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SAVINGS BANKS AND COOPERATIVE BANKS IN EUROPEAN BANKING SYSTEMS[1]

Until about 25 years ago, almost all European countries had a so-called "three pillar" banking system comprising private banks, public savings banks and (mutual) cooperative banks. Since that time, several European countries have implemented far-reaching changes in their banking systems, which have more than anything else affected the two "pillars" of the savings and cooperative banks. The paper first describes these changes and points out the specific situation in Germany, as this country is almost unique in so far as the German savings banks and cooperative banks have maintained most of their traditional features. The article then describes the structure of the German "Three-Pillar" banking system and the place and role of savings and cooperative banks in it and concludes with

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[1] This paper is a brief summary of two recently published papers by the same authors. One of them, *Caisses d'Épargne et Banques Cooperatives en Europe,* has been published in French in the *Revue d'Économie Financière*; and the other one, entitled *The Persistence of the Three-Pillar Banking System in Germany* appeared in O. Butzbach and K. von Mettenheim, eds., *Alternative Banking and Financial Crisis.* For details, see the list of references.

a plea for diversity of institutional forms of banks by arguing why it is important to safeguard the strengths of those types of banks that do not conform to the model of a large shareholder-oriented commercial bank.

1. SAVINGS BANKS AND COOPERATIVE BANKS ACROSS EUROPE

Historically, savings banks and cooperative (or mutual, customer-owned) banks have played an important role in the financial systems of almost all European countries. However, the wave of financial deregulation, liberalization and privatization in the late 20th century has changed the role and the institutional forms of these banks in most European countries. The general tendency of the past years was to regard these types of banks as somehow old-fashioned, outdated and inefficient, and to advocate and even implement policies that correspond to this view. In some European countries, savings and cooperative banks have completely disappeared as specific groups of financial institutions, and in some others, they have changed so much that it suggests asking whether there is still today any substantial difference between these banks and conventional commercial banks in the legal form of a corporation and with the set of objectives that private banks can be assumed to have.

Until about 25 years ago, almost all European countries had a so-called "three pillar" banking system comprising private banks, (public) savings banks and cooperative (mutual) banks. Historically, the German savings banks and in particular the German cooperative banks had served as a model for creating similar banks in other European countries and even around the entire world. However, while those in other European countries have greatly changed in recent years, the German savings and cooperative banks have maintained most of their traditional features over the last decades. As far as their legal and institutional features are concerned, the German savings and cooperative banks are today almost exactly as they had been 50 and even 80 years ago.[2] Therefore, they arguably still correspond best to what one might call their prototypes.

Several European countries have implemented far-reaching changes in their banking systems, which have more than anything else affected the two "pillars" of the savings and cooperative banks. There have been several factors that drove the changes in Europe. Certainly, the political climate of the time and EU-wide harmonization were important. However, there was also the presumption that in their former set-up the regional banks were not competitive.

2 For a description of these features see the references in note 2 above and the respective country sections on Germany in Ayadi et al. (2009) and Ayadi et al. (2010).

The most important changes occurred in Austria, France, Italy and Spain. In a nutshell the changes are as follows:[3]

❖ In Austria the three networks of formerly independent local savings and cooperative banks have been transformed in such a way that their respective central institutions have gained far reaching power over the now *de facto* "subordinated" local and regional institutions. The reform in 1979 abolished the regional principle, which encouraged several savings banks to start operating at the national level. In 1986, a revision of the Savings Banks Law permitted splitting up a savings bank into two entities with different legal forms. This reform led to a complex structure of cross-ownerships with some savings banks holding shares in other savings banks, allowing for the creation of central institutions.

❖ In France, savings banks have been converted into yet another group of cooperative banks – of which there had been three for a long time – and have been phased out as a special type of financial institution in 1999. In 2009, the newly created group of cooperative savings banks merged with the cooperative group *Banque Populaires*. Today, French savings banks still exist merely as a brand under the group *Banque Populaire Caisse d'Epargne* (BPCE), but they are no longer comparable to publicly owned savings banks in the traditional sense.[4] In contrast to the former public savings banks, the cooperative banks continue to be an important element of the French banking system.

❖ In Italy, savings banks were partially privatized and several of them were integrated into large commercial banks like UniCredit and INTESA. Cooperative banks consolidated in a big way, and for both groups of banks, as much as for other Italian banks, the regional principle was abolished. Legislative changes in the 1990s further pushed the privatization of the numerous Italian state-owned banks, abolished geographical restrictions, limited the fraction of the shares that any one foundation could hold in one savings bank and finally led to the merger with banks of various types and the creation of large nationally as well as internationally operating banks.

For the cooperative banks the relevant laws largely removed the former restrictions and allowed the *Banche Popolari* (BP) to drift away from their former cooperative status and their local roots. A wave of mergers led to the

[3] For more details, see Adyadi et al. (2009 and 2010) and, for the more recent developments Bülbül et al. (2013) and Schmidt et al. (2014. On cooperative banks in Europe, see also Fonetyne (2007).

[4] For a discussion of the French savings banks and their reform, see Moreau and Boukhorssa (2002) and Polster (2005).

development of large cooperative banks belonging to the BP banking network, while the *Banche di Credito Cooperativo* (BBC) retained their original model as far as their organization as cooperatives and their local business focus are concerned.

- In Spain, the reforms and the economic liberalization that began in the 1970s, reshaped the savings banks with the intention of making them become modern and efficient financial institutions – in spite of the strong role they already played at that time. They were formally and partially privatized, the regional principle was abolished and they were granted the freedom to provide a broad range of financial services in all parts of the country. This transformed them into universal banks and important competitors to other institutions in the banking sector. However, for many of them this new business model proved to be unsustainable, as the recent crisis has shown with surprising clarity.

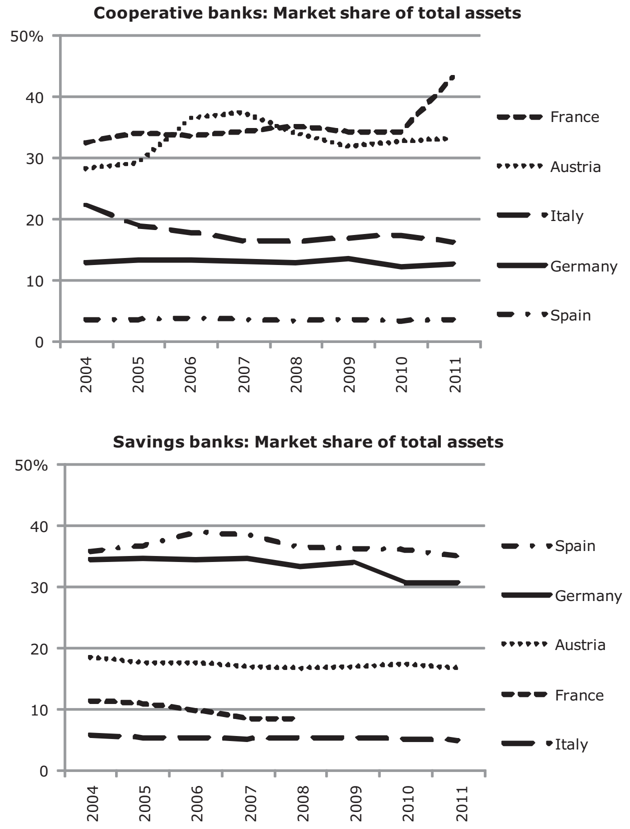
A few brief remarks on other European countries show that in some countries the changes have gone even further:

- In Belgium savings and cooperative banks have essentially disappeared.
- In Great Britain the large former public savings bank (TSB) was sold to Lloyds Banking Group, and several cooperative banks, especially the larger so-called building societies, were converted into corporations and sold to large private commercial banks. Most of the converted building societies or the private banks that had bought them ran into serious problems during the financial crisis.
- In the Netherlands savings banks have disappeared and the formerly independent cooperative banks have been amalgamated into one big national bank (Rabobank).
- In Sweden, the former local savings banks have been converted into joint stock corporations in the 1990s, and most of them were consolidated into a single national savings bank (Swedbank).

The role of savings banks and cooperative banks varies significantly between European countries. This is related both to historical reasons and to developments over the last decades as described above.

Figure 1 presents the market share of savings banks and cooperative banks in terms of total assets in selected countries over the last years (including total assets of the respective central institutions). As illustrated in the left panel, until today savings banks continue to play an important role particularly in Spain and Germany, but not so any more in several other countries. The right panel highlights the strong role of cooperative banks in France and Austria and only a very limited role in other countries. In some countries, such as Austria and Germany, both banking groups play an important role.

Figure 1. The role of savings banks and cooperative banks across Europe



Based on the European Savings Banks Group (ESBG, 2013), the European Association of Co-operative Banks (EACB, 2013) and the European Central Bank (ECB, 2013). Note that the figures for savings banks and cooperative banks include the respective central institutions. For savings banks and cooperative banks, we calculate the market share for each country as the total assets of the respective ESBG and EACB member organizations, respectively, divided by the total assets of all financial institutions in that country as reported by the ECB. Missing values for savings banks for the years 2006, 2009 and 2010 were interpolated.

As one of the motives for initiating far reaching reforms was the belief that the efficiency of local savings and cooperative banks is lower than that of other banks with comparably large branch networks, it is instructive to take a closer look at this aspect. As we will demonstrate below, evidence from the German banking market does not support the belief that local savings banks and cooperative banks are less efficient.

2. THE GERMAN "THREE PILLAR" BANKING SYSTEM

Until today, the German banking system is a so-called "three-pillar system". The first pillar is formed by the private banks. It includes the "big banks" which have nationwide branch networks.[5] The savings bank group is the second pillar, and the cooperative banking group is the third pillar.[6] Table 1 shows the numbers of institutions and branches of the three "pillars" for 2000 and 2012.

Table 1. Number of banks and branches by banking groups in 2000 and 2012

	Institutions				Branches			
	2000		2012		2000		2012	
	number	(%)	number	(%)	number	(%)	number	(%)
Private commercial banks	294	(10.7)	390	(19.7)	6,520	(15.1)	9,610	(26.5)
Big banks	4	(0.1)	4	(0.2)	2,873	(6.6)	7,041	(19.4)
Regional banks and others	200	(7.3)	209	(10.6)	3,567	(8.2)	2,444	(6.7)
Branches of foreign banks	90	(3.3)	177	(9.0)	80	(0.2)	125	(0.3)
Savings bank groups	575	(21.0)	432	(21.9)	17,530	(40.5)	13,094	(36.1)
Savings banks	562	(20.5)	423	(21.4)	16,892	(39.0)	12,643	(34.9)
Landesbanken and DekaBank	13	(0.5)	9	(0.5)	638	(1.5)	451	(1.2)
Cooperative bank groups	1,796	(65.5)	1,106	(56.0)	15,357	(35.5)	11,789	(32.5)
Cooperative banks	1,792	(65.4)	1,104	(55.9)	15,332	(35.4)	11,778	(32.5)
Central institutions	4	(0.1)	2	(0.1)	25	(0.1)	11	(0.0)
Other banks	75	(2.7)	48	(2.4)	3,887	(9.0)	1,746	(4.8)
All banks	2,740	(100.0)	1,976	(100.0)	43,294	(100.0)	36,239	(100.0)

Based on Deutsche Bundesbank (2013). Note that as of 2004, big banks include Postbank AG with its many branches.

[5] "Big banks" (Grossbanken) is a term and a classification employed in the official statistics of the Bundesbank, Germany's central bank. It refers to those banks that have large branch networks. The group currently includes Commerzbank AG, Deutsche Bank AG, Deutsche Postbank AG and UniCredit Bank AG (formerly HypoVereinsbank AG).

[6] For a thorough description and analysis of the German banking sector see Hackethal (2004).

Table 2 contains information on the groups' market shares with respect to total assets, loans to non-banks and deposits and borrowing from non-banks for the years 2000 and 2012.

Table 2. Market share by banking groups in 2000 and 2012

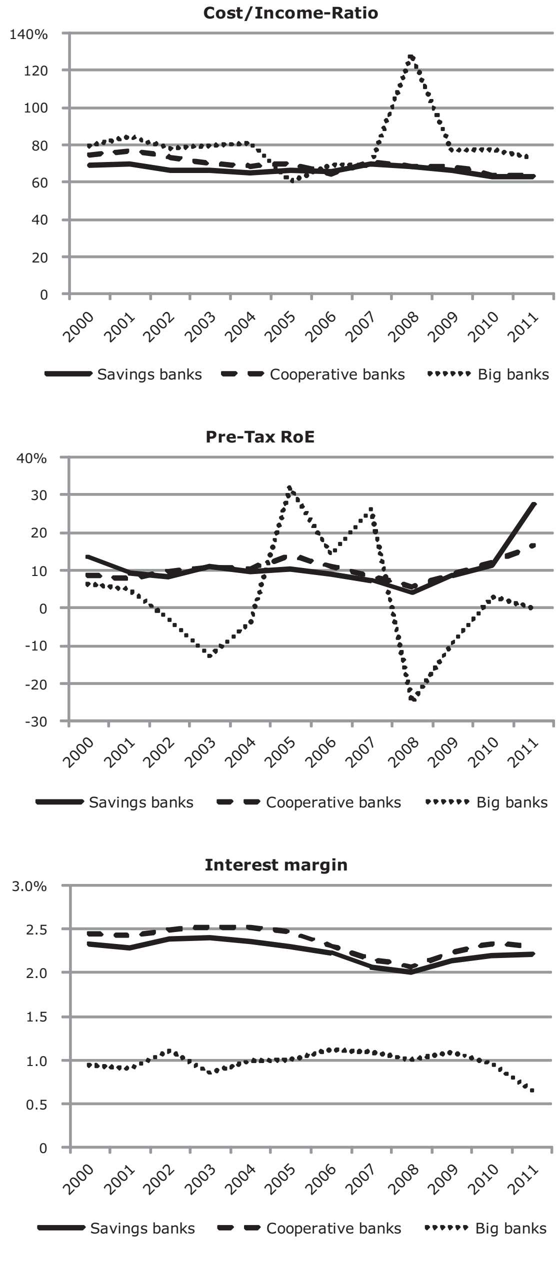
	Total assets		Loans to non-banks		Deposits and borrowing from non-banks	
	2000	**2012**	**2000**	**2012**	**2000**	**2012**
Private commercial banks	28%	39%	26%	27%	26%	36%
Big banks	16%	25%	15%	13%	14%	17%
Regional banks and others	10%	10%	10%	13%	12%	16%
Branches of foreign banks	2%	4%	1%	1%	0%	3%
Savings bank groups	35%	28%	35%	36%	39%	34%
Savings banks	16%	13%	19%	21%	26%	24%
Landesbanken and DekaBank	20%	15%	16%	15%	13%	11%
Cooperative bank groups	12%	12%	12%	15%	18%	17%
Cooperative banks	9%	9%	11%	13%	17%	16%
Central institutions	4%	3%	2%	2%	1%	1%
Other banks	24%	20%	26%	22%	17%	12%
All banks (in billion Euros)	6,148	8,315	3,479	3,949	2,261	3,328

Based on Deutsche Bundesbank (2013).

Over the years, the local savings and cooperative banks have been able to prosper and at times even outperform the commercial and purely shareholder oriented banks. The following Figure 2 provides performance indicators of German branch banking and allows for an assessment of the financial situation of those banks in the three pillars that have extended branch networks and are therefore to some extent comparable. The left panel of Figure 2 shows that the cost-income ratio is lower for savings banks and cooperative banks than for the large commercial banks. As shown in the middle panel, return on equity is on average higher and clearly more stable for savings banks and cooperative banks. Finally, the right panel shows that the interest margins for all banks have been steadily declining, but throughout the years the interest margins are higher for savings banks and cooperative banks than for big banks.[7]

[7] The performance indicators of the central financial institutions of the savings bank group and the cooperative bank group, which are not shown in Figure 2, are largely similar to those of the big private banks.

Figure 2. Performance indicators of German branch banking



Based on Deutsche Bundesbank, Monthly Reports, September 2001–2012.

Not only standard performance indicators show that the local banks performed about as well and at times even better than the private big banks, but also more elaborate ways of analyzing and comparing performance confirm this result for the years before the financial crisis began in 2007. For example, Altunbas et al. (2001) examined a sample of German banks between 1989 and 1996. They found that public and mutual banks are not less efficient, but rather have slight cost and profit advantages over their private sector competitors. This may appear particularly surprising given that savings and cooperative banks pursue the dual objective of profit and benefit for their customers, an effect that cannot be included in standard performance measurements.[8] Probably less surprising, but equally relevant, is that German savings banks and cooperative banks are on average less risky than private commercial banks (Beck et al., 2009).

Further, using a sample for the period 1995 to 2007, Behr et al. (2013) find that the lending of German savings banks is less cyclical compared to that of the private banks and that German small and medium-sized enterprises that increase their borrowing from savings banks are less credit constrained. Hence, the high financial stability of German savings banks also benefits their clients.

In contrast to the large banks which experienced large losses due to overly risky investments and off-balance sheet activities of a precarious nature in the pre-crisis years, German local savings and cooperative banks weathered the storm largely unharmed. This is foremost due to their traditional business model concentrating on the core-business of banking and corresponding to their mission and tradition. The local banks benefitted from their strong deposit-gathering ability and the established and close relationships with their business clients. Moreover, their conservative business models prevented them from becoming involved in those lines of risky business that hurt most large private banks. Moreover, in contrast to other banks, the savings and cooperative banks have not curtailed lending during the crisis period.

Nevertheless, like almost every financial group, the savings banks group as a whole was also affected by the financial crisis. *Landesbanken* or regional banks also belong to the savings bank group and serve, among other capital market related activites, as clearing banks for the local savings banks operating in their respective regions. Four of them (HSH Nord, BayernLB, SachsenLB and WestLB,) suffered greatly, indirectly also causing large losses to local savings banks in their roles as co-owners, guarantors and business partners. This is one reason why some *Landesbanken* are currently undergoing major reforms (HSH Nordbank and BayernLB), were merged (SachsenLB with LBBW), were largely liquidated (WestLB), or are re-aligning their business models. Other *Landesbanken*, such as

[8] This point is also made very clearly in Fonteyne (2007).

Helaba, did relatively well during the financial crisis and thus even strengthened their positions within the savings banks group.

Being even less involved in structured finance and capital markets products than the savings banks, the cooperative banks have survived the financial crisis better than any other banking group in Germany, even though their central financial institution DZ-Bank also had some problems and needed help, which it got from other institutions belonging to the network. Very soon, these problems were overcome, and DZ-Bank returned to profitability.

In conclusion, one can say that despite some problems with their central financial institutions, savings banks and cooperative banks have proved to be a stabilizing factor for the German financial system and for their clients and thus also for the entire German economy. The financial crisis has strengthened the positions of the two groups of banks and thereby has also stabilized the traditional three-pillar structure of the German banking system.

3. FINANCIAL CRISIS: LESSON LEARNED

While during the years before the financial crisis the general views concerning the merits and the potential of savings banks and, though to a lesser extent, also those concerning cooperative banks in Europe and worldwide had become more and more skeptical over the years, it seems that as a consequence of the crisis this attitude has changed. Banks with public ownership and member or client based financial institutions have regained some recognition, because the vast majority of them had fared better than their larger, purely private competitors and also because they have held up their supply of loans to the economy at a time when big banks cut back lending.

The financial crisis has generated the insight that in the area of banking there can be too much profit orientation, too much profit pressure emanating from the capital market on listed banks and too much financial sophistication. Working together, these factors can lead to banks accepting and even generating too much risk for themselves as institutions, for their respective national financial systems and even for society at large. Local and regional banks are less risky and this contributes to the stability of entire financial systems. After all, many big private banks had incurred so much risk that policy makers and regulators have adopted a skeptical view of their merits and are now trying to find ways of limiting their riskiness. Indeed, many current policy initiatives try to make all banks behave a bit more like the savings banks and cooperative banks of yesteryear.

The formerly “modern” view that all financial systems should resemble as much as possible the model of a financial system in which capital markets are the most important force and in which banks are large, private, purely shareholder-oriented and exchange-listed corporations has been severely discredited by the experiences from the recent financial crisis. It is a very important lesson of the financial crisis that we simply do not know which type of bank and which structure of a financial system are better under different circumstances.

This agnostic position leads to the argument of diversity. In the life sciences, from where the notion of diversity comes, the value of diversity has been widely recognized in recent years, and there is a crucial underlying argument why biodiversity is so important: Even the best experts do not know, and in fact cannot know, what the future challenges to human life and health and to the environment may be, and this is the main argument put forth for preserving biodiversity. Currently endangered species might some time later serve to cure diseases which are not even known today, and this is why they need to be preserved already now.

Much the same applies to the types of banks and banking groups that are the topic of this article. As we simply do not know which type of bank is best if regarded in isolation and which mix of different types of banks within a financial system is best for the economy and for society at large, we regard it as very important to "preserve" these types of banks and prevent them from being sidelined or even abolished. If policy makers accept this argument and act accordingly, they would not only ensure the good prospects of savings banks and cooperative banks, but also provide for the future development of the banking system in Europe.

Abstract

Until about 25 years ago, almost all European countries had a so-called "three pillar" banking system comprising private banks, public savings banks and (mutual) cooperative banks. Since that time, several European countries have implemented far-reaching changes in their banking systems, which have more than anything else affected the two "pillars" of the savings and cooperative banks. The paper first describes these changes and points out the specific situation in Germany, as this country is almost unique in so far as the German savings banks and cooperative banks have maintained most of their traditional features. The article then describes the structure of the German "Three-Pillar" banking system and the place and role of savings and cooperative banks in it and concludes with a plea for diversity of institutional forms of banks by arguing why it is important to safeguard the strengths of those types of banks that do not conform to the model of a large shareholder-oriented commercial bank.

Key words: German three pillar banking system, cooperative banks, savings banks

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