Uniwersytet Wrocławski

Witold Srokosz
Tomasz Kopyściański
Rafał Kowalczyk

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Witold Srokosz
University of Wrocław, Faculty of Law, Administration and Economics
ORCID: 0000-0003-2307-9658

Tomasz Kopyściański
WSB University in Wrocław
ORCID: 0000-0003-0659-8915

Rafał Kowalczyk
University of Wrocław, Faculty of Law, Administration and Economics
ORCID: 0000-0002-2981-9226

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Reviewers: *dr hab. Elżbieta Feret, prof. University of Rzeszów;*
dr hab. Anna Zalcewicz, prof. Warsaw University of Technology

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Contents

Introduction

This book was written as part of the grant project titled "Local Government Financial Institutions as an Innovative Way of Conducting Business in the Financial Market" funded by the Polish National Science Centre (NCN). It is the culmination of two lines of research. The first line of research concerns the functioning of local government financial institutions in Poland and in the European Union, with the term "local government financial institutions" being understood as such financial institutions which are controlled by local government units (through capital or personal ties). And the second line of research concerns the preparation of the basic assumptions of legal regulation of the system of Polish depository and credit institutions (i.e. credit institutions, according to the European Union nomenclature), which are controlled by Polish local government units. After conducting the research, the authors came to the conclusion that, in practice, two types of local government financial institutions exist in the European Union: deposit-taking and credit institutions and credit guarantee funds (which may also grant loans in addition to guarantees). Out of these two types of local government financial institutions, local government credit guarantee funds and loan funds created by provinces (województwo), operating as regional development funds (they usually also provide credit guarantees), exist in Poland. However, there are no local government depository and credit institutions in the Polish financial market at all. These findings are reflected in the structure of the monograph. It analyses the existing legal regulations concerning local government depository and credit institutions and credit guarantee funds in selected European Union countries, as well as the existing legal regulations in Poland concerning the establishment of local government financial institutions by Polish local government units (with an emphasis on the role of municipal savings banks existing in Poland before World War II). The economic conditions for the operation of the credit guarantee funds in Poland were also taken into account. These findings were then used to prepare a proposal for a general outline of legal regulations for municipal credit institutions in Poland. The preparation of this proposal makes this monograph a part of the

current reflection in Polish literature after 1989 on the reactivation of pre-war Polish municipal savings banks. Due to the passage of time, and above all the fact that Poland is a member of the European Union and has to comply with the restrictive treaty regulations on state aid, this proposal is tailored to the challenges of the 21st century. The authors' intention was not to prepare a detailed draft of the relevant act, but only to indicate the basic assumptions on which such act could be based in the future.

The main purpose of the monograph is not so much to give the best recommendation for Polish municipal depository and credit institutions, but rather to provide material for further, intensified discussion on such institutions, or even more broadly – the role, significance and legal regulation of local government financial institutions.

This volume is current with law through December 2019.

Chapter 1

Concept and Types of Local Government Financial Institutions

1.1. Concept of Local Government Financial Institution

The activity of local government units in the financial market creates questions about the admissibility and legitimacy of creation and operation of local government financial institutions, or LGFIs. These institutions should support the implementation of public tasks of a local nature. The concept of local government financial institution is not defined by law nor by literature. For the purpose of this book, it can be assumed that local government financial institutions are financial institutions, i.e. entities providing financial services, which are exclusively owned by local government units (LGUs) or a group of local government units, or are totally controlled by LGUs or a group of LGUs (e.g. through the majority of votes on the general meeting or the statutory possibility to elect members of the bodies of a local government financial institution).

The financial institutions are understood as both financial intermediaries and other institutions the activities of which are necessary for the functioning of the financial market. The financial institutions may be classified as[1]:

Financial institutions from the group of financial intermediaries can be classified according to different criteria, e.g.:

- type of institution: bank, quasi-bank, non-bank institution,
- nature of the institution: local, supra-local,
- purpose of the institution: for-profit, non-profit,

[1] M. Białasiewicz, *Podstawy nauki o organizacji: Przedsiębiorstwo jako organizacja gospodarcza*, Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie, Kraków 2011, s. 94. For more on non-bank institutions in Poland, see: W. Srokosz*, Instytucje parabankowe w Polsce*, Wolters Kluwer, Warszawa 2011, p. 76 and next.

- nature of the provision of monetary capital to entities: direct provision, indirect provision.

The above division of financial institutions is not fully dichotomous. The institutions in one group may at the same time be representatives of the other group. In the group of bank, non-bank and quasi-bank financial institutions there are both for-profit and non-profit financial institutions, of local and supra-local nature, which provide other market entities with monetary capital either directly or indirectly.

In terms of the type of financial institution, in Poland, a distinction is made between banking institutions, which include banks (banks in the form of a joint-stock company and cooperative banks), quasi-bank institutions such as Credit and Savings Unions (in Polish, SKOK) and loan institutions (companies) (including also loan funds), and non-banking institutions such as: leasing companies, factoring companies, financial intermediaries and brokers, credit guarantee funds as well as collective investment institutions such as investment and pension funds, insurance companies, brokerage houses and offices.

Another criterion, i.e. the territorial scope of activity, allows to separate a group of financial institutions of a local and supra-local nature. A characteristic feature of local institutions, as opposed to supra-local institutions, is their limited territorial scope of activity. Both local and supra-local financial institutions can operate in the local market, i.e. in an area constituting an economic and cultural whole, where the organisation of community life is usually concentrated around a specific, single urban centre.

Local financial institutions can be considered to be those for which an important objective is to act for the benefit of the local community and its development, supporting the development of local entrepreneurship while maintaining a safe level of profit. These institutions accumulate local community savings, which are used by local entities for their development[2], and are important institutions from the point of view of supporting local entrepreneurship. By stimulating local investment, these institutions contribute to job creation in the long term. Polish local financial institutions include: Credit and Savings Unions, cooperative banks and local credit guarantee funds and loan funds (both local government and private funds).

Supra-local financial institutions in Poland include banks in the form of joint stock companies, insurance companies, investment funds, factoring companies, leasing companies, brokerage houses and offices. Supra-local financial institutions also contribute to local development, but their primary objective is to make the highest possible profit. They provide their services to persons with financial resources without any restrictions concerning, for example, membership in an institution or the territorial scope of activity.

[2] J. Solarz, *Międzynarodowy system finansowy, istota i perspektywy*, Bank i Kredyt 2001, Nr 1-2, p. 9–10.

Another group of financial institutions are for-profit and non-profit financial institutions. All the financial institutions mentioned above except local government credit guarantee funds and loan funds are for-profit entities. In practice, this is also the case with the Polish Credit and Savings Unions (SKOK, which are included in quasi-bank institutions), which belong to the credit union movement and the purpose of which is primarily to grant credits and loans to meet the financial needs of their members. Although, in line with the ideas of the global credit union movement, the credit unions should operate on a non-profit basis, i.e. they should not be profit-making, but should provide assistance to their members, in practice, most of the Credit and Savings Unions are operated for profit (this is permitted under the Act on Credit and Savings Unions of 2009[3]). Among other things, the for-profit nature of Credit and Savings Unions' activities is what led to the current huge crisis of the Credit and Savings Union system in Poland, apart from the fact that most of the Credit and Savings Unions did not observe the principle of common bonds between members.

The scale of the problem with Credit and Savings Unions is reflected in the amount of PLN 4.3 billion, paid out from the Polish Bank Guarantee Fund since 2014 to 250,000 customers of 13 bankrupt Credit and Savings Unions[4].

According to the criterion of the nature of the provision of monetary capital to other entities, a distinction is made between financial institutions which directly and indirectly provide monetary capital to market entities. Financial institutions such as banks, Credit and Savings Unions, investment and pension funds, leasing companies, and insurance and venture capital companies are institutions that directly provide monetary capital to other market participants. It is often said that these are so-called active financial intermediaries, i.e. those which create their own financial instruments[5]. Financial institutions that indirectly provide monetary capital to market participants include factoring companies, financial intermediaries and brokers, brokerage houses and offices and credit guarantee funds. These financial intermediaries are also referred to as passive financial intermediaries because they are institutions that redistribute financial instruments already in circulation[6] or are only intermediaries making them available to other market players.

[3] Ustawa z dnia 5 listopada 2009 r. o spółdzielczych kasach oszczędnościowo-kredytowych (Dz. U. z 2018 r., poz. 2386 ze zm.) [The Law of 5 November 2009 on Credit and Savings Unions, Journal of Laws of 2018, item 2386, as amended].

[4] Data from article by D. Szymański, *Afera SKOK-ów kosztowała już 4,9 mld zł. Sam Wołomin pochłonął 2,2 mld zł*, Business Insider Poland, 06/12/2018, published on https://businessinsider.com.pl/firmy/zarzadzanie/ile-kosztowala-afera-skok-ow-dane-z-bankowego-funduszu-gwarancyjnego/thd3dph (accessed: 7.03.2020).

[5] B. Pietrzak, Z. Polański, B. Woźniak, *System finansowy w Polsce*, PWN, Warszawa 2006, p. 35.

[6] *Ibidem*.

Financial institutions controlled by local government units, due to the fact that their purpose is to act for the benefit of the local community and its development, including supporting the development of local entrepreneurship, should be considered as institutions acting locally. Thus, they should be included in the same group as Credit and Savings Unions, cooperative banks and local credit guarantee funds.

1.2. Involvement of Polish Local Government Units in the Sphere of Business Activity

Taking up, pursuing and initiating business activities (including in the financial services market) by public entities should be considered from a multi-faceted perspective, not only through the prism of the legal effects but also economic and social effects of these activities. Business activity also concerns local government units, which, by implementing the subsidiarity principle, remain the public administration bodies closest to the inhabitants, identifying their needs and responding to them. For the full extent of implementation of this principle, they should have an impact on social and economic phenomena occurring in the local market. In view of the tasks and expectations of the local community, which are incumbent on these entities, they cannot be a passive observer of the phenomena taking place in the local dimension, but, having legal instruments at their disposal, they can stimulate (positively or negatively) the phenomena expected by the local society. One of these instruments is the possibility of functioning in the sphere of business activity. The limits of engaging in this activity are very difficult to establish, not only in legal terms, but above all in economic and social terms. However, it is difficult to imagine a complete lack of participation of local government units in the local market. Therefore, as a rule, it should be allowed as a standard for all developed countries (and this is the case in Polish legal system) for public entities to engage in business activity, first of all as a regulator of provisions for the local government community. In addition to the rationale for undertaking such an activity presented above, another, no less important, reason inspiring to conduct business activity should be indicated, which is the achievement of fiscal objectives. Local government units not only enter into economic relations in order to stimulate them, but also treat these spheres of their activity as a source of benefit from such activity. Despite the existing doubts concerning the role of local government and its commercial activity, in view of the limited public funding sources for local government tasks, this aspect of undertaking business activity cannot be omitted either. It seems to be essential to determine in which situations a local government unit conducts business (commercial) activities and in which it performs only statutory tasks entrusted to it by law. The answer to this question is not an easy one, as is

evidenced by both the views of the doctrine and the acquis of law enforcement practice, which are often contradictory. It is worth quoting here the decision of the Court of Appeal in Warsaw of 17 April 2013, which stated that: "A local government unit may be regarded as an entrepreneur conducting business activity only within the scope of performing its own tasks and only if they are related to the unit's participation in conducting of civil law transactions. The assumption that each investment activity of a local government unit, undertaken on its own account in connection with the performance of public service tasks, constitutes a form of business activity within the meaning of the Code of Civil Procedure, is not based on the provisions of law"[7]. In contrast, it is worth quoting the decision of the Supreme Administrative Court of 13 July 2016, which stated that: "Business activity is a fact, an objective category. The fact that an entity conducting a specific activity does not assess it (subjectively) as a business activity, does not call it so or declares that it does not conduct any activity, is irrelevant. Therefore, as long as the activity is (objectively) capable of making a profit for the entity conducting such activity (and is not illegal), it should be treated as a business activity"[8]. Based on these decisions alone, it is already difficult to define the role of a local government unit in the local market. Therefore, it should be assumed that it is possible for the local government units to carry out their own tasks, with a profit resulting from the implementation of these tasks. Or, to put it in a different way, it should be assumed that it is possible to conduct a business activity if this activity falls within the category of implementation of local government unit tasks (see more on this topic below). However, regardless of whether a local government unit acts as an active entrepreneur or not, the activity of this unit must be aimed at achieving some objective or function. Both in the case of fulfilment of the intervention and fiscal function within the framework of business activity, it should be considered as a necessary condition to equip local government units with legal instruments using which they can participate in this activity. It is not only about indicating the limits of this activity, but also the forms of activity conducted and the reasons for undertaking it. Establishing the type of these instruments, affects the capacity of local government units to influence this market, or to participate in this market, directly or indirectly. This division is obviously not unambiguous and fixed, but it is only an attempt to organise systemic legal solutions concerning the business activity of local government.

Instruments of direct participation in the sphere of business activity are a consequence of legal regulations allowing local government units to undertake business activity by means of organisational forms created by this unit or by joining entities that have already been operating. Thus, the directness of this activity consists in the fact that

[7] Sygn. akt. IV AC 1371/13, LEX nr 1331149.
[8] Sygn. akt. II OSK 1383/16, LEX nr 2142361.

a local government unit is engaged in the sphere of business activity in its own name and on its own account, or using the legal entities created by this unit in the form of municipal companies. The possibility of engaging in this scope of business activity is the result of several conditions: the scope of tasks incumbent on this entity, permissible forms of conducting this activity and limitations in the scope of involvement of local government units in business activity, especially in the dimension including profit-oriented activity.

Instruments of indirect impact on the market do not require direct involvement of the public entity, but the creation of a friendly environment for entrepreneurs already operating in the market or planning to start their business. Therefore, a local government unit does not engage in a business activity with its assets (acting on its own behalf or through the organisational forms created), but stimulates desired economic phenomena, e.g. through appropriate tax policy.

The scope of influence on the local market (with both direct and indirect forms) depends primarily on the system provisions shaping the areas of activity of individual local government units, due to the types of tasks they are obliged to carry out. Therefore, it is necessary to adopt a diversified range of possibilities of influencing business activity, either directly or indirectly, and determined by the type of local government unit and its own tasks it is in charge of. Assuming as an axiom that it is necessary for local government units to influence the local market, it should first of all be determined on the basis of the applicable legal provisions, which units are allowed to conduct business activity and to what extent. In view of the above problems, further consideration should be split into parts describing legal regulations concerning both the forms of conducting business activity by local government units (divided for further consideration into direct and indirect forms) and the scope of this activity, based on the area that does not go beyond the scope of public service, as well as the activity that does so, because this is how you usually define the activity of a public entity aimed at profit.

Local government units as public entities have to follow the legality principle, i.e. they need to have legal basis for the activities undertaken by them. The lack of adequate legal provisions makes it difficult or even impossible for them to function adequately. For this reason, local government units may establish local government financial institutions or participate in them only when it is possible according to the provisions of law. The basic free market principle does not apply to local government units, i.e.: everything that is not forbidden is allowed. Thus, it is necessary for the legislator to create appropriate provisions for local government units so that they can create and join local government financial institutions.

In Poland, there are three levels of local government units: province (województwo), county (powiat) and commune (gmina). Each type of local government unit has

a separate legal regulation, these are the so-called "system provisions"[9] but of course some of the provisions in the area of local government units' business activity are the same. Such common regulation is the Law on Municipal Economy[10] (hereinafter: LME). This law defines the principles and forms of municipal economy of local government units, consisting in the performance of their own tasks by these units in order to meet the collective needs of the local community.

The system provisions, which regulate the position and functioning of local government in Poland, directly relate to the issues concerning the admissibility and scope of conducting business activity by these units. Due to the organisational position of the commune, which is the basic unit of local government in Poland, it is worthwhile to start establishing the limits of conducting business activity from the commune level, in order to subsequently deal with other levels of local government.

Pursuant to the provision of Article 9 of the Act on Commune Self-government, a commune and another communal legal person may conduct business activity exceeding the tasks of public service only in cases specified in a separate act (the Law on Municipal Economy). This law contains a definition of genuine public service tasks which is important for further consideration. The public service tasks, within the meaning of the law, are the commune's own tasks, as defined in Article 7(1) of the Act on Commune Self-government, the aim of which is to satisfy the collective needs of the people on an ongoing and continuous basis by means of the provision of publicly available services.

The provisions of the Act on County Self-government, similarly as in the case of communes, contain a division and a generic catalogue of tasks to which the characteristics of the county's own tasks are assigned. In addition, with regard to the way these tasks are carried out, the legislator refers to the solutions adopted for communes, allowing the county to create organisational units or delegate tasks to be carried out to external entities. However, the most important difference between the compared system regulations is the fact that counties are not allowed to conduct business activity beyond the public service. While the commune may carry out business activity beyond the public service, the county does not have such a possibility. It is limited to carrying out its own tasks, which may be attributed a public service characteristic. Of course, this does not mean that it is not possible to establish commercial law companies and partnerships to carry

[9] Ustawa z dnia 5 czerwca 1998 r. o samorządzie województwa (Dz. U. z 2018 r., poz. 913 ze zm.) [The Law of 5 June, 1998 on the self-government of the province, Journal of Laws of 2018, item 913 as amended], ustawa z dnia 5 października 1998 r. o samorządzie powiatowym (Dz. U. z 2018 r., poz. 995 ze zm.) [The Law of 5 October 1998 on county self-government, Journal of Laws of 2018, item 995 as amended], ustawa z dnia 8 marca 1990 r. o samorządzie gminnym (Dz. U. z 2018 r., poz. 994 ze zm.) [The Law of 8 March 1990 on local government, Journal of Laws of 2018, item 994 as amended].

[10] Ustawa z dnia 20 grudnia 1996 r. o gospodarce komunalnej (Dz. U. z 2017 r., poz. 827 ze zm.) [The Law of 20 December, 1996 on Municipal Economy, Journal of Laws of 2017, item 827 as amended].

out the tasks of a county. However, the activity of these companies must be limited to the performance of those tasks, which are treated by the Act on County Self-government as county's own tasks and are characterised by a public service feature[11].

In the provisions of the Law of 5 June 1998 on Province Self-government, the legislator, as in the previous regulations, indicated the scope of province's own tasks, and at the same time significantly extended the rules for conducting business activity by a province (in relation to counties). In the public service sphere, a province may establish limited liability companies, joint stock companies or cooperatives, and may join such companies or cooperatives. In addition, in the public service sphere, a province may, in order to implement activities in the field of province development policy, establish a regional development fund in the form of a limited liability company or a joint stock company. Outside the sphere of public service, a province may establish and join limited liability companies and joint stock companies, if the activity of the companies consists in the performance of promotional, educational, publishing and telecommunications activities for the development of the province.

The presented legal regulations show that the business activity in individual local government units is regulated in a completely different way. The legislator has decided on a different scope of this activity for each unit, from very broad possibilities in the case of communes to a prohibition by law to go beyond the sphere of public service in the case of counties. At the same time, a number of common and seemingly coherent solutions applied in the legislation should be identified and developed. First of all, the interpretation of the system provisions indicates that regardless of the scope of permissibility of business activity, the leading motive for undertaking it is the implementation of broadly understood public tasks. The second identical regulation, which is repeated in all quoted provisions, is the distinction between business activity that does not go beyond the limits of public service and that goes beyond those limits. Establishing this limit is extremely important because public service, as a normative concept, has become a determinant of both the objective and subjective limitations of local government units in the sphere of business activity. The activity within the limits of public service frees a local government unit from restrictions concerning the purpose of this activity, as well as the choice of organisational form of conducting such activity.

The body of literature[12] assumes that the characteristics of public service tasks include:

1) service-like nature,
2) simultaneity of production, delivery and consumption,

[11] See: C. Kociński, *Możliwość nieodpłatnego zbycia 100% akcji PKS S.A. przez Ministra Skarbu na rzecz powiatu*, Nowe Zeszyty Samorządowe 2010, Nr 3, p. 48.

[12] C. Kosikowski, *Komentarz do ustawy o gospodarce komunalnej*, Zachodnie Centrum Organizacji, Łódź – Zielona Góra 1997, p. 22.

3) impossibility to store most of the benefits,
4) significant variation in demand between periods of the year and times of day,
5) the need for continuous provision of benefits,
6) high capital intensity,
7) slow pace of technological progress,
8) technical indivisibility,
9) natural monopoly.

Other characteristics of public service include, first and foremost, the activity consisting in meeting the collective needs of the people in such a way as to provide ongoing, continuous and accessible benefits. Therefore, the existence of an enterprise depends on the existence of the collective needs of the people and not on the degree of profitability; moreover, the law authorises the enterprise to make a claim for subsidies. This creates a convenient instrument for subsidising certain activities, with a view to the recipient of these services, for whom they become generally available. The basis for the establishment of a public-benefit corporation (a common name for the organisational forms established to carry out public service tasks) are non-legal assessments, such as the unmet needs of the people. This wording allows for flexibility in assessing whether there are unmet needs in local circumstances, in terms of taking account of local conditions. The evaluation of the public-benefit corporation's activity will be determined by measuring satisfaction of social needs[13]. Such a capacious and, at the same time, open statement makes it possible for local government units to enter the areas which are customarily reserved for non-public entities. It is a rather common view that public-benefit corporations should not use their monopoly position to generate higher revenues than those dictated by the needs of their operating and development activities in order to be able to transfer surpluses to finance the general needs of the commune budget. Such entities should be run as independent and self-sufficient business units, but not profit-oriented and not treated only as a source of income for the local government unit.

An important characteristic, although not resulting from a normative regulation, but rather from the practice of applying the law and doctrine, is the performance of public service tasks not for profit (sometimes it is said that this activity is not aimed at maximising profit). The characteristics of this feature of public service tasks can be supplemented by the statement that performing such tasks puts social needs first, while economic considerations of such activity are in the background. However, profit is not an element excluded from the outcomes of public service tasks. Moreover, it is difficult to imagine that no area of public service tasks is accompanied by a positive financial result. Therefore, this economic category cannot be referred to as the one diversifying

[13] S. Piątek, *Prawo przedsiębiorstw państwowych*, Warszawa 1986, p. 38.

the division of tasks into those that fall within the category of public service and those that do not. The determining criterion (in addition to those indicated above) will be the motive for undertaking such activity. The Constitutional Tribunal commented on the profit element in relation to public service activities, and in its resolution of 12 March 1997[14] it stated that: "the state and municipal organisational units performing public service tasks referred to in Article 4(1)(4) of the Law of 10 June 1994 on Public Procurement (Journal of Laws No. 76, item 344; as amended: No. 130, item 645; of 1995 No. 99, item 488) should be understood as the state and municipal units established in order to perform tasks in the field of public administration consisting in meeting social needs of a general nature, the activity of which is not aimed at profit maximisation". It is clear from the position presented above that entities carrying out the tasks that will not serve to satisfy the collective needs of the people, in the sense of public service, may direct their activities towards making a profit, but this objective will coexist with the obligation to carry out public service tasks. This is so since it is impossible for a commune to create entities the activity of which would be limited only to making a profit (which will be discussed below), regardless of the circumstances accompanying such activity.

Going beyond the scope of public service is an issue related to statutory restrictions of both an objective and subjective nature. Subjectively, the provisions of the government system acts and the Law on Municipal Economy limit the possibility to go beyond the public service tasks, and make it available only to communes and provinces, eliminating counties from this catalogue. In another sense, subjective restrictions also apply to the forms used to conduct such activities. As previously indicated, the legislator allows only to use commercial law companies and partnerships to conduct this type of activity.

On the other hand, the objective statutory restrictions relate to the fulfilment of legal or social conditions for starting an activity outside the scope of the public service.

The Law on Municipal Economy, LME, is the common municipal economy regulation for all levels of local government. Municipal economy includes, in particular, public service tasks the purpose of which is to continually and uninterruptedly address the collective needs of the people through the provision of universally available services (Article 1 of the LME). Municipal economy can be carried out by local government units, in particular in the form of local government budgetary institutions (in Polish, samorządowe zakłady budżetowe) or commercial law companies and partnerships (Article 2 of the LME)[15]. Article 14 of the Public Finance Act (hereinafter: PFA) clearly shows that the

[14] Uchwała TK z 12 marca 1997 r., sygn. akt W 8/96, OTK z 1997 r., nr 1, poz. 15 [Resolution of the Constitutional Tribunal of March, 21, 1997; Signature No. W 8/96].

[15] The Supreme Court stated that art. 2 LME, which defines the forms of municipal economy, contains only an exemplary enumeration (as indicated by the expression "in particular" used by the legislator) and in

list of tasks that may be performed by local government budgetary institutions does not include the provision of financial services.

On the basis of the Act on Commune Self-government and the Law on Municipal Economy, it is impossible to create a full definition of municipal economy. One can only try to explain this concept by describing the characteristics of this economy and confronting them with other concepts used by the above mentioned laws. Pursuant to the provision of Article 1(2) of the Law on Municipal Economy, the municipal economy consists in the performance by local government units of their own tasks, in order to satisfy the collective needs of the local government community. The municipal economy includes, in particular, public service tasks intended to meet the collective needs of the people on an ongoing and continuous basis through the provision of publicly available services. The doctrine assumes that the economy includes all forms of using the assets of local government units both in terms of direct production or provision of services, and by organizing these processes[16]. The term "municipal" used in the name should be understood as implemented by local government units[17].

Therefore, it can be assumed that municipal economy consists in the performance by local government units of some specific type of their own tasks. This specific nature consists in the provision of services to the public in a specific form, because it ensures the unidentified public general access to these services. It follows from the previously quoted Article 1 of the Law on Municipal Economy that this economy is to serve the implementation of local government units' own tasks by means of providing services which are generally available. In the next provision, the legislator indicates that such tasks include public service tasks. Such a construction of definitions implies discrepancies in the scope of the terms used in the law. The use of simplifications and conceptual confusion may be especially problematic. Public service tasks carried out by local government units as their own tasks are not equivalent to municipal economy, while municipal economy is not equivalent to the public service sphere. Thus, these are own tasks which are carried out for a specific purpose, which makes it possible to formulate a thesis that own tasks have diversified nature, as their implementation can fall within the boundaries of the municipal economy, but some of them are not covered by it[18].

The local government units' own tasks performed within the framework of the municipal economy are performed as a basic obligation of local government units acting

no case can it be argued that the catalog should be closed and exhaustive [Postanowienie Sądu Najwyższego z 21 lipca 2011 r., sygn. akt V CZ 49/11], (SC judgment of July 21, 2011; Signature No. V CZ 49/11).

[16] M. Pyziak-Szafnicka, P. Płaszczyk, *Działalność gospodarcza gmin a granice sfery użyteczności publicznej*, Finanse Komunalne 1997, nr 2, p. 15.

[17] See: M. Bałdyga, *Gospodarka komunalna: aspekty prawne*, Ostrołęka 2006, p. 17.

[18] See: M. Stec, *O potrzebie reinterpretacji (i nie tylko) niektórych pojęć w zakresie samorządowych zadań i kompetencji*, Ruch Prawniczy, Ekonomiczny i Socjologiczny 2017, Nr 3, p. 33 and next.

as a public-private entity. In addition to the Constitution of the Republic of Poland, the basis for performing these tasks are the government system acts indicating their scope and the basic feature of satisfying the collective needs of the community. At the same time, it should be emphasised once again that the catalogue of tasks listed in the government system acts is not exhaustive: "The tasks listed in Article 7(1)(3) of the Act on Commune Self-government are undoubtedly the tasks included in the concept of municipal economy, i.e. 'the public service tasks intended to meet the collective needs of the people on an ongoing and continuous basis through the provision of publicly available services' (Article 1(2) in conjunction with Article 3(1) of the Law of 1996 on Municipal Economy). Article 2 of the Law of 1996 on Municipal Economy, which defines the ways of conducting municipal economy, contains only an illustrative list (as indicated by the expression 'in particular' used by the legislator) and it cannot in any event be claimed to be exhaustive and closed"[19].

The municipal economy consists only in the performance of tasks in the field of satisfying the collective needs of the local government community, so it is not applicable to the performance of all the tasks of a commune.

From the wording used by the legislator it should be deduced that not the entire municipal economy is oriented towards the provision of services of general interest. The municipal economy may include in its scope the tasks not listed in the catalogue of public service tasks, although these tasks fulfil the intention of the legislator to create the concept of municipal economy as best as possible. It is also significant that the Law on Municipal Economy limits its scope of application to the local government unit's own tasks only, and such a provision, by way of a grammatical interpretation, leads to the conclusion that the performance of commissioned tasks will not be based on the Law on Municipal Economy.

1.3. Types of Local Government Financial Institutions in Poland

Article 10(1) and (2) of the LME defines the conditions under which a commune may establish commercial law companies and partnerships and join them[20]. Pursuant to

[19] Postanowienie Sądu Najwyższego z dnia 21 lipca 2011 r. [Decision of the Supreme Court of 21 July 2011, ref. V CZ 49/11, SIP LEX No. 898283].

[20] Pursuant to Article 10(1) of the LME, outside the sphere of public service, a commune may create and join commercial law companies and partnerships if the following cumulative conditions are met: 1) there are unsatisfied needs of the local community in the local market; 2) the unemployment in the commune has a significant negative impact on the standard of living of the local community, and the application of other measures and legal measures resulting from the existing regulations has not led to economic activation, and in particular to a significant revival of the local market or a permanent reduction in unemployment. However, pursuant to Section 2 of this Article, outside the sphere of public service, a commune may establish and join commercial law companies and partnerships if the disposal of a municipal asset which may constitute a contribution in kind to the company or partnership, or disposing of it in another way causes serious damage

Article 10(3) of the LME these restrictions do not apply to the ownership of shares or stocks of companies dealing in banking and insurance activities. Thus, the communes may establish and join commercial law companies and partnerships dealing with banking and insurance activities, outside the sphere of public services. However, pursuant to Article 10 (4) of the LME, the establishment of and joining such companies by the communes shall be subject to rules which guarantee fair and free competition and compliance with the principles of equal treatment, transparency and proportionality. It is good that the provision of Article 10(4) is included in the LME, but even without this provision the communes would have to comply with the principles set out therein, as such an obligation stems from the Treaty rules on aid granted by the State and more generally from EU competition rules (Title VII, Chapter 1, TFEU).

In general, financial services may be provided by commercial law companies and partnerships. However, a distinction should be made: some financial services can be provided without a licence and some only after obtaining a permit issued by the relevant authorities (in Poland by KNF: Polish Financial Supervision Authority).

It is necessary to differentiate between three basic types of local government financial institutions. The first of them includes local government financial institutions established and functioning based on general regulations concerning a given type of financial institution. The second type includes local government financial institutions established based on a special separate regulation. These two types of institutions usually carry out regulated activities and must be authorised in accordance with the law. The third type are local financial institutions that perform financial services without a licence and operate on the basis of general provisions of commercial and civil law.

The best example of the first type of local government financial institutions are community banks, i.e. banks established based on appropriate regulations referring to banks, for example, by LGUs or groups of LGUs. In Poland, such banks were functioning before the World War II[21].

to property for the commune. It should also be remembered that pursuant to Article 18(2)(9) of the Act on Commune Self-government, the exclusive competence of the Commune Council includes adopting resolutions in commune property matters which exceed the scope of competence of the ordinary management board, concerning the establishment and joining of companies, partnerships and cooperatives and their dissolution and withdrawal from them.

[21] In the interwar period, the banks in Poland were established by inter-community unions basing on the Ordinance of the President of the Republic of Poland as of March 17th 1928 on bank law (Journal of Laws No. 34, item 321), which means that these banks were established according to general rules. Single local government units did not use to establish banks. There existed community banks of a regional character (Komunalny Bank Kredytowy in Poznań, Krajowy Bank Pożyczkowy for the Poznań Voivodeship) as well as community bank of a national character – Polski Bank Komunalny with its seat in Warsaw. See more e.g. A. Młynarczyk, *Komunalne kasy oszczędności i banki samorządowe – zagadnienia prawne*, Kampol s.c., Szczecin 2005, p. 22 and next.

The law which is currently in force in Poland allows the communes to establish banks and insurance companies on such general conditions (but only in certain specific organisational and legal forms). This is a consequence of the provisions of Article 10(1), (2) and (3) of the LME.

Article 10 of the LME clearly speaks only about banking and insurance activities. Interestingly, the application of Article 10 (3) depends on the type of services provided by the company, and not on how the company is qualified by Polish law. In addition, the regulation of Article 10(3) is not precise, because the Polish Banking Law Act[22] (hereafter: the Banking Law) recognises two types of banking activities: those that can only be performed by banks (reserved to banks) and those that may also be performed by other entities. The list of bank activities reserved to banks is included in Article 5(1) of the Banking Law[23]. While the list of bank activities that are not reserved to banks is included in Article 5(2) of the Banking Law. Article 5(2) begins with the words: "If they are performed by banks, the following shall also be considered as banking activities: […]" Thus, the activities mentioned in Article 5(2) are called banking activities only when they are carried out by banks. This means that the activities referred to in Article 5(2) of the Banking Law may be performed by the company referred to in Article 10(3) of the LME only if the company is a bank within the meaning of Article 2 of the Banking Law[24]. There are only two organisational forms of banks in Poland: banks in the form of a joint-stock company or cooperative banks. Article 20(3) of the LME applies only to banks in the form of a joint-stock company. However, currently in Poland no commune has established a bank in the form of a joint-stock company or even holds shares in such bank. In practice, at present Polish communes hold shares in cooperative banks only. And it is rather a unique situation, often a consequence of historical events (e.g. communes purchased shares in cooperative banks in the early 1990s, when there was no legal regulation regarding this issue)[25].

[22] Ustawa z dnia 29 sierpnia 1997 r. Prawo bankowe (Dz. U. z 2017 r., poz. 1876 ze zm.) [Banking Law of 28 August 1997 Journal of Laws of 2017, item 1876 as amended].

[23] According to article 5 (1) banking operations shall be: 1) accepting cash deposits payable on request or within due time limits and operating the accounts of such deposits; 2) operating other bank accounts; 3) granting credits; 4) granting and confirming bank guarantees and also opening and confirming letters of credit; 5) issuing bank securities; 6) effecting bank financial settlements; 7) performing other operations provided exclusively for banks in separate Acts; see more: W. Srokosz, *Czynności bankowe zastrzeżone dla banków*, Branta, Bydgoszcz – Wrocław 2003.

[24] According to article 2 Bank Law "Banks shall be legal persons established under provisions of statutory law and operating by virtue of permits entitling them to perform banking operations involving risk to the assets entrusted to them under whatever terms of obligation of repayment".

[25] See more: A. Zalcewicz, *Bank lokalny. Studium prawne*, Difin, Warszawa 2013, p. 262–270.

The Act on Insurance and Reinsurance Activities[26] (hereinafter: AIRA) contains the insurance activities catalogue in Article 4(7) and (8). In addition, Article 4(9) of this Act indicates activities that become insurance activities, if they are performed by an insurance company. Pursuant to Article 7(1) and (2) of the AIRA, in order to carry out insurance activities, the approval of the supervisory body (Polish Financial Supervision Authority) is required. The insurance activities are carried out by an insurance company. Therefore, the insurance activities may be carried out by the company referred to in Article 10(3) only if the company is an insurance company within the meaning of the AIRA[27]. In practice, Polish communes neither establish insurance companies nor have shares in insurance companies.

In Polish law, there are no regulations addressed to communes, which regulate the establishment of banks or insurance companies in the form of a joint-stock company or joining such companies by the communes. There are only general provisions contained in the Banking Law Act (for banks) and in the Act on Insurance and Reinsurance Activities (for insurance companies). In Poland, apart from Article 10(1) and (2), and Article 10(3) of the LME, there are no other legal provisions empowering local government units to set up entities providing financial services or to participate in such entities.

Admittedly, the law which is currently in force in Poland accepts the establishing of banks on such general conditions by communes, but in practice, communal banks and communal insurance companies are currently absent in Poland. It cannot be said, though, that in Poland, local government financial institutions do not operate at all. The third type of such institutions develops quite dynamically (institutions that are not subject to any special financial law provisions and commercial and civil law provisions). These are:

1) regional development funds (commercial law companies and partnerships) established by the province on the basis of Article 13(1a) of the Act on Province Self-government (hereinafter: PSG), which provide loans or credit guarantees to local entrepreneurs (they can also be called local government loan funds, due to their local government nature);
2) local government credit guarantee funds – commercial law companies and partnerships established by local government units pursuant to Article 2 of the LME in the sphere of public service, which only provide guarantees to local entrepreneurs.

[26] Ustawa o działalności ubezpieczeniowej i reasekuracyjnej z dnia 11 września 2015 r. (Dz. U. z 2018 r., poz. 999 ze zm.) [Act on Insurance and Reinsurance Activities of 11 September 2015, Journal of Laws of 2018, item 999 as amended].

[27] According to the article 6 AIRA „An insurance undertaking may perform insurance activities only in the form of a joint stock company, a mutual insurance society or an European company as defined in Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the statute for a European company". Thus, the commune cannot establish a mutual insurance society because it is not a company. He cannot also have shares in such a company.

Chapter 2

Establishment and Operation of Local Government Credit Guarantee and Loan Funds in Poland

In the sphere of public service, the province may establish commercial law companies on the basis of principles and forms defined in the Act on Province Self-government (PSG). This is primarily provided for in Article 13(1a), according to which, the province may establish a regional development fund in the form of a limited liability company or a joint-stock company in the sphere of public service in order to carry out activities in the field referred to in Article 11 (2). On this basis, the Polish provinces established regional development funds, which are limited liability companies and which provide certain financial services, first of all by granting loans[28]. The provinces have full control over these companies, holding 100 percent of the shares in them. Regional development funds grant loans to micro-enterprises and small and medium-sized enterprises that are based in the province that established the fund. This determines that these funds should be included in a wider group of loan funds (in 2015 there were 87 loan funds in Poland[29]). The equity of the regional development funds, operating as loan funds, comes from paid-up shares of the provinces and also from remuneration received for the loans under JEREMIE 2007-2013 and JESSICA 2007-2013 initiatives[30].

[28] For example: Dolnośląski Fundusz Rozwoju sp. z o.o. https://www.dfr.org.pl/o-nas/; Wielkopolski Fundusz Rozwoju sp. z o.o. https://www.wfr.org.pl/; Małopolski Fundusz Rozwoju http://mfr.com.pl/o-nas/ (accessed: 7.03.2020).

[29] This number is given by B. Z. Filipiak, [in:] *Rynek funduszy pożyczkowych w Polsce. Raport 2015*, ed. B. Z. Filipiak, Polski Związek Funduszy Pożyczkowych 2015, p. 10, http://www.pzfp.pl/file_store/Aktualno%C5%9Bci/PZFP_Raport_2016_.pdf (accessed: 7.03.2020). Unfortunately, this report does not distinguish a separate group of local government loan funds, nor does it give their number.

[30] More on the genesis and history of loan funds in Poland, see P. Mikołajczak, *Ewolucja i stan obecny funduszy poręczeniowych i pożyczkowych jako źródeł finansowych wsparcia sektora MŚP w Polsce*, [in:] *Fundusze poręczeniowe i pożyczkowe w finansowym wspieraniu sektora mikro-, małych i średnich przedsiębiorstw w Polsce*, ed. A. Janc, K. Waliszewski, Warszawa 2014, p. 42–47.

Local government loan funds do not only take the form of a limited-liability company established on the basis of PSG, but also act as associations or foundations created by local government units[31].

A regional development fund is a legal concept used by the legislator (in Article 13(1a) of the PSG). However, provinces and communes, also in the sphere of public service, on the general basis of Article 2 of the LME establish limited liability companies that only provide guarantees to micro-enterprises and small and medium-sized enterprises based in the area of a given province (local guarantee funds)[32]. These companies operate on a non-profit basis and guarantee loans and credits granted to SMEs by banks and other financial institutions.

Local government credit guarantee funds use their equity for guarantees or use external funds, usually from EU projects. They benefited from JEREMIE funds between 2007 and 2013 and now they benefit from European programmes such as: COSME[33], Horizon 2020[34], Easi[35], or Creative Europe[36]. The credit guarantee funds also use funds from the European Regional Development Fund. Moreover, some of the credit guarantee funds manage to obtain funds from the Polish Agency for Enterprise Development[37].

[31] For example, Local Government Centre for Entrepreneurship and Development (Association "Samorządowe Centrum Przedsiębiorczości i Rozwoju") in Sucha Beskidzka created by the following communes: Maków Podhalański, Stryszawa, Sucha Beskidzka and Zembrzyce, see: http://funduszemalopolska.pl (accessed: 7.03.2020); Pierzchnica Regional Development Foundation, the founder of which is the commune of Pierzchnica, see http://www.frrp.pl/index1.php?go=o_fundacji (accessed: 7.03.2020).

[32] For example: Dolnośląski Fundusz Gospodarczy sp. z o.o., https://dfg.pl/fundusz/; Bydgoski Fundusz Poręczeń Kapitałowych http://www.bfpk.bydgoszcz.pl/ (accessed: 7.03.2020).

[33] Regulation (EU) No 1287/2013 of the European Parliament and of the Council of 11 December 2013 establishing a Programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME) (2014-2020) and repealing Decision No 1639/2006/EC (OJ L 347, 20.12.2013, p. 33–49); http://ec.europa.eu/growth/smes/cosme/ (accessed: 7.03.2020). See to: J. P. Gwizdała, *The Financing of Small and Medium-Sized Enterprises with the EU Structural Funds in Poland Between 2014 and 2020*, International Journal of Synergy and Research 2017, Vol. 6, pp. 43–55.

[34] Regulation 1291/2013 of the European Parliament and of the Council of 11 December 2013 establishing Horizon 2020 – the Framework Programme for Research and Innovation (2014-2020) (OJ L 347, 20.12.2013, p. 104–173); Regulation 1290/2013 of the European Parliament and of the Council of 11 December 2013 laying down the rules for participation and dissemination in "Horizon 2020 – the Framework Programme for Research and Innovation (2014-2020)" (OJ L 347, 20.12.2013, p. 81–103); Council Decision 2013/743/EU of 3 December 2013 establishing the specific programme implementing Horizon 2020 - the Framework Programme for Research and Innovation (2014-2020); http://ec.europa.eu/programmes/horizon2020/en/h2020-section/access-risk-finance (accessed: 7.03.2020).

[35] EU Programme for Employment and Social Innovation (EaSI), see more: https://ec.europa.eu/social/main.jsp?catId=1081&langId=en; (accessed: 7.03.2020). Regulation (EU) No 1296/2013 of the European Parliament and of the Council of 11 December 2013 on a European Union Programme for Employment and Social Innovation ("EaSI"), OJ L 347, 20.12.2013, p. 238–252.

[36] Regulation (EU) No 1295/2013 of the European Parliament and of the Council of 11 December 2013 establishing the Creative Europe Programme (2014 to 2020), OJ L 347, 20.12.2013, p. 221–237; https://ec.europa.eu/programmes/creative-europe/ (accessed: 7.03.2020).

[37] The Polish Agency for Enterprise Development (PARP) is involved in the implementation of national and international programmes financed from the EU structural funds, state budget and multiannual

The equity of the local government credit guarantee funds comes from shareholders' contributions, as well as partly from the financial resources received by these companies for granting credit guarantees funded under JEREMIE 2007-2013. Bank Gospodarstwa Krajowego (BGK) is the shareholder of the majority of local government credit guarantee funds, holding quite substantial shareholding, but usually not exceeding half of the capital[38]. The legal basis for BGK's acquisition of shares in local government credit guarantee institutions is Article 34a(3) of the Law of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons[39]: ASG). According to this provision, BGK may, within the framework of government schemes, take up, acquire or dispose of shares in entities providing guarantees or sureties for the liabilities of SMEs and public benefit organisations within the meaning of the provisions on public benefit activity and volunteerism, and take up or dispose of shares (stocks) in entities co-created by BGK to provide guarantees or sureties for the liabilities of SMEs and public benefit organisations. The key is that such taking up, acquisition, or disposal of shares (stocks) takes place under "government schemes". These are schemes within the meaning of Article 1(1)(3) of the ASG, i.e. government guarantee and surety schemes. The government guarantee scheme of 7 March 2018 titled "Supporting Entrepreneurship with the Use of Sureties and Guarantees of Bank Gospodarstwa Krajowego" is currently in force. Sometimes, apart from BGK and a local government unit, also another company is a shareholder of a local government credit guarantee fund. The shares of this company are, as a rule, held by local government units or the State Treasury (e.g. Special Economic Zone operating as a joint-stock company or a limited liability company under the Law of 20 October 1994 on Special Economic Zones[40] or the Agency for Regional Development Joint Stock Company)[41].

Thus, EU funds were an important factor for lending and credit guarantee institutions in Poland. Besides, one can speak about the system of lending and credit guarantee

programmes of the European Commission. As a key authority responsible for creating a business-friendly environment in Poland, PARP contributes to the creation and effective implementation of the state policy related to enterprise, innovation and staff adaptability. Pursuant to the principle "Think Small First", in all its activities the Agency puts a particular emphasis on the needs of the SME sector. See: https://www.parp.gov.pl/ (accessed: 7.03.2020).

[38] For example Bank Gospodarstwa Krajowego (BGK) is the shareholder of 42,6% of the capital of Dolnośląski Fundusz Gospodarczy, https://dfg.pl/fundusz/ (accessed: 7.03.2020).

[39] Dz. U. z 2018 r., poz. 1808 ze zm.

[40] Dz. U. z 2018 r., poz. 1162 ze zm. Pursuant to Article 6(1), the administrator of a special economic zone may only be a joint stock company or a limited liability company in which the State Treasury or a province local government holds a majority of votes, which may be cast at the general meeting or the shareholders' meeting.

[41] For example, in the case of Fundusz Poręczeń Kredytowych Sp. z o.o. in Jelenia Góra, the shares are held by Specjalna Strefa Ekonomiczna Małej Przedsiębiorczości S.A. in Kamienna Góra, Karkonoska Agencja Rozwoju Regionalnego S.A. and the following communes: Jelenia Góra, Lwówek Śląski, Nowogrodziec, Zgorzelec.

institutions in Poland. The important elements of this system are, for loan funds, the Polish Union of Loan Funds (Polski Związek Funduszy Pożyczkowych – PZFP)[42], and, for credit guarantee funds, the National Association of Guarantee Funds (Krajowe Stowarzyszenie Funduszy Poręczeniowych – KSFP)[43].

An important element of this system is also Bank Gospodarstwa Krajowego. This is the only Polish state bank. Its tasks, scope of activity and organisation are defined in the Law of 8 May 1997 on Bank Gospodarstwa Krajowego[44]. Pursuant to Article 5(1)(5) of this Act, its tasks include, inter alia, conducting (directly or indirectly) the activity in the field of guarantees or sureties as part of the implementation of government guarantee and surety schemes or on behalf of and for the account of the State Treasury on the basis of the ASG, in particular for the micro-enterprises, and the small and medium-sized enterprise sector. As already noted, such indirect activity in the area of sureties as part of the implementation of guarantee and surety schemes consists in that Bank Gospodarstwa Krajowego, on the basis of the already mentioned Article 34a(3), takes up, acquires or sells shares (stocks) in local government credit guarantee institutions. In addition, BGK assists them in their activities, thus fulfilling its objectives set out in Article 4 of the Act on BGK, and provides re-guarantees. According to Article 4 of the Act on BGK, the basic objectives of BGK's activities, within the scope defined by the Act and by separate provisions, include support for the economic policy of the Council of Ministers, governmental social and economic programmes, including the surety and guarantee schemes, and local government and regional development programmes and schemes, covering in particular the following projects:

1) projects implemented using funds from the European Union and international financial institutions,
2) infrastructural projects,
3) projects related to the development of the micro-enterprises, and the small and medium-sized enterprise sector;

– including those implemented using public funds.

The credit guarantee funds that meet the functional standards for the activity in the field of guarantees and sureties[45] and the conditions set by BGK may apply for BGK's

[42] http://www.pzfp.pl/ (accessed: 7.03.2020).

[43] https://ksfp.org.pl/ (accessed: 7.03.2020).

[44] Dz. U. z 2018 r., poz. 1543. See: S. Skuza, *Bank Gospodarstwa Krajowego (Domestic Management Bank) As a Financial Institution in the State Public Finance System* [in:] *Basic problems of public finance reforms in the 21st century in Europe = Les réformes principales des finances publiques en Europe au début du XXIème siècle*, Białystok 2009, p. 98–106, https://repozytorium.uwb.edu.pl/jspui/bitstream/11320/2335/1/BSP_5_2009_Skuza.pdf (accessed: 7.03.2020).

[45] Standardy Prowadzenia Działalności Poręczeniowej, https://www.bgk.pl/files/public/Pliki/Fundusze_i_programy/Standardy_prowadzenia_dzialalnosci_poreczeniowej.doc (accessed: 7.03.2020).

capital participation (i.e. the acquisition of shares/stocks by BGK). Some of these conditions result from statutory regulations, such as the fact that the credit guarantee fund must operate in the form of a capital company (i.e. a limited liability company or a joint-stock company), however, most of the conditions are set by BGK itself, and some are prudential standards. Thus, a credit guarantee fund may apply to BGK for acquisition of its shares/stocks, if it meets the following conditions[46]:

1) it operates in the form of a capital company,
2) the amount of its share capital, in the opinion of BGK, allows it to conduct stable activity in the field of sureties and guarantees (and this is a typical prudential standard),
3) it will provide BGK with the following authorisations:
   – delegation of a BGK representative to the supervisory board of the credit guarantee fund,
   – introduction of provisions to the articles of association/company agreement which make the following actions dependent on BGK's consent: amendments to the articles of association/company agreement, decision on the increase and decrease of the share capital, amendments to the regulations governing the activity in the field of guarantees and sureties and possible additional capital contributions,
4) its financial standing is good or, in the opinion of BGK, the financial forecast predicts a profit within 3 years at the most,
5) it is not in arrears with the payment of taxes and social security contributions,
6) it conducts non-profit activity and the profit is allocated to its statutory activities,
7) it conducts the activity in the field of guarantees and sureties exclusively for the benefit of micro, small and medium-sized enterprises and public benefit institutions, which is the main activity of the fund, and which is reflected in the relevant company records; the fund may not conduct other activities that are not complementary or supporting to the activity in the field of guarantees and sureties (this results from the standards for conducting the activity in the field of guarantees and sureties),
8) it manages the capital taking into account the security of the deposits/capital investments, in accordance with the standards for conducting the activity in the field of guarantees and sureties, i.e. the capital must be invested in safe and liquid financial instruments such as Treasury bonds, securities issued by the National Bank of Poland and bank deposits, or in units of money market funds (up to 20 percent

[46] https://www.bgk.pl/fundusze-i-programy/programy/wsparcie-funduszy-poreczeniowych-dla-msp/ (accessed: 7.03.2020).

of the fund's available resources) and municipal bonds with a guarantee that the issue will be effected by the bank organising the issue (up to 15 percent of the fund's available resources) – this is a typical prudential standard,

9) it has at its disposal appropriate human resources within the meaning of the standards for conducting the activity in the field of guarantees and sureties (this refers to the education and professional experience of fund managers and employees),
10) it meets other conditions specified in the standards for conducting the activity in the field of guarantees and sureties, e.g. it has the necessary economic and technical potential to grant credit guarantees, takes into account the recommendation of the Polish Bank Association concerning cooperation between banks and credit guarantee funds[47], or acts on the basis of the regulations governing the activity in the field of guarantees and sureties, which is the basic document describing the rules of operation of the credit guarantee fund.

Bank Gospodarstwa Krajowego, which took up shares/stocks in the credit guarantee fund, is represented in the company's Supervisory Board by at least one representative. As a holder of shares/stocks, BGK exercises owner's supervision over the credit guarantee fund, including[48]:

- monitoring of the implementation of functional standards of the activity in the field of guarantees and sureties,
- quarterly analysis of financial statements and substantive reports of the fund, which are obligatorily submitted to BGK,
- assessment of the processes of granting credit guarantees, their compliance with the company's regulations, adequacy to the size of the fund's capital,
- monitoring of the allocation of funds,
- monitoring of the amount of the reserves created.

This owner's supervision is private as it is performed by the owner of the shares/stocks. This is not a public-law supervision, as there is no explicit, public-law authorisation contained in the provisions of law. Above all, BGK is not authorised to interfere in the legal and factual situation of the credit guarantee fund through an administrative decision. Such an interference is made by BGK by virtue of its ownership rights. The fact that BGK is a 100 percent state-owned bank (both in the sense of ownership of

[47] Rekomendacja Związku Banków Polskich dotycząca współpracy pomiędzy bankami a funduszami poręczeniowymi na rynku polskim przyjęta przez ZBP w dniu 22 maja 2009 r [Recommendation of the Polish Bank Association (ZBP) concerning cooperation between banks and credit guarantee funds in the Polish market adopted by ZBP on 22 May 2009].

[48] https://www.bgk.pl/fundusze-i-programy/programy/wsparcie-funduszy-poreczeniowych-dla-msp (accessed: 7.03.2020).

equity, and due to its organisational and legal form) is irrelevant here for the qualification of the legal nature of its supervision, which is private.

BGK's assistance to local government credit guarantee institutions is manifested primarily by the fact that Bank Gospodarstwa Krajowego created a limited liability company together with local funds. This company under the name of Krajowa Grupa Poręczeniowa sp. o.o. (National Guarantee Group) conducts advertising, publishing, consulting and training activity, as well as database management and provides support in the use of modern IT tools. One of the main objectives of Krajowa Grupa Poręczeniowa activity is to offer support to local credit guarantee funds related to their activity in the field of sureties and guarantees[49].

Krajowa Grupa Poręczeniowa comprises of 19 regional and local credit guarantee funds, with equity participation by Bank Gospodarstwa Krajowego, which constitute 44 percent of the total number of funds operating in Poland. The Group's objective is to cooperate in preparing the standardisation of services in the surety and guarantee market. The strength of the Group is reflected in its activity in the surety and guarantee market, expressed in the number and value of the sureties and guarantees granted. In 2016, the guarantee and surety action of the Group's funds already exceeded 75 percent of the number of all guarantees and sureties granted and 77 percent of the value of all guarantees and sureties granted[50].

In total, all 43 Polish credit guarantee funds operating in 2016 (i.e. local government funds and other funds) granted guarantees and sureties in the amount of PLN 7453 million. For comparison, in 2010, it was PLN 7144 million and so the progress is not large. Similarly, the equities of credit guarantee funds increased to a small extent – in 2010 they amounted to PLN 869 million, and in 2016 they amounted to PLN 949 million (or PLN 1098 million, depending on the data source)[51].

[49] https://grupaporeczeniowa.pl/index.php/o-spolce (accessed: 7.03.2020).

[50] https://grupaporeczeniowa.pl/index.php/grupa-kgp (accessed: 7.03.2020).

[51] https://grupaporeczeniowa.pl/index.php/grupa-kgp; M. Gajewski, R. Kubajek, J. Szczucki, *Raport o stanie funduszy poręczeniowych w Polsce – stan na dzień 31.12.2016 r.*, https://ksfp.org.pl/wp-content/uploads/2018/01/Raport_KSFP_2016_ver-fin-5xi.docx (accessed: 7.03.2020).

Chapter 3

Local Government Financial Institutions in the EU

3.1. Municipal Credit Institutions

In practice, there are two basic types of local government financial institutions in the European Union: municipal credit institutions (the principal activity of which is granting loans on the basis of deposits) and local government credit guarantee institutions (the main activity of which is to provide credit guarantees to SMEs).

Municipal credit institutions operate in EU countries such as Germany, Austria, France, Denmark, Finland, Sweden and Spain. Therefore, municipal credit institutions do not operate in all countries of the European Union. For example, despite the existence of formal and legal possibilities[52], municipal credit institutions do not operate at all in the Czech Republic and Slovakia.

Historically, the model for European municipal credit institution systems (with the exception of France, which was building its own model) was primarily the German Sparkassen system, but over time the solutions have evolved in individual countries. The development of municipal credit institutions was mostly affected by the progressive unification of European Union banking law, in particular prudential standards, and by increasingly stringent competition laws and State aid restrictions. This resulted in re-modelling of municipal credit institution systems, reducing the number of such institutions

[52] The rules for the performance of tasks and the establishment of organisational forms by local government units are governed by the provisions of Zákon o rozpočtových pravidlech územních rozpočtů (Act on Territorial Budgets, 9 August 2000, Sb. 250/2000 as amended), which in the provisions of § 23 provides that local government units may carry out their tasks, including conducting business activity, in order to carry out the tasks imposed on them and to pursue the interests of the local community. To do this, local government units may establish commercial law companies and partnerships, join them or acquire shares or stocks in them.

and in some cases changing their nature from public to private. This process was particularly visible in Austria, Germany, Italy, France, Spain or Belgium[53].

In Austria, the three networks of formerly independent local savings and cooperative banks were transformed in such a way that their respective central institutions gained far reaching power over the now de facto "subordinated" local and regional institutions. In France, the savings banks still exist only 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. In turn, in Italy, the savings banks were partially privatised and several of them were integrated into large commercial banks like UniCredit and INTENSA. In Belgium, however, the savings banks have essentially disappeared. In Spain, the savings banks were formally and partially privatised already in the 1970s. 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. In fact, they have become universal banks and important competitors of other banks, and thus the 2007 crisis affected them just as adversely as other banks[54].

There is no common definition of municipal credit institution in the doctrine and practice[55]. This paper uses this concept in a narrower sense, i.e. it is limited to entities that meet the EU's definition of a credit institution, which are wholly or partly owned or controlled by local government units.

So, municipal credit institutions are usually the entities meeting the definition of a credit institution according to European Union law[56]. Only a few of them are excluded from the scope of application of the directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV)[57]. Pursuant to Article 2(1) of this directive, *KommuneKredit* from Denmark and *municipal banks* from the United Kingdom are excluded from its scope of application.

In the literature[58], based on the criterion of local government unit's ownership share in a credit institution, a division of municipal credit institutions operating in the EU was made into:

[53] See more: A. Zalcewicz*, op. cit*., p. 134–141 and literature cited there.

[54] R. H. Schmidt, D. Bülbül, U. Schüwer, *Savings Banks and Cooperative Banks in European Banking Systems*, Bezpieczny Bank 2014, Nr 2 (55), s. 40, http://cejsh.icm.edu.pl/cejsh/element/bwmeta1.element.desklight-cc747e51-1910-478a-93ed-3bcd67e73419 (accessed: 7.03.2020).

[55] A. Zalcewicz, *op. cit*., p. 130 and literature cited there.

[56] According to article 4.1(1) Regulation (Eu) No 575/2013 Of The European Parliament And Of The Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ L 176, 27.6.2013, p. 1–337) "credit institution – means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account".

[57] OJ L 176, 27.6.2013, p. 338–436 as amended.

[58] Cf. A. Zalcewicz, *op. cit*., p. 130 and next.

– municipal credit institutions owned by local government units (e.g. Les caisses de crédit municipal in France) and
– municipal credit institutions which are owned (in whole or in part) by other entities, but which remain under full or partial management of a local government unit (e.g. Sparkasse in Austria).

This division can be complemented by a third type of credit institutions – which are not owned at all by local government units and yet remain under their full control (e.g. Sparkasse in Germany).

Moreover, the literature distinguishes the following organisational and legal forms of municipal credit institutions operating in the EU member states[59]:

– public-law establishments (e.g. Anstalten öffentlichen Rechts – a form of operation of Sparkasse in Germany),
– public credit and social assistance establishment (Établissement public communal de crédit et d'aide sociale in France – this is the form of operation of les caisses de crédit municipal),
– savings bank (e.g. Sparbank in Sweden),
– communal savings bank (Gemeindesparkasse – another possible form of operation of Sparkasse in Germany),
– joint stock company (e.g. Landesbanken in Germany).

It should also be noted that in some countries the municipal credit institutions can operate in several different legal forms, as is the case in Germany and Sweden.

There are usually additional, special legal regulations for municipal credit institutions. Such specific legal provisions apply to:

– German Sparkasse system[60],
– Austrian Sparkasse system[61],
– KommuneKredit in Denmark[62],
– Sparekasse in Denmark[63],
– Les caisses de crédit municipal in France[64],

[59] *Ibidem*.

[60] For example: Sparkassengesetz für Baden-Württemberg (SpG) in der Fassung der Bekanntmachung in der Fassung der Bekanntmachung vom 19. Juli 2005 (GBI. 2005, 587, 588 as amended); Gesetz über die Berliner Sparkasse und die Umwandlung der Landesbank Berlin – Girozentrale – in eine Aktiengesellschaft (Berliner Sparkassengesetz – SpkG) Vom 28. Juni 2005 (GVBl. S. 346 as amended); Bremisches Sparkassengesetz in der Fassung der Bekanntmachung vom 12. Oktober 2005 (Brem.GBl. 2005, 555 as amended).

[61] Bundesgesetz vom 24. Jänner 1979 über die Ordnung des Sparkassenwesens (Sparkassengesetz – SpG), BGBl. No. 64/1979 as amended.

[62] Act on the Credit Institution for Local and Regional Authorities in Denmark (Lov om Kreditforeningen af kommuner og regioner i Danmark), Act No. 383 of 3 May 2006.

[63] Lov om finansiel virksomhed.

[64] Article L514-1 and L514-2 to L514-4 of Code monétaire et financier, Version consolidée au 7 novembre 2018.

– Sparbanker in Sweden[65],
– Cajas de Ahorros in Spain[66],
– Säästöpankki and Sparbank in Finland[67].

It is, however, worth noticing that for example within the German Sparkasse system, there are savings banks (Sparkassen) specific exclusively for this system and operating under the organisational and legal form of a public law institution (Anstalten öffentlichen Rechts) as well as seven national banks (Landesbanken) in the form of a joint stock company and to which the provisions of the German Banking Law apply.

Among the municipal credit institution systems in Western Europe, it is the Sparkassen system that is the most resilient. Together, the members of German Association of Savings Banks or Sparkassen-Finanzgruppe (SFG) form one of the largest financial Groups globally, with total aggregated assets of EUR 2.12 trillion as of year-end 2016 (the most recent date for which aggregated data are available)[68]. The government system provisions of the Federal Republic of Germany does not contain any provisions which prescribe or prohibit pursuing of economic activity by public entities. This principle also applies to local government units. What is more, the government system provisions indicate a special role attributed to communes in the structure of public administration, delegating to them the power to deal with all tasks of the local community, not reserved to other entities[69]. This creates the basis for a thesis about the universality that the provisions of law provide to the German commune, which should meet the needs of the community, as long as this activity does not violate other legal norms. At the same time, neither the law nor the doctrine of German law uses the concept of a public enterprise[70]. The forms of conducting business activity are appropriate either under public law or under private law, especially for capital companies: limited liability companies (GmbH) and joint stock companies (AG). As in the case of Polish solutions, the key issue is to answer the question about the motives for undertaking such activity. The classic division of tasks of local government units, which is in force also in German legislation, limits the possibility of undertaking this activity only to the sphere of their own tasks[71]. As in

[65] Sparbankslag (1987:619; t.o.m. SFS 2018:1392).

[66] Ley 26/2013, de 27 de diciembre, de cajas de ahorros y fundaciones bancarias. (BOE de 28).

[67] Säästöpankkilaki 28.12.2001/1502.

[68] Data quoted from: DBRS Sparkassen-Finanzgruppe Rating Report, May 2018, published on https://www.dsgv.de/bin/servlets/sparkasse/download?path=%2Fcontent%2Fdam%2Fdsgv-de%2Fenglische-inhalte%2FDBRS-Rating-Report-May-2018.pdf&name=DBRS%20Rating%20Report,%20May%202018%20.pdf (accessed: 7.03.2020).

[69] See: R. Stasikowski, *Gwarancje samorządności gminnej w systemie prawnym Republiki Federalnej Niemiec i Rzeczypospolitej Polskiej*, Bydgoszcz-Katowice 2005, p. 44 together with the literature quoted there.

[70] St. Biernat, A. Wasilewski, *Wolność gospodarcza w Europie*, Kraków 2000, p. 118.

[71] J. Korczak, [in:] *Gmina w wybranych państwach Europy Zachodniej*, ed. J. Jeżewski, Wydawnictwo Uniwersytetu Wrocławskiego, Wrocław 1995, p. 261.

Polish regulations, German law allows for business activity of local authorities, but under certain conditions[72]. For example, in the Local Government Act of North Rhine-Westphalia, Article 107 states that communes may carry out business activity while carrying out their own tasks only if this is justified by a public objective and if that objective cannot be achieved in other way. The commune is further prohibited from establishing banks, but it is allowed to participate in public savings banks (Sparkassen)[73]. In German science, the concept of public enterprise is used to define a separate organisational unit through which the activities of an entity, governed by public law, are carried out[74]. However, the most important division of these companies is that based on the type of legal regulation. Based on this criterion, a distinction is made between enterprises based on private law forms and enterprises governed by public law[75]. Another important division relates to the purpose of carrying out this activity, which may be profit or another objective which is important mainly from the point of view of public interest, e.g. it is assumed as a rule that a local government unit (public entity) should refrain from business activity whenever there is a conflict of interest with a private entity that can and wants to carry out this activity[76]. The concepts and scope of business activity and municipal economy should be assumed to be similar to Polish definitions. The whole municipal economy, understood as the implementation of public tasks aimed at satisfying the needs of the inhabitants, should be seen as a broader concept than business activity. Thus, the implementation of the Polish local government's own tasks carried out as part of the municipal economy may or may not have the characteristics of business activity, understood primarily as profit-oriented activity.

The Sparkassen system has, in principle, resisted the global financial crisis of 2007 and has retained most of its historical features in the process of the above-mentioned remodelling of European municipal credit institution systems[77]. Just as it was, when this system began to emerge in the 18th century, and just as it is today, one of the main objectives

[72] M.-E. Geis, *Constitutional law fundamentals of municipality self-government*, [in:] *Organisation und Funktionweise der Selbstverwaltung in Polen und in Deutschland. Rechtsvergleichende Analyse*, ed. J. Jagoda, Warszawa 2018, p. 318; H. Scholler, *Grundzüge des Kommunalrechts in der Bundesrepublik Deutschland*, Heidelberg 1990, p. 217.

[73] Gemeindeordnung für das Land Nordrhein-Westfalen (GO NRW), Bekanntmachung der Neufassung vom 14.07.1994.

[74] S. Biernat, A. Wasilewski, *Wolność gospodarcza w Europie*, Zakamycze 2001, p. 118.

[75] See: R. Schmidt, *Die Privatisierung* öffentlicher *Aufgaben als Problem des Staats-und Verwaltungsrecht,* [in:] *Grundfragen des Verwaltungsrechts und der Privatsierung*, ed. S. Biernat, R. Handler, F. Schoch, A. Wasilewski, Stuttgart 1994, p. 210.

[76] M. Balcerek-Kosiarz, *Działalność gospodarcza samorządu gminnego w RFN*, Środkowoeuropejskie Studia Polityczne 2018, Nr 2, p. 19.

[77] In fact, the process of moving away from public ownership and "privatising" local government credit institutions began in Europe as early as in the 1970s, see more: R. H. Schmidt, D. Bülbül, U. Schüwer, *op. cit*., p. 39. This "conservatism" of the Sparkasse system is an advantage for some and a disadvantage for others.

of Sparkassen is to promote the idea of saving and increasing access to capital[78]. The Sparkassen system consists of 385 savings banks (as of 2018) operating in the legal and organisational form of a public law establishment[79]. Their total assets (bilanzsumme) at the end of 2018 amounted to EUR 1.243 billion[80].

The legal status of the Sparkassen is defined in special laws passed by the parliaments of individual federal states, but in addition to being a credit institution from the perspective of both European Union and German law, all those laws that apply to German credit institutions, including in particular the German Banking Act (Kreditwesengesetz – KWG)[81], apply to them as well.

Like other German banks, Sparkassen are subject to banking supervision by German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin), the German Central Bank (Bundesbank) and most of them are, under the Single Supervisory Mechanism – SSM, indirectly supervised by the European Central Bank (ECB)[82].

Sparkassen are also, at Länder level, subject to additional supervision by the competent state supervisory authorities pursuant to the special savings banks laws. Depending on the state, this responsibility may lie with the State Ministry of Finance, Economics or with the Home Affairs Ministry (supervisory authority for savings banks)[83].

From a legal perspective, the special organisational and legal form of a public law establishment distinguishes German Sparkassen from other municipal depository institutions. It also has a significant impact on their "locality" as it ensures the control of German local government units over their Sparkassen, which is particularly important as Sparkassen are not formally "owned" by them. Moreover, Sparkassen, due to their

[78] Zur Geschichte Der Sparkassen in Deutschland Nr 45, 2010, http://www.saalesparkasse-web.de/ (accessed: 7.03.2020).

[79] Because of historic reasons Germany currently has five so-called 'free' savings banks. These are Sparkassen that are organized under private law. They can be found e.g. in Hamburg and Bremen. Although these five Sparkassen based on self-regulation and not on a statutory obligation, their remit is largely identical with the public mandate of Sparkassen organized under public law – see: The Legal Structure of Savings and Retail Banks in Europe, October 2014, European Savings and Retail Banking Group, p. 29, https://www.wsbi-esbg.org/SiteCollectionDocuments/The%20Legal%20Structure%20of%20Savings%20and%20Retail%20Banks%20in%20Europe.pdf (accessed: 7.03.2020).

[80] https://www.dsgv.de/sparkassen-finanzgruppe/organisation/verbandsstruktur.html (accessed: 7.03.2020).

[81] "Kreditwesengesetz in der Fassung der Bekanntmachung vom 9. September 1998 (BGBl. I S. 2776), das zuletzt durch Artikel 6 des Gesetzes vom 8. Juli 2019 (BGBl. I S. 1002) geändert worden ist".

[82] See: The list of the significant supervised entities, which are directly supervised by the ECB (part A) and the less significant supervised entities which are indirectly supervised by the ECB (Part B) – https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.listofsupervisedentities201912.en.pdf (accessed: 7.03.2020). More about SSM see: G. Boccuzi, *The European Banking Union. Supervision and Resolution*, Palgrave Macmillan 2016, p. 23–47; A. Baglioni, *The European Banking Union. A Crtitical Assessment*, Palgrave Macmillan 2016, p. 31–60.

[83] The Legal Structure of Savings and Retail Banks in Europe, October 2014, European Savings and Retail Banking Group, p. 32.

form of a public-law establishment, cannot be "sold" by the competent German local government unit. However, some laws concerning Sparkassen provide for the possibility to transform a savings bank into a joint stock company[84].

The rules of operation of Sparkassen are regulated in the legislation of the individual German federal states, however, all these regulations emphasise that they are to be business entities and their main task is to meet the needs of the local community for financial services. This is the so-called "public mandate" of the German savings banks, which consists in that Sparkassen implement a sustainable business philosophy focusing on the adequate provision of financial services to all customer groups from all parts of society. This is to ensure the financial inclusion of private customers, regardless of their personal income and financial situation, and a lasting commitment to the development of local businesses, and in particular, small and medium-sized enterprises in the area of activity of the savings bank in question. The laws of the individual German federal states indicate that, although savings banks should operate in accordance with market requirements and competition laws, Sparkassen's primary role is to provide open and accessible high-quality financial services to local private customers, small and medium-sized enterprises and the public sector in their area of activity[85].

For example, the law establishing the savings bank of Brandenburg states in §2 that Sparkassen are business enterprises and their task is to ensure the provision of money and credit services in their area of activity. They strengthen competition in the banking industry. They provide their services to the population, the economy, in particular, the middle class and the public sector, taking into account market requirements. They promote savings and overall wealth creation in society. They contribute to the financing of debt counselling, insofar as this task is the responsibility of the institution or its members[86]. The purpose of savings banks in the Federal State of Lower Saxony is formulated differently. The provision of §4 of the Lower Saxony Savings Bank Act of 16 December 2004 states that savings banks are economically independent enterprises which have a municipal function and their task is to strengthen competition on the basis of market requirements and competition laws in their area of activity and to provide appropriate and adequate services to all sectors of the population, including small and medium-sized enterprises. In the business area, Sparkassen support the implementation

[84] For example, pursuant to § 3b(1) of Bremisches Sparkassengesetz, a savings bank based on public law may be converted into a joint stock company. The conversion requires the approval of the supervisory authority.

[85] The Legal Structure of Savings and Retail Banks in Europe, October 2014, European Savings and Retail Banking Group, p. 29.

[86] Act on the Brandenburg Savings Bank (BbgSpkG) of 26 June 1996 GVBl.I/96, [No. 16], S. 210, as amended.

of municipal tasks of the sponsor related to economic, regional, political, social and cultural issues[87].

Sparkassen ceased to be owned by German local government units as early as in the 1930s, when they received the status of a public law establishment. As independent legal persons, they have governing bodies such as the Management Board and the Supervisory Board, with some savings banks having an additional governing body – the Credit Committee. The Management Board is responsible for day-to-day operation and reporting to the Supervisory Board. It is composed of at least two (2) qualified members with appropriate education, experience and knowledge in the field of banking, although in practice there are usually more board members (appointment of members of the Management Board requires the approval of the German financial supervisory authority Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin). As a rule, the Supervisory Board is composed of representatives of the local community (clients), representatives of employees and representatives of the commune elected by the legislative body a given local government unit (e.g. city council). It is responsible for the appointment and dismissal of the Management Board and determines the remuneration and any substantial changes to the operations. The responsible public authority (and not the owner) of the Savings Bank is the respective local authority (commune – *Gemeinden* or county – *Kreise*) or the communal special purpose association (*Zweckverbände*) of the local authorities for the joint operation of the Sparkasse (municipal trusteeship). The legal form of a "public law institution" ensures that the population in the region allocated to a given Sparkasse is represented in the bodies of this institution. It should be stressed here that the savings banks are not "assets" of the commune. The commune has no shares; it cannot sell its savings bank and the income of such bank does not flow into its budget. The Supervisory Board ensures that the savings bank fulfils its public service obligations. The position of the chairman of the supervisory board is usually held by the mayor (or head of the district authority). As a rule, as the literature points out, the rights of participation do not extend so far as to facilitate political influence on daily activities. This is the responsibility of the Management Board[88].

Unfortunately, as practice shows, such strong influence of the politicians on the functioning of Sparkassen can lead to corrupt behaviour at the local level. This relationship between Sparkassen and the politics is also reflected in their day-to-day operations, e.g., the quality of credits granted by Sparkassen is deteriorating during the election years when politicians influence the increase in lending to 'buy' the voters' votes; in turn, more

[87] Niedersächsisches Sparkassengesetz (NSpG).

[88] C.V.J. Simpson, *The german sparkassen (savings banks). A commentary and case study*, London 2013, p. 11–12, https://www.civitas.org.uk/content/files/SimpsonSparkassen.pdf (accessed: 7.03.2020).

aggressive purchases of government bonds after the election suggest that Sparkassen are trying to win the favour of newly elected officials[89].

There is no single legal regulation that defines a catalogue of financial services provided by savings banks. This issue is regulated in legal provisions relating to Sparkassen of individual German federal states, with federal state legislators being able to choose between two different regulatory approaches. Most legislators follow a black list approach (the so-called "qualified universal principle") and only a few rely on a white list (the so-called "enumeration principle"). In principle, according to the white list approach, Sparkassen can only engage in types of transactions that are specifically included in this list. If they want to carry out a transaction that is not in the white list, they must apply for an exemption to the competent supervisory authority. By contrast, the "qualified universal principle" consists in that a savings bank may provide any banking service it wishes, unless such service is expressly blacklisted. This black list may either contain an absolute ban on the provision of certain banking services or may impose certain restrictions on the provision of such services[90].

For example, pursuant to the provisions of §6(2) of the Sparkassengesetz für Baden-Württemberg (SpG) Law, the savings banks may carry out all customary banking transactions insofar as this law or orders issued on the basis of this law or the statutes provide for no restrictions. Housing savings department, investment and insurance activities operate in conjunction with the existing companies in the savings bank organisations. Likewise, pursuant to the provisions of §2(2) of the Gesetz über die Berliner Sparkasse und die Umwandlung der Landesbank Berlin – Girozentrale – in eine Aktiengesellschaft Law, Berliner Sparkasse carries out all kinds of banking transactions and other transactions which serve Berliner Sparkasse. It is entitled to issue covered bonds (Pfandbriefe), municipal bonds and other bonds. And pursuant to the provisions of §4(3) of the Niedersächsisches Sparkassengesetz Law, Sparkassen may carry out all standard banking transactions, provided that certain types of transactions are not excluded according to §6(1). Other transactions, which are normally also offered by other banks to other customers and are closely related to the permitted transactions of the savings bank, are also permitted. Pursuant to the provisions of §6(1) of this Law, the authority supervising a savings bank is empowered, by regulation, to limit business risks by deciding that

[89] See, for example, S. Kahl, P. Skolimowski, B. Groendahl, *How Germany's Little Savings Banks Threaten Big Financial Woes*, Bloomberg Businessweek 5.10.2018, https://www.bloomberg.com/news/articles/2018-10-05/germany-s-sparkassen-little-banks-big-worries (accessed: 7.03.2020); The negative impact of politicians on the functioning of public enterprises has already been scientifically analyzed many times, see, for example, A. Shleifer, R.W. Vishny, *Politicians and Firms*, Quarterly Journal of Economics 1994, No. 109 (4), p. 995–1025.

[90] The Legal Structure of Savings and Retail Banks in Europe, October 2014, European Savings and Retail Banking Group, p. 30–31.

savings banks may not carry out certain activities or may carry them out only under certain conditions.

Sparkassen and Landsbanken grant loans to German communes (in 2014, the share in the total number of loans granted to communes amounted to 21 percent for Sparkassen and 26 percent for Ladesbanken), but the question arises as to what extent such loans are granted objectively (and therefore safely), since the banks are controlled by communes[91].

Since the status of a public law establishment is based on the principle of subsidiarity, a Sparkasse "belongs", to a certain extent, to its commune (or "to the citizens"). Sparkassen do not have the same financial objectives as commercial banks, but this does not mean that they are non-profit organisations as they can only strengthen their equity through the incorporation of profits as reserves, and maintaining stable profitability is essential[92].

The local nature of Sparkasse is also significantly influenced by the principle that there is always one fund in the area (city, county). This is about the administrative boundaries of a local government unit. This is to ensure that the funds invested in the region remain there. In addition, with a few exceptions, the competition between individual savings banks is practically non-existent[93]. They may not open branches or conduct operations outside their area of competence. This regional principle aims to ensure that amounts once invested in the region are reinvested there. In this way, it is avoided that a region is neglected, or underfunded. It also gives Sparkasse a strong link to local economies and protects it from competition from other regional banks, at the same time providing greater stability of funding. This regionality principle is indicated as an important element of the success of the Sparkassen system[94].

Furthermore, the regionality principle applied to Sparkassen has had a significant impact on the decentralisation of the German banking system and is therefore one of the factors contributing to its greater resilience to the financial crisis[95].

Sparkassen are also prohibited from conducting speculative operations on their own account. The purpose of Sparkassen is not to make a profit in itself, but to carry out a variety of tasks, and their large proportion are public service tasks.

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[91] S. Brand, *Paradigmenwechsel in der Kommunalfinanzierung – der lange Schatten der Finanzkrise*, Wirtschaftsdienst. Zeitschrift für Wirtschaftspolitik 2015, Heft 1, p. 53–54.

[92] C. Choulet, *German Sparkassen: a model to follow?*, economic-research.bnpparibas.com, April 2016, p. 4, https://economic-research.bnpparibas.com/html/en-US/German-Sparkassen-model-follow-4/29/2016,28761 (accessed: 7.03.2020).

[93] Ł. Włodarski, *Funkcjonowanie systemu Sparkasse w Niemczech*, Prawo Bankowe 2001, Nr 3, p. 70.

[94] C. Choulet, *op. cit*., p. 5.

[95] S. Gärtner, F. Flögel, *Dezentrale vs. zentrale Finanzsysteme? Wissen und Raum als Distinguierungsfaktoren*, Forschung Aktuell, No. 06/2012, p. 14 and next, https://www.researchgate.net/publication/241769649_Dezentrale_vs_zentrale_Finanzsysteme_Wissen_und_Raum_als_Distinguierungsfaktoren (accessed: 7.03.2020).

These tasks rely on the involvement of Sparkassen in the development of the communes and regions in which they operate, including in particular the funding of retail customers (individuals, non-profit organisations, self-employed and SMEs). Moreover, they are involved in the development of volunteering[96].

In general, as the literature points out, the objective of Sparkasse is sustainable development of real economy in their business territories[97].

As already indicated, there were 385 Sparkassen operating in 2018, with a decrease from 438 to 385 over 10 years from 2008 to 2018, i.e. by as many as 53. However, despite the decrease in the number of Sparkassen, the savings banks themselves had good financial standing in 2017. They recorded a strong growth in lending activity, increased commission income while increasing reserves, maintaining statutory capital requirements and an average capital ratio above the minimum required by the supervisory authorities. Only their net interest income fell year-on-year due to persistently low interest rates. At the same time, Sparkassen were reducing their network of branches which was too dense, thus resulting in too high costs[98].

An important feature of Sparkassen is that these savings banks form a financial group (financial system) called Sparkassen-Finanzgruppe or S-Group, although formally they are obviously independent legal entities (they have legal personality). Members of the group operate under the trade name "Sparkasse". The organisation representing Sparkassen Finanzgruppe is Deutscher Sparkassen- und Giroverband (DSGV), which coordinates the decision-making process within the group and defines the strategic direction.

Under this system, Sparkassen cooperate closely with the other members, in particular, the six Landesbanken (banks in the form of a joint stock company formed by the German federal states, which are: Bayern LB, Helaba, LBBW, NORD/LB, Saar LB, LB Berlin/Berliner Sparkasse), but also with specialised providers of services such as factoring, leasing, insurance, securities-related services and building societies. In 2018, Sparkassen-Finanzgruppe included, apart from the savings banks and Landesbanken: DekaBank[99], 8 Regional Building Societies (Landesbausparkassen – LBS, total assets €71 billion), Deutsche Leasing Group, 11 Regional Public Insurance Groups

[96] C. Choulet, *op. cit*., p. 5.

[97] C.V.J. Simpson, *op. cit*., p. 7–8.

[98] Jahresbericht 2018 der Bundesanstalt für Finanzdienstleistungsaufsicht [Annual Report 2018 of the Federal Financial Supervisory Authority], p. 80.

[99] DekaBank is the Wertpapierhaus of the German savings banks and, together with its subsidiaries, forms the Deka Group. With total customer assets totalling approximately € 276 billion as at december 2018 and around four and a half million managed securities accounts, the Deka Group ranks among Germany's major securities service providers. It ensures access to a wide range of investment products and services for retail and institutional investors. The savings banks collectively own 100% of DekaBank, which was previously 50% owned by the Landesbanken. See https://www.deka.de/deka-group/about-us/profile (accessed: 7.03.2020).

(Öffentliche Erstversicherergruppen), 2 Additional Leasing Companies, 5 Capital Investment Companies of the Landesbanks, DSV Group, Finanz Informatik, 55 Capital Investment Companies (Kapitalbeteiligungsgesellschaften), 3 Factoring Companies (Factoring-Gesellschaften), 7 Regional Property Companies (LBS-Immobiliengesellschaften) and Consulting Firms providing services to enterprises and communes[100].

The Group achieves economies of scale in the areas of IT, back-office, product development, compliance with regulatory requirements, and finally, employee training. In particular, as noted in the literature, the financial group of savings banks cannot be compared with the structure of a group of companies or a holding company. However, the savings banks and other members of the group cooperate closely, which ensures their high efficiency[101].

The Landesbanken take the organisational and legal form of a joint stock company and their stockholders are the German Länder and individual Sparkassen. The Landesbanken have more capital than individual Sparkassen and also more competences, so that they can carry out activities within the Sparkassen-Finanzgruppe (S-Group) which could not be carried out by individual Sparkassen. Thus, the Landesbanken are engaged in securities trading, funding that requires high exposition, clearing (payments) intermediation in relation to savings banks and foreign investment support for German companies. In addition, these are the banks serving the German federal state authorities.

The majority of Landesbanken, due to the size of their capital, are considered as significant entities and are subject to direct supervision by the European Central Bank within SSM (Landesbank Berlin AG, Landesbank Baden-Württemberg, Landesbank Hessen-Thüringen Girozentrale (Helaba), Norddeutsche Landesbank-Girozentrale (NORD/LB))[102].

Sparkassen invest their surplus resources in the Landesbanken in the form of short-term deposits or by subscribing the shares issued by Landesbank (on their behalf or on behalf of their customers). These interbank relationships within the network are beneficial to all members. They reduce the dependence of the German federal state banks – which do not have access to a stable depository base – on market-based funding and allow

[100] Data quoted from: DBRS Sparkassen-Finanzgruppe Rating Report, May 2018 and https://www.dsgv.de/sparkassen-finanzgruppe/organisation/verbandsstruktur.html (accessed: 7.03.2020).

[101] *Ibidem*. However, the German supervisory authorities treat transactions between group members as intra-group transactions, by analogy with intra-holding transactions.

[102] See: The list of the significant supervised entities, which are directly supervised by the ECB (part A) and the less significant supervised entities which are indirectly supervised by the ECB (Part B) – https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.listofsupervisedentities201912.en.pdf (accessed: 7.03.2020); on the criteria for considering a bank as significant, see for example: SSM Supervisory Manual European banking supervision: functioning of the SSM and supervisory approach, European Central Bank, March 2018, https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorymanual201803.en.pdf?42da4200dd38971a82c2d15b9ebc0e65 (accessed: 7.03.2020).

Sparkassen to manage the risk of maturity transformation more effectively. However, they increase Landesbanken exposure to interest rate risk[103].

At the turn of 2018/2019 and in 2019, DSGV attempted to consolidate the Landesbanken into one "Super-Landesbank" (or "Sparkassen-Zentralbank" – Central Bank of Sparkassen), since the regionality of Landesbanken no longer provides those advantages which it provided in the past[104]. Anyway, the idea of *Sparkassen-Zentralbank* is not new. It was raised earlier, as a result of the global financial crisis which started in 2007[105].

German savings banks (Sparkassen) were not actually affected by this crisis, mainly because of the "locality" and the structure of the system as indicated above, and, in particular, they did not require State aid. However, the global crisis has hit some regional banks (Landesbanken). Five Landesbanken (BayernLB, HSH Nordbank, LBBW, NORD/LB and WestLB) suffered significant losses, requiring recapitalisation schemes and balance sheet reorganisation (some reduced their balance sheets, some had to go through a merger process and some went into liquidation under pressure from the European Commission)[106].

Sparkassen has had a system for several decades that is aimed at achieving two goals: protection of the solvency and liquidity of members and guarantee of customer deposits (Institutssicherung or Institutional Protection Scheme). This system is in compliance with German law transposing Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes[107] (DGSD) – Gesetz zur Umsetzung der Richtlinie 2014/49/EU des Europäischen Parlaments und des Rates vom 16. April 2014 über Einlagensicherungssysteme (DGSD-Umsetzungsgesetz)[108]. The solidarity mechanism in operation within this system can also be considered as a solution fitting in the resolution process provided for by Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms[109] (BRRD). This system consists

[103] C. Choulet, *op. cit*., p. 5.

[104] See: The Little-Known Banker Shaking Up Germany's Beleaguered Lenders, Bloomberg Businessweek 2.11.2018, opub. https://www.bloomberg.com/news/articles/2018-11-02/the-mystery-banker-quietly-shaking-up-germany-s-finance-industry; DSGV will "Super-Landesbank" – und erteilt Deutscher Bank eine Abfuhr, 6.02.2019, Fonds Online Professionell, https://www.fondsprofessionell.de/news/unternehmen/headline/dsgv-will-super-landesbank-und-erteilt-deutscher-bank-eine-abfuhr-150605/ (accessed: 7.03.2020).

[105] M. Schrooten, *Landesbanken: Rettung allein reicht nicht*, Wochenbericht des DIW Berlin Nr. 24/2009, p. 395 and next, https://www.researchgate.net/publication/46568329_Landesbanken_Rettung_allein_reicht_nicht (accessed: 7.03.2020).

[106] C. Choulet, *op. cit*., p. 5.

[107] OJ L 173, 12 June 2014, p. 149–178.

[108] Bundesgesetzblatt Teil 1 (BGB 1), OJ 21 z 5.06.2105, p. 00786–00812.

[109] OJ L 173, 12 June 2014, p. 190–348 the directive was implemented into German law by Gesetz zur Umsetzung der Richtlinie 2014/59/EU des Europäischen Parlaments und des Rates vom 15. Mai 2014 zur Festlegung eines Rahmens für die Sanierung und Abwicklung von Kreditinstituten und Wertpapierfirmen (BRRD-Umsetzungsgesetz), Bundesgesetzblatt Teil 1 (BGB 1), Number Dz.U.: 59 z 18.12.2014, p. 02091–02186.

of thirteen rescue funds: eleven regional funds to which the savings banks contribute, one funded by the Landesbanken and the second one funded by regional building societies (Landesbausparkassen). If a Sparkasse has financial troubles, it first uses the regional fund to which it belongs, then the resources from other regions and only at the end the financial resources of Landesbanken and Landesbausparkassen. Likewise, the Landesbank would first be supported by the Landesbanken fund and the Sparkassen funds will only be mobilised if that fund is depleted[110].

Three-quarters of the Deposit Guarantee Fund may be used for rescuing a system member, but the resources of this fund must be rebuilt quickly, using additional contributions. Assistance to a network member may take the form of credits and loans, capital transfers or provision of guarantee. Preventive structures are strengthened, which should allow the system to start up early enough to avoid a member falling. So far, only about thirty-three institutions used the funds and supra-regional funds were used only four times[111].

The French local government is a political institution, governed by the Constitution of the Republic of France of 4 October 1958, in Articles 72-76, and by ordinary laws, in particular the Law of 2 March 1982 on the Rights and Freedoms of Communes, Departments and Regions[112] and the Law of 7 January 1983 on the Division of Powers between Communes, Departments, Regions and the State[113]. However, the most important legal act regulating the scope of business activity of local government is the General Code of Territorial Communities (Code général des collectivités territoriales) adopted in 1996[114]. The provisions of this act authorise local government units to support private entities, create organisational forms together with them, conduct business activity, as well as establish commercial law companies and partnerships on their own or join already established ones. This right is not subjectively limited, as it applies to all levels of local government including communes, departments and regions. There are no restrictions also with regard to entities with which local government units may conduct joint ventures. The restrictions on this cooperation are objective, since, pursuant to the provisions of the General Code of Territorial Communities, they relate to carrying out development and construction activities, to the provision of public services of an industrial or commercial nature or to any other public service activity. Regardless of the cooperation with private

[110] C. Choulet, *op. cit*., p. 5.

[111] *Ibidem*.

[112] Loi n° 82-213 du 2 mars 1982 relative aux droits et libertés des communes, des départements et des régions.

[113] Loi n° 83-8 du 7 janvier 1983 relative à la répartition de compétences entre les communes, les départements, les régions et l'Etat *loi Defferre*.

[114] Loi n° 96–142 du 21 février 1996 relative à la partie Législative du code général des collectivités territoriales.

entities, local government units are entitled to set up, on their own, commercial law companies and partnerships, which are local public companies. The scope of their activities includes construction work, the provision of public services of an industrial or commercial nature, or any other activity in so far as it is directed towards the general interest of the local community. The requirement of acting within the framework of public service, excluding activities aimed only at making a profit, is particularly visible in the case of communes, which are prohibited by law to conduct such activity. It seems that the high fragmentation of French communes and the limited scope for their autonomy lies at the root of these restrictions[115]. Nevertheless, the French communes have the right to provide guarantees and sureties to both public and non-public entities. In addition, the provisions of law allow the communes, either alone or with other local government units, for capital participation in a credit institution or a joint stock company, the sole purpose of which is to guarantee financial assistance granted to legal persons under private law, in particular, those running newly established companies. The condition for engaging in such undertakings is the participation of representatives of local government units in governing bodies of such credit institutions. An important form of business activity of local government units in France, is the possibility of granting loans and guaranteeing loans by financial institutions created by local government units or those in which part of the shares is held by local government units. An original solution of the French system of local government, is the possibility of granting loans to individuals by communes (mainly urban ones). These loans (in Paris the Le pret Paris logement[116], in Bordeaux: Le pret 0% de Bordeaux Metropole[117]), are granted in the form of subsidised loans to residents or future residents of these local government units. The subsidies are not paid out of the local government unit's budget, but transferred through banks with which the local government units have signed the agreements. The advantage lies in the 0 percent interest rate and the possibility to combine these loans with other forms of state aid.

The creation of local government credit institutions has a long history in France, dating back to the 17th century. Although originally they were similar to pawnshops, providing loans secured by a lien, they were granted at a very low cost at the time and were intended to provide access to money to the nearest residents of the cities[118]. The first such institutions were established in Paris (Mont-de-Piete), with the consent of King Louis XIII. In the twentieth century, the activities of the savings banks expanded to

[115] M. Ofiarska, *Francja,* Annales Universitatis Paedagogicae Cracoviensis, Studia Politologica 2010, nr 4, p. 110.

[116] https://www.paris.fr/pages/devenir-proprietaire-236 (accessed: 7.03.2020).

[117] https://www.bordeaux-metropole.fr/Vivre-habiter/Se-loger-et-habiter/Devenir-proprietaire (accessed: 7.03.2020).

[118] G. Pastureau, *Le Mont-de-piété en France: une réponse* économique *aux problèmes sociaux de son époque (1462-1919),* Revue d'histoire de la protection sociale 2011, No 1, p. 25.

include typical banking activities. Currently, there are approx. 20 municipal banks (credit unions)[119].

Reference should be made in this respect to the provisions of the French Code monétaire et financier, the legal basis for the operation of municipal credit unions. Pursuant to the provision of Article 514, they are public credit institutions and their main mission is to combat usury by granting loans in an accessible manner. An important element of their mission is also their activity in the category of social assistance, primarily by providing access to money. In addition, their activities include accepting deposits and granting loans to both individuals and other entities, primarily associations. The establishment of municipal credit unions is carried out by the central administration, by decree of the minister in charge of economy and the minister in charge of local affairs, but at the request of the legislative body of the local government unit. The structure of the governing bodies of the credit unions is of mixed nature, combining the professional element (management body and part of the supervisory body) with the participation of persons representing the public interest (part of the composition of the supervisory body), due to the need to combine expertise in the management of the credit union and the implementation of the local public interest by the credit unions. The governing bodies of the credit unions are the Management Board, the Consultative Board and the Supervisory Board. The president of the credit union is elected by the mayor of the commune in which the credit union is located, after consultation with the Supervisory Board. The mayor is a member of the Supervisory Board, together with the elected members of the governing body. Other members of the Board are the persons with knowledge of banking services. The legal structure of the internal organisation of the credit union, as well as the objectives of their activities and strong personal connections with the local government unit on the territory of which the credit union operates, allow the authors to claim that the legal nature of the credit unions combines public and civil law regulations[120].

Apart from the spheres of activity discussed above, local government units participate in the ownership of some French cooperative banks – Caisses d'Epargne (CEP) (Savings Banks). This is done in such a way that the local authorities are shareholders in certain Sociétés Locales d'Epargne (SLE) (Local Savings Companies), which take the legal form of cooperatives and which cannot carry out banking activities[121]. Subsequently, these cooperatives, Sociétés Locales d'Epargne, become the shareholders in Caisses

[119] See: W. Przybylska-Kapuścińska, *Sektor bankowy Francji*, [in:] *Sektory bankowe w Unii Europejskiej,* ed. J. Cichy, B. Puszer, Katowice 2016, p. 216.

[120] See: Judgment Conflicts Tribunal z dnia 12 lutego 2018 r., sign. C4108, https://juricaf.org (accessed: 7.03.2020).

[121] For example, local authorities participate La Caisse d'Epargne Bretagne – Pays de Loire – see: https://www.federation.caisse-epargne.fr/les-15-caisses-depargne/bretagne-pays-de-loire/#; https://www.caisse-epargne.fr/bretagne-pays-de-loire/particuliers (accessed: 7.03.2020).

d'Epargne, which take the organisational and legal form of a limited liability company. This means that Caisses d'Epargne are cooperative societies in the form of a limited liability company (cooperative joint stock company). Caisses d'Epargne may provide all banking services, and all the provisions that apply to credit institutions and the provisions of the French Act on Cooperatives (the Law of 10 September 1947 on the Status of Cooperatives) apply to them[122].

Caisses d'Epargne form a system that consists of:

- The Fédération Nationale des Caisses d'Epargne (FNCE) (National Federation of Saving Banks) at the national level;
- BPCE SA bank;
- 15 Caisses d'Epargne (CEP) (Savings Banks) at the regional level[123] and
- 228 Sociétés Locales d'Epargne (SLE) (Local Savings Companies) at the local level.

It is also worth mentioning the possibilities of the French local government units to provide indirect support for credit activity. This is mainly about subsidised loans funded, first of all, from the budgets of communes, and granted through banks, to individuals wishing to purchase real property in the commune using such a stimulus tool. Many French cities (communes), e.g. Paris, Bordeaux, have decided to allocate public funds to initiate a settlement action in their area.

3.2. Local Government Credit Guarantee Organisations

The term local government credit guarantee organisations is rather not used in the literature and in practice. For the purpose of this study, this term is understood as credit guarantee organisation (or credit guarantee fund), the shares or stocks of which are held by a local government unit or otherwise controlled by such unit.

Credit guarantee organisations were established in nearly all EU Member States, Bosnia and Herzegovina, Serbia, Russia and Turkey. They operate as non-profit organisations at the national, regional or local level. Four main typologies exist: Mutual Guarantee Societies, other types of Private Guarantee Societies, Public Guarantee Institutions and Public-Private Partnership Initiatives[124]. Four major types of schemes of guarantee

[122] The Legal Structure of Savings and Retail Banks in Europe, October 2014, European Savings and Retail Banking Group, p. 22 i next; see also: https://www.societaires.caisse-epargne.fr/auvergne-limousin/etre-societaire/des-parts-sociales#.XXE1iygzZPZ (accessed: 7.03.2020).

[123] As of 31 December 2017 fifteen Caisses d'Epargne have 4080 branches, 20 million customers, 4,8 million cooperative shareholders, €412 bn customers deposits, €253 bn loans to customers, 36 000 employees, see: https://www.caisse-epargne.fr/bretagne-pays-de-loire/who-are-we-ce (accessed: 7.03.2020).

[124] https://aecm.eu/members/what-are-guarantee-institutions/ (accessed: 7.03.2020).

funds can be also pointed out: public guarantee schemes, corporate funds, international schemes and mutual guarantee associations[125].

Also, the following division can be found[126]:

– legal or commercial companies,
– public institutions,
– non-profit foundations or entities.

Credit guarantee organisations in Europe form part of AECM – European Association of Guarantee Institutions. This association has 47 member organisations operating in 28 EU countries, Bosnia and Herzegovina, Serbia, Russia and Turkey. Its members are mutual, private sector guarantee schemes as well as public institutions, which are either credit guarantee funds or development banks with a guarantee division (for example: Polish Bank Gospodarstwa Krajowego, which is a member of AECM). They all have a common mission of providing loan guarantees to SMEs which have an economically sound project but cannot provide sufficient bankable collateral. In 2017, AECM member organisations had a total guarantee volume in the portfolio of over EUR 125.6 billion and issued a total volume of over EUR 74.2 billion of new guarantees[127].

The majority of those AECM members which were endowed with public capital, disposes of state owned capital (such as the Polish Bank Gospodarstwa Krajowego, the Croatian Agency for SMEs, Innovations and Investments (HAMAG-BICRO). A part of them, like Bank Gospodarstwa Krajowego, is an important element (or even a key element) of the system of credit guarantee funds in a given country. The few members of AECM are institutions in which local government units have shares/stocks or which are controlled by them, e.g. the Municipal Guarantee Fund for SMEs of Sofia (not a company, but in the legal form of a fund established by the City of Sofia)[128].

Independent from their legal statutes, a great majority of AECM members have a statute of financial intermediary or a mono-line banking licence. They are thus subject to financial supervision by their national authorities[129].

From the perspective of the topic of this monograph, the most important type of credit guarantee organisation is the Public Guarantee Institution or possibly Public-Private

[125] A. Green, *Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-Led Growth?*, the United Nations Industrial Development Organization (UNIDO) Working Paper No. 10, August 2003, p. 18–19 and literature cited there; https://www.unido.org/sites/default/files/2007-11/18223_PSDseries10_0.pdf (accessed: 7.03.2020).

[126] Guarantee Systems. Keys for their implementation, AECA Pronouncement Valuation and Financing Companies, No. 13, Spanish Association of Accounting and Business Administration, p. 29; https://aecm.eu/wp-content/uploads/2016/01/GUARANTEE-SCHEMES-KEYS-FOR-THEIR-IMPLEMENTATION-pv13_english-VF-3.pdf (accessed: 7.03.2020).

[127] See: https://aecm.eu/about/mission/ (accessed: 7.03.2020).

[128] https://ogf-sofia.com/en/za-nas/ (accessed: 7.03.2020).

[129] R-H. Samujh, L. Twiname, J. Reutemann, *op. cit*., p. 22.

Partnership Initiatives. The Public Guarantee Institution or the Public-Private Partnership Initiative may have a state or local government profile. Public Guarantee Institution or Public-Private Partnership is a local government credit guarantee organisation when it is controlled by a local government unit, either through holding shares/stocks or otherwise.

Local government credit guarantee organisations may be part of the state (public) guarantee schemes. Such state (public) guarantee schemes are run either by an administrative unit of the government (e.g. development agencies, ministries, the central bank or publicly-owned banks) or by a legally separate credit guarantee organisation (Public Guarantee Institutions)[130].

Public Guarantee Institutions were established by public authorities in a number of countries (the same public guarantee schemes still represent the majority of guarantee schemes worldwide). European Association of Guarantee Institutions believes that Public Guarantee Institutions are legally independent entities and can chose from a variety of organisational and legal forms, e.g. development bank, development fund, etc. They are entirely funded and run by public shareholders[131].

A narrower understanding of the concept of public guarantee institution can be also found: in the case of schemes created to administer a net resource under the management of bank or a government agency for development. Operators are part of a public sector institution in the broad sense, established in the county and can undertake various forms, such as: public development banks, public development agencies, public corporations or public fiduciary trust (for example*: Austria wirtschaftsservice* (AWS) from Austria which is qualified as limited company with 100 percent state shareholder structure)[132].

Public Guarantee Institutions implement public support policy towards SMEs and either provide guarantees to SMEs directly or provide counter-guarantees to Private Guarantee Societies. In some cases, the Guarantee Societies chose a Public-Private Partnership model, where the public shareholder usually holds a minority stake[133].

The basic role of guarantee institutions is to support SMEs by providing guarantees (and sureties). The development of SMEs is crucial for the development of the global economy. SMEs play an important role in developing and developed economies as they create new businesses, increase employment opportunities, develop innovative product ideas, and raise productivity. SMEs represent 99 percent of the enterprises around the world and account for more than half of all private sector employment in the OECD

[130] A. Green, *op. cit*., p. 18–19.

[131] https://aecm.eu/members/what-are-guarantee-institutions/ (accessed: 7.03.2020).

[132] Guarantee Systems. Keys for their implementation, AECA Pronouncement Valuation and Financing Companies, No. 13, Spanish Association of Accounting and Business Adminstration, p. 30; https://aecm.eu/aws-austria-wirtschaftsservice/ (accessed: 7.03.2020).

[133] https://aecm.eu/members/what-are-guarantee-institutions/ (accessed: 7.03.2020).

countries. Their role and need for support in funding are recognised by the governments not only in EU but also globally. The authorities introduced a variety of initiatives including credit guarantee schemes (CGS)[134].

In many Western European countries credit guarantees play a key role in supporting SME access to funding. CGSs are particularly wide-spread in Italy and Portugal, where the outstanding volume of SME credit guarantees amounts to approx. 2 percent of the GDP. In absolute terms, the guarantee sector is the largest in Italy (outstanding volume: EUR 33.6 billion), France (EUR 16.7 billion), Germany (EUR 5.6 billion) and Spain (EUR 4.1 billion)[135].

An analysis of the existing guarantee institutions operating in the European Union shows that local government credit guarantee institutions are rare and there is no system composed only of local government credit guarantee institutions anywhere in the EU.

In the countries of the so-called "old European Union" such as France, Germany, Italy, Spain or Portugal, the system is dominated by the credit guarantee institutions based on the "Mutual Guarantee Societies" model[136]. The most representative example of the Italian local mutual guarantee schemes (MGSs) is Confidi. In this scheme, SMEs are members and shareholders of the guarantee institutions, providing them with capital. The member companies of these guarantee institutions elect their authorities. The institutions operating under the Confidi system are therefore private. Over 200 local institutions are grouped in 7 federations: Fedart Fidi, FederConfidi, Fincredit, FederAscomFidi, FederFidi, CreditAgri, Asscooperfidi. The Confidi system has two levels. The first local one, where individual credit guarantee institutions operate, usually in a limited territory, and the second one covering groups (federations) of credit guarantee institutions that provide re-guarantees. In addition, re-guarantees are provided by the regional authorities and the state owned Italian Central Guarantee Fund[137].

Thus, the role of local authorities in the Confidi system is mainly to provide re-guarantees.

[134] R-H. Samujh, L. Twiname, J. Reutemann, *Credit Guarantee Schemes Supporting Small Enterprise Development*: *A Review*, Asian Journal of Business and Accounting 5(2), 2012, p. 22 and literature cited there, https://www.researchgate.net/publication/287315852_Credit_guarantee_schemes_supporting_small_enterprise_development_A_review (accessed: 7.03.2020).

[135] M. Chatzouz, A. Gereben, F. Lang, W. Torfs, *Credit Guarantee Schemes for SME lending in Western Europe*. *EIF Research & Market Analysis*, Working Paper 2017/42, p. 4, http://www.eif.org/news_centre/publications/EIF_Working_Paper_2017_42.htm (accessed: 7.03.2020).

[136] See: A. Biernat-Jarka, E. Palntus, *Credit Guarantee Scheme For The Sme Sector In Poland Against The Background Of The Selected Eu Member States*, Economic Science for Rural Development 2013, No. 30, p. 32–33.

[137] OECD Studies on SMEs and Entrepreneurship Italy: Key Issues and Policies, OECD 2014, p. 109, http://dx.doi.org/10.1787/9789264213951-en (accessed: 7.03.2020).

In France, the credit guarantee institutions operate exclusively in the form of commercial companies and cooperatives. The most important role is played by the state-controlled Oseo Garantie joint stock company. The other credit guarantee institutions are purely private and act as a mutual guarantee institution. The largest such company is SIAGI, which operates as a company controlled by the French chambers of commerce and crafts (which hold the majority of shares, the remaining capital is controlled by banks). SOCAMAs also plays an important role in the French guarantee market. It operates in the form of a cooperative society based entirely on private capital, bringing together companies benefiting from guarantees and smaller mutual guarantee institutions[138].

In Germany, 17 guarantee banks called Bürgschaftsbanken play the role of mutual guarantee institutions. They are private, non-profit entities. Their shareholders are chambers of commerce and crafts and business federations of all sectors, credit institutions and insurance companies. Guarantee banks support SMEs as well as founders of new business enterprises in their respective federal state. They grant guarantees of up to EUR 1.25 million for any type of short, medium- and long-term loan. In 2017 the guarantee banks supported nearly 5,900 companies with guarantees worth more than EUR 1.1 billion. These guarantees secured loans of almost EUR 1.7 billion. Together with 15 SME-oriented investment companies (Mittelständische Beteiligungsgesellschaften or MBGs) they form the Association of German Guarantee Banks (Verband Deutscher Bürgschaftsbanken), which is a member of AECM[139].

Bürgschaftsbanken are credit institutions within the meaning of EU law and are subject to supervision by the German financial supervisory authorities (BaFin – Bundesanstalt für Finanzdienstleistungsaufsicht) and the European Central Bank within SSM. It should be noted that the system of the Association of German Guarantee Banks is independent of the German Sparkasse system.

In Spain mutual guarantee systems adopt a hybrid type of society inspired by French regulation. On the one hand, it is a corporation like a private corporation and, on the other hand, it is a mutual company. This system is supported by public funds, both from the state (from the Ministry of Industry, Energy, and Tourism) and from the local government, at the regional level (by the Autonomous Communities' Administration). Furthermore, private resources of trade associations, chambers of commerce and financial institutions (banks and lending institutions or saving banks) are involved in the system[140].

[138] P. Pasqualina, I.G. Bikoula, *The Guarantee System in France*, [in:] *Credit Guarantee Institutions and SME Finance*, ed. P. Leone, G.A. Vento, Hampshire 2012, p. 38–45.

[139] https://www.vdb-info.de/englisch/association-of-german-guarantee-banks-verband-deutscher-buergschaftsbanken2 (accessed: 7.03.2020).

[140] C. Cardone-Riportella, M. Garcia-Mandaloniz, *Does Recent Regulation Improve (or not) the Spanish Mutual Guarantee System?,* International Journal of Economics and Financia Issues 2017, 7(1), p. 518, http://www.econjournals.com/index.php/ijefi/article/viewFile/3532/pdf (accessed: 7.03.2020).

Mutual guarantee system in Spain consists of 2 levels. The first basic one groups 18 mutual guarantee institutions (Sociedades de Garantía Recíproca (SGR)) with mainly private capital and the Sociedad Anónima Estatal de Caución Agraria – SAECA[141] (State joint-stock company for guarantees in the agricultural sector). And at the second level, there is CERSA (Compañía Española de Reafianzamiento)[142], integrating the whole system. It is a joint stock company with mainly state-owned capital (74 percent), which, among other things, provides re-guarantees to individual SGRs and supervises SGRs' compliance with the criteria for risk analysis and monitoring. It also ensures unification of rules and procedures and coordination of activities[143].

The 18 Spanish SGRs are associated in CESGAR[144] (Sociedades de Garantía Recíproca). It is a non-profit association established in 1980 with the aim of coordinating, cooperating, defending and representing the interests of 18 associated SGRs.

As already mentioned, the capital of SGRs is mainly private, however, it is held by, among others, the regions (Spanish medium-level local government units). The SGRs are non-profit financial institutions and although they are not qualified as credit institutions, they are supervised by the Bank of Spain[145]. This is an interesting example of mixing private and local government capital.

In Portugal, the mutual guarantee system is based on three pillars[146]:

1) Four mutual guarantee institutions (Sociedades de Garantia Mútua – SGM) and these are Norgarante, Lisgarante, Garval and Agrogarante,
2) Mutual Guarantee Fund (Fundo de Contragarantia Mútuo – FCGM) – a publicly funded "reinsurance" fund, providing SGMs with re-guarantee and thus partially covering the risk borne by SGMs,
3) Sociedade de Investimento[147], a joint stock company, which is in practice a holding company for the entire system, and which manages the FCGM (Mutual Guarantee Fund) and at the same time acts as a shared service centre. The majority of the shares in this company (74 percent) are held by the State Agency for

[141] https://www.saeca.es/ (accessed: 7.03.2020).

[142] http://www.cersa-sme.es/ (accessed: 7.03.2020).

[143] http://www.cersa-sme.es/garantias-y-avales/sistema-de-garantias/; http://www.cersa-sme.es/sobre-cersa/quienes-somos/ (accessed: 7.03.2020).

[144] http://www.cesgar.es/ (accessed: 7.03.2020).

[145] They operate on the basis of the Law of 11 March 1994 on the Legal Regime of Mutual Guarantee Associations, which was subsequently amended by various laws (Ley 1/1994, de 11 de marzo, sobre el Régimen Jurídico de las Sociedades de Garantía Recíproca, «BOE» núm. 61, de 12 de marzo de 1994 Referencia: BOE-A-1994-5925 as amended), unified text is available at https://www.boe.es/buscar/pdf/1994/BOE-A-1994-5925-consolidado.pdf (accessed: 7.03.2020).

[146] See: https://www.spgm.pt/pt/institucional/sobre-nos/quem-somos/; https://www.iapmei.pt/Paginas/Garantia-Mutua.aspx (accessed: 7.03.2020).

[147] https://www.pmeinvestimentos.pt/ (accessed: 7.03.2020).

Competitiveness and Innovation (IAPMEI – Agência para a Competitividade e Inovação, I.P.)[148].

The coordinator of the Portuguese mutual guarantee system is SPGM – Sociedade de Investimento S. A., which promotes and develops the entire system. This company is also controlled by the State, with IAPMEI holding 79,64 percent of its share capital.

The Portuguese local government units are not involved in the Portuguese mutual guarantee system.

[148] https://www.iapmei.pt (accessed: 7.03.2020).

Chapter 4

Legal Barriers to Creation and Functioning of Local Government Financial Institutions Resulting from the Treaty Rules on State Aid

After presenting the arguments contained in Chapters 1 to 3 of this monograph, the following legal barriers to the formation of local government financial institutions can be distinguished:

1) Legal regulations concerning the establishment of financial institutions not adapted to the specific nature of the LGU, in particular, the provisions on establishment of banks (credit institutions), insurance institutions and investment institutions (such a situation is clearly present in Polish law),
2) Lack of detailed regulation relating to the creation of local government depository institutions (Polish law is a good example),
3) Limited territoriality of local government financial institutions (this applies to developed systems that have evolved over decades; this is primarily about deposit and loan systems of local government institutions, such as the Sparkasse system in Germany), which in turn blocks the possibility of creating new local government financial institutions,
4) Barriers arising from the Treaty rules on competition (in particular those arising from the provisions on State aid, Articles 107 to 109 of the Treaty on the Functioning of the European Union, TFEU).

Beyond the considerations of the national legal order, it is worthwhile to refer to the regulation of Community law. Legal barriers to the creation of local government financial institutions in the EU result from EU regulation contained in Title VII, Chapter 1 of the TFEU, titled Rules on competition. In particular, this concerns the rules on State aid contained in Articles 107 to 108 of the TFEU and in Council Regulation 2015/1589

of 13 July 2015 issued based on Article 109 of the TFEU, laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union[149]. These provisions, in particular Article 107 of the TFEU, have not yet been analysed in this monograph.

Pursuant to Article 107(1) of the TFEU, save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the internal market. Article 107(3) thereof indicates when State aid may be declared compatible with the internal market and Article 107(2) indicates which aid is compatible with the internal market.

In the CJEU case-law it is assumed that the classification of a measure as aid within the meaning of the Treaty requires that each of the four cumulative criteria set out in Article 107(1) of the TFEU is fulfilled. First, there must be an intervention by the State or through State resources; second, the intervention must be capable of affecting trade between Member States; third, it must confer a selective advantage on the beneficiary; fourth, it must distort or threaten to distort competition[150].

There is no doubt that local government financial institutions should be considered as entrepreneurs within the meaning of Article 107 of the TFEU. As stated by the CJEU in Sections 41 and 42 of its judgement of 27 June 2017 in Case C-74/16[151], "according to the settled case-law of the Court of Justice, the concept of 'undertaking' under EU competition law covers any entity engaged in a business activity, regardless of the legal form of that entity and the way in which it is funded" (judgement of 10 January 2006, Cassa di Risparmio di Firenze and others, C-222/04, EU:C:2006:8, Section 107). It follows from the above that the public or private nature of the entity carrying out the activities at issue cannot affect the issue of whether or not that entity has the status of "undertaking". Moreover, local government financial institutions should be regarded as a public undertaking as referred to in Article 106(1) of the TFEU, which obliges the Member States, as regards public undertakings, not to introduce or maintain any measure contrary to the rules of the Treaties, in particular those provided for in Article 7 of the TFEU and Articles 101 to 109 of the TFEU. For Treaty purposes it is assumed that the following

[149] OJ L 248, 24 September 2015, p. 9 et seq.

[150] See, judgement of the Court of 17 November 2009 in case C-169/08 Presidente del Consiglio dei Ministri, European Court Reports 2009 I-10821, point 52 and the case law cited therein; ECLI identifier: ECLI:EU:C:2009:709. The Court has also recently stated the same in Section 43 of the Judgement of 6 March 2018 in Case C-579/16 P European Commission v FIH Holding A/S, FIH Erhvervsbank A/S, ECLI identifier: ECLI:EU:C:2018:159.

[151] Judgment of the Court of 27 June 2017 in the case C-74/16 Congregación de Escuelas Pías Provincia Betania versus Ayuntamiento de Getafe, ECLI identifier: ECLI:EU:C:2017:496.

definition of public undertaking may be used: the definition contained in Article 2(b) of COMMISSION DIRECTIVE 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings[152], whereby the concept of public undertaking should not be interpreted for the purposes of the TFEU in a more narrow way than is provided for in this Directive and may possibly be interpreted somewhat more broadly[153]. Pursuant to Article 2(b) of Commission Directive 2006/111/EC, for the purpose of this directive, a "public undertaking" means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it. A dominant influence on the part of the public authorities shall be presumed when these authorities, directly or indirectly in relation to an undertaking:

(i) hold the major part of the undertaking's subscribed capital; or
(ii) control the majority of the votes attaching to shares issued by the undertakings; or
(iii) can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body.

There is no doubt that local and regional authorities satisfy the condition related to public authorities, since, pursuant to Article 2(a) of Commission Directive 2006/111/EC, 'public authorities' means all public authorities, including the State and regional, local and all other territorial authorities.

The fact that, in the case of local government financial institutions, financial resources come from the budgets of LGUs and not from the State budget, does not exclude the application of Article 107 of the TFEU. In its judgement of 12 May 2011 in joined cases T-267/08 and T-279/08[154], the Region of Nord-Pas-de-Calais (France) and the Communauté d'agglomération du Douaisis (France) v European Commission, the CJEU stated that "the measures taken by entities within the Member States (decentralised, federal, regional, etc.), irrespective of their legal status and name, as well as measures taken by federal or central authorities, fall within the scope of Article 107(1) of the TFEU, if the conditions referred to in that provision are met (judgement of the Court of 6 March 2002 in joined cases T-103/00 and T-92/00 Diputación Foral de Álava and others v Commission, ECR II-1385, Section 57)". The Court also referred to the notion of State resources, recalling that "it follows from the case-law of the Court that Article 107(1) of

[152] OJ L 318, 17 November 2006, p. 17–25.

[153] M. Szydło, *Komentarz do art. 106 TFUE*, [in:] *Traktat o funkcjonowaniu Unii Europejskiej. Komentarz*. Tom II, ed. K. Kowalik-Bańczyk, M. Szwarc-Kuczer, A. Wróbel, Wolters Kluwer 2012, System Informacji Prawnej LEX, and literature cited there.

[154] European Court Reports 2011 II-01999; ECLI identifier: ECLI:EU:T:2011:209.

the TFEU applies to any monies which the public authorities may actually use to support undertakings, whether or not those monies are permanently part of State assets. Consequently, even if the sums equivalent to the measure at issue are not permanently held by the public authorities, the fact that they are permanently under public control, and therefore at the disposal of the competent national authorities, is sufficient for them to be classified as State resources (see also judgements of the Court: of 16 May 2000, Case C-83/98 P France v Ladbroke Racing and Commission, ECR I-3271, Section 50; of 16 May 2002, Case C-482/99 France v Commission, ECR I-4397, Section 37)". The literature also assumes that aid through State resources also means support provided by private or public entities established or designated by State authorities and benefiting from measures that are or should be owned or controlled by the State[155].

It should therefore be considered whether the capital involvement of a local government unit in a local government financial institution can be regarded as State aid under Article 107 of the TFEU. In general, the European Commission takes the view that Article 345 of the Treaty on the Functioning of the EU[156] (former Article 295 of the EC Treaty) guarantees neutrality with regard to public and private property. The Commission stated that "On the one hand, the Commission does not question whether undertakings responsible for providing general interest services should be public or private. Therefore, it does not require privatisation of public undertakings. On the other hand, the rules of the Treaty and in particular competition and internal market rules apply regardless of the ownership of an undertaking (public or private)"[157]. Thus, in principle, the fact that certain local government financial institutions are wholly or partly publicly owned (LGU ownership) does not constitute an infringement of the Treaty provisions, including Article 107 of the TFEU[158].

Continuing the topic of interpretation of Article 345 of the TFEU, in the context of local government financial institutions, it is possible to cite the view of Advocate General Reischl who, in his opinion in joined cases 188/80 to 190/80 French Republic, Italian Republic and United Kingdom v Commission, concluded that former Article 295 of the EC Treaty and current Article 345 of the TFEU impose restrictions on the power of the Commission to influence the internal structure of public undertakings as provided for in former Article 86(1) of the EC Treaty and current Article 106(3) of the TFEU. He

[155] See: B. Kurcz, *Komentarz do art. 107 TFUE*, [in:] *Traktat o funkcjonowaniu Unii Europejskiej...*

[156] According art. 345 TSUE The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.

[157] See: point 21 of the Communication from the Commission – Services of general interest in Europe (COM/2000/0580 final). According art. 345 TFEU The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.

[158] See: on the ownership of a German landesbanks and savings banks T. Döring, *German Public Banks under the Pressure of the EU Subsidy Proceedings*, Intereconomics, March/April 2003, p. 100.

also recognised that the freedom of public authorities to engage in business activity must not be restricted to any greater extent than is provided for in the Treaty. On the other hand, Advocate General Tesauro, in his opinion in case C-202/88 French Republic v Commission, concludes that it follows from the direct and obvious relationship between the current provisions of Articles 345 and 106 that there is at least a strong presumption in favour of the compatibility with EU law of the existence of public undertakings and holders of exclusive rights[159].

However, the answer to whether or not the capital involvement of a local government unit in a local government financial institution can be regarded as State aid under Article 107 of the TFEU must always be conditional on the specific facts. What is important here is first and foremost the implementation of the so-called market economy investor test, i.e. the application of the market economy private investor principle (possibly the private creditor test). If a LGU, when acquiring shares or stocks in a local government financial institution, behaves in the same way as a market investor, then there is no advantage and thus no State aid. Similarly, as regards the private creditor test, the State, as a creditor, should seek recovery in the same way as a private creditor[160]. However, in order to determine how a market investor or a private creditor would behave, it is necessary to know normal market conditions[161]. For example, in its judgement in case T-366/00, the Court stated that "the value of the aid is thus equal to the difference between the price actually paid by the beneficiary and the price which the beneficiary would have paid in an arm's length transaction on the open-market to buy a similar plot of land from a private sector seller at the time of the relevant transaction"[162]. So, in order to decide whether, for example, LGUs, by creating a system of local government depository and credit institutions in Poland, commit a breach of Article 107 of the TFEU, it is required to conduct an appropriate economic analysis. From this perspective, non-profit activity of an entity, i.e. a local government financial institution with participation of LGU capital, actually predetermines the State aid criterion, as it is difficult to assume that a market economy investor would invest its funds in a non-profit entity in a market economy. As the CJEU stated in Section 39 of the reasons of its judgement of 4 September 2014 in joined cases C-533/12 P and C-536/12 P[163], "according to the case-law, when contributions of capital by a public investor disregard any prospect of profitability, even in the long

[159] M. Mataczyński, *Komentarz do art. 107 TFUE*, [in:] *Traktat o funkcjonowaniu Unii Europejskiej. Komentarz*. Tom III, ed. D. Kornobis-Romanowska, J. Łacny, A. Wróbel, Warszawa 2012.

[160] B. Kurcz, *Komentarz do art. 107 TFUE*, [in:] *Traktat o funkcjonowaniu Unii Europejskiej...*

[161] *Ibidem*.

[162] Judgment of 29 March 2007 in case T-366/00 Scott SA versus Commission of the European Communities, point 105, ECLI identifier: ECLI:EU:T:2007:99

[163] Judgment of 4 September 2014 in joined cases C-533/12 P and C-536/12 P Société nationale maritime Corse-Méditerranée (SNCM) SA versus European Commission, ECLI identifier: ECLI:EU:C:2014:2142.

term, such contributions must be regarded as aid within the meaning of Article 107 of the TFEU, and their compatibility with the common market must be assessed on the basis solely of the criteria laid down in that provision (see also judgement, Italy/Commission, C-303/88, EU:C:1991:136, Section 22)".

So, LGU's capital participation in non-profit local government financial institutions may not be qualified as State (public) aid incompatible with the internal market under Article 107(1) if one of the conditions laid down in Article 107(3) of the TFEU is met[164]. The corresponding scrutiny pursuant to Article 108 of the TFEU is carried out by the European Commission taking into account the provisions of Council Regulation 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union. Pursuant to Article 108(3) of the TFEU, the European Commission is informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the internal market within the meaning of Article 107, it shall without delay initiate the procedure provided for in Article 108(2) of the TFEU. The Member State in question may not put the proposed measures into effect until this procedure has resulted in a final decision. However, pursuant to Article 109 of the TFEU, the Council may define the categories of aid which are exempt from the notification requirement and, in turn, pursuant to Article 108(4) of the TFEU, the Commission may adopt regulations for such categories of State aid. In recital 4 of Council Regulation 2015/1588 of 13 July 2015 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to certain categories of horizontal State aid[165] the Council stated that the Commission should be enabled to declare by means of regulations, in areas where the Commission has sufficient experience to define general compatibility criteria, that certain specified categories of aid are compatible with the internal market pursuant to one or more of the provisions of Article 107(2) and (3) of the TFEU and are exempted from the procedure provided for in Article 108(3) thereof. The content of recital 4 of Council Regulation 2015/1588 is reflected in Article 1(1) thereof.

[164] Pursuant to Article 107(3) of the TFEU, the following types of aid may be declared compatible with the internal market: (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest; (e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

[165] OJ L 248 z 24 September 2015, p. 1–8.

For local government credit guarantee and loan funds, the provision in Article 1(1)(a)(i) of Council Regulation 2015/1588 is relevant, according to which the Commission may by means of a regulation adopted in accordance with the procedure laid down in Article 8 of this Regulation and in accordance with Article 107 of the TFEU declare aid to small and medium-sized enterprises to be compatible with the internal market and not subject to the notification requirement of Article 108(3) of the TFEU. Commission Regulation 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty[166], the Commission declared aid to SMEs in the form of investment aid, operating aid and access to finance compatible with the internal market. However, this Regulation does not apply to investment aid to SMEs exceeding EUR 7.5 million per undertaking per investment project.

This means that the activities of local government credit guarantee and loan funds are without prejudice to the provisions of Article 107 of the TFEU. It also means that the activities of other local government financial institutions (mainly local government credit institutions) are without prejudice to these provisions as long as they consist of aid to SMEs in the form of investment aid, operating aid and access to finance for SMEs.

Under pressure from private German banks and the European Commission, Germany withdrew from the guarantee for the Sparkassen scheme (German communes guaranteed the solvency of Sparkassen), and it was a classic example of a breach of Article 107 of the TFEU. Currently, as has already been argued, Sparkassen have a system of deposit guarantees, resolution process and liquidity coverage in line with European Union regulations. State aid to the Sparkassen and Landesbanken savings banks under this system is allowed, provided that certain conditions are met, just as the aid of this kind is generally allowed to credit institutions[167].

As local government credit institutions are generally qualified as credit institutions and are generally covered by EU regulations on credit institutions, including their winding-up and reorganisation (i.e. the two directives, DGSD and BRRD), the provisions of Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ("Banking Communication"), hereinafter: Communication[168], can be used for the assessment of the aid received by them from the State in the event of financial market crisis.

[166] OJ L 187 of 26 June 2014, p. 1 as amended, this Regulation shall apply until 31 December 2020 (see Article 59).

[167] However, some types of public aid to German regional banks are still controversial, see e.g. C. Choulet, Does the support of an IPS constitute state aid?, 29 April 2019, published on https://economic-research.bnpparibas.com/html/en-US/Does-support-IPS-constitute-state-4/29/2019,32946 (accessed: 7.03.2020).

[168] OJ C 216, 30 July 2013, p. 1–15.

First of all, it should be stressed that this is State aid to credit institutions which can be declared compatible with the internal market under Article 107(3)(b) of the TFEU. This provision makes it possible to declare aid to promote the execution of important projects of common European interest or to remedy a serious disturbance in the economy of a Member State compatible with the internal market.

In Section 24 of this Communication, the Commission indicated the subject matter covered by it. So, the Communication sets out the necessary adaptations to the parameters for the compatibility of crisis-related State aid to banks as from 1 August 2013. In particular, the Communication:

a) replaces the 2008 Banking Communication, and provides guidance on the compatibility criteria for liquidity support;
b) adapts and complements the Recapitalisation and Impaired Assets Communications;
c) supplements the Restructuring Communication by providing more detailed guidance on burden-sharing by shareholders and subordinated creditors;
d) establishes the principle that no recapitalisation or asset protection measure can be granted without prior authorisation of a restructuring plan, and proposes a procedure for the permanent authorisation of such measures;
e) provides guidance on the compatibility requirements for liquidation aid.

First of all, it should be stressed that, according to Sections 63 and 64 of the Communication, interventions by deposit guarantee funds to reimburse depositors in accordance with Member States' obligations under the Deposit Guarantee Scheme Directive do not constitute State aid. However, the use of those or similar funds to assist in the restructuring of credit institutions may constitute State aid. Whilst the funds in question may derive from the private sector, they may constitute aid to the extent that they come within the control of the State and the decision as to the funds' application is imputable to the State. The Commission will assess the compatibility of State aid in the form of such interventions under this Communication.

Also, as the Commission argues in Section 62 of the Communication, the ordinary activities of central banks related to monetary policy, such as open market operations and standing facilities, do not fall within the scope of the State aid rules. Dedicated support to a specific credit institution (commonly referred to as "emergency liquidity assistance") may constitute aid unless the following cumulative conditions are met (20):

a) the credit institution is temporarily illiquid but solvent at the moment of the liquidity provision which occurs in exceptional circumstances and is not part of a larger aid package;

b) the facility is fully secured by collateral to which appropriate haircuts are applied, in function of its quality and market value;
c) the central bank charges a penal interest rate to the beneficiary;
d) the measure is taken at the central bank's own initiative, and in particular is not backed by any counter-guarantee of the State.

However, state guarantees ancillary to liquidity facilities granted by the central bank or securing newly issued liabilities or public precautionary recapitalisation, even when compatible with the resolution regime, are subject to State aid control under Article 107(3)(b) of the TFEU[169].

The basic principle introduced by the Communication is that the State aid can be authorised only if the relevant Member State is able to demonstrate that all the measures to limit such aid to the lowest level possible have been exploited. Those measures can be of two types: capital-raising (the issue of new shares, voluntary conversion of subordinated debt into equity, capital-generating sales of assets and securitisation of portfolios, and earnings retention) and burden-sharing (loss-absorption by equity-holders, contributions by hybrid capital holders, contributions by subordinated debt holders)[170].

[169] A. Gardella, *Bail-in and the financing of resolution within the SRM framework*, [in:] ed. D. Busch, G. Ferrarini, *European Banking Union*, Oxford 2015, p. 380.
[170] A. Baglioni, *op. cit*., p. 106.

Chapter 5

Analysis of Economic Motives and Effects of Local Government Financial Institutions Formation

5.1. Models of Local Government Intervention in Conditions for Social and Economic Development in the Local and Regional Dimension

The issue of the comprehensive impact of local government units on the shaping of local conditions for social and economic development was a relatively rare issue raised in Poland at the initial stage of political transformation. The difficulties related to the course of socio-economic transformation significantly influenced the directions of communes' activities in the first years of their existence. Frequent changes to legal regulations, unstable solutions in terms of funding rules for local government units, little experience in managing local area, did not create the right atmosphere for undertaking discussions about long-term prospects for the functioning of communes. It is mainly for these reasons that over the years the local authorities have focused rather on ad hoc satisfaction of collective needs of the local community, paying less attention to broader programmes related to development initiatives[171]. However, with time, the symptoms of deviating from this trend began to appear. What becomes noticeable, first of all, is the fact that local government units, due to their functions, cause permanent changes in the local area, which makes it necessary to consider a change in the approach of local authorities towards a multidimensional view of the problems of the local community.

From a formal and legal point of view, there are no clear prohibitions on the influence of local government on local market processes. At the same time, there are no clear

[171] K. Byjoch, D. Klimek, *Spółka komunalna. Aspekty prawne, ekonomiczne i społeczne*, Wydawnictwo Adam Marszałek, Toruń 2015, p. 80.

premises specifying the attitude of local government units to these issues. In this situation, local government units define their role in the creation of local development individually, which is reflected in the tasks they perform. By influencing the social and economic processes taking place on a local scale, a local government unit can fulfil two functions[172]:

a) regulatory functions, i.e. counteracting emerging conflicts between the economic subjects and also eliminating barriers to development or at least limiting their negative effects,
b) real functions, consisting in undertaking actions stimulating and dynamising development processes in the commune.

It is also worth recalling the formal and legal motives for undertaking this activity. The decision to enter the sphere of business activity should be correlated with the implementation of public interest. The basic premise for a local government unit to conduct business activity, both for-profit and non-profit, must be the performance of public service tasks[173]. The performance of these tasks must be in accordance with the local interest, which in turn should not conflict either with the interest of the state or with the interest of local market operators.

However, the absence of legal restrictions does not automatically mean that taking action in these areas is economically justified. Local authorities in the institutional sense are not the only participant in the processes of shaping the conditions for local social and economic development. Particularly important here are the links with the private sector, which, in a market economy, is also the main provider of goods and services locally. It is worth noting that the relations between the economic subjects in the territory of a local government unit and local authorities are often described in the body of literature as a kind of game, completely detached from the win-win economic logic[174] and resulting from a clearly defined conflict of interests[175]. In their actions, business entities strive to maximise individual benefits, while local government should guard the general interest of the local community. Liberal trends in the economy explain this contradiction with the existence of the "invisible hand of the market", which intertwines individual efforts of entrepreneurs in improving the welfare of the general population. However, the experience with the functioning of the market economy shows that it often fails to deal with local problems, as evidenced, among others, by the existence of monopolies, external

[172] M. Ziółkowski, M. Goleń, *Zarządzanie strategiczne rozwojem lokalnym*, [in:] *Zarządzanie rozwojem lokalnym*, ed. H. Sochacka-Krysiak, Wydawnictwo SGH, Warszawa 2003, p. 63.

[173] S. Dudzik, *Działalność gospodarcza samorządu terytorialnego*, Zakamycze, Kraków 1998, p. 278.

[174] E. Caperchione, F. Salvatori, *Rethinking the relationship between local government and financial markets*, Public Money and management 201, Vol. 32, Issue 1, p. 24.

[175] J. Parysek, *Podstawy gospodarki lokalnej*, UAM, Poznań 2001, p. 14–16.

effects, pollution of the environment, which, according to some researchers of the subject, gives rise to the need for active interference of local government units in the sphere of socio-economic development. Of course, one cannot ignore the fact that, according to the assumptions of the government system, local government is to support and not replace the operation of the market mechanism. In this situation, the local authority is deprived of instruments that would allow for manual control of local development in a directive-based manner. Nevertheless, through the implementation of the tasks imposed by law, the commune may significantly influence the behaviour of business entities, by modifying it in the desired direction.

The presented thoughts are the background for the discussion on the scope of influence of local government on the course of development processes in the local dimension. Based on theoretical considerations, the following approaches to this issue can be distinguished[176].

a) Radical interventionism of the local government sector, manifested in the development of a number of economic programmes aimed at creating new jobs, in organising offices, agencies, economic promotion centres, in influencing business entities located in the commune by applying tax or credit preferences, as well as in mobilising local government and private sector organisational units around the strategic objectives of the development of the local government unit.
b) The model of public non-intervention of the local government sector, close to the conservative and orthodox liberal trends, agreeing to marginalise the role of local authorities in the economic and social sphere. This approach is dominated by the conviction that each intervention of a local government unit may mean a distortion of the market mechanism, ineffective spending of public funds in the local government sector and the consolidation of traditional structures.
c) The model of traditional public intervention, which does not question the need to engage public funds of a local government unit in economic and social spheres, but recognises the dominant importance of market mechanisms in this respect.

Although the above mentioned division is of mainly theoretical importance, it generally defines the local government's approach to the principles of influencing local development. In some countries, state and municipal ownership (often referred to as public ownership) has found recognition in many Western societies primarily because of the belief that it is more "sensitive" to public interest such as the issues of public security or energy industry. In the United States, the authorities tend to take over the role of a public service regulator, while in France or Germany, public ownership is of great

[176] L. Patrzałek, *Finanse samorządu terytorialnego*, Wydawnictwo Akademii Ekonomicznej, Wrocław 2004, p. 40–41.

economic importance and has a high level of public acceptance[177]. The implementation of the postulate presented is also reflected at the level of observation of experience from the practice of functioning of local government units, which under the pressure of the expectations of the local community, undertake actions going beyond the obligatory scope of public services provided more and more often, aiming at increasing the competitiveness of the local area.

The answer to the question about the need for or extent of government interference in the economy is the principle of subsidiarity. According to it, neither the state nor any wider community can replace the initiative and responsibility of citizens. Two aspects can be distinguished; on the negative side – the government should not hamper citizens, on the positive side – it should stimulate, sustain and ultimately (if necessary) complement the efforts of those who are not self-sufficient[178]. According to the assumptions of the principle of subsidiarity and the theory of public choice – public authorities are predestined to engage in the production of the so-called public goods, i.e. goods that can be shared by all members of a given community. Joint consumption and non-exclusiveness of use of a given good generate problems in price differentiation and demand determination, which can lead to inefficiency of providers of a given good and consequently endanger its availability to all. In such a situation, public authorities may, through specialised companies, take on the task of providing certain goods and services[179]. It is worth pointing out at this point a motive of business activity of local government units, i.e. the phenomenon called natural monopoly. The consequence of the existence of a natural monopoly is a situation where there is only one entity providing a specific type of service in the local market. The essence of a natural monopoly is the specific nature of a given type of service, which, for objective reasons, can only be performed by a public entity. Economic science assumes that a natural monopoly in the provision of services is characterised by the fact that, in order to meet total demand in the local market, only one entity may exist which will minimise the costs of the services provided, so that all entities on a local scale can use these services[180]. Another feature of a natural monopoly is the possibility of lowering the costs of the services provided, this is because as the number of users increases, the unit costs of the services decrease. Moreover, the existence of a natural monopoly may be determined by infrastructure conditions, i.e. the location of facilities enabling services to be provided in such a way as to minimise the costs associated with providing access to them and to ensure that these services are provided in

[177] W. Eucken, *Podstawy polityki gospodarczej*, Wyd. Poznańskie, Poznań 2005, p. 400.

[178] B. Dolnicki, *Samorząd terytorialny*, Wolter Kluwer, Warszawa 2009, p. 45.

[179] J. Jeżak, *Ład korporacyjny. Doświadczenia światowe oraz kierunki rozwoju*, C. H. Beck, Warszawa 2010, p. 46.

[180] S. Dudzik*, op. cit.*, p. 280.

important places from the point of view of local interest. Thus, a natural monopoly will result from the real and objective possibilities of an entity providing a specific type of services. In the current situation only a local government unit will have such possibilities.

The scope and intensity of application of individual instruments depends on the intentions and expected needs in terms of intervening in the local sphere of socio-economic relations. It should be stressed that in the assumptions of the functioning of local government units in market economy conditions, all forms of local government units' interference in the market should not be an expression of a desire to centrally manage market processes, but rather an attempt to respond to the expected needs of the local community, including, in particular, filling in the gaps which cannot be filled in by themselves when the economic relations are shaped by the market. Therefore, it is also necessary to consider the purpose and legitimacy of the activities undertaken by local government units in the financial market from this perspective.

5.2. Motives of Local Government Units' Activity in the Financial Market

In the light of considerations resulting from the previous section, it is clear that local government units should care not only about maintaining the social and economic potential, but also about taking measures in the scope of development of instruments that create new opportunities to influence the local market. The activity of local government units in the financial market may be a special area of intervention, which results from specific functions that the financial market performs in terms of stimulating social and economic development. The financial market facilitates the flow of financial resources between entities with surpluses and those that require cash.

The main functions of the financial market described in theory are:

- Capital mobilisation – transforming savings into investments. The market encourages investment by offering an attractive return as a reward for taking the risks associated with investing and postponing consumption. The financial market is not only about bank deposits, but also about the possibility of investing in other instruments,
- Allocation of capital – in the sense that by identifying financial needs in the market, the market directs the flow of funds there. In other words, it directs funds to economic sectors in need for development, which ensures the most efficient use of funds,
- Valuation of capital and risk – each capital investment involves risk. The risk is related to the uncertainty of investment effects. Through a market offering

a variety of investment opportunities, the effects of the investment are assessed and the risks associated with the investment are determined.

The financial market functions at four levels: objective, subjective, functional and mixed. The main point of the objective level is the object of trade, in other words the value that is of interest to the participants. On a subjective level, it exerts pressure on an objective element of the market. Within the framework of the third functional level, the market emphasises the nature and course of the transaction. While with the mixed approach, the financial market is treated comprehensively as a whole.

From the point of view of the analysis of the motives for local government intervention in the financial market, the analysis from the subjective and functional perspective is crucial. The subjective approach to financial phenomena is related to the fact that such phenomena take place between specific entities and arise within economic relations. Thus, in the subjective aspect of this study, the problem boils down to determining the forms of establishing relations between entities operating in the local and regional environment in terms of cash flow. Such relationships may arise between businesses, households, the institutional sphere and local authorities, in a manner directly or indirectly related to the creation of local development conditions.

The subjective activity of a local government unit in the financial market may come down to establishing and running institutions operating in the financial sector. In economic terms, the entities created would fall within the concept of financial institutions, i.e. organisations the main purpose of which is to provide financial services and advice on financial products[181].

Based on the body of literature, financial institutions in the market economy created and run by local government units pursue the following objectives:

- participation in the process of improving the transaction system,
- creation of conditions to reduce the risk of decision-making,
- organisation of sources and methods to provide capital to business entities
- contribution to stimulating demand,
- creation of safety conditions[182].

The activity of local government units in terms of creating financial institutions directing their offer to the local market can be seen in the following terms:

a) creation and running of financial institutions in order to expand the offer of financial products for local or regional environment,

[181] R. Malczewski, *Słownik finansów i bankowości*, Wydawnictwo Naukowe PWN, Warszawa 2009, p. 140.

[182] S. Smyczek, *Modele zachowań konsumentów na rynku finansowym*, Wydawnictwo Akademii Ekonomicznej, Katowice 2007, p. 104–105.

b) creation of an offer which is more attractive for the market understood as ease of access, higher acceptability of economic and financial risk (local and regional aspect, actions taken), more convenient repayment terms, cost aspect,
c) social dimension, building civil society.

Naturally, the presented range of functions and motives for undertaking activity should be considered as a wide range of possibilities for the local government to influence the local market through activity in the financial market. The manner of intervention, intensity and scope of execution of particular functions should result from individual development strategy of each local government unit, taking into account the conditions resulting from the specific needs and tasks related to a particular local environment.

5.3. Characteristics of the Current Role of Local Government Units in Creating and Running Institutions in the Financial Market

5.3.1. Activity of Local Government Units in the Financial Market

In economic terms, and taking into account the solutions acceptable within the limits of applicable law, the activity of local government units in the financial market is directional and is based on:

a) passive use of the offer of existing financial institutions operating in the market,
b) active creation of solutions supporting local and regional conditions for social and economic development, through creation and implementation of:
- credit guarantee funds,
- loan funds.

In terms of using the existing offer in the financial market, the cooperation of local government units with financial institutions comes down to:

a) safe storage of funds in the accounts and their prompt, timely and secure transfer to other entities in connection with the performance of local tasks,
b) hedging the cash held by the local government unit against impairment due to inflation (mainly short-term and long-term bank deposits),
c) advisory services and active participation of financial institutions in the creation of a system of guarantees of proper execution of agreements between local government units and business entities (e.g. bank guarantees, sureties),
d) assistance in restructuring local government sector entities,
e) providing repayable financing for the tasks of the local government sector (crediting, bond issue, leasing),
f) conducting or co-financing of capital projects based on the economic account in the formula of public-private partnership.

The diversity of forms and levels of cooperation between a financial institution and a local government unit is reflected in the benefits for local government units in four spheres:

a) financing services, i.e. services that lead to an increase in the resources of the local government unit for the implementation of local tasks,
b) deposit services, enabling the use of free funds held by local government units,
c) services related to the handling of payment transactions, consisting in the execution of orders of local government units to execute specific operations in the scope of the transactions made,
d) other services related to the management of the local government unit, e.g. insurance services, financial consultancy.

These areas of cooperation and the nature of services should be considered as manifestations of passive participation by Polish local government units in the financial market. In this respect, the passive nature should be understood as the fact that the activity is limited to using the existing solutions and offer on the terms and conditions of a financial institution. The desire of local government units to create and run their own financial institutions should therefore be considered as an alternative manifestation of activity in the financial market:

a) an alternative to using the current offer of external financial institutions,
b) a chance to influence the local environment by creating financial products that stimulate conditions for social and economic development.

The analysis of the current activities of local government units in Poland allows the authors to indicate two main directions of these activities, i.e. the creation and operation of **local government loan** funds and/or **local government credit guarantee** funds.

5.3.2. Characteristics of Local Government Loan Funds' Activities

The purpose of loan funds is to provide external financing, primarily to micro and small-sized enterprises and individuals starting a business who have difficulties in obtaining commercial financing (e.g. bank credit) because they do not have the required collateral or credit history. Due to the nature of their activities and their mission, resulting from their not-for-profit activities, the loan funds as microfinance institutions manage public funds in the form of loan capital. The main activity of the loan funds is to finance undertakings of already existing enterprises and to provide the capital necessary to start a business. In the financial services market, the loan funds focus mainly on providing services to the micro and small business sector, for which loan funds often become the only source of financial support, given the limited availability of other forms of external financing, including bank

loans. Within the scope of its activities, a loan fund, by its very nature, is limited to the provision of services to business entities operating in the area covered by the fund.

An important element of the functioning of the network of funds are the associations that bring together most of these financial institutions. In the case of loan funds it is the Polish Union of Loan Funds (PZFP). They work to improve the conditions of their functioning, publicise the results of the funds, exchange good practices, prepare periodic reports on their activities, etc. Thus, they work on improving companies' access to external funding.

Currently, 109 loan funds operate in Poland, including 47 local government loan funds. Local government funds should be understood as entities which are directly or indirectly controlled by local government institutions.

Table 1. Spatial distribution of loan funds

Voivodeship	Number of loan funds	Value of loans granted	Local government loan funds
Dolnośląskie	6	58 826 057,74 PLN	• Fundacja Wałbrzych 2000 • Karkonoska Agencja Rozwoju Regionalnego S.A.
Kujawsko-pomorskie	5	40 769 593,96 PLN	• Kujawsko-Pomorski Fundusz Pożyczkowy Sp. z o.o.
Lubelskie	6	42 815 241,34 PLN	• Biłgorajska Agencja Rozwoju Regionalnego S.A. • Fundacja Puławskie Centrum Przedsiębiorczości • Lubelska Fundacja Rozwoju
Lubuskie	5	13 561 255,84 PLN	• Agencja Rozwoju Regionalnego S.A. • Stowarzyszenie Wspierania Małej Przedsiębiorczości Z/S w Dobiegniewie
Łódzkie	9	52 532 146,65 PLN	• Fundacja Centrum Wspierania Przedsiębiorczości w Poddębicach • Fundacja Inkubator • Fundacja Rozwoju Gminy Zelów
Małopolskie	10	62 533 833,93 PLN	• Centrum Biznesu Małopolski Zachodniej sp. z o.o. • Fundacja Rozwoju Regionu Rabka • Małopolska Agencja Rozwoju Regionalnego S.A. • Stowarzyszenie Samorządowe Centrum Przedsiębiorczości i Rozwoju
Mazowieckie	10	47 731 694,86 PLN	• „Poręczenia Kredytowe" Sp. z o.o. • Black Rose Finance Sp. z o.o. • Fundacja na rzecz Rozwoju Polskiego Rolnictwa • Fundacja Wspomagania Wsi • Mazowiecki Regionalny Fundusz Pożyczkowy Sp. z o.o. • Stowarzyszenie Rozwoju Przedsiębiorczości i Inicjatyw Lokalnych • Żyrardowskie Stowarzyszenie Wspierania Przedsiębiorczości
Opolskie	2	33 043 449,35 PLN	• Fundacja Rozwoju Śląska

Voivodeship	Number of loan funds	Value of loans granted	Local government loan funds
Podkarpackie	8	41 642 143,76 PLN	• Agencja Rozwoju Regionalnego MARR S.A.
Podlaskie	4	27 997 502,32 PLN	• Agencja Rozwoju Regionalnego „ARES" S.A. w Suwałkach • Fundacja Rozwoju Przedsiębiorczości w Suwałkach
Pomorskie	8	64 241 497,69 PLN	• Pomorski Fundusz Pożyczkowy Sp. z o.o. • Słupskie Stowarzyszenie Innowacji Gospodarczych i Przedsiębiorczości
Śląskie	9	56 705 836,13 PLN	• Agencja Rozwoju Lokalnego S.A. • Agencja Rozwoju Regionalnego w Częstochowie S. A. • Bielski Fundusz Projektów Kapitałowych Sp. z o.o. • Fundusz Górnośląski S.A. • Rudzka Agencja Rozwoju 'Inwestor' Sp. z o.o.
Święto-krzyskie	6	50 037 404,02 PLN	• Fundacja Rozwoju Regionu Pierzchnica • Fundusz Pożyczkowy Województwa Świętokrzyskiego Sp. z o.o. • Krajowe Stowarzyszenie Wspierania Przedsiębiorczości • Ośrodek Promowania i Wspierania Przedsiębiorczości Rolnej
Warmińsko-mazurskie	8	67 362 414,78 PLN	• Działdowska Agencja Rozwoju S.A. • Fundacja Rozwoju Regionu Łukta • Fundacja Wspierania Przedsiębiorczości Regionalnej • Stowarzyszenie Centrum Rozwoju Ekonomicznego Pasłęka • Warmińsko-Mazurskie Stowarzyszenie Wspierania Przedsiębiorczości • Warmińsko-Mazurska Agencja Rozwoju Regionalnego S.A. w Olsztynie
Wielkopolskie	6	149 510 217,33 PLN	• Fundacja Kaliski Inkubator Przedsiębiorczości • Ostrowskie Centrum Wspierania Przedsiębiorczości
Zachodnio-pomorskie	7	69 518 240,61 PLN	• Polska Fundacja Przedsiębiorczości • Szczeciński Fundusz Pożyczkowy Sp. z o.o.

Source: own elaboration on the basis of data of the Polish Union of Loan Funds.

The highest value of loans was granted in the Wielkopolska province, while the lowest in the Lubusz province. The number and value of granted loans depends on many factors, most of which are independent of the funds themselves, e.g. the degree of economic development of the region, its size, the number of funds operating in a given province, demographic structure, availability of loan capital. Diversification of regional conditions for lending activity is one of the reasons why the funds open their branches in different provinces. In principle, the number of funds operating in a given region is directly proportional to two seemingly opposing factors, i.e. the level of economic development of the province and the scope of support needed. In other words, loan funds

respond to the demand for their offer from both a quantitative and a qualitative point of view, acting where their support is most needed (the following regions: Lesser Poland, West Pomerania, Subcarpathia, Lodz Province).

By focusing on the local government loan funds, it can be seen that they are operated based on the following four legal forms:

a) Joint stock companies – in which the sole or main shareholder is a local government unit (other shareholders are companies and individuals conducting business in the commune),
b) Limited liability companies – in Polish Sp. z o. o. the companies with an exclusive or majority shareholding of local government units,
c) Foundations, where one of the founders is a local government unit,
d) Associations of which a local government unit is a member.

Within the scope of the activities carried out, one may point out the entities which are engaged only in lending activities, but also in mixed activities, i.e. granting loans in parallel with the provision of guarantee and surety services.

The customers of the loan funds include entrepreneurs from the SME sector and persons intending to start a business. The above mentioned group is not homogeneous. One can make various types of divisions, e.g. by industry or company size.

Table 2. Loans granted by loan funds in 2015 under the period of the borrower's business activity

Business time	Number of loans granted	Value (in PLN, thousand)
Up to 12 months	2920	178 444,72
More than 12 months	5852	700 383,81

Source: own elaboration on the basis of data of the Polish Union of Loan Funds.

As results from the presented data, the entrepreneurs conducting business activity for more than 12 months dominate by far among the entities using the services of loan funds. Nearly 80 percent of the value of the loans granted goes to the enterprises that have been already operating. This is largely due to the fact that these entities are naturally able to obtain a larger loan and have even greater collateral potential than start-ups. Lower amounts of loans (almost twice as much as in average) for new companies are also associated with higher risk of funding this type of business ventures. Moreover, a significant number of projects implemented by loan funds planning support for newly established enterprises assume, independent of the funds themselves, regulations providing for limiting the maximum amount of the loan to a lesser amount than in the case of companies that have been operating on the market for a longer time. In addition, in terms

of companies in the initial phase of their operations, public funding programmes compete with the activity of loan funds. For example, in 2015, the government's Support to Start Programme was in operation, which made it possible to obtain a loan to start a business with a minimum interest rate (0.44 percent per annum) and a long repayment period (up to 7 years), and which naturally limited the demand for support offered by loan funds.

In terms of the size of the enterprise, the loan fund customer base is definitely dominated by micro-enterprises. The detailed structure is presented in the table below.

Table 3. Loans granted by loan funds in 2015 by size classes of enterprises

	Number of loans granted	Value (in PLN, thousand)
Micro enterprises	7829	664 305,30
Small enterprises	765	179 388,81
Medium enterprises	108	28 189,44
Social organizations (associations, foundations)	70	6 944,97
Other (e.g. public institutions)	15	870,40

Source: own elaboration on the basis of data of the Polish Union of Loan Funds.

The above breakdown shows that both in terms of quantity (89 percent) and value (75 percent of the total value of the loans granted), micro-enterprises remain the dominant customer of loan funds. As indicated in the table above, borrowers in the "other" category and social economy institutions occupy a marginal place in the funds' loan portfolio, as in previous years. This is due to the fact that, in accordance with the tasks set for the sector studied, the main recipient of support is to be and has been the SME sector.

The loan funds provide financing for investment, investment and trading, and for trading purposes.

Table 4. Demand for loans in the context of the purpose of granted funds

Type	Number of loans granted	Value (in PLN, thousand)
Revolving loans	1112	116 113,17
Investment loans	5886	611 240,73
Revolving and investment loans	1774	151 474,62

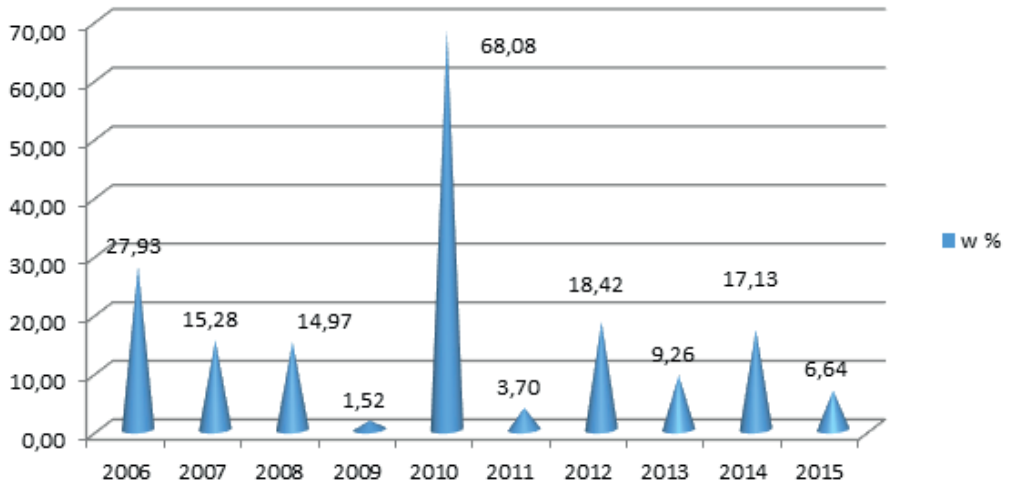
Source: own elaboration on the basis of data of the Polish Union of Loan Funds, p. 24.

The number of investment loans granted in 2015 more than doubled the total number of revolving loans and revolving and investment loans. The situation is similar in terms of value. Thus, it is clearly visible that the funds primarily finance the development of enterprises (it is worth noting that investment loans also dominate among those granted to newly established enterprises). This is all the more so because investment and

revolving loans have a larger share in the loan portfolio than revolving loans. This phenomenon should be considered positive. By funding business development, the funds contribute to the expansion of the scale of Polish entrepreneurship as a whole. However, it should be kept in mind that the regulations under which the funds operate impose such a state of affairs to some extent, limiting the possibility of granting revolving loans. Therefore, as it was pointed out in last year's report, it cannot be concluded from the above data that there is no demand for working capital among SMEs. It exists and it would be useful to enable the funds to meet these needs on a larger scale. Fulfilling this requirement would allow even more comprehensive support for the development of entrepreneurship by funds. It should be remembered that it is a normal business situation (especially in micro-enterprises) where an entrepreneur has a contractor ready to purchase a specific batch of goods in the short or medium term, and the company does not have the capital needed to ensure the execution of the order. The help of loan funds would be very valuable here.

It should be stressed that a key issue for the operation of loan funds is the availability and way of raising capital for their activities. In recent years, the main source of capital have been EU funds from regional operational programmes. There are considerable variations in this respect, due to the fact that the implementation of the 2014-2020 perspective at the national level is delayed by 6-9 months.

Fig. 1. Dynamics of changes in the value of capital equipment of loan funds in Poland in 2005-2015 (year on year, in %)



Source: own elaboration on the basis of data of the Polish Union of Loan Funds, p. 21.

Since 2012, the dynamics of capital growth has been stable. Under the EU Financial Perspectives 2014-2020, approximately EUR 4 billion has been allocated to repayable financial instruments. Due to delays, there was a problem of lack of financial support

for the funds themselves, which increased the uncertainty of their operation and functioning in the future. However, reliance on EU funding should be considered as a significant risk factor for the functioning of loan funds in subsequent years.

Among the determinants for the current challenges and prospects for the activity of local government loan funds, one should indicate the following factors:

- the loan funds operate in the area of the so-called "funding gap" by providing capital to external business entities which are not able to use the offer of commercial financial institutions. Such activities carry an increased risk, as the vast majority of funds' customers are small or very small business entities and, thus, the most vulnerable to economic fluctuations and liquidity disruptions. It should be strongly emphasised that providing external funding (lending) to the SME sector is a high-risk activity,
- the need to adjust the offer to the specifics of the customers served. One of the adjustment factors must be the preferential interest rate of the loan. This allows companies in the funding gap to expand their business, gain credit history and possibly get more external funds in the commercial market, with the help of external capital,
- as a rule, the funds do not finance large companies and those which are at a stage of development that allows them to obtain capital in the commercial market,
- Micro-enterprises continue to dominate by far in the structure of customers of loan funds in decisive manner, both in terms of quantity and value.

One of the measures of the quality of service provided by loan funds may be the percentage of customers returning for another loan. Nevertheless, a reservation must be made here. As a rule, the percentage in question will never be too high. This is due to the mission of the loan funds. Their task is primarily to prepare companies to obtain financing in the commercial market and thus reduce the funding gap. Therefore, it is natural, and even desirable, for the fund's customer to obtain any other investment funds from other sources. On the other hand, it would be highly worrying if borrowers did not return to the funds at all. This would mean that the customer service is not proper and the offer is inadequate, ergo borrowing from the fund is the last resort. There is a group of borrowers the characteristics of which allow them to legitimately become customers of the fund once again. The authors are referring to entrepreneurs and those companies that took the first loan from the fund as a start-up. Such entities may not be strong enough to apply for funding in the commercial market even after the first loan has been paid. In absolute numbers, the share of the number of loans granted to an entrepreneur once again in relation to borrowers taking out a loan in the fund for the first time is no more than 25 percent.

5.3.3. Activity of Local Government Credit Guarantee Funds

A credit guarantee fund is an institution that offers guarantees for financial liabilities to certain entities. Its main function is to facilitate access to external funding in the form of bank credits and loans. In practice, this means that an entity intending to take out a loan to set up a business can apply to the credit guarantee fund for appropriate collateral. This institution then becomes the guarantor of the repayment of that loan taken out by the future entrepreneur towards the bank or other institution in the event of the insolvency of the company owner. Credit guarantee funds are therefore an instrument for indirectly meeting the capital needs of enterprises. The institution which provides a guarantee facilitates entrepreneurs' access to credits and loans by providing debt guarantees in relation to the credits and loans granted in the event of the enterprise's insolvency. Funds in Poland generally offer to small and medium-sized companies a collateral for up to 70 percent of the value of a loan or credit. The maximum value of the guarantee depends on the fund's capital. Most of the funds provide a maximum guarantee of between PLN 50,000 and 300,000, but there are also guarantees with a value above this amount. The credit guarantee fund is not a party providing the entrepreneur with capital, but only guaranteeing the repayment of the resulting liabilities. The credit guarantee fund compensates the bank or the loan fund for any loss up to the amount of the guarantee agreement, less any earlier repayment of part of loan principal instalments. The entrepreneur pays a commission on the guarantee granted, which is expressed as a percentage of the guarantee amount[183].

The origins of the development of loan and guarantee funds in Poland can be traced back to the beginnings of microfinance organisations around the world, since the beginnings of microfinance in the 20th century worldwide were connected with finding a way to use poverty, which usually occurs in the form of structural disadvantages in rural areas. The main primary source of capital and know-how of the loan and credit guarantee funds operating in Poland to this day were foreign aid programmes implemented in Poland in the early 1990s. This support was a kind of "driving wheel" for the creation of subsequent loan and guarantee schemes addressed to the final beneficiaries, i.e. the SME sector. The first credit guarantee funds were established in Poland in the first half of the 1990s as part of the Local Initiative Programme (PHARE) with use of European funds[184]. Since 1996 the National Association of Guarantee Funds (KSFP) has been operating: The main objectives of the National Association of Guarantee Funds are: supporting the development of the credit guarantee system, disseminating knowledge and exchanging

[183] B. Bartkowiak, *Fundusze pożyczkowe i poręczeniowe w finansowaniu małych i średnich przedsiębiorstw w Polsce*, CeDeWu Sp. z o.o., Warszawa 2009, p. 202.

[184] *Ibidem*, p. 205.

experience in the field of conducting guarantee and surety activities, cooperation with government, local government, financial and other institutions pursuing similar objectives in the development of credit guarantee schemes. The Association cooperates with Bank Gospodarstwa Krajowego S.A., the Polish Agency for Enterprise Development (PARP) and other agencies involved in the processes of building a system of financial instruments in Poland, including mainly guarantees and sureties.

Currently, forty-three local government credit guarantee funds operate in Poland. Their structure and territorial distribution is presented in the table below.

Table 5. Basic data on local government guarantee funds

Voivodeship	Number of operating Funds Guarantee capital	Guarantee capital (in PLN, million)	Active guarantees (in PLN, million)	List of Funds
Dolnośląskie	5	39,5	67,3	• Dolnośląski Fundusz Gospodarczy Sp. z o.o. • Fundusz Poręczeń Kredytowych Sp. z o.o. w Złotoryi • Samorządowy Fundusz Poręczeń Kredytowych • Fundusz Poręczeń Kredytowych Powiatu Dzierżoniowskiego Sp. z o.o. • Fundusz Poręczeń Kredytowych Sp. z o.o.
Kujawsko-pomorskie	5	139,6	174,4	• Kujawskie Poręczenia Kredytowe Sp. z o.o. • Kujawsko-Pomorski Fundusz Poręczeń Kredytowych Sp. z o.o. • Toruński Fundusz Poręczeń Kredytowych Sp. z o.o. • Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o. • Grudziądzkie Poręczenia Kredytowe Sp. z o.o.
Lubelskie	3	82,8	30,4	• Biłgorajska Agencja Rozwoju Regionalnego SA • Puławski Fundusz Poręczeń Kredytowych • Polski Fundusz Gwarancyjny Sp. z o. o.
Lubuskie	1	47,3	38,6	• Lubuski Fundusz Poręczeń Kredytowych Sp. z o.o.
Łódzkie	1	1,0	2,8	• Łódzki Fundusz Poręczeń Kredytowych Sp. z o.o.
Małopolskie	3	92,8	133,9	• Fundusz Poręczeń Kredytowych Tarnowskiej Agencji Rozwoju Regionalnego SA • Małopolski Regionalny Fundusz Poręczeniowy Sp. z o.o Małopolski Fundusz Poręczeń Kredytowych Sp. z o.o.
Mazowieckie	2	86,6	79,1	• Mazowiecki Fundusz Poręczeń Kredytowych Sp. z o.o. • Poręczenia Kredytowe Sp. z o.o.

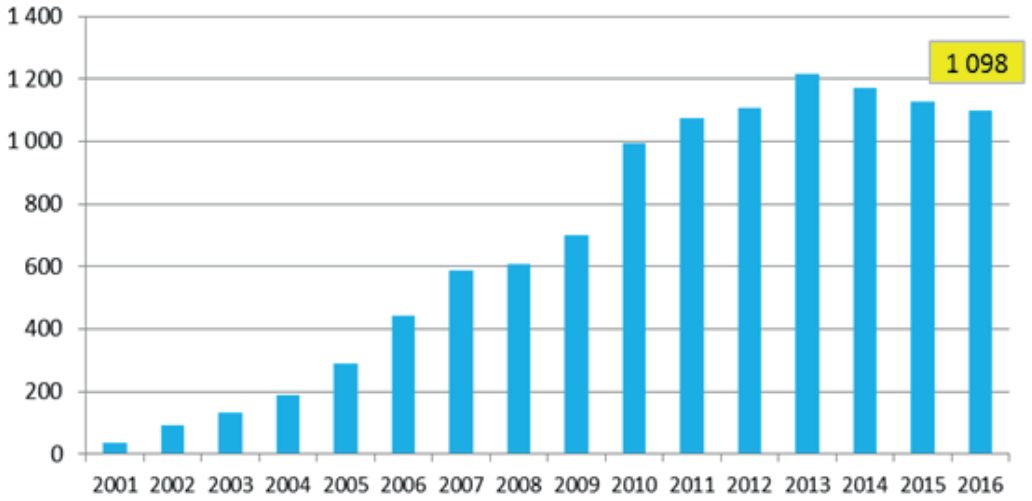
Voivodeship	Number of operating Funds Guarantee capital	Guarantee capital (in PLN, million)	Active guarantees (in PLN, million)	List of Funds
Opolskie	1	16,7	12,0	• Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.
Podkarpackie	2	20,0	25,9	• Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o. • Lokalny Fundusz Poręczeń Kredytowych Sp. z o.o.
Podlaskie	2	78,6	24,8	• Podlaski Fundusz Poręczeniowy Sp. z o.o. • Łomżyński Fundusz Poręczeń Kredytowych Sp. z o.o.
Pomorskie	1	45,6	80,8	• Regionalne Towarzystwo Inwestycyjne SA
Śląskie	2	57,5	64,9	• Bielski Fundusz Projektów Kapitałowych Sp. z o.o. • Śląski Regionalny Fundusz Poręczeniowy Sp. z o.o.
Świętokrzyskie	2	38,9	26,5	• Fundusz Poręczeń Kredytowych i Wspierania Finansowego „FUNDSTAR” • Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.
Warmińsko-mazurskie	4	78,1	76,4	• Działdowska Agencja Rozwoju SA • Warmińsko-Mazurski Fundusz „Poręczenia Kredytowe” Sp. z o.o. • Fundusz Poręczeń Kredytowych przy Fundacji Rozwoju Przedsiębiorczości ATUT • Nidzicka Fundacja Rozwoju “NIDA”
Wielkopolskie	4	100,6	455,3	• Fundusz Rozwoju i Promocji Województwa Wielkopolskiego SA • Poznański Fundusz Poręczeń Kredytowych Sp. z o.o. • Samorządowy Fundusz Poręczeń Kredytowych Sp. z o.o. • Jarociński Fundusz Poręczeń Kredytowych Sp. z o.o.
Zachodniopomorskie	4	172,6	297,1	• Agencja Rozwoju Metropolii Szczecińskiej Sp. z o.o. • POLFUND Fundusz Poręczeń Kredytowych SA • Zachodniopomorski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o. • Fundusz Poręczeń Kredytowych w Stargardzie Sp. z o.o.

Source: own elaboration.

It is worth noting that in many of the mentioned funds operating in the form of a capital company, Bank Gospodarstwa Krajowego is the shareholder, and often the supporting shareholders are the provincial funds for environmental protection.

The credit guarantee funds are based in all provinces of Poland. Most of them are located in the Kujawy-Pomerania and Lower Silesia provinces (five in each). In each of the following three provinces four funds are based: the Warmia-Masuria, Wielkopolska and West Pomerania provinces. Most often (in six cases) two guarantee funds are located in a given province, while in three provinces only one fund is located. Understandably, the funds are the most active (and most often: only active) in the regions where their headquarters are located, but, although these are relatively rare cases, it happens that credit guarantee funds also operate outside the region where they are based.

Fig. 2. Equity for guarantee funds (in PLN million, at the end of the year)

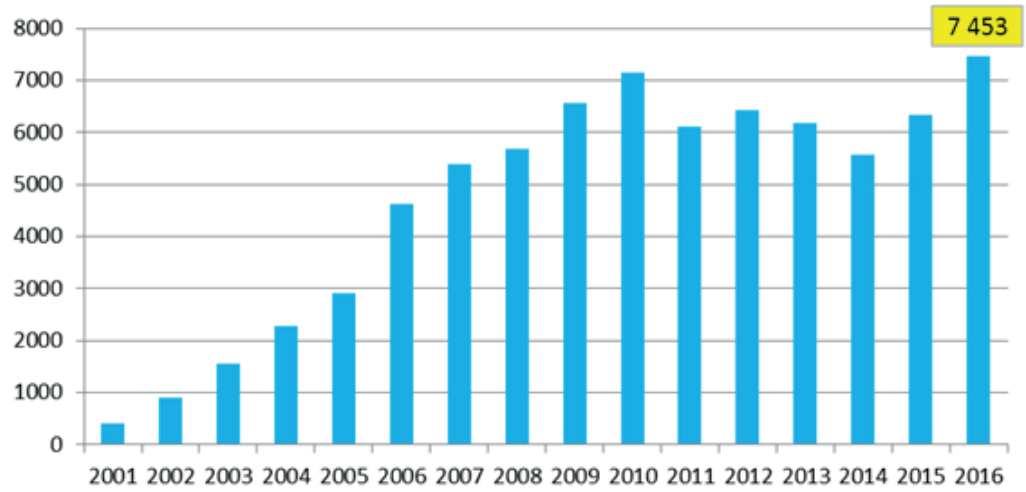


Source: calculations based on the reporting data of the guarantee funds for 2016.

The guarantee capital of the 43 funds operating in 2016 amounted to approximately PLN 1.1 billion at the end of the year, which translates into an average amount of PLN 25.5 million per entity. However, only a minority of funds, i.e. 18 entities, holds the capital equal to or higher than this amount, while in the majority of funds, i.e. 25 entities (58 percent of the total number of funds), the amount of capital is lower, which shows quite a significant diversity of entities in terms of the amount of the guarantee capital, and thus their capability to conduct their operating activities. The capitals of the eight largest funds in this respect (the capital of each of these funds exceeds the level of PLN 50 million), with a total of PLN 528 million, is almost exactly half of the capital of all credit guarantee funds (48 percent). On the other hand, the eight smallest funds (in none of them the capital reaches the value of PLN 5 million) have the capital of a total value of PLN 17.8 million at their disposal, which constitutes only 1.6 percent of the sector's capital.

Despite a slow decline in the capitalisation of credit guarantee funds for the last 3 years, the guarantee and surety activity has been growing slowly, both in terms of the number of transactions and their value. This is largely due to the growing scale of tender guarantees under public procurement law, which already represents a very significant share of the portfolio of many credit guarantee funds.

Fig. 3. The number of guarantees granted annually by all funds



Source: calculations based on the reporting data of the guarantee funds for 2016.

A direct result of the increase in the involvement of the funds and the simultaneous decrease in the value of their capital is another year of increase in the involvement of capital (the quotient of the value of active credit guarantees and the guarantee capital). The efficiency of use of financial resources at the disposal of the credit guarantee funds is therefore improving. Naturally, it can still be said that it is well below the values recorded in some European countries

The guarantees granted for the benefit of the banks account for the largest part of the total (47.6 percent in quantity, and 75 percent in value), followed by those granted for the benefit of other entities (43.9 percent in quantity, and 20.1 percent in value), which de facto means tender guarantees, leasing guarantees and other types of guarantees and sureties (e.g. hedging financial liabilities in connection with subsidies obtained). The drop in the number of bank loan guarantees compared to 2015 is as much as 15 percentage points and 7 percentage points when the value of the guarantees is taken into account. Banks remain the leading recipient of guarantees, but their predominance over the group of "other entities" is already much smaller.

Table 6. Guarantees granted in 2016 by type of financing institution

	Volume		Value		Medium value of guarantee (in PLN, thousand)
	number	share	mln PLN	share	
Total	**7 453**	**100,0%**	**949,5**	**100,0%**	**127,4**
including:					
Banks	3 548	47,6%	712,3	75,0%	200,8
Loan funds	634	8,5%	46,6	4,9%	73,5
Other entitites	3 271	43,9%	190,6	20,1%	58,3

Source: calculations based on the reporting data of the guarantee funds for 2016.

Slightly below 60 percent of the value and 40 percent of the total number of guarantees and sureties granted by the funds in 2016 related to revolving debt financing. Investment guarantees were more than two times smaller (15 percent of the total number and 21 percent of the value of guarantees; the share of this type of loans has clearly decreased in relation to the previous year, which was, respectively: 21 percent and 25 percent). The third most important group of guaranteed obligations are tender guarantees, which in terms of the number of transactions represent as many as 38 percent, which is an increase by as many as 21 percentage points compared to 2015 (sic!), and in terms of their value – 16 percent (increase by 8 percentage points). On the other hand, leasing guarantees account for only 1 percent of the total number of guarantees and 2 percent of the transaction value. Guarantees for other types of transactions are still quite numerous (432 agreements, i.e. less than 6 percent of the total number of guarantees). These "other" guarantees amount to an average of PLN 66,000. The guarantees of subsidy agreements, granted by labour offices to persons starting their own business, constitute probably a significant part of them.

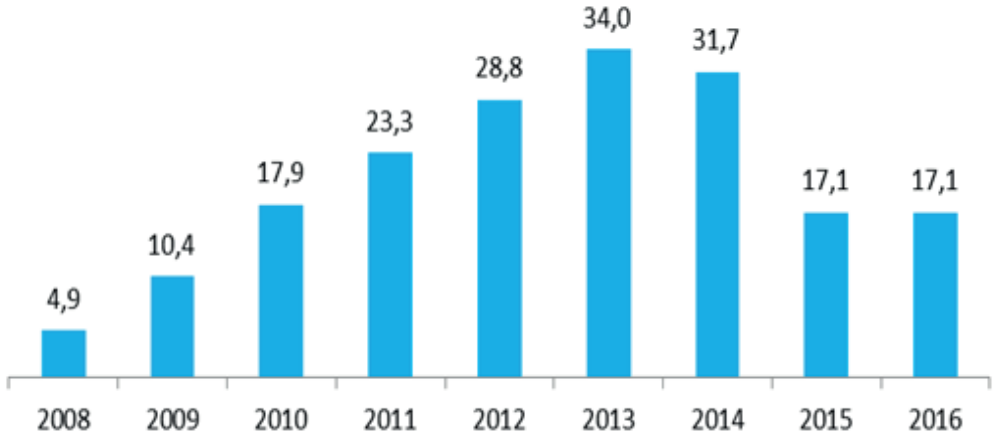
Table 7. Guarantees granted in 2016 by value

Value range (in PLN, thousand)	Total value (in PLN, million)	Volume	Medium value (in PLN, thousand)
Up to 50	69,5	3 828	18,2
50 – 100	89,0	1 158	76,9
100 – 250	232,1	1 378	168,5
250 – 500	269,1	737	365,1
Over 500	289,7	352	823,1
Total	**949,5**	**7 453**	**127,4**

Source: calculations based on the reporting data of the guarantee funds for 2016.

The amount of guarantees paid annually by all the funds has been growing steadily for a number of years, from the level of PLN 5 million in 2008 to PLN 34 million in 2013, which was the worst in this respect. In 2014 the first reduction in this value was recorded (to approx. PLN 32 million), and the decrease in 2015 was well-marked – to PLN 17 million. The value of sureties paid in 2016 also remained at a similar level.

Fig. 4. The value of guarantees paid in a given year (in PLN million)



Source: calculations based on the reporting data of the guarantee funds for 2016.

When analysing the prospects for the continuation of the activity in the field of guarantees and sureties, it should be noted that the reduction (between 2015 and 2016) in the number of guarantees paid out (from 176 to 163), while maintaining their value, is particularly beneficial. In general, the value and number of the guarantees paid out does not pose a threat to the security of the operation of all the credit guarantee funds. It is worth noting, however, that the lack of a permanent offer of re-guarantees in the Polish market makes it very difficult to conduct active business in the field of guarantees and sureties. In addition, it is important to be aware of the fact that there are funds in the market, although relatively few, where the guarantees paid out and the related diminution of equity may threaten the institution's existence in the short or medium term.

Over the next few years, local and regional credit guarantee funds will have to face very serious challenges, mainly related to the possible further centralisation of public support in the form of guarantees and sureties and the creation of the National Guarantee Fund, as well as problems related to the rules for supporting credit guarantee funds by European Union structural funds in the period 2014-2020. As part of Regional Operational Programmes for the new EU funding period (2014-2020), different amounts of financial resources for the purpose of the activities in the field of guarantees and sureties

were allocated in each region, while no calls for tender for the selection of financial intermediaries to provide guarantees have yet been announced anywhere.

A separate issue is the significant and growing share of guarantees other than debt financing guarantees, i.e. tender guarantees or performance bonds (with the former dominating). This trend is of course caused by the problems in cooperation with the banking sector, mainly due to competition from centralised schemes, i.e. currently mainly de minimis guarantees (in the future, other such schemes). The situation described may have various consequences. On the one hand, it improves the financial situation of the funds, since at least the tender guarantees are a very safe and relatively profitable instrument, and the very nice rules for obtaining them are certainly a significant help to entrepreneurs participating in the tenders. On the other hand, however, the decreasing share of bank loans may lead to further loosening of relations between the funds and the banking sector, which would definitely be undesirable. As a result, in the long run, the whole system may move towards hedging transactions that do not constitute debt financing, which has always been the main objective in the process of developing (and supporting) the local/regional credit guarantee fund sector in Poland.

The biggest limit to the activity of local/regional credit guarantee funds is still related to the governmental scheme of the Portfolio De Minimis Guarantee Line (de minimis guarantee) launched by Bank Gospodarstwa Krajowego in 2013. This scheme, which is attractive both to banks and borrowers, was initially to be completed by the end of 2015. Ultimately, however, it was extended twice and, in accordance with the Ordinance of the Minister of Finance of September 2016, was in place until the end of 2017. During the first 4 years of operation of the de minimis guarantee scheme (until the end of August 2017), the amount of the guarantees granted was nearly PLN 41.6 billion (it was, on average, about PLN 10 billion annually – i.e. much more than ten times the total value of guarantees granted annually by all local and regional credit guarantee funds). The de minimis guarantees were related to the loans worth over PLN 73 billion, which shows the scale of competition in relation to the activities of local government credit guarantee funds. In addition, the government scheme adopted on 7 March 2018 by the Council of Ministers, entitled "Supporting Entrepreneurship with the Use of Sureties and Guarantees Granted by Bank Gospodarstwa Krajowego" significantly ignores the essence and possibility of providing real support to regional credit guarantee funds at the expense of central institutions.

5.3.4. Wielkopolska Agency for Enterprise Development (WARP) – case study

The activity of the local government loan fund will be presented in more detail on the example of Wielkopolska Agency for Enterprise Development Ltd, currently the

largest local government loan fund in Poland in terms of value and number of loans granted. Wielkopolska Agencja Rozwoju Przedsiębiorczości Sp. z o. o. (WARP) was established in 2003, based on the resolution of the Local Government Assembly of the Wielkopolska province, in connection with the need to establish an entity which, in addition to educational activities, could provide assistance, especially to small entrepreneurs in the form of granting loans in the Wielkopolska region. WARP sp. z o.o. was established by three founders: Local Government of Wielkopolska Province, Piła City Council and Lewiatan Group. Since then, WARP Sp. z o.o. specialises in financing, consulting and training of people who increase the competitiveness of the economy in the Wielkopolska region. It offers dedicated products and services that reflect the real needs of entrepreneurs.

As part of its activities in 2017, WARP Sp. z o.o. runs:

- Loan fund,
- Development Services – subsidies for training, courses, postgraduate studies, consulting for SMEs,
- Regional Financing Institution for the purpose of settlement of subsidies from the Operational Programme Innovative Economy,
- Subsidies to start a business,
- European Fund Information Points in Piła and Nowy Tomyśl.

The loans for small businesses are a very important element in implementing the region's strategy. The possibility of granting loans to entrepreneurs by the established Company contributes to the development of micro, small and medium-sized enterprises, and above all, it creates new jobs.

The Loan Fund of the Wielkopolska Agency for Enterprise Development Ltd has so far supported micro, small and medium-sized enterprises from the Wielkopolska province by granting loans for the development of both the business activity that has been just started and the business activity that has been already conducted. In 2017, WARP granted the following loans:

a) Jeremie initiative under the Operational Agreement 2.7/2016/FP3W/3/293 from the 2007-2013 perspective,
b) Jeremie2 initiative under Operational Agreement 2/RPWP/3217/2017/1/DIF/004 from the perspective 2014-2020, concluded on 30 August 2017,
c) Classic loan.

In 2017, 89 loans were paid out in the amount of PLN 23,031,354.71 (including the contribution of Trust Fund Manager of the JEREMIE Initiative in the amount of 19,196,476.28). The average value of the loan paid out to customers in 2017 was PLN 258,779.27. The breakdown of loans disbursed in 2017 by company size is shown in Table 8.

Table 8. The structure of loans granted in 2017 by enterprise size

Enterprise size	Volume	Value of support
Micro enterprise	70	12 408 955,77
Small enterprises	16	8 502 398,94
Medium enterprise	3	2 120 000,00
Total	**89**	**23 031 354,71**

Source: Financial statements of WARP sp. z. o. o. year 2017.

As of 31 December 2017, the value of outstanding principal balance of the effective loan agreements was PLN 94,342,1,79.28 (750 active loans). On the other hand, for the same period, the balance of overdue principal debt on account of active loan agreements increased in relation to the level of 31 December 2016 by PLN 345,448,87 and amounted to PLN 1,778,830.23. Wielkopolska Agencja Rozwoju Przedsiębiorczości Sp. z o. o. employed 82 people as of 31 December 2017.

The activities conducted by WARP sp. z o. o. require that the asset and equity analysis is carried out and the financial results of the Company are analysed:

Table 9. Balance sheet

Specification	2016	2017
Fixed assets	78 083 335,14	61 339 732,60
Intangible assets	0,00	0,00
Tangible assets	2 097 668,47	2 032 719,21
Long-term receivables	1 500,00	1 700,00
Long-term investments	75 889 817,17	59 172 862,89
Long-term prepayments	94 349,50	132 450,50
Current assets	86 568 758,26	84 812 476,22
Inventory	0,00	0,00
Short-term receivables	1 146 906,42	2 130 803,48
Short-term investments, including:	84 630 584,86	81 068 558,96
Granted loans	47 476 930,66	44 013 227,18
Cash and equivalents	37 152 073,88	37 037 098,63
Short-term prepayments	791 266,98	1 613 113,78
Total assets	164 652 093,40	146 152 208,82

Source: Financial statements of WARP sp. z. o. o. year 2017.

The structure of the company's assets is dominated by financial investments reflecting the company's involvement in the loans granted.

Table 10. Source of financing

	2016	2017
Equity	33 710 814,34	34 006 435,82
Liabilities, including:	130 941 279,06	112 145 773,00
Provisions for liabilities	214 942,28	356 880,57
Long-term liabilities	76 411 679,44	53 523 179,43
Short-term liabilities	53 825 016,67	58 259 457,03
Accruals	489 640,67	6 255,97
TOTAL LIABILITIES AND EQUITY	164 652 093,40	146 152 208,82

Source: Financial statements of WARP sp. z. o. o. year 2017.

The financing structure is dominated by liabilities resulting from the external funding obtained for conducting lending activities. From the point of view of the Fund's financial security, the positive information is the high coverage of short-term liabilities by current assets, which is to secure financial liquidity.

Table 11. Profit and Loss Account

Specification	2016	2017
Net revenues from sales	9 270 946,39	7 409 821,89
Operating expenses, including:	8 251 546,05	7 019 923,77
Amortisation	155 457,52	135 269,06
Materials and energy	224 104,01	118 156,23
External services	1 357 672,89	1 246 343,57
Taxes and charges	129 824,81	96 698,18
Payroll	5 284 995,53	4 454 210,82
Social security and other benefits	1 004 410,20	863 961,99
Other costs	95 081,09	105 283,92
Profit (loss) on sales	1 019 400,34	389 898,12
Other operating revenues	324 170,42	329 329,35
Other operating revenues	468 960,79	346 778,72
Profit (loss) on operating activities	874 609,97	372 448,75
Financial revenues	627 748,82	224 830,20
Financial expenses	1 016 405,64	205 387,47
Net profit (loss)	485 953,15	391 891,48
Income tax	197 953,00	96 270,00
Net profit (loss)	288 000,15	295 621,48

Source: Financial statements of WARP sp. z. o. o. year 2017.

In the presented period there was a decrease in revenue from sales. Nevertheless, the generated profit on sales at the level of PLN 389,000 indicates a margin on operating activities at the level of approx. 5 percent, which, from the perspective of comparison to the broad market of financial institutions, should be considered a satisfactory result.

When assessing the current situation and prospects for the future, it should be stressed that the EU programming period 2014-2020 has significantly increased the availability of funds for borrowers. Naturally, at the same time, the number of lending institutions has increased, which is additional competition for WARP at the lending stage. However, the predominant role of EU funds in financing the lending activities is, in the long term, a key risk factor for the development of the entity, given the likely significant reduction in available EU funding in the 2021-2027 budgetary perspective.

5.3.5. Silesian Regional Guarantee Fund as an Example of Activity of a Local Government Credit Guarantee Fund

The fund Śląski Regionalny Fundusz Poręczeniowy Sp. z o.o. was officially launched on 1 December 2000. The institution was established under an agreement between Fundusz Górnośląski S.A.[185] and Bank Gospodarstwa Krajowego. The main motive behind the establishment of the entity was the creation of an organisation to enable granting of bank credit and loan guarantees to small and medium-sized enterprises in a systematic manner. Since 2012, as a result of amendments to the articles of association, the provisions have been introduced that relate to granting of guarantees or sureties under a lease agreement, factoring and granting tender guarantee or performance bond. The introduction of these provisions enabled the Company to expand its offer with new products related to the granting of guarantees in order to develop entrepreneurship.

The guarantees are granted with use of a separate guarantee capital created from the company's share capital and funds obtained thanks to the subsidy and support of the Polish Agency for Enterprise Development (PARP). The guarantee capital was increased thanks to the funding obtained by the Company under the Regional Operational Programme of the Silesia Province for 2007-2011

An important factor in the activities of the Fund is the cooperation with its partners, i.e. banks and lending institutions operating in the Silesia province. At the end of 2017, the Fund cooperated with:

- Cooperative Bank in Jaworzno,
- Cooperative Bank in Ustroń,

[185] Fundusz Górnośląski was established in December 1995 as a company where the current dominant shareholder is the Silesia Province (87 percent of votes) and minority shareholders are the communes of Bytom, Chorzów, Jastrzębie-Zdrój, Klucze, Psary, Ruda Śląska, Siemianowice Śląskie, Świętochłowice, Tarnowskie Góry, Trzebinia, Tychy, Żarnowiec, Żory.

- Cooperative Bank in Żory,
- Cooperative Bank in Wodzisław Śląski,
- Cooperative Bank in Sośnicowice,
- Rybnik Cooperative Bank,
- Cooperative Bank in Pszczyna,
- Cooperative Bank in Tworóg,
- Cooperative Bank in Cieszyn,
- ING Bank Śląski S.A.,
- PKO Bank Polski S.A.,
- Bank Ochrony Środowiska S.A.,
- ESBANK Cooperative Bank in Radomsko,
- Cooperative Bank in Zator,
- Bank BGŻ BNP Paribas S.A.,
- PEKAO S.A.,
- Getin NOBLE Bank S.A.,
- Cooperative Bank in Tychy,
- Silesian Cooperative Bank "SILESIA" in Katowice,
- SGB-BANK S.A.,
- Cooperative Bank in Jastrzębie Zdrój,
- Cooperative Bank in Porąbka,
- Cooperative Bank in Leśnica,
- Cooperative Bank in Będzin,
- Krakow Cooperative Bank.

The current offer structure focuses on the following product groups:

a) Credit and loan guarantees, concerning entrepreneurs that:

- have the status of micro, small or medium-sized enterprise (employment below 250 employees and balance sheet total <EUR 43 million or turnover <EUR 50 million,
- have a registered office or carry out investments in the territory of the Silesia province,
- have been in business for at least 6 months.

It is also important that the Fund guarantees loans up to PLN 1,000,000.00 in an amount not exceeding 50 percent of the loan or credit principal, for a maximum period of 60 months.

b) The tender guarantees are granted for entities entering a tender conducted on the basis of the provisions of the Public Procurement Law, obliged by tender

organiser to provide collateral in the form of a tender guarantee. In this respect, the Fund offers:

- a package of tender guarantees, i.e. the total limit of tender guarantees for which an entrepreneur may apply, for a period of 12 months, in the maximum amount of PLN 1 million,
- single guarantees, granted under a tender guarantee package for a period of up to 90 days and up to PLN 1 million,

c) Leasing guarantees, provided to entrepreneurs that:

- have the status of micro, small or medium-sized enterprise (employment below 250 employees and balance sheet total <EUR 43 million or turnover <EUR 50 million,
- have a registered office or carry out investments in the territory of the Silesia province,
- have been in business for at least 6 months.

The guarantee in this respect is granted up to 80 percent of the financing value, up to the amount of PLN 500,000 for the guarantee period of up to 5 years.

Table 12. Information on the number of guarantees granted and the current commitment of the fund's resources (as at 31 December 2017)

Specification		Accumulated from the beginning of the Fund's existence	
		volume	value (in PLN)
Current commitment of the Fund's capital due to granted guarantees		**8 086**	**60 836 694,40**
Information on guarantees granted	Guarantees for banks	1 704	217 505 703,21
	Guarantees granted to entities other than banks	2 339	202 605 050,76
	Total granted	4 043	420 110 783,97

Source: own elaboration on the basis of the financial statements of the Silesian Regional Guarantee Fund for year 2017.

As of 31 December 2017 Śląski Regionalny Fundusz Poręczeniowy Sp. z o.o. employed eight people, the Fund operates within the National Guarantee Group and the National Credit Guarantee and Surety Scheme for Small and Medium Enterprises.

Table 13. Balance sheet

in PLN	2016	2017
Fixed assets	75 922,31	110 033,58
Intangible assets	25 922,31	45 264,04
Tangible assets	0,00	14 769,54
Long-term receivables	0,00	0,00
Long-term investments	50 000,00	50 000,00
Long-term prepayments	0,00	0,00
Current assets	59 694 464,73	59 616 413,77
Inventory	103 937,98	99 419,71
Short-term receivables	3 602 883,45	3 515 679,19
Short-term investments, including:	55 984 022,49	55 986 655,38
Cash and equivalents	55 881 329,34	55 880 124,49
Short-term prepayments	3 620,81	14 659,49
Total assets	59 770 387,04	59 726 447,35

Source: own elaboration on the basis of the financial statements of the Silesian Regional Guarantee Fund for year 2017.

Due to the specific nature of the business conducted, the current assets are the dominant component of the assets, and among them cash constituting the capital securing the possibility of conducting activities in the field of guarantees and sureties. The current assets also include goods, taken over by way of recovery.

Table 14. Source of financing of the Silesian Regional Guarantee Fund

(in PLN)	2016	2017
Equity	9 331 907,01	9 521 424,61
Liabilities, incl.:	50 438 480,03	50 205 022,74
Provisions for liabilities	5 525 165,03	5 212 412,6
Long-term liabilities	20 846 697,59	20 883 726,97
Short-term liabilities	24 066 141,6	24 108 514,43
Accruals	475,81	368,74
TOTAL LIABILITIES AND EQUITY	59 770 387,04	59 726 447,35

Source: own elaboration on the basis of the financial statements of the Silesian Regional Guarantee Fund for year 2017.

The fund's equity consists of the share capital of PLN 6,510,000.00 and retained earnings from previous years of operations. As of 31 December 2017, the Fund had

long-term liabilities in the amount of PLN 20,883,726,97. This amount consists of PLN 19,981,696.58 of the subsidy to the project titled "Facilitating Access to Financing of Entrepreneurs' Activities in the Silesia Province through Co-funding by the Silesian Regional Guarantee Fund" No. UDA.-1 FS 01.01.01-00-011/09-00 under the Regional Operational Programme of the Silesia Province for 2007-2013 and the result obtained under this project.

The value of short-term liabilities is PLN 24,108,514.43. This amount includes a special fund of PLN 24,057,00.00 and liabilities to other entities of PLN 51,514.43.

Table 15. Profit and loss account of the Silesian Regional Guarantee Fund

in PLN	2016	2017
Net revenues from sales	269 893,96	225 467,49
Operating expenses; including:	1 325 260,23	1 505 309,41
Amortisation	28 443,69	22 847,27
Materials and energy	35 766,15	51 845,38
External services	279 118,76	292 520,22
Taxes and charges	81 239,05	76 637,18
Payroll	719 518,14	877 443,00
Social security and other benefits	115 015,43	137 752,43
Other costs	66 159,01	46 263,93
Profit (loss) on sales	-1 055 366,27	-1 279 841,92
Other operating revenues	725 273,93	984 805,43
Other operating revenues	678 221,16	655 290,38
Profit (loss) on operating activities	-1 008 313,50	-950 326,87
Financial revenues	1 195 835,78	1 145 624,26
Financial expenses	534,00	5 779,79
Net profit (loss)	186 988,28	189 517,60
Income tax	0,00	0,00
Net profit (loss)	**186 988,28**	**189 517,60**

Source: own elaboration on the basis of the financial statements of the Silesian Regional Guarantee Fund for year 2017.

The analysis of the financial result indicates net profits generated by the Fund at the level of less than PLN 200,000. Although, from the point of view of the effectiveness of the activities carried out, it is worrying that revenues from the core business (commissions on guarantees granted) are not able to cover the costs of core business. Apart from salaries, the incurred operating costs were significantly influenced by foreign services

related to legal services, accounting services, office space rental, telephones, internet, office maintenance. cost of developing an IT system. In this situation, the main source of cost coverage and the profit generated is financial income resulting from investing surplus cash (according to the balance sheet data over PLN 50 million). Of course, on the one hand, the fact that the financial resources are invested in a safe way in order to secure the income to cover the costs of the conducted activity, can be perceived as a positive signal confirming the stability of the Fund's operations. On the other hand, however, the fact that the Fund generates a dominant part of its revenues from passive investments of its resources constitutes a distortion of the assumptions of the Fund's operation, which should be the credit guarantee support for local enterprises. While maintaining impartiality in the assessment of the presented results, one cannot ignore the fact that such a structure of revenues is the result of increasing domestic competition from other funds or companies and banks conducting similar activity, and above all the implementation of the government's de minimis guarantee scheme. During the period of development of this scheme, all guarantees were granted at below market price using a simplified procedure for obtaining such guarantees in the form of "portfolio guarantees". The implementation of such a scheme results in the fact that credit guarantees granted by the Silesian Regional Guarantee Fund are not very competitive and, as a result, banks have given up on them completely or have only applied for a credit guarantee in relation limited to the value of the loan.

Chapter 6

Proposals for Innovative Changes in the Establishment and Functioning of Municipal Credit Institutions in Poland

6.1. Reasons for Choosing Municipal Credit Institutions

In the European Union, local government financial institutions have developed in two areas of financial activity: in the area of deposit and lending activities and in the area of lending and in the field of guarantees and sureties targeting SMEs. At the same time, it should be noted that the period of development of municipal credit institutions was followed by a period of stagnation and "winding-up" of the systems under which they operated, which was caused primarily by the Community and then the EU regulation on State aid, and more recently, additionally, by the global financial crisis of the early 21st century. The Sparkassen system was least affected, but this system, as mentioned earlier, has also been substantially transformed and adapted to the requirements of EU law. At the same time, it should be noted that the current systems of municipal credit institutions in the EU have a long tradition, generally (as in the case of Sparkassen or French municipal credit institutions) having existed for decades, dating back to pre-war times. And here is the fundamental difference between the European Union countries belonging to Western Europe and Poland. Namely, before World War II there was a system of municipal credit institutions in Poland – the Municipal Savings Banks operated dynamically. However, after the end of World War II when Poland fell into the sphere of influence of the Union of Soviet Socialist Republics, due to the forced change of the social and economic system from capitalist to socialist, the system of municipal savings banks was liquidated, as was the system of local government and private banking. Thus, while in Western European countries the systems of municipal credit institutions developed and

transformed throughout the post-war period, there were no such institutions at all in Poland. Interestingly, they also did not appear when Poland regained full independence in 1989, although in the early 1990s attempts were made to restore municipal savings banks. In 1992, the employees of the Faculty of Law and Administration of the University of Wrocław prepared an original law on municipal savings banks[186], and in the same year a relevant draft law on municipal savings banks was submitted to the Parliament of the Republic of Poland, which, however, did not become a binding law[187]. Instead of municipal savings banks, other types of local credit institutions developed in Poland after 1989: private co-operative banks and Credit and Savings Unions[188] (which are the Polish equivalent of world-famous credit unions). Whereas in the area of lending and the activities in the field of guarantees and sureties addressed to SMEs, local government credit guarantee funds and local government loan funds have been developing in Poland since the beginning of the 1990s, and a significant part of this study is devoted to this topic.

As already noted, the pre-war Polish system of municipal savings banks was liquidated for socio-political reasons, as it did not fit into the communist ideology. From the perspective of Western European financial systems, it is clear that the Polish financial system lacks municipal credit institutions, which could support the local community, mainly SMEs, on the basis of public funds. In fact, the creation of such municipal credit institutions, which are essentially local and operate on a small scale, corresponds to the European Union's banking policy. In Section 49 of CRD IV, the EU legislator explicitly stated that "in order to secure a sustainable and diverse Union banking culture which primarily serves the interest of the citizens of the Union, small-scale banking activities, such as those of credit unions and cooperative banks, should be encouraged".

6.2. Economic Assumptions for Establishing Municipal Credit Institutions

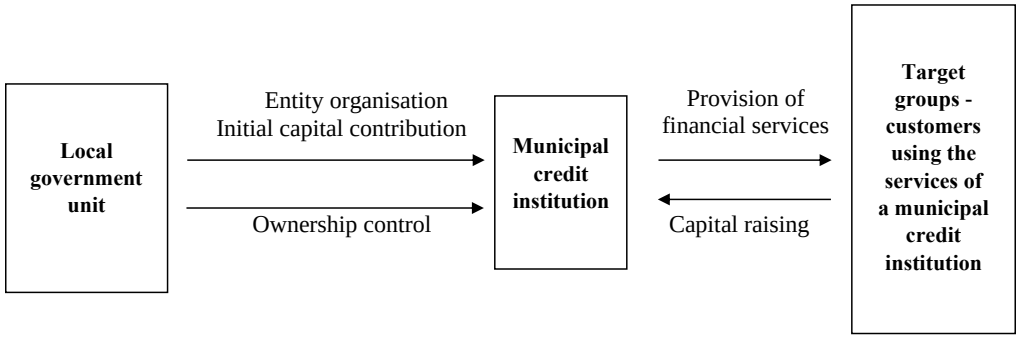
The involvement of local government units in the creation and development of municipal credit institutions requires outlining the economic principles for their functioning and the areas of their services. The working diagram in this respect is shown in Fig. 5.

[186] Original draft law on municipal savings banks of 1992 prepared by W. Miemiec and M. Mazurkiewicz from the Faculty of Law and Administration of the University of Wrocław, pub. Wspólnota [Community Magazine] 1992, No 19, p. 14 et seq.

[187] Parliamentary draft law on municipal savings banks of 24 January 1992, Parliament issue 73 of 1992.

[188] The Credit and Savings Union (SKOK) system in Poland is currently experiencing very significant financial problems, which put its future in doubt.

Fig. 5. Schematic diagram of functioning of municipal credit institutions



Source: own elaboration.

The general role of local government unit in the establishment and operation of municipal credit institutions should therefore be divided into two stages:

a) Creation and organisation, related to initiating the establishment of a municipal credit institution and participation in its creation, i.e. the selection of the form of conducted activity, contribution of initial capital constituting the first capital injection to the created entity, development and implementation of organisational rules for the functioning of municipal credit institution;
b) Current affairs, taking place when the entity has already been in operation. In this respect, the role of the local government unit should focus on exercising the function of ownership control over the effectiveness of functioning of the created entity. This control, similar to that of private corporate governance, is intended to regulate the relationships and ensure the necessary balance between the interests of all the parties involved in the operation of a municipal credit institution to promote its development.

It should be noted that from the point of view of the logic of creating new municipal financial institutions, a question arises as to the possible admissibility of the current provision of financial resources to an existing entity. Such an eventuality should be considered inadvisable not only from a legal but also from an economic point of view. The established municipal credit institution should have organisational autonomy but also financial independence. At least the economic sense of such an entity operating under market conditions exists when these criteria are met. Of course, this assumption automatically implies a question about the scope of sources of financing for the activities of a functioning financial institution. This issue will be developed in the next section.

The assumption of the separate nature of the created municipal credit institution needs to be developed in several respects. First of all, there is a question of choosing the right organisational and legal form. From the point of view of ensuring, or at least

significantly increasing the probability, that the created entity will have organisational independence, and will build its own financial and market position, it is advisable for the created financial institution to have a legal personality in the form of a joint stock company (S.A.) or a limited liability company (Sp. z o. o. Functioning in these organisational and legal forms additionally increases the potential scope of possibilities of obtaining financing in the capital market, which will be discussed in more detail in the next section.

6.3. Proposals for Changes in the Municipal Credit Institution Financing Model

The key factor determining the scope of activity and development prospects of financial institutions created by local government units is to secure their financing opportunities. As indicated in Chapter 5, the current forms of activity of LGUs in the financial market, i.e. local government loan and credit guarantee institutions, are based to a large extent on the EU funds they obtain in order to finance their activities. However, the dependence of activity on this source of financing raises dilemmas both in the current and long-term perspective. This is due, in particular, to the following factors:

a) The dominant role of EU funds in financing the tasks of local government financial institutions naturally limits the scale of their activity, as the scope of undertaken activities is limited to directions determined by areas of support from acquired funds;
b) There is a lot of competition for this source of financing, from the perspective of local government financial institutions, mainly from central institutions, and the BGK scheme is a clear example of this problem;
c) There are serious doubts about the sustainability of this source of funding over the next years, given the expected reduction in the scale of support under the next EU budgetary perspective.

This makes it necessary for the local government institutions, operating in the financial market in the form of loan or guarantee funds, to consider alternative sources of financing of their activities, not only to develop their activities but at least to maintain them on the same level.

When considering these issues in a systematic way, the following potential sources of funding for the existing local government financial institutions or newly established municipal credit institutions can be distinguished:

a) internal sources, based on the resources of the local government unit,

b) external sources from institutions and entities operating in the nearby or general environment of a local government unit.

A natural source of internal capital supply for local government institutions operating on the financial market may be the contribution of the parent local government unit. In accordance with the assumptions described in the previous section, this contribution should only be provided at the beginning, securing the financing of the entity in the initial phase of its operations. This formula is the typical capital financing assuming the establishment by a local government unit of a municipal company in which the shares (stocks) are taken up by the financing institution, contributing appropriate capital to enable the company to implement specific undertakings or projects. A local government unit may acquire shares by paying for them in accordance with a flexible schedule (one-off or step-by-step). In theory, municipal credit institutions could also be supported by increasing the value of their shares, by increasing their share capital, by subsidies provided for in the articles of association, by financial assistance in the form of repayment of their guaranteed liabilities to the banks. However, according to the considerations presented in the previous section, this form of capital injection should not be treated as a systematic and integral way of conducting a business. Allowing the possibility of a permanent, ongoing provision of funds of the parent local government unit to a municipal credit institution would certainly weaken the motivation to effectively manage the funds and seek external sources of capital for the entity. And at the same time it would be in conflict with the need to achieve the desired state, i.e. financial independence of an institution providing services in the financial market. Moreover, allowing the possibility of creating permanent and ongoing capital injections from a local government unit to a municipal credit institution raises doubts of a legal nature as to the admissibility of such contributions within the limits of public aid. Therefore, the internal sources of financing in the form of a contribution from the parent local government unit should rather be reduced to the function of a one-off injection as initial capital, on the basis of similarities to the creation of share capital in commercial companies.

The inclusion of an internal, initial capital injection has the undoubted advantage of the autonomy of such financing, making the establishment of a municipal credit institution independent of external financing at the outset. However, the general dilemma is the limited level of funds that can be raised in this way. After all, not every local government unit has such a stable financial situation that it can afford to engage resources in this form of activity, which may cause difficulties in popularising this model.

The assumption of a limited role of internal funding in the functioning of municipal credit institutions implies the need to develop a potential range of external sources of funding, securing the liquidity capacity and development of the entity. Given the

fact that one of potential organisational and legal forms appropriate for running municipal credit institutions is a joint stock company, a natural potential option is to obtain financing in the capital market by issuing shares. From the point of view of the likelihood of obtaining the expected capital, the public or private offer could be addressed to institutions rather than individual entities. The motives of an individual customer for buying shares in a municipal credit institution could face an obvious barrier of lack of economic incentives in the form of permanent benefits for the investor (dividends, waiting for a speculative increase in the institution's value, which is the main motive for investing in commercial listed companies). In this case, directing the issue of shares to institutional entities, including mainly companies located on the territory of the parent local government unit, could generate greater chances for obtaining the necessary capital. The intention of institutional entities' participation could be social reasons (corporate social responsibility) or also economic reasons, if the application of a policy of tax relief or preferences in local taxes and charges for entities contributing to the established financial institution is considered.

An alternative form of raising funds by a municipal credit institution in the capital market may be the use of debt instruments such as income bonds. According to the Bond Act of 15 January 2015, income bonds are securities which can be issued, among others, by local government units, unions of these units and municipal companies. In principle, almost every area of the local government's activity may be financed by issuing such bonds, however, in practice, these are mainly infrastructural projects which require more resources and a longer repayment period for the debt incurred. The financing period in this case is usually more than ten years, but may be shortened or extended depending on the type of project and the issuer's financial situation.

Increasing the probability of success in issuing income bonds as long-term debt instruments would require a municipal credit institution to secure the issue through a precisely defined and separated income stream or part of the company's assets. The liabilities arising from the issue of income bonds would be repaid from the revenue generated by the municipal credit institution. A marketing and advertising effect would also be a side benefit of the bond issue by a municipal credit institution. The mere participation in the capital market would increase the chance that a municipal credit institution would be perceived as a transparent entity, reaching for modern financing sources. Moreover, the disclosure of information about the issue and the issuer related to the requirements of the bond issue would make it possible to show the entity's financial management at different times of the year (disclosure obligations), forcing transparency and timeliness of information disclosure. This effect could be multiplied by the introduction of the issued

bonds for secondary trading in the Catalyst market, and this way has been already paved by the local government units in Poland.

A potentially interesting type of capital protection for the activities of a municipal credit institution may be used in a leaseback financing model. The leaseback implies debt financing based on the transfer of property rights for consideration and reciprocal transfer of property rights for the purpose of capital release without prejudice to existing rights of use. Local government units have been actively using this instrument for years by selling their own fixed asset to the lessor, and then (or simultaneously with the sale agreement) they enter into a lease agreement with this entity, under which they will continue to use the fixed asset. The leaseback structure is based on the leasing instalment constituting the price of the leased object (principal) and remuneration (profit) evenly distributed over time. The leaseback may also be used as an alternative source of obtaining loan capital for a local government unit, however, this approach, although perhaps attractive from the point of view of circumventing debt limits, is not welcomed by the Regional Chambers of Auditors. It is also objectionable due to the fact that in this way the entity's fixed assets are used to raise funds to cover current financial deficits. However, the use of assets as a basis for obtaining financing for a municipal credit institution for local development activating measures is economically justified.

Obviously, from the perspective of a municipal credit institution, the prerequisite for launching this source of funding is that it already has assets that can be subject to a leaseback transaction. However, taking into account the logic of the creation and initial capital injection by the parent local government unit, the asset contribution may be a way of contributing share capital to the established municipal credit institution (which may be an attractive alternative for local governments interested in creating this type of institution and not having free capital to invest). The use of assets held for a specific kind of refinancing by the municipal credit institution would enable it to release free funds to secure its current operations and to actively engage its resources in the services it offers in the financial market.

As part of building a stable potential of a municipal credit institution, a natural option may be to build transfers based on classic principles for commercial credit institutions, i.e. to raise funds from individual or institutional customers in the form of deposit-based products offered by a municipal credit institution. Clearly, the economic probability of raising capital for the active operations of a municipal credit institution in this way would require:

a) creating an offer to invest funds at parameters similar to or more attractive in comparison with the current market conditions,

b) building up the credibility of a municipal credit institution with regard to the security of the funds received and their solvency. Certainly, in this case, the participation and ownership supervision by the parent local government unit can be a natural factor in building confidence in a municipal credit institution's activities. However, the most important element of building such credibility is to include the municipal credit institutions, as well as other credit institutions, in the deposit guarantee scheme (in Poland these are the Bank Guarantee Fund guarantees).

Obtaining ongoing funding from local stakeholders (both individual and institutional) is ideationally a prerequisite for the long-term sustainability of operations of a municipal credit institution.

These alternative financing options for municipal credit institutions represent a diverse set of potential opportunities, indicating that activities do not necessarily depend on the degree of utilisation of European Union structural funds in this respect. Naturally, the range of possible sources of financing presented in this section is not exhaustive. Financial resources related to the implementation of the activities of a municipal credit institution can be obtained from various sources. In practice, the current activities of municipal credit institution will require the use of a variety of instruments in order to make their selection the most rational and to allow for activities justified by the economic and social objectives of the entity.

6.4. Characteristics of Potential Target Groups for Services Provided by Municipal Credit Institutions

The discussion on the economic legitimacy of the establishment and functioning of municipal credit institutions cannot be dissociated from the attempt to define the areas of assumed activity and the objectives to be achieved in this respect. Ideationally, municipal credit institutions are supposed to play a servant role towards local communities, which makes them "missionary" companies. On the other hand, however, they are players in the free market and must operate in a way that is closest to purely private companies. This also applies to the sphere of influence understood as target groups of customers and the scope of services provided to them. The answers to these questions should be consistent with the vision of setting up municipal credit institutions in the context of stimulating local economic development.

The key direction in this respect is to identify specific target groups to which the activities of municipal credit institutions should be directed in order to bring added value through the involvement of local government units in offering financial services to the

local community. Apart from the legal conditions, mainly related to the risk of entering the areas of prohibited public aid, in terms of direction, the following segmentation of potential target groups impacted by local government financial institution can be determined:

a) Local small and medium-sized enterprises. This area of activity is the most natural continuation of the experience of providing financial services through the activity of loan or credit guarantee funds described in the previous chapters. Small and medium-sized enterprises are a group of customers who demand financial services, mainly in the area of repayable financing. The formula of the local government institution's activity in terms of its impact on small and medium-sized enterprises could evolve from the current loan or credit guarantee funds into a wider range of venture capital services, or hybrid financing under the public-private partnership formula. Undoubtedly, also the mentioned area of influence would raise the least doubts from the point of view of the local government unit's activity in the financial market within the allowed limits of public aid.
b) Parent local government unit (in the institutional sense as providing services for the benefit of entities with specific organisational and legal forms, carrying out public tasks, i.e. budgetary units, budgetary establishments, municipal companies). On the one hand, from the economic point of view, establishing such a "refundable" relationship would be a completely natural area of activity of a local government financial institution. On the other hand, however, if this activity were to go beyond simple passive services (such as the maintenance of accounts, the provision of payment services) and start entering more active areas such as providing financing to these entities, it could be very controversial and significantly increase business risks. The creation of connections between LGU, local government financial institution and managers of local public entities could lead to the transfer of capital not based on purely market motives but under the influence of arbitrary, non-economic factors. This problem was described in the previous chapters on the basis of mainly German experience related with the functioning of Sparkasse.
c) Individual customers. The impact on this target group would be a complete novelty in terms of the activity of local government units in the area of direct or indirect provision of financial services in the country.
d) Non-Government Organisations (NGOs), i.e. associations, foundations, non-profit institutions in the field of handling current payments, disbursements, investments, or financing of social projects affecting a local government unit.

Of course, the presented segmentation of potential target groups does not exhaust the full range of possible groups of customers of local government financial institutions. On the other hand, certain types of stakeholders may be probably excluded from this group, e.g. large companies, multinational corporations, global institutions, mainly due to the supra-local dimension of their activities, as well as the low chance for securing by local government financial institutions the scale and scope of financing expected by these entities.

Naturally the scope and intensity of the impact on the mentioned target groups should strictly depend on the diagnosis of needs in a local area. After all, taking into account different economic conditions, the social demand in individual units for the creation and scale of services provided may be completely different. The need to supervise the activities of local government financial institutions remains a separate issue. The general, centralised prudential supervision of financial institutions should be borne in mind here, after all, by potentially offering deposit and credit services, municipal credit institutions will automatically enter the area of interest of the Polish Financial Supervision Authority. At the same time, one should not forget about the need for corporate governance understood as the verification of the economic effectiveness of the activities carried out within a local government financial institution by an entity creating it or having shares in it, i.e. a local government unit. After all, the creation of a municipal credit institution so it exists in the financial market, is not the objective in itself. In order for the activity of a municipal credit institution to be meaningful and economically justified, it is necessary for the parent local government units to exercise ownership control. The control understood as taking into account in its perspective both the wider social context of the activity of a municipal credit institution, but based on the verification of hard financial indicators on a commercial basis. After all, a municipal credit institution cannot be ideationally identified with an organisation in the non-profit sector. Naturally, in their case, profit should not be the main and only goal, but this does not mean that these entities are not to strive for continuous improvement of efficiency and maximisation of business results and, consequently, creation of value for the owners, i.e. in this case, the local government unit and the local community that forms it.

The entry of a local government unit into the areas of activity in the financial market raises a dilemma in terms of combining economic and social motives. The need to choose between the expected social objectives and maintaining the economic rationality of the functioning of a municipal credit institution in market conditions leads to the need to develop legal and organisational solutions, which would define a framework conducive to the creation of conditions combining the indicated objectives.

6.5. New System of Municipal Credit Institutions and State Aid

The reconstruction of the system of municipal credit institutions in Poland is hindered mainly by European Union law, which, as already noted in Chapter 4, upholds fair competition in a rigorous manner, significantly limiting the freedom to provide State aid. The systems existing in Western Europe have had the time and opportunity to gradually adapt to these regulations, while the establishment of a system of municipal credit institutions in Poland would in practice require notification to the European Commission under Article 108(3) of the TFEU and an assessment by the European Commission of whether the involvement of local government units in this system is compatible with the internal market under Article 107 of the TFEU. It seems that such a system would be most likely to be accepted by the Commission in particular if the scope of its activities was limited to supporting SMEs (although a final position on this issue can only be taken with regard to a specifically planned system, preferably at the stage of drafting the relevant law).

6.6. Establishment of Municipal Credit Institutions and Government System Constraints on Local Government

The effects of allowing a public entity to the sphere traditionally attributed to private entities, have consequences in the field of public law, in particular, the provisions concerning the tasks of local government units. Undoubtedly, a public entity, regardless of the way in which it chooses to carry out such activities, is not a natural participant in trading and its involvement implies concerns about possible losses inherent in the market game, or the abuse of the dominant entity's position and thus distortion of fair and free competition. Thus, undertaking business activity by a public entity causes not only legal but also economic and social effects. Nevertheless, while agreeing with the arguments that a public entity should refrain from business activity where this activity is performed by private entities, one should notice the danger resulting from a conventional limitation of the role of local government units to the role of a passive observer of the economic situation in the local market, without taking into account the changing conditions. However, the answer to the question of whether a business activity, including that in the financial service market, is included in the catalogue of tasks to be performed by a local government unit, may become a fundamental problem. In accordance with the doctrine and the case law, it should be assumed that not all own tasks of local government units can be considered as public service tasks. Going even further, it should be assumed that not every activity falls within the category of local government unit own tasks (which

was more widely discussed in the previous sections of this study). Despite attempts to enter the area of business activity, which can be justified by the broadly understood public interest, it is necessary to categorically exclude unrestricted business activity of local government units, which, however, does not exclude the evolution of the needs of the local government community and the consequent expansion of business activity. In conclusion, it cannot be considered that every manifestation of the activity of a local government unit should be treated as the fulfilment of the role of a public entity. An example of the existence of doubts as to the admissibility of the creation of broadly defined local government credit institutions as the performance of public service tasks is the Supreme Administrative Court's ruling of 16 May 2006, in which the court found that the company's activities, involving the granting of guarantees for loans and credits taken out by local government units, do not show the necessary elements for such activities to be considered as the performance of public service tasks. This type of activity cannot be considered as a form of implementation of tasks aimed at the current and continuous satisfaction of the collective needs of the community[189]. A local government unit, despite having a legal personality and being allowed to trade, remains primarily a public entity and this feature should determine its scope of activity. This includes engaging directly or indirectly in the establishment of local government credit institutions. Thus, as a rule, they are allowed under national and EU law to conduct business activity, but it must be connected with the pursuit of the public interest (public service tasks) as well as without prejudice to other overriding values, such as freedom of competition. Therefore, it would be possible to establish a local government credit institution, in accordance with the regulation on the local government system, only after it has been recognised (which would be done by the supervisory authority overseeing local government units) that the implementation of objectives pursued by a local government credit institution falls within the category of public service tasks.

6.7. Need for Detailed Regulation of Municipal Credit Institutions

As it was already mentioned in the first chapter, Polish law allows for the creation of a bank by local government units on general principles, but this possibility is not used in practice by Polish local government units. It seems that this is a consequence of, among other things, excessive generality of regulations, and this generality in the case of a public entity such as a LGU is a disadvantage, not an advantage. Pursuant to Article 7 of the Constitution of the Republic of Poland, public authorities act on the basis and within the

[189] Wyrok Naczelnego Sądu Administracyjnego z 16 maja 2006 r. [Judgement of the Supreme Administrative Court of 16 May 2006], II OSK 288/06, LEX 195704.

limits of the law. There should also be no doubt that the involvement of local government units in municipal credit institutions does not fall within the public service sphere. Hence, the system provisions analysed in this monograph and the provisions of the Law on Municipal Economy concerning the conduct of business activities by LGUs cannot be applied to the establishment and joining of municipal credit institutions by LGUs. Therefore, the establishment and operation of municipal credit institutions should be separately, transparently and in detail regulated in a legal act equivalent to act of parliament and in executive regulations issued on the basis of the act by the minister competent for financial institutions.

6.8. Basing the System of Municipal Credit Institutions on Existing Local Government Loan Funds and Local Government Credit Guarantee Funds

In practice, the creation of a system of municipal credit institutions from scratch, if only for organisational reasons and due to capital requirements, has little chance of being implemented (although it depends to a large extent on the financial capabilities of individual LGUs and the possibility of establishing a municipal credit institution "from scratch" cannot be excluded). On the other hand, these chances will increase if the system of municipal deposit institutions is built in Poland on the basis of the already existing local government loan and credit guarantee funds. This would make all the more sense given that these funds support SMEs and have been adapted over the years to EU requirements on State aid to entrepreneurs. Two paths can be envisaged for the creation of municipal credit institutions based on these funds. Firstly, due to the fact that the funds function as limited liability companies or joint stock companies, it is possible to create a statutory possibility of transforming them into municipal credit institutions (which would also have the organisational form of capital companies), and secondly, the assets of the funds and, above all, their enterprise may be contributed to a municipal credit institution (in such a case, the organisational and legal form of a cooperative may also be considered for such an institution).

6.9. Safeguards against the Use of the Planned Municipal Credit Institution System by Politicians for Particularistic Purposes

However, there is another problem inherent in the functioning of public enterprises, namely the tendency to use public enterprises for the particularistic interests of politicians who control them. This is an important problem, already signalled in this monograph, which casts a shadow on the basic benefit of a public enterprise operating in

the financial market that is a real possibility of its non-profit operation[190]. It is therefore necessary to propose an innovative solution for the management of municipal credit institutions that preserves the public and local nature of these institutions while at the same time ensuring that pathologies resulting from the control of these institutions by politicians are reduced.

The authors suggest that some of the members of the supervisory board of a municipal credit institution in the form of a joint stock company or a limited liability company should be named by the entrepreneurs (SMEs) which are its customers. The election of such a representative or representatives of customers to the supervisory board would have to be carried out in a democratic manner, in a secret and universal ballot. The authors propose that the election method should be left to the entrepreneurs to consider, giving them several alternative solutions, e.g. either traditional or blockchain technology (more broadly – distributed ledger technology – DLT). One of the widely recognised applications of this technology is to enable democratic elections. The blockchain technology is so universal that it can be used not only in global systems, but also in organic systems for a specific group of people, and thus – on a given territory. The amendment of the existing legal provisions in not necessary for this, the corresponding provisions in the articles of association will suffice. It is also possible to consider an option in which a municipal credit institution takes the organisational and legal form of a cooperative of legal persons (including, above all, local government units) and natural persons, provided that it renders services exclusively to its members. With such a solution, entrepreneurs would at the same time be members of a cooperative with all the resulting rights, including the possibility to participate in the general meeting (directly or through their representatives, depending on the size of the cooperative) and thus have a real impact on the authorities of the cooperative and its functioning.

6.10. Scope of Activities of the Proposed Municipal Credit Institutions

If the scope of activity of potential Polish municipal credit institutions is limited to SMEs, then, as already indicated, it should in principle be presumed that the scheme set up by such institutions is compatible with the State aid rules of the TFEU (although a final position on this issue can only be taken with regard to a fully-planned, detailed scheme). Thus, the only customers for the deposit and lending services of the planned Polish

[190] By the way, it is worth noting that private Credit and Savings Unions have, to a large extent, actually carried out and are carrying out gainful activity, although one of the ideas of the credit union movement is non-profit activity.

municipal credit institutions should be entrepreneurs meeting the European Union requirements for SMEs. On the other hand, in order to ensure that such an institution is local and has adequate financial stability, its customers should have their registered office in a limited area, depending on which local government units have made capital contributions to a given municipal credit institution. It seems that it should be at most the area of a province, and at least the area of a large commune, e.g. from 200,000 inhabitants[191]. The institutions covering a smaller area would be too weak both in terms of capital and in terms of the number of customers (especially since they are entrepreneurs, SMEs), while institutions operating throughout the country would lose their local nature. The area of operation of a municipal credit institution depends on which LGU is the shareholder of this institution, a commune or province. The authors propose the general principle that a municipal credit institution could operate in the territory of its shareholder/stockholder communes. If a province is the shareholder (stockholder) of a municipal credit institution, then such an institution should be able to operate in the whole area of the province. Such territorial restrictions would not restrict competition in business activities, as they would only apply to municipal credit institutions, i.e. public entities controlled by LGUs and would not apply to other credit institutions (banks in the form of a joint stock company, cooperative banks or Credit and Savings Unions). Moreover, by a certain analogy with the Sparkassen system, it should be stipulated that only one municipal credit institution may operate on the territory of one commune, i.e. the one in which the commune holds shares/stocks.

It is known that the basic prudential standard for a depository and credit institution is a limited catalogue of its banking services. In general, the weaker the capital position of an institution and the more the legislator wants to reduce the risk to which the funds entrusted to it are exposed, the narrower the range of banking and other financial services that a credit institution can perform. In the case of municipal credit institutions, in addition to the subjective limitation (only SMEs would be the customers of these institutions) and territorial restriction (SMEs based in the area where the institution operates), it should be proposed to introduce an objective restriction, i.e. a rather narrow catalogue of banking and possibly other financial services. The authors propose that the municipal credit institutions are able to maintain bank accounts for SMEs based in their area of activity, to grant them credits and loans and to provide them with guarantees and sureties. In addition, the authors suggest that the municipal credit institutions should be able to provide the payment services provided for in Annex I to the PSD 2[192] (and provided for

[191] A certain analogy can be found here in the legal regulation concerning the territorial scope of activity of Polish associated cooperative banks.

[192] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, OJ L 337, 23.12.2015, p. 35–127.

in Article 3(1) of the Payment Services Act[193]). It should also be postulated that municipal credit institutions are able to organise the issue of municipal bonds for LGUs. At the same time, the ability of municipal credit institutions to serve local government units which are their shareholders/stockholders (including organisational units of such LGUs, i.e. budgetary units or budgetary establishments) as well as municipal companies established by such LGUs should be treated very carefully. On the one hand, maintaining bank accounts for LGUs (and municipal companies) by a municipal credit institution which is its shareholder/stockholder constitutes a distortion of free competition in the local market (such services are currently offered by commercial banks; banks in the form of a joint stock company and cooperative banks), and on the other hand, there is a danger of abuse by LGUs of their ownership position in relation to the municipal credit institution providing them with loan/credit. Therefore, it should be demanded that the municipal credit institution is included in the content of Article 264 of the Polish Public Finance Act[194].

It appears that the non-profit nature of municipal credit institutions should be explicitly ensured by law, including an explicit statutory definition of what is meant by non-profit-making activities by the legislator. The experience with the functioning of Credit and Savings Unions in Poland clearly shows that it is not enough to make a reservation on the non-profit activities in the law[195]. It is necessary to specify that municipal credit institutions must not act to maximise profits. Their primary objective is not to make a profit, but to support SMEs. It could be considered, as in the case of the German Sparkassen regulations, to incorporate the purpose of municipal credit institutions into the law, e.g. increasing access to capital, or making a lasting commitment to the development of local small and medium-sized enterprises by providing them with high-quality financial services.

[193] Ustawa z dnia 19 sierpnia 2011 r. o usługach płatniczych (Dz. U. z 2019 r., poz. 659 ze zm.) [Law of 19 August 2011 on Payment Services, Journal of Laws of 2019, item 659 as amended].

[194] Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych (Dz. U. z 2019 r., poz. 869 ze zm.) [Law of 27 August 2009 on Public Finance, Journal of Laws of 2019, item 869 as amended]. Pursuant to Article 264(1) and (2) of this Act, the banking service for the budget of a local government unit shall be provided by a bank selected on the principles set out in the regulations on public procurement, and rules for providing banking services are set out in the agreement concluded between the management board of the local government unit and the bank. In turn, pursuant to Article 264(3) and (4), the management board of a local government unit may, within the limits of the authorisations contained in the budget resolution, take out loans in banks of its choice, in accordance with the procedure set out in the regulations on public procurement. However, in order to hedge a credit or loan, no power of attorney may be granted to dispose of a bank account of a local government unit.

[195] The Act on the Credit and Savings Unions of 1995 (which was amended by the Act on the Credit and Savings Unions of 2009) contained a provision stating that the unions carry out a non-profit activity, however, without defining this concept. The unions did not treat this provision as a ban on profit maximisation activities, but interpreted it as an order to allocate the profit generated to the current fund, which was one of the union's own funds. The current law on the Credit and Savings Unions of 2009 no longer contains a similar provision, which is interpreted as the legislator's consent to the gainful activity of the Credit and Savings Unions.

In Poland there is no tradition (especially recently) of systemic support for the development of civil society by the state, an important element of which are Non-Government Organisations (NGO), such as associations, foundations, non-profit institutions. Such support, often due to the local nature of such organisations, is provided by local government units. Therefore, it seems natural to extend the catalogue of customers of municipal credit institutions to include Non-Government Organisations. Nevertheless, due to restrictions in the area of State aid, it would be recommended to limit the NGO group to institutions operating in such areas that their service by a municipal credit institution can be considered as one of the aid categories listed in Article 1(1)(a) of Council Regulation 2015/1588. This means, for example, the aid in favour of: research, development and innovation (ii), environmental protection (iii), employment and training (iv), culture and heritage conservation (v), sports (xi).

6.11. Consequences of Recognising a Municipal Credit Institution as a Credit Institution under EU Law

If a municipal credit institution is to carry out depository and credit activities, it will meet the definition of a credit institution specified in Article 4(1)(1) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012[196] (hereinafter CRR). This means that all these European Union regulations that apply to credit institutions, notably the CRD IV, BRRD, DGSD and CRR, will have to apply to it. The municipal institutions will have to be covered by the Polish deposit guarantee scheme, which is organised by the Bank Guarantee Fund. Consequently, since banking supervision and integrated financial supervision is performed in Poland by the Polish Financial Supervision Authority (KNF), this authority should exercise state supervision over municipal credit institutions. Moreover, it should be the responsibility of KNF to issue an administrative decision with permission to establish a municipal credit institution. It seems that there is no need to construct a separate type of state supervision for municipal credit institutions (as is the case with Polish Credit and Savings Unions) and it is sufficient to apply to municipal credit institutions the legal regulations on banking supervision contained in the Banking Law (possibly with modifications resulting from the specific nature of the activity of municipal credit institutions). The municipal credit institutions will have to bear the cost of participating in a deposit guarantee scheme which means that they are obliged to pay the relevant participation fee.

[196] OJ L 176, 27 June 2013, p. 1–337.

They will also have to bear the cost of supervision carried out by KNF and pay an appropriate fee.

The minimum initial capital of a credit institution under Article 12(1) of CRD IV shall be at least EUR 5 million and at least such initial capital, converted into Polish zloty, shall be held by municipal credit institutions[197]. Subsequently, throughout their term, municipal credit institutions, like Polish banks in the form of a joint stock company, will have to comply with the strict conditions of internal financial management provided for in the CRD IV and CRR, including, inter alia, the requirement to hold own funds within the meaning of Article 4(1)(118) of the CRR (that is the sum of Tier 1 capital and Tier 2 capital) adjusted to the size of their business. A high initial capital, followed by high own funds, and the scope of activities with subjective, objective and territorial restrictions should ensure adequate financial security for the activities of municipal credit institutions, including compliance with the relevant liquidity standards set out in the CRR.

Unlike the systems of the Credit and Savings Unions and cooperative banks, it does not seem appropriate to create a central entity in the system of municipal credit institutions for the whole system to support individual municipal credit institutions (an entity similar to Landesbank in the Sparkassen system). Practice shows that such entities have bigger financial problems than their subordinate institutions in the system (an example is the poor financial standing of some Landesbanken). This phenomenon is particularly visible in the Polish financial market, where the National Association of Credit and Savings Unions (associating all the Credit and Savings Unions (SKOK) is largely responsible for the financial crisis in the SKOK system, also Polish banks associating cooperative banks are not in the best financial condition. Above all, however, municipal credit institutions with the initial capital of more than EUR 5 million (expressed in Polish zloty) will be capital-strong enough to meet the liquidity standards provided for in the CRR, with a narrow scope of activities (narrower than that of cooperative banks and some Credit and Savings Unions) that they will not need a central entity providing support.

[197] It seems inappropriate to make use of the Directive's exception, provided for in Article 12(4) of CRD IV, and limit the initial capital to EUR 1 million (expressed in Polish zloty). From the very beginning of the system, the aim should be to make municipal credit institutions financially strong.

Conclusions

Local government financial institutions should be classified as local financial institutions. The currently operating local credit guarantee and loan funds are not in competition with other Polish local financial institutions, such as Credit and Savings Unions and cooperative banks. On the other hand, the municipal credit institutions proposed in this monograph would become such a competition for cooperative banks in terms of banking services for local government units, since the budget accounts for most small communes are maintained by cooperative banks. Moreover, municipal credit institutions would undoubtedly become a competition for cooperative banks and Credit and Savings Unions serving small and medium-sized enterprises operating in the local market. Such increased competitiveness is beneficial for local government units and entrepreneurs and would force greater efficiency of cooperative banks and Credit and Savings Unions (especially cooperative banks in fact monopolised banking services for small communes).

Local government financial institutions are instruments of direct participation of local government units in the area of business activity. And as such, they are a manifestation of the implementation of the model of classic public intervention, and at the same time they are a manifestation of an alternative subjective activity of local government in the financial market. This is also an example of the fact that market mechanisms do not spontaneously create lasting forms in which the individual interest would be compatible with the collective interest. This requires activity on the part of the local government, which, however, cannot operate without a legal basis; the laws which in turn are created by the national legislator. There is no doubt that the activities of local government financial institutions go, by their very nature (provision of financial services), beyond the sphere of public service within the meaning of Polish law. This also applies to institutions providing financial services such as the provision of credit guarantees or loans, not least because there are private providers of such services in the financial market. And yet, in practice, there are local government credit guarantee funds and local government loan funds. This is justified by the fact that their offer is addressed exclusively to small and medium-sized

entrepreneurs and thanks to these resources the province (regional-level local government unit) performs its own tasks, that is conducts the province development policy, which consists, inter alia, in creating conditions for economic development, including the creation of the labour market (Article 12(2) of the Act on Province Self-government), and the commune satisfies the collective needs of the community (in the sample catalogue of commune's own tasks under Article 7(1) of the Act on Commune Self-government there is no commune's own task matching the operation of the credit guarantee funds, but as previously indicated it is not an exhaustive catalogue). Such an interpretation of the system provisions may raise doubts and it should be postulated that provinces, and above all communes, should be explicitly empowered to establish and participate in loan and credit guarantee funds, so that the possibility of establishing and operating them, within the framework of own tasks of these local government units, remains beyond doubt. Moreover, it does not seem possible to apply similar legal interpretations to justify the establishment of (and participation in) municipal credit institutions by provinces and communes. Thus, a separate, detailed legal regulation is needed, which will clearly empower communes and provinces to establish and participate in municipal credit institutions. The provision of Article 10(3) of the Municipal Economy Law is not sufficient here, as it is too general. Its unusefulness has been demonstrated by past practice. It has been in force for 22 years and it was virtually not used. At most, it served to maintain a specific status quo, consisting in the fact that few communes held (and still hold) shares in cooperative banks. It also seems unreasonable to postulate legislative changes to make it easier for the communes to set up banks and insurance companies on general principles, above all because of a questionable economic rationality of such activity by the communes. There is also a question of justifying a wide range of banking services that can be provided by a bank established on general principles (or insurance services provided by an insurance company) from the perspective of the tasks of communes. Above all, however, the main obstacle to the establishment of banks and insurance companies by commune under Article 10(3) of the Law on Municipal Economy are the Treaty provisions on competition rules, including mainly those concerning aid granted by the State.

Due to the statutory prohibition to go beyond the sphere of public service, it seems justified to omit the county from the catalogue of local government units that may establish and join communal credit institutions. This is all the more justified because, as we know, counties have a much worse financial situation than communes and provinces, which is primarily a consequence of the fact that counties have a very limited catalogue of budget revenues compared to communes and provinces.

When designing Polish system of municipal credit institutions, one can use the experience of Western European countries, especially Germany, where the system of

such institutions, the Sparkassen system, is the most developed of all the EU countries. In particular, it is worth incorporating in Poland those features of the Sparkassen system that determine its stability and resistance to change, bearing in mind, however, that the system has evolved in Germany for decades and has had time to adapt to the requirements of European Union law on State aid (and the fact that German authorities have been unfolding a kind of political umbrella over the Sparkassen system for years, is a public secret). Thus, it should be postulated that Polish municipal credit institutions, like the German Sparkassen, have the following features:

- the territorial limitation of the scope of activity (to the administrative boundaries of the selected local government unit), a feature which is, moreover, characteristic of local financial institutions in general and local credit institutions in particular;
- providing for exclusivity of operation of a given municipal credit institution within the administrative boundaries of a specific local government unit, i.e. introducing a rule that only one municipal credit institution may operate within such boundaries (this rule is to ensure that amounts once invested in the region will be reinvested there);
- clearly defined objectives of the activity that is not of a commercial nature but of a public nature (serving the public interest), these are objectives such as: promoting the idea of saving, increasing access to capital, permanent involvement in the development of local small and medium-sized enterprises, by providing them with high quality financial services, and ensuring development of LGU participating in a given municipal credit institution by supporting the performance of its own tasks. This does not mean, however, that no profit should be made from the business, but it should not be a priority objective;
- requisite to be committed to the development of volunteering (which will strengthen the development of civil society, the level of which in Poland is still much lower than in Western Europe);
- prohibition of conducting speculative operations by municipal credit institutions on their own account. The purpose of municipal credit institutions is not to make a profit in itself, but to fulfil various tasks, and their large proportion are public service tasks (the introduction of such a prohibition may be difficult as there are currently no regulations in Poland providing for such restrictions), however, municipal credit institutions are to conduct for-profit activities.

Unfortunately, due to EU requirements concerning State aid for entrepreneurs, it does not seem possible to incorporate a wide range of Sparkasse subjective activities in Poland. It should be remembered that Sparkassen currently operate practically on the

basis of their own financial resources, which are not legally owned by German local government units. The creation from scratch of a system of municipal credit institutions in Poland automatically assumes the need to recapitalise such a system from funds owned by Polish local government units. However, the contribution of a local government unit to a municipal credit institution should only be of an initial nature, securing the financing of the entity in its initial phase of operation. In order to avoid the allegation that these entities are thus granting inadmissible State aid (State aid in the nomenclature of TFEU), the subjective scope of the activities of municipal credit institutions should be limited exclusively to SMEs and, possibly, to local government units themselves. However, the experience of Polish pre-war municipal savings banks, as well as Sparkassen, shows that granting a credit by a municipal credit institution, in particular, to a local government unit that controls such an institution carries a significant risk, resulting from possible pressure from the unit to be granted a credit in a situation where such credit, objectively, should not be granted.

In general, it should be concluded that the European Union requirements concerning State aid for entrepreneurs limit the possibility for local government units to implement such objectives as organising sources of capital and ways to provide financial resources to economic entities, or participation in stimulating demand, by means of financial institutions, in particular, municipal credit institutions. On the other hand, the EU State aid regulations clearly have no impact on the use of local government financial institutions to build civil society. Evidently, in the countries of the old European Union, the long-term development of municipal credit institutions and mutual guarantee institutions has gone hand in hand with the development of civil society. Perhaps still insufficient development of civil society in Poland is to some extent a consequence of the lack of municipal credit institutions and mutual guarantee institutions in Poland.

One of characteristic features of the Sparkassen system is that, in addition to Sparkassen, it consists of large regional banks, Landesbanken, and other financial institutions providing a whole range of financial services. This system was shaped gradually, in a natural way and it seems neither purposeful nor even possible to transfer this model to Polish conditions. It should be also noted that each Sparkasse is a fully independent entity and that the regional Landesbanken do not have control or supervisory functions over individual Sparkassen. In the case of Polish Credit and Savings Unions and cooperative banks, the scheme of creating an associating institution and the obligation for the entities to be associated in it (for Credit and Savings Unions it is the National Association of Credit and Savings Unions, and for cooperative banks – the associating banks), did not work. Therefore, each municipal credit institution should be fully independent and supervised only by the Polish Financial Supervisory Authority. At the same time, from the very

beginning, the capital and liquidity of municipal credit institutions should reach such a level that it is not necessary to create an institutional protection system. It also does not seem advisable to create any special rescue or stabilisation funds. They mainly make sense when they are embedded in the structures of such an institutional protection system (as is the case with the institutional protection system under the Sparkassen system).

In the countries of the so-called Old European Union (France, Germany, Italy, Spain or Portugal), the most popular credit guarantee institutions are mutual guarantee institutions, with domination of private guarantee institutions, which are supported by the State, most often in such a way that the highest-ranking institution in the mutual guarantee institution system is financially controlled by the State and/or a state entity or local government provides re-guarantees. These schemes involve little participation by local government units. Usually their role consists in providing re-guarantees (as in the Italian Confidi scheme) or, as in the case of the Spanish 18 mutual guarantee institutions (Sociedades de Garantía Recíproca (GSC)), in holding shares in these institutions, which, although mainly private, are partially controlled by the regions, i.e. Spanish medium-level local government units.

The well-developed Polish system of local government credit guarantee and loan funds is quite unique in comparison with the credit guarantee systems of the "old" European Union countries. It is distinguished by its self-government nature, as the whole system is based on commercial companies, which are 100 percent controlled by local government units. First of all, it is not a system based on mutual guarantees, which means that entrepreneurs participate in it only as customers to which the guarantees are granted. The reasons for this state of affairs should be seen not only in the capital weakness of Polish entrepreneurs, but mainly in the weakness of Polish business associations (chambers of commerce, industry and skilled crafts). In the countries of the "old" European Union there was no break in the development of market economy based on private property, while in Poland, between 1945 and 1989, the socialist system prevailed, which by definition was against private entrepreneurs. Thus, in the countries of the "old" European Union, various types of associations of small and medium-sized entrepreneurs have developed and strengthened without any obstacles, and they are the foundation of successful mutual guarantee institutions. Polish small and medium-sized entrepreneurs are still learning to cooperate and perhaps only now, the ground for Polish mutual guarantee institutions is slowly being created. It seems that it would be a completely natural process if the currently functioning local government credit guarantee and loan funds were transformed into municipal credit institutions and replaced by Polish mutual guarantee institutions.

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List of figures

List of tables

The monograph analyses the existing legal regulations regarding local credit institutions and credit guarantee funds in selected European Union countries, as well as the existing legal regulations in Poland regarding the creation of local government financial institutions by local government units. The economic conditions of functioning of guarantee funds in Poland were also taken into account. Then, the findings were used to prepare a proposal for a general outline of the legal regulation of municipal credit institutions in Poland.

The main purpose of the monograph is not so much to give the best recommendation for Polish municipal credit institutions, but rather to provide material for further, intensified discussion on such institutions, or even more broadly – the role, significance and legal regulation of local government financial institutions.

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