Green Party
Public Banking Policy

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The need for a second tier of banking in Ireland

The banking crisis that began in 2008 caused widespread economic damage throughout the economy of Ireland. Given the cyclical nature of economic activity it is clear that we are moving ever closer to the next economic crisis. It may come as a result of different factors or be of a different magnitude, but Ireland, being a small open economy is bound to feel its effects. As a healthy, stable financial system is at the heart of any economy this is an area of particular concern when looking at the potential resilience of our economy.

On a macro level the consensus is that Ireland has recovered well from the Great Recession but the recovery is neither equally spread nor without underlying areas of concern at the micro level. Small and medium sized enterprises (SMEs) are widely accepted as being the backbone of any economy, and for good reason. SMEs account for 99.8% of enterprises in Ireland and employ nearly 70% of people engaged.[1] Micro-enterprises (employing <10) comprise 91.8% of the total SMEs and these are the enterprises that we would be most concerned about having been abandoned by the banks during the crisis and now not being served as the banks withdraw from many rural locations particularly and they bring their loan decision bases to a centralized head office location.

Evidence of the unbalanced economic recovery is exemplified by the Western Development Commission's (WDC) contribution to a recent Seanad Public Consultation on SMEs. The WDC reported that the number of active enterprises in their region between 2008 and 2016 actually declined by 4.3% whereas nationally it grew by 4%. A healthy economy needs enterprise start-ups to be at a level of between 8-12 % of existing enterprises and Ireland has been well below that since 2008.[2]

If the aims as set out in the National Planning Framework[3] for a more balanced economic development across all regions of Ireland urban and rural are to be achieved, the financial service requirements of this important section of the real economy needs to be fully addressed.

Patrick Honohan described the need for another tier of banking in Ireland when he was Governor of the Central Bank of Ireland when he said:
"There should be a second tier of banking which is geared more towards local concerns, with local managers and a greater level of local awareness. This would be on a scale larger than the credit unions. They could be the nucleus of it, but

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[1] CSO figures, available here: https://www.cso.ie/en/releasesandpublications/er/bd/businessdemography2016/

[2] CSO figures, ibid.

[3] Objectives of the National Planning Framework, http://npf.ie/project-ireland-2040-national-planning-framework/

the credit unions as they stand are too small individually to be really effective suppliers of services."[4]

A Local Public Bank would be a locally focused bank with a public mandate to serve the community in its region by providing finance and other modern banking services to the real economy. This would fill the space previously occupied by the ACC and ICC, which were unfortunately sold to commercial banks during the Celtic Tiger years. Public banks such as these number some 1000 and exist in 21 countries across Europe[5].

Current Irish banking system

There remain weaknesses in the existing banking system in Ireland as the remaining pillar banks struggle to overcome the legacy issues they still have. This is particularly obvious in the on-going problems with the mortgage market. The banks still have higher than desirable level of Non-performing loans (NPL), which increases the capital they must put aside to cover this risk and in turn feeds into the mortgage pricing. There is also a distinct lack of competition in the traditional retail banking sector in Ireland. Mario Draghi pointed to this as the main reason for the continuing high cost of mortgages in Ireland at a recent appearance before the Oireachtas Finance Committee[6].

The latest Systemic Risk Pack[7] issued by the Central Bank of Ireland also highlights that property related lending accounts for 68% of Irish banks loan book, compared to a European average of 60%. There is also a credit exposure to the UK market in the order of 25%, which is of concern in light of the as yet unknown impact of Brexit. Both of these observations add to a picture of a banking system that is vulnerable to shocks from either a property market crash or a less than orderly Brexit.

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[4] Patrick Honohan, Governor of the Central Bank of Ireland speaking at Overview of Banking Sector; Joint Committee on Finance, Public Expenditure and Reform Debate 26th November 2016, available to download here: https://data.oireachtas.ie/ie/oireachtas/debateRecord/joint_committee_on_finance_public_expenditure_and_reform/2014-11-26/debate/mul@/main.pdf

[5] Together for a growing and more integrated Europe: Savings and retail banks' drive to help Europeans prosper. Published by European Savings and Retail Banking Group (ESBG). Download here: https://www.wsbi-esbg.org/SiteCollectionDocuments/ESBG%20final%20member.pdf

[6] https://www.independent.ie/business/irish/ecbs-draghi-blames-irish-bank-monopoly-for-high-mortgage-costs-37509130.html

[7] Systemic Risk Pack, March 2019, available here: http://www.centralbank.ie/docs/default-source/publications/systemic-risk-pack/systemic-risk-pack-march-20191368d8134644629bacc1ff0000269695.pdf?sfvrsn=10

Leaving aside any major shocks, there are also changes in the banking sector that affect all the established incumbents in the form of technological disruption, regulatory squeezing and monoline entrants[8]. With the concentration of banks' balance sheets so much on the property market it is not surprising that the area of SME lending has not been a growth area. There have however been plenty of new entrants who have seen this as an opportunity. For example the Chief Executive of one such entrant, Capitalflow stated: "Thankfully, the pillar banks have ignored key sectors of Irish industry and abandoned the idea of people doing business with people. This has provided us with a golden opportunity and our disruptive business model is to reintroduce traditional lending practices".

It would be of concern that, while any financial institution that is willing to serve the SME sector is welcome, what is required is a full retail banking service for the sector. SMEs mostly rely on banks to finance themselves, especially in a start-up situation, and often end up as "dependent borrowers" which means it is more costly for them to switch once they have established a relationship with a bank.[9] This has been proven to be the case in Ireland where Irish SMEs have fewer bank relationships than SMEs in other EU countries at only an average of 1 or 2 banking relationships. Furthermore, 86% of new lending to SMEs in 2018 was by the three main banks according to the Central Bank's SME Market Report 2018[10].

A distinction must be made between the various alternative non-bank finance options currently in the market and a full retail bank. On the one hand non-bank finance will offer a limited range of services addressing specific needs of the SME, mainly liquidity and risk management, finance and funding. Other fundamental day-to-day needs are still required to be provided such as Business current accounts, credit cards, foreign exchange and savings. It should also be remembered that financial literacy among small business owners is not always at the level it should be; a recent SFA survey found less than half of those surveyed believe they have good or expert financial literacy.[11]

There is also scope for addressing some of the negative impacts on individuals and households of the fall-out of the recession. Many are still dealing with much changed financial positions as a result of the recession with impaired credit ratings, perhaps lower income or more unpredictable income. A "one-size fits all" approach to banking will not address this profile of customer so this is another gap in the banking market that needs addressing.

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[8] 'Don't bank on big returns with BOI investment' Sunday Business Post, March 3, 2019

[9] Financing the economy – SMEs, banks and capital markets; Speech by Danièle Nouy, Chair of the Supervisory Board of the ECB.

[10] SME Market Report 2018, Central Bank of Ireland, available here: https://www.centralbank.ie/docs/default-source/publications/sme-market-reports/sme-market-report-2018.pdf?sfvrsn=6

[11] Financial Literacy amongst Irish micro, small and medium-sized businesses, Small Firms Association, September 2019

The model being proposed

The proposed model is based on the Sparkassen banks in Germany, however the principles of the model of bank being proposed are general ones and allow for a specific Irish model to be devised according to our requirements.

The core features of the model are the following:

- A business model that is not profit orientated: The bank must have profits in order to survive and grow but the core goal of the bank is to create value and sustainability for their communities.
- A defined regional basis: The bank has a clear geographical area within which it operates, which allows it to gain in depth knowledge of their area and build lasting relationships within their communities.
- A decentralized, network structure: Each bank would be independent with decisions taken locally. Jointly the network would own a Service Provider that would allow efficiencies and uniformity to products, costs and controls.
- A stakeholder model: the public ownership allows model to avoid focusing on shareholder value and speculation and instead focus on the real economy.

These banks would also have an important public mandate that would aim to provide money and credit services to all and thus will support financial inclusion. This also allows the bank to promote savings and to support increased financial literacy among its customers.

As a population in the region of 300,000 is necessary to make such a bank viable, 8 to 10 such small banks would form an Irish network. The estimated equity requirements to set up a system of 8 banks and the Service Provider is €170m. As a publicly owned model this would be state funded, although it could be supplemented by other sources.

The governance model proposed is a dual board structure, based on the Sparkassen model. This comprises of a professional management board to carry out the day-to-day running of the bank and a supervisory board to oversee other functions of the bank and would include representatives of the community in the region the bank operates in. The role of the supervisory board is to ensure that the bank fulfills its public mandate. This also allows scope for local authorities to have a trusteeship role in the banks allowing them to support their obligation to economic development within their region.