



Constitutive Elements of a (German) Savings Bank

Preliminary Notes

Over the past months we have observed a growing interest in the savings banks' business model and structure. Market participants and government institutions from other (non-)European countries who are looking for an insight into the workings of the German economy are likely to encounter the “hidden champion” of Germany's financing industry: the German savings banks. Savings banks, however, may sometimes seem a little opaque to outsiders, especially to those who are more accustomed to large international financial corporations rather than to credit institutions which have evolved from grass-roots banking.

The characteristics of the German Savings Banks Group can also be seen as its principal advantages:

- a business model and a legal form which ensure the supply of banking services to the wider public
- a focus on the regional economy, rooted in the business model and in the so-called “regional principle”
- strong cooperation within the Group, sustained by a common trademark and a joint liability scheme
- a decentralised structure, group-wide division of labour and the generation of economies of scope.

This document aims to shed light on the legal facts. It comments on the savings banks' welfare-oriented business model and their decentralised structure, taking German savings banks as an example. It should be noted that savings banks in many other countries, such as Austria or France, have similar business models. There are even some parallels with co-operative banks, which also follow a decentralised business strategy with a strong focus on customer proximity.

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1. Public Mandate

Savings Banks follow a sustainable business philosophy which focuses on the appropriate and adequate provision of money and credit 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 small and medium-sized enterprises in the regions.

In Germany, this purpose has been laid down by law in the savings banks' "public mandate". This public mandate shapes the entire business model which comprises the following elements:

- supply function: the non-discriminatory provision of financial services with appropriate conditions to all citizens, regardless of their level of income or their financial situation, particularly to small and medium-sized enterprises in the region
- to promote savings
- to strengthen competition based on the competitive requirements of their business area (workable competition)
- the use of part of their surpluses for a broad range of social commitments (in the arts and for social, cultural, sports, scientific and educational purposes).

2. Regional Principle

The regional principle fundamentally stipulates that savings banks are only authorised to operate branches within their own region and that their loan activities should focus on that region. Their business area is specified as the administrative region of the responsible public body.

In Germany, the regional principle is stipulated in the federal savings banks laws. The effects of the regional principle are:

- Savings banks only operate within their regions; “cherry-picking” in more prosperous regions is not permitted. This increases their incentive to invest sustainably in the development of their original region of operation.
- This also prevents them from growing too quickly and underlines a sense of responsibility in corporate governance.
- The strong focus on the home region increases their customer knowledge and their interest in a long-term, stable economy. Additionally, their range of services can be adapted to meet the specific needs of the region.
- Savings banks work according to market conditions. As they cannot subsidise services from the profits of other regions, the regional principle directly adds to their effectiveness.

Savings banks fuel local economic cycles.

- The principle of “local deposits into local loans” also provides financing opportunities for economically weak regions, preventing the economic depletion of regions.
- Savings banks contribute to domestic welfare.
- Furthermore, savings banks are taxed as local businesses and in most German regions contribute substantially to the local budget.

3. Municipal Trusteeship

“Municipal trusteeship” is a special legal aspect of German savings banks laws. It has historic roots which may not be directly transferrable to other legal systems. However, it can provide indications of how locally anchored banks can provide strong ties with their regions whilst remaining legally and financially independent.

Municipalities and savings banks have a common interest in regional development. Savings banks support their municipalities through their obligation to economic development, regional policy, and in social and cultural areas.

In Germany, a municipality is the responsible public body of a savings bank - but not its owner. “Municipality” can mean a city, town or district, or a municipal special purpose association of a local authority for the purpose of jointly running a savings bank.

- The municipality has no shares. It cannot sell the local savings bank and put the resulting revenue into its budget. Savings banks are not “assets” of a municipality.
- The supervisory board of the savings bank ensures that the savings bank fulfills its public mandate. The supervisory board is made up of a percentage of city council representatives, qualified citizens and employees. The position of chairman of the supervisory board is generally held by the mayor (or head of the district authority).
- The supervisory board’s rights of participation do not include the day-to-day business. The responsibility for this is taken by the management board.

Municipalities profit from savings banks in numerous ways, as savings banks

- strengthen sustainable development and stability in the region
- guarantee financial inclusion
- strengthen financial education
- understand the financing needs and risk situations of citizens, businesses and the municipality itself, providing appropriate offers
- generate local tax revenues
- promote non-profit activities within the business area.

4. Legal Status and Ownership

The primary challenge is to ensure that a savings bank cannot be taken over by private banking groups or investors, whose principal aim is generally to increase profits. For this reason the legal form “institutions incorporated under public law” is applied to savings banks in Germany. It is also possible to set up a decentralised banking system in a private legal form (particularly in the co-operative form or as a foundation).

The legal status of savings banks in Germany is laid down in the special savings banks acts of the federal states. A large majority of savings banks are incorporated as “institution under public law”:

- They are legally and financially independent.
- Savings banks have no “owner”. There are no proprietary rights: based on current legislation, savings banks cannot be sold. In some respects savings banks have similarities with foundations.
- The legal form of “institutions under public law” ensures that the population within the business region is adequately represented: the supervisory board is made up of a percentage of representatives of the city council, local citizens and employees. These representatives have to prove that they are qualified in financial matters.
- The day-to-day business is handled by the management board, which is comprised of banking professionals (proof of qualification is required from the supervisory authority). The management board is not formed from local politicians and thus acts impartially.
- In principle, savings banks may perform all customary banking business, although they have very limited options for carrying out speculative transactions on their own behalf.
- Like every other financial institution, savings banks are subject to the German Banking Act and general banking supervision.

Savings banks operate according to commercial principles. However, they do not aim for profit maximisation - rather for “welfare maximisation”. There is no pressure for dividend distribution to shareholders and core capital is principally formed from retained earnings.

5. Decentralised Group (“Network”)

Although savings banks are comparatively small entities, it is possible to increase efficiency, provide for diversified risks and profit from the knowledge of other such banks.

In Germany, savings banks and many other financial institutions have formed the Savings Banks Finance Group. Close co-operation exists between savings banks and other members of the Group, although it is not a consolidated group or a holding company. The following elements constitute the German Savings Banks Finance Group:

- Division of labour: for example Landesbanken operate as central banks for savings banks, as leading banks for large exposures etc. The Group also comprises specialist providers for leasing, factoring, insurance, building society savings, asset management and securities etc.
- Economies of scale and economies of scope: division of labour e.g. in IT and back-office areas, product development, dealing with regulatory requirements and in employee training adds to savings banks’ competitiveness
- Members of the Group share a common trade name (“Sparkasse”).
- Joint liability scheme: in cases of economic difficulty, savings banks support each other at regional or supra-regional level to ensure the continued 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 internally within the Group (in addition to the work of the German supervisory authority, BaFin).

Savings banks groups in other countries have developed various approaches in the areas of internal co-operation, risk-sharing and joint liability. In Germany, despite intense Group interaction, decisions made by savings banks’ management boards remain autonomous. This is vital to ensure that responsibilities are not “socialised”.

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