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## Paper for

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## Paper titel

Why should companies found a corporate bank in Europe?

An analysis from an European monetary system point of view.

## Paper

### I. Introduction

What role do commercial banks (hereafter called banks) have in today's monetary system in the Euro area and how is money created? These issues are closely linked and are intensively discussed in scientific circles. In mainstream literature two common theories describe different role of banks. On one hand, these are described as financial intermediaries, who take deposits from savors and provide credit to borrowers. Hereby, banks do not differ, from a monetary system point of view, from other economic actors, such as real economic enterprises or households. On the other hand, the money multiplier theory describes banks as money-creating institutions, which can generate money by multiplying existing central bank money. Prior to this act banks require customer funds and the money-creating ability is limited based on a central bank percentage. In this case, the complete control over the amount of money is situated at the central bank and the money creation process of banks starts by customers depositing savings. Since the 2008 financial crisis the role of banks has been argued by the Deutsche Bundesbank, the Bank of England and the academic world and they mentioned that these two theories do not match the role of banks in economic reality.<sup>1</sup> So what is the role of banks and how is their role connected to the question of the source of money? This paper refers to the monetary system structure in the Euro area and therefore does not apply to other currency areas, however the classification at the global level is similar.<sup>2</sup>

In today's monetary system banks can be described as “active deposit money creators” and are the primary institutions which influence money supply. This means that banks do not need neither excess

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<sup>1</sup> Werner, International Review of Financial Analysis 36/2014 S.1-19;  
Werner, International Review of Financial Analysis 36/2014, S. 71-77;  
Bank of England, Quarterly Bulletin 2014 Q1 S. 14-27;  
Deutsche Bundesbank, Wie das Buchgeld in Umlauf kommt,  
[http://www.bundesbank.de/Redaktion/DE/Dossier/Service/schule\\_und\\_bildung\\_kapitel\\_3.html?notFirst=true&docId=147694#doc147694bodyText2](http://www.bundesbank.de/Redaktion/DE/Dossier/Service/schule_und_bildung_kapitel_3.html?notFirst=true&docId=147694#doc147694bodyText2), checked at 31.08.2016

<sup>2</sup> Ryan-Collins/Greenham, Where does money come from?,  
<http://www.neweconomics.org/publications/entry/where-does-money-come-from>, checked at 06.09.2016

reserves prior the step of creating money nor customer deposits. They create money by lending loans or asset purchases. Today's most important form of money are sight deposits, which are created by banks. The amount of money is thus mainly determined by the actions (lending or asset-purchasing) of banks and not by the central bank. These findings are the fundament for the questions why a non-banking-company should found a corporate bank? Exemplary corporate banks are VW-, SIEMENS- or Trumpp-Bank.

By founding a corporate bank non-banking-companies take two of three roles in the monetary system. On the one hand the role of a non-bank (financial intermediary) and on the other hand the role of a bank (money creator). The third role is the central bank, which is the only creator of central bank money.

The aim of this paper is to discuss which reasons argue for a corporate bank foundation in the Euro area based on the structure of the monetary system. Therefore, three according reasons are described, that could lead to business advantages due to the corporate bank. It is necessary to highlight that these following reasons and potential economic advantages have to be contrasted with different risks and influencing factors which exist by founding a corporate bank. For example the influence of the payment system on the money creating capability, banking regulation and general risks of the banking business.<sup>3</sup>

## II. Reasons to found a corporate bank

The following discussed three reasons for founding a corporate bank, based on the monetary system are:

- Ability to actively create bank deposit money
- Access to central bank accounts and their payment systems
- Refinancing possibilities in central bank money

### II.a. Ability to actively create bank deposit money

The ability to actively create bank deposit money is the major distinctive feature between a bank and a non-bank, hence, between a company with and without a corporate bank. In today's monetary system there are three distinguishable roles, the central bank, banks and non-banks. Non-banks are financial intermediaries as they have no possibility to create money and they use existing money for their activities. Banks are active creators of today's most relevant type of money, bank deposit money which is used as sight deposits.<sup>4</sup> The central bank is the only creator of central bank money in cash and digital form. The latter is only accessible for banks, is usually called central bank "reserves" and is discussed in chapter II.b.

By founding a corporate bank a non-banking-company gets the ability to create the most important form of today's money, namely bank deposit money. How does the money creation work and what means the description as an "active" money creator?

The ability to actively create money means, that new bank deposit money can be created without needing customer deposits or central bank money. The money creation process is based on the banks activity by lending out loans or buying assets. The according accounting record would be "Sales

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<sup>3</sup> Görden/Rosar, Bankbetriebslehre, 1. Aufl. , S. 44-45; Tolkmitt, Neue Bankbetriebslehre, 2. Aufl. 2007 , S. 82

<sup>4</sup> Deutsche Bundesbank, Das Buchgeld Messung der Geldmenge,  
[https://www.bundesbank.de/Redaktion/DE/Dossier/Service/schule\\_und\\_bildung\\_kapitel\\_3.html?notFirst=true&docId=147672](https://www.bundesbank.de/Redaktion/DE/Dossier/Service/schule_und_bildung_kapitel_3.html?notFirst=true&docId=147672), Abruf am 24.08.2016

credit/Liability customer” or “Real-estate/Liability vendor”. The liabilities of the customer or the vendor represent new bank deposit money. Why are these liabilities money?

These liabilities are bank deposits for the bank’s loan customer respectively real-estate vendor. These bank deposits can be seen at the bank statement. These bank deposits are used and accepted as money in today’s economy. In detail this means, that everyone can make payments through bank deposits, similar to cash (central bank money). Bammé describes this effect as follows: “*Money is, what is used as money*”.<sup>5</sup> An object or medium can become money, if it combines the monetary characteristics (means of payment, unit of account, store of purchasing power). Bank deposits combines these characteristics and are used as money in today’s economy. Hence, based on these two facts banks are active money creators, as bank deposits are used as money and banks have the ability to create bank deposits via the described accounting records.

From a business perspective the ability to create money offers interesting economic potential. For example supporting sales loans, asset-purchases or even wage payments by money creation. Hereby, the specific amounts of Euro are credited to the corporate bank account holder. Compared to a non-banking-company these transactions can be financed with money creation and initially without negative effects on the liquidity.

Yet, there are different factors that influence and limit the money creation capability of a corporate bank. The payment system, as a major influence factor, can be referred directly to the structure of the monetary system. Bank deposits are liabilities of a bank to pay out central bank money on demand. This pay-out takes place if a customer withdraws cash or places an order to transfer money to another bank account at a different bank. In both cases the bank has to fulfill her liability and has to pay out central bank money. In the first case the bank pays out cash to the customer in the second case the bank pays out central bank reserves to the other bank. Hence, the outflow of central bank money is a major limitation factor for the money creation capability of an individual bank. If a bank would have to fulfill all her liabilities but without having enough central bank money, the bank would become illiquid and insolvent. This risk is usually known as “bank-run” problematic.<sup>6</sup>

The advantage of the ability to actively create money is higher the bigger the difference of central bank money incoming payments and payoffs is. Additional influencing factors are market demands, regulations, business risks and the willingness of a bank to create money by the action of granting loans or buying assets.

Despite of these influencing factors the ability of a corporate bank to create money offers interesting business opportunities to support the parent company, especially from a sales and financing point of view.

## II.b. Access to central bank accounts and their payment systems

In today’s monetary system of the Euro area the access to the European Central Bank, hereby it’s central bank accounts and payment systems, is permitted just to banks and few other organizations (e.g. charitable institutions...). Non-bank-companies keep their “digital” instrument of payments at commercial banks in form of sight deposits (alternative forms of digital instrument of payments as bitcoin are not included in this paper). As sight deposits like all bank deposits are liabilities for the bank,

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<sup>5</sup> Bammé, in: Kellermann (Hrsg.), *Geld und Gesellschaft : interdisziplinäre Perspektiven*, 2. Aufl. 2006, S. 9–82.

<sup>6</sup> Bank of England, *Quarterly Bulletin* 2014 Q1 S. 14-27

thereby bank customers are kind of investors in the bank, these sight deposits have a general creditor and liquidity risk. These two risks exist for the sight deposit holder although sight deposits are primary means of payment or liquidity reserve, similar to cash, and no profit seeking investment.

The liquidity risk refers to the mentioned phenomenon “bank-run” and this risk occurs when the bank cannot fulfill its liability to pay out central bank money on demand. The creditor risk refers to the fact that sight deposits are accounted as liabilities so that bank account holder become financiers of the bank. Besides a risk management point of view concerning the latent creditor and liquidity risk for sight deposits, these two risks and the potential consequences of a bank insolvency are relevant from an economically point of view. Sight deposits present the majority of monetary assets which are shared across the whole community, from poorer to richer households or companies. Hence, if banks would go bankrupt in a systematic scope (e.g. financial crisis 2008) the main monetary assets of nearly all society members, sight deposits but also saving deposits, would be elementary endangered (catchword: “Too big to fail”)<sup>7</sup>. Due to this risk there is the duty for banks to pay into a legal deposit protection fund which usually protects € 100.000 per customer per bank in the Euro area (this amount can differ between the Euro countries). Yet, this deposit protection fund is constructed for singular and smaller bankruptcies and the capacity of the fund would not cover a systematic crisis as in 2008.<sup>8</sup>

Hence, if a non-bank-company wants to reduce the creditor risk for its sight deposits, the company would have to spread the deposits over several different banks with accounts amounting below € 100.000 per bank or withdraw all sight deposits as cash. Both of this options are not practical and laborious. By founding a corporate bank a non-banking-company can theoretically eliminate the liquidity and creditor risk of sight deposits.

Therefore, two aspects are relevant. In the first place, by founding a corporate bank the bank has access to central bank accounts and belonging central bank reserves. As the central bank cannot go bankrupt the creditor risk is eliminated for the sight deposits hold on the central bank account in form of reserves (=“digital cash”). The reason for this advantage is that the liabilities of the central bank (=sight deposits of central bank account owners like the corporate bank) are liabilities to pay out central bank money. As the central bank is the only institution with the allowance to create central bank money, the central bank has the possibility to create more liabilities even under negative equity. The European Central Bank sums this up as follows: „*Central banks are protected from insolvency due to their ability to create money and can therefore operate with negative equity.*“<sup>9</sup> Commercial banks do not have this ability as their liabilities refer to the payout of central bank money and this form of money can only be created by the central bank. Next to the elimination of the creditor risk, the liquidity risk for sight deposits on central bank accounts is neutralized. The reason therefore is that the payment system between banks is based on their central bank accounts and belonging reserve deposits. Hence, if a corporate bank places an order for a payment to another bank, the payment will be settled from the corporate banks central bank account. So the central bank is not dependent on a commercial bank for operating payments to other banks.

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<sup>7</sup> Pflock, Europäische Bankenregulierung und das “Too big to fail-Dilemma”, 1. Aufl. 2014, S. 1-15

<sup>8</sup> Finanztip, Wie die Einlagensicherung Ihr Vermögen schützt, <http://www.finanztip.de/einlagensicherung/>, Abruf am 26.08.2016

<sup>9</sup> Europäische Zentralbank, Profit distribution and loss coverage rules for central banks, 2016, S. 14, abrufbar unter <http://www.ecb.europa.eu/pub/pdf/scpops/ecbop169.en.pdf>

Hence, due to the central bank access, the belonging account and payment services, the corporate bank could theoretically eliminate the creditor and liquidity risk against external banks by transferring all sight deposits of external commercial bank accounts to the corporate bank's central bank account. Due to these advantages of a central bank account, the German insurance corporate Talanx inquired a central bank account but without success, as Talanx has no banking license.<sup>10</sup> Compared to Talanx the German corporation Siemens has an own corporate bank, the Siemens Bank. During the financial crisis 2008 Siemens transferred a half billion Euros from a French bank to the Siemens Bank, also due to the creditor and liquidity risk.<sup>11</sup> Hence, from a risk management point of view a corporate bank and the belonging possibility to access central bank accounts could reduce the creditor and liquidity risk for sight deposits of a company.

### II.c. Refinancing possibilities in central bank money

The third economic advantage of a corporate bank based on the structure of today's monetary system refers to additional refinancing sources for central bank money. The additional sources are the central bank's instruments of monetary policy, the interbank market and the possibility to take customer deposits. Each of these sources offers different possibilities for refinancing concerning period of validity, amount and compulsory underlying. Next to the additional refinancing sources, the quality of the refinanced assets has to be highlighted. As this sources lead to an inflow of central bank money on the corporate bank's central bank account the corporate bank receives secure, highly liquid central bank reserves. The advantages of central bank reserves has been discussed in chapter II.b.

### III. Summary

Banks have a distinctive role in today's monetary system as active creators of bank deposit money. Hence, banks can be differentiated to non-bank-companies (financial intermediaries) and the central bank (creator of central bank money) in the monetary system. By founding a corporate bank a non-bank-company could take two of these three roles. Three main reasons based on the structure of today's monetary system argue for the set-up of a corporate bank. First, the ability to actively create bank deposit money by primary granting loans or buying assets. Hence, corporate banks can financially support the mother company in different business activities like sales loans or asset purchases. Second, by the direct access to central bank accounts and the central bank payment systems the company can hold and pay with sight deposits directly from central bank accounts. Thereby, the creditor and liquidity risk of sight deposits at commercial banks could be eliminated as the central bank cannot go bankrupt and the payment system is executed directly via central bank accounts. Third, corporate banks have access to additional refinancing sources of the central bank, the interbank market and the possibility to receive customer deposits. Next to the additional sources the quality of the refinanced assets have to be highlighted, as they are highly liquid and secure central bank reserves.

These advantageous reasons for founding a corporate bank should be compared to influence factors which reduce the capability of an individual corporate bank to create money (e.g. payment system). In

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<sup>10</sup> Frankfurter Allgemeine Zeitung, Talanx fühlt sich nur bei der Bundesbank sicher, <http://www.faz.net/aktuell/wirtschaft/unternehmen/konto-talanx-fuehlt-sich-nur-bei-der-bundesbank-sicher-1911150.html>, checked at 31.08.2016

<sup>11</sup> Handelsblatt, Siemens könnte Nachahmer finden, <http://app.wiwo.de/unternehmen/bankenkrise-siemens-koennte-nachahmer-finden-/5218726.html?mwl=ok>, checked at 31.08.2016

addition other risks and efforts combined with founding and operating a corporate bank have to be included into any implementation plans (e.g. bank regulations, business risks...).

The outcomes of this paper want to contribute to the discussion about commercial banks and in special the role of corporate banks. Next to further business administration and finance based research questions (e.g. comparison of corporate banks business model, implementation case study...) economical questions arise, like the relevance and influence of companies which own corporate banks and if these companies should be evaluated in a different way. Thereby, the paper is attended to give input for a plural discussion in economics and business administration studies.

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