Establishing Local Public Banks
Experience from the German Sparkassen Model
- October 2016 -

Essential elements of a sustainable Local Public Bank

The Legal Status and the Business Model have to reflect following essentials:

1. **Public Mandate** - Local Public Banks have a public mandate, i.e. they provide for financial inclusion of private customers - regardless of their personal income and financial situation - and for the development of local businesses.

2. **Regional Principle** - Local Public Banks operate in a geographically defined business area. Their business activities are restricted to their “home region”, i.e. they follow the principle of “local deposits into local loans”. Following the regional principle, Local Public Banks are not subsidizing each other.

3. **Network of Local Public Banks** - Each Local Public Bank is legally and financially independent and is managed by its own management team. Local Public Banks cooperate with each other in a network in order to increase their efficiency. They outsource certain back-office services (e.g. IT, controlling, product development or human resource development) to a centralized service provider (CSP) they jointly own. Through such a cooperation model, costs are reduced and “economies of scale” will be achieved.

4. **Professional Management** - Local Public Banks are run by professional bankers as stipulated by the regulator. The day-to-day business is handled by a management board without participation from local politicians. The management is controlled by a supervisory board which is made up by representatives of the local community, e.g. representatives from the city council, local citizens and or local business people.

5. **Sustainability and Economic Viability** - Local Public Banks do not pursue profit maximization or shareholder value maximization. Anyway, they must operate sustainably, i.e. they must be profitable. Profits generally stay in the bank as “retained earnings” to strengthen the capital base. When a local public bank has sufficient capital, profits can be distributed into social funds for the benefit of the local community.

6. **Sustainable legal status and ownership** - Depending on the respective legal framework of a given country, Local Public Banks have to be founded under a suitable legal status with appropriate by-laws. The legal status has to ensure that a Local Public Bank cannot be taken over by private banking groups or investors, whose principal aim is generally to maximize profits.
**Sustainable Business Model and Business Plan**

**a) Location** - Suitable locations for Head Office, branches and ATMs have to be cautiously selected, taking into account the underlying local business structure and infrastructure.

**b) Size of business region** - Local public banks are limited to a specific geographical area, therefore this must have an adequate size (number of bankable inhabitants and local businesses, diversified economic structure etc.).

**c) Product Offering** - Local Public Banks offer all traditional banking services on the lending and deposit side. The actual product mix will be determined by the respective demand of clients, the aim is to fill the gap between the usual credit union business and services provided by larger commercial banks. Anyway, the focus is on smaller SME customers and local households.

Local Public Banks may provide specialized services in the fields of agricultural lending, start-up finance, green finance or other areas. Housing finance might be offered, depending on the legal and regulatory framework and the respective local market conditions. Local Public Banks might also cooperate with other (e.g. Government) institutions to provide promotional loans.

Being local public banks, they can also function as “house banks” for the city council or regional government, i.e. all related banking services and transfers should be canalized through the Local Public Bank. This also includes transfers from citizens to the council or public entities, like taxes or payments for utilities.

**d) Terms and Conditions** - Local Public Banks ensure access to financial services for everyone in a specific region. They need to be sustainable institutions, the income they generate must cover all costs. Therefore, their prime objective is not to be “cheaper” than other banks – anyway, working in a competitive environment, they also should not charge higher prices for products and services than other banks. Prices must therefore be competitive, with a focus on quality of service, i.e. fast and fair credit decisions (based primarily on cash-flow analysis and not on collateral), high quality advisory services offered close to clients.

**e) Capital and Liquidity Management** - Local Public Banks need to have a strong capital base to strengthen the confidence of clients. Capital adequacy ratios in the area of 12 to 15 % are recommended - especially in the start-up phase of a new Local Public Bank. Obviously, this question has to be solved in line with legal and regulatory requirements.

**f) Risk Management** - The principle of “really-know-your-customer” is the basis of a thorough risk management system. Deep knowledge of the clients business, not just based of figures and business plans but also exactly understanding his personal and business environment ensures a limitation of risks. This is accompanied by central guidelines for risk management and a
regular internal supervision of all existing exposures through the Risk Management Department of the CSP.

**g) Profitable business plan** – All Local Public Banks must be sustainable financial institutions. Anyway, in the start-up phase this probably will not be immediately possible. They should generate first operational profits after the initial three years, with break-even after five years, thereby compensating for the initial losses and set-up costs.

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**Setting up a local public bank**  
*Foundation Concept & Time Table*

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**Preparation Phase**

**Working Group**  
(6 members)

- Local Government
- Local Stakeholders  
  SME Association, Chamber of Commerce
- Regulator of the Financial Sector  
  14 - 20

**external advisors**

- prerequisites fulfilled:  
  Capital, Funding Base, Legal Status, Ownership License, Deposit Insurance  
  20

**Implementation**  
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