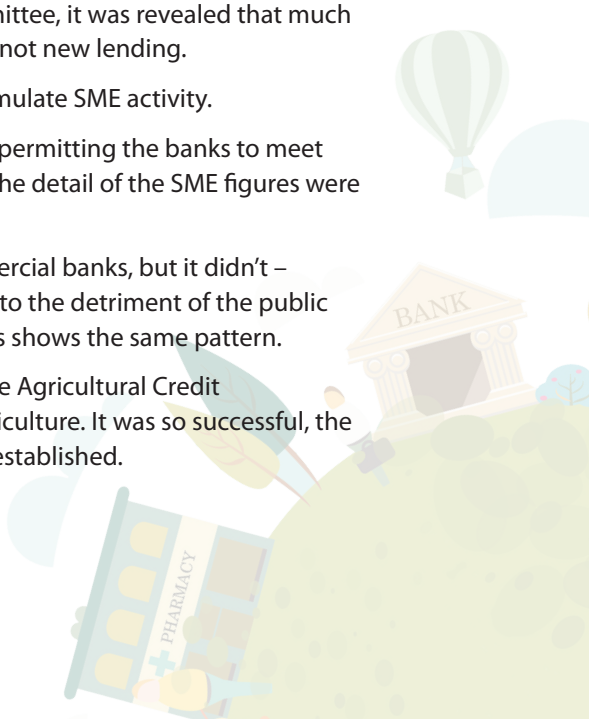
However, under questioning in the Dáil and Oireachtas Finance Committee, it was revealed that much of what was being extended to SMEs was a roll-over of existing loans, not new lending.

The banks were using capital to massage their account sheets, not stimulate SME activity.

The published mortgage target figures have been widely criticised as permitting the banks to meet the targets in unfair and arbitrary ways. We can only speculate that if the detail of the SME figures were available they would present a similar picture.

The government could have exercised more control over these commercial banks, but it didn't – choosing to allow them instead to make purely commercial decisions to the detriment of the public good. The situation concerning the management of mortgage distress shows the same pattern.

In 1927, in one of its first economic acts, the Irish Free State created the Agricultural Credit Corporation. Its aim was to finance business and developments in agriculture. It was so successful, the Industrial Credit Corporation, with the aim of financing industry, was established.



Throughout that decade and the next, despite the fact the State's founding parties were economically conservative, public money was used to stimulate social enterprise. The development of the electricity network is proof of that, alongside the insightful creation of the ACC and ICC.

Unfortunately, neither of those banks exists in their original capacity any longer.

That is where the concept of a new system of public banking steps in.

## A PUBLIC BANKING PROPOSAL

This short discussion paper examines a proposal to establish a local public banking system in Ireland.

Sinn Féin is producing this paper following engagement and consultation with the Savings Banks Foundation for International Cooperation SBFIC, the research arm of the German Savings Bank Association, DSGV, which represents 417 Sparkassen (savings banks) with 15,300 branches in Germany.

The Sparkasse banks are the public part of the three-pillared banking approach in Germany and hold 40% of the market share – which indicates just how successful this sort of banking can be.

This system can complement the good work undertaken by the credit union sector in providing small household finance.

Everyone agrees that improved access to finance will be vital for a continuous economic recovery and development, and we believe that the proposed local Public Banks could act as mediator for public funds being made available by the newly established Strategic Banking Corporation.

## CURRENT BANK SYSTEM

Following the financial crisis, the Irish financial sector was rationalised into three main banks:

- Allied Irish Bank (AIB)
- Bank of Ireland (BoI)
- Permanent TSB (PTSB)

These banks hold a market share of roughly 90%. The Irish State holds almost 14% in shares at Bank of Ireland, 99% of AIB and a 75% stake in Permanent TSB. All three banks are still undergoing adjustments to their balance sheets and all are still carrying portions of fragile mortgages and distressed loans.

The crisis saw a huge reduction in their numbers of both branches and employees.

Speaking to the Finance Committee in November 2014 Central Bank Governor Patrick Honohan spoke about the need for a "a second tier of banking which is geared more towards local concerns, with local managers and a greater level of local awareness."

## THE STRATEGIC BANKING CORPORATION OF IRELAND

Whilst the Strategic Banking Corporation of Ireland has recently been established, its limitations are already evident and it is a far cry from what was committed to in the Programme for Government.

The aim of this Corporation is to provide:

- Additional credit, in particular to SMEs
- Competition in markets for the provision of credit to borrowers, in particular SMEs
- A diversity in the types of finance available in the State
- Finance to projects that promote economic development of the State

The Corporation is to secure €800 million in funding for SMEs and act as an intermediary between capital providers, including German public bank KfW, the European Investment Bank, the Irish Strategic Investment Fund (formerly the National Pension Reserve Fund) and others. It is intended that the current commercial banks in Ireland act as a distribution platform.

While the government insists that new entrants can avail of the SBCI funding, to date we have simply seen the existing banks use the funding. Only time will tell of how effective this model is and our concern is that these banks will ultimately soak up the credit with no real positive impact for SMEs.

It is Sinn Féin's view that a new system of local public banks would be better suited to act as intermediaries between business and the Corporation, in the stead of existing commercial banks.

## LOCAL PUBLIC BANKS PROPOSAL

1. 10 public banks, managed independently but with an identical business model and management principles, throughout the 26 Counties. 2 to 4 pilot banks to be established initially, with the roll-out of the network over a full term of government (5 years). We would like to see these banks established in the 6 Counties also, subject to an agreed funding model
2. The establishment of a centralised specialist unit to provide internal services including: procurement; risk management; auditing
3. The new public banks will follow a business model that will provide economic viability but will not be ran for profit maximisation for shareholders
4. Earnings will be distributed between: the cost of running the banks; strengthening capital bases; invested in local community and regional projects
5. The local bank will operate within a well-defined region to prevent cherry-picking, and increase the incentive to invest in the sustainable development of their region
6. The focus on the home region will increase customer and local economy knowledge
7. The principle of local deposits to local loans will provide finance opportunities for economically weaker regions

## BUSINESS MODEL

All Local Public Banks will follow the same business model, although various regions might ask for emphasis on some specific businesses.

This model will ensure:

- Appropriate and sufficient provision of financial services to all customers in a responsible and sustainable way
- The promotion of local economic development, particularly for small and medium-sized enterprises in the region
- The encouragement of savings and strengthening of basic financial education
- Provide competition to existing banking system
- Retention of profits for capital strengthening and local investment
- Farmers and small to medium enterprises will be the main clientele
- The 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 to €500,000

## FINANCING THE BANKS

While this is a discussion document, we are striving to provide indicative figures for what this type of proposal would require in financing.

Detailed business plans are being developed with the aid of the Savings Bank Foundation for International Cooperation, a not for profit foundation that is part of the German DSGV.

In the interim, it is suggested that each Local Public Bank would require at least an initial capital provision of €10 million. In addition, €5 to €10 million would be required for the development of the Central Service Provider. Finally, sufficient liquidity has to be available to allow a smooth business start for each regional bank, as the deposit base still has to grow over time.

Based on the German experience, a business area with a population of 200,000 to 400,000 inhabitants would allow the development of a viable business and sufficient deposit base.

It is envisioned the banks would act as intermediaries for the Strategic Banking Corporation of Ireland.

Economies of scale will be achieved through the Central Service Provider (CSP), which is jointly owned by the banks. The CSP will provide services such as auditing, IT, risk management, product development, marketing, accounting, personnel management etc. to the banks. The CSP itself will not be a seller of services in the market; it will have no banking licence.

The local banks will work under a joint liability scheme. In cases of economic difficulty, the banks will support each other to ensure the survival and stability of another institution.

Each Local Public Bank will be managed by a professional management team which will be recruited from the Irish market. Specific preconditions will be set by the regulatory authorities for licence allocation. All key positions will only be given to qualified personnel.

In the initial phase of the new local institutions it could be reasonable and necessary to provide coaching for the management board. External consultancy as well as training and further training for members of staff of new Local Public Banks can be provided by SBFIC and the German Sparkassen.

## LEGAL ISSUES

The public banks in Germany receive backing from their regional authorities and in the Irish case, local authorities could be considered as trustees.

In the long run, an important challenge will be to ensure that the banks cannot be taken over by private banking groups or investors, whose principal aim is generally to increase profits.

The final legal status and form of ownership would have to be decided by the stakeholders involved in close cooperation with the Central Bank of Ireland. Sinn Féin recommends that the new system be established under specific legislation setting it apart from commercial banking.

This legislation will have to ensure that:

- Each bank is a legally and financially independent entity
- The population within the business region is adequately represented in the supervisory board, which is also established under the Sinn Féin corporate governance recommendations (40% gender quota requirements; fair and transparent appointments process and pay; a bar of excessive directorship holdings)
- The day-to-day business is handled by the management board, comprised of banking professionals as required by the Regulator
- The banks operate under commercial principles, but no pressure is applied by the need for dividend distribution
- The banks are supervised by the current regulation system
- No overlapping services but rather complimentary financial services are presently offered by Irish Microfinance and by the Irish Post office. Cooperation might be feasible, especially with the existing credit union structure, which could also benefit from the centralised specialist provider

## FINANCING SMES AND AGRICULTURE

- The focus of the banks will be on SME lending. Finance will be available for working capital, investments and most importantly, start-up finance
- A competent and efficient team will be established in each bank, providing special products developed by the Centralised Service Provider
- The banks will work closely with Enterprise Ireland, InterTrade Ireland and the Local Enterprise Offices (LEOs) in identifying and connecting with the SME sector
- There will be a special focus on sustainable economic investment – that is, in areas of social and environmental friendly growth
- Finance through equipment and machinery leasing will be provided by the CSP
- Lending decisions will be based on business plans, results from cash-flow analysis, solvency and credit-history of the customer. Lending decisions will be based on a multi-tier decision process operated by the directorate of each local bank and will be performed within the shortest-possible decision time. Decisions on standardised products and very small loan amounts will be taken at branch-level. However, all decisions will be based on a "four eye principle" and on standardised Group risk management guidelines

- The availability and provision of collateral will be a contributory decision-making factor, but not the determining criterion
- Effective borrowing costs and conditions will reflect market rates
- The focus on local business for local clients will support an effective risk management and will help to keep costs of risk at comparatively low levels
- Funding will be based on deposit taking which will facilitate long-term lending
- The self-supervision team from the Central Service Provider will monitor the lending performance of all individual Local Public Banks. Compliance with all internal guidelines and official regulatory requirements will be subject to the Group's internal audit