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Special Institutions

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According to section 1 para 1 of the German Banking Act (*Kreditwesengesetz*, KWG), credit institutions are enterprises that conduct banking business commercially or to the extent that it requires a commercially organised business establishment.

However, it is noteworthy that some institutions are special in the German banking system and in the following a description of their business, governance, legal restrictions, and deposit protection will be given.

As outlined in chapter 1, the German banking sector is characterised by a strict separation between three types of banks: public law banks (*öffentlich-rechtliche Kreditinstitute*), cooperative banks (*Genossenschaftsbanken*), and the privately organised banks. Within this system, special institutions evolved, often due to a special financial need. Savings banks (*Sparkassen*), for example, were initially established to meet the financial needs of the working class to enable them to do some savings. Cooperative banks have their origin in the need of certain professional groups to help each other with financial undertakings. In addition to these two special institutions building societies (*Bausparkassen*), promotional banks (*Förderbanken*) and covered bonds banks (*Pfandbriefbanken*) will be outlined below.

There will be a special emphasis on *Pfandbriefbanks*, since they are a successful German “financial innovation” and have recently been copied by a number of other countries.

2.1 Savings banks (*Sparkassen*)

The savings banks belong to the public law credit institutions. The legal basis for the foundation and the operation of a savings banks are (i) the relevant Savings Banks Act (*Sparkassengesetz*) of the respective German federal state in which it has its registered office, and (ii) its articles of association. Although every state has its own Savings Banks Act, these acts are largely comparable.

Savings banks are credit institutions pursuant section 1 of the Banking Act and they are, therefore, subject to the applicable German banking laws such as the Banking Act and the Securities Trading Act (*Wertpapierhandelsgesetz*, WpHG).

As public law institutions (*Anstalten*), savings banks have to fulfil specific public duties assigned to them by law. The main objective of the savings banks is the fundamental social

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care (*Daseinsvorsorge*) being anchored in all of the Savings Banks Acts. Hence the savings banks are obliged to supply the population, the economy within their regions and their responsible bodies with sufficient money and credit facilities. Furthermore, the savings banks support the local authorities to perform their tasks in the political, economical, cultural, and social sector.

The savings banks are a part of the so-called Savings Banks Finance Group (*Sparkassen-Finanzgruppe*), which also comprises state banks (*Landesbanken*), public law building societies (*Landesbausparkassen*), public law insurance companies and other financial services providers. The Savings Banks Finance Group is organised in an umbrella organisation, the German Savings Bank Association (*Deutscher Sparkassen- und Giroverband*). It represents the interests of the Savings Banks Finance Group on banking policy, regulatory law, and other banking industry issues on a national and international level. It also organises decision-making and stipulates the strategic direction of the group.¹

2.1.1 Usage of term *Sparkasse*

The designation *Sparkasse* is statutorily protected. According to section 40 of the Banking Act, the term *Sparkasse* (savings bank), or a term in which the word *Sparkasse* appears, can only be used in a firm's name or as an addition thereto by a public law savings bank. However, the act also permits some other enterprises which, when the Banking Act came into force, were legitimately using the designation *Sparkasse* in their name, to continue to use this expression – the so called free (private law) savings banks (*freie Sparkassen*). Furthermore, any new bank established through acquisition of such a *Sparkasse* may use the term *Sparkasse* as long as its articles of association contain the specific restrictions as set out under section 40 of the Banking Act (in particular, it needs to target the common good and is restricted to activities in the economic region in which it has its seat).

There have been some arguments on whether section 40 of the Banking Act is fully in line with European law, as its wording prevents in particular foreign savings banks that are organised under private law in their home country from establishing themselves as *Sparkassen* in Germany, as this section states that the designation *Sparkasse* may only be used by public law banks and not in case of a privatisation. In June 2006, the European Commission sent a reasoned opinion to Germany in which it considered section 40 of the Banking Act to be in violation of the EC-Treaty rules on the freedom of establishment (article 43) and free movement of capital (article 56) because it prevents private investors from benefiting from the goodwill value of the said designation.

The context of the Commission's request was the sale of Berliner *Sparkasse*. On 18 February 2004, the Commission had adopted a decision authorising the German authorities to give restructuring aid to the banking group Bankgesellschaft Berlin AG (*Bankgesellschaft*), which included the Berliner *Sparkasse*, with the condition that the state of Berlin sells its majority stake in this group. According to this decision, Bankgesellschaft had to be sold through "an open, transparent, and non-discriminatory tendering procedure". This

¹ http://www.dsgv.de/en/dsgv_portraet/aufgaben_und_ziele/index.html.

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meant that the sale had to be open to both public and private bidders under equal conditions. Consequently, both private and public investors had to be able to acquire a bank using the name Berliner *Sparkasse*, which was Bankgesellschaft's main retail brand. In order to comply with the Commission's decision in the proceedings mentioned above, the German state of Berlin had enacted a Savings Banks Act (Berliner Sparkassengesetz of 28 June 2005) which permitted private investors to acquire Bankgesellschaft and to continue using the designation *Sparkasse* under certain conditions. However, the sale of Bankgesellschaft in accordance with this law could not be carried out by the state of Berlin because of the conflicting provision of the federal Banking Act's section 40 (Banking: Commission calls on Germany to modify its rules on use of the name *Sparkasse*).²

In December 2006, the European Commission and the German authorities reached an agreement. The solution confirmed the principle of neutrality of European law with regard to the decision to privatise a public enterprise, but also recognised that in the application of national law, European law has to be respected. Germany committed itself to apply section 40 of the Banking Act in a manner that does not infringe the provisions of the EC-Treaty on the principles mentioned above (Agreement on *Sparkasse*).³ The agreement did, however, not entail a change of law.

2.1.2 Business activities

With respect to their business activities, the savings banks usually offer the full range of universal banking business.

Traditionally, savings banks are only permitted to conduct transactions that are explicitly mentioned in a statutory provision (i. e., their establishment act) or in their articles of association. However, since the 1990ies amendments to Savings Banks Acts clarify the scope of permitted activities by allowing the savings banks to conduct all kinds of transactions customary in banking.

Their business activities are, however, influenced by the public duties as described above, the so-called regional principle and restrictions in the Savings Banks Acts.

Due to their public duties, the savings banks are restricted in their pursuit of profit. Their intention to realise profit must aim at the creation of equity reserves. Any accumulated profits not accrued as reserve are either distributed to their supervising public law owners which in turn use the money for their own public budgets, or are provided directly to charitable projects. However, savings banks are obliged to conduct their business operations in line with commercial and economic principles.

² <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/870&format=HTML&aged=1&language=EN&guiLanguage=en>.

³ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1692&format=HTML&aged=0&language=EN&guiLanguage=en>.

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The so-called regional principle (*Regionalprinzip*) means that the geographic business area of a relevant savings bank is exclusively confined to the area of administration assigned to it by its supervising public law owner, effectively preventing the savings banks from competing with each other.

Further restrictions can result from the respective Savings Banks Acts. Typical limitations for business activities are: upper limits for lending activities, limits for the acquisition of participations (*Beteiligungserwerb*) and limits for the acquisition of shares. Some Savings Banks Acts contain restrictions for certain risk carrying businesses. If a savings bank acts beyond those limitations, the respective actions are assumed to be null and void according to the doctrine of *ultra vires*. The doctrine of *ultra vires* was confirmed with respect to public law institutions by a decision of the German Supreme Court for civil law matters (*Bundesgerichtshof*, BGH) in the year 1956. The German Supreme Court for civil law matters argued that the legal capacity of a public law institution to enter into contracts is limited by its purpose, as stipulated by its articles. Any legal action, which is not covered by its purpose, is not only illegal, but null and void.

The management of the savings bank is executed through a board of managing directors (*Vorstand*). An administrative board (*Verwaltungsrat*) determines the broad guidelines for the business activities, controls the business dealings, and has to approve certain types of activities. This separation of management and supervision mirrors the organisation of corporations organised under private law.

However, the savings banks are (usually) a legal entity established under public law, a public law institution (*Anstalt*). It is its public law owner (i. e., a local authority) that determines the basic structure of the savings bank's organisation. Hence it is this local authority that appoints the members of the relevant administrative board. The administrative board in turn elects the members of the board of managing directors, which need to be approved by the local authority.

2.1.3 Maintenance obligation (*Anstaltslast*) and guarantee obligation (*Gewährträgerhaftung*)

Until 17 July 2001, as fundamental principles of (financial) institutions governed by public law, the principle of maintenance obligation (*Anstaltslast*) and the statutory guarantee obligation (*Gewährträgerhaftung*) served as guarantees for the financial institutions' continued existence and ongoing operations, and ensured the creditors' security. Under the maintenance obligation, the local authority (also referred to as sponsor) was obliged to guarantee the institution's operational capability for the duration of its existence by closing possible financial gaps, either by subsidies or other appropriate measures.⁴ This constituted an obligation within the legal relationship between the savings bank and the local authority, and did not result in a direct entitlement of any creditors.⁵ In contrast, the guarantee obligation

⁴ Rümker/Keßeböhmer, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, (vol. 2), 3rd edition, page 2135; Scherer/Schödermeier, *Staatliche Beihilfen und Kreditgewerbe*, ZBB 1996, pages 165, 172 *et seq.*

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lead to an entitlement of the creditor directly against the local authority, which bore unlimited liability for the savings bank's debts. Most of the provisions in the Savings Banks Acts concerning the guarantee obligation originally constituted that the creditors could only call upon the local authority if and as far as the savings banks and its assets could not satisfy them.⁶ More recent versions of the laws determine that the local authorities need to fulfil their obligation as soon as they determine that the assets of the savings banks cannot satisfy the liabilities.⁷ The details were disputed: Some in the legal literature required an unsuccessful enforcement into the savings bank's assets, which usually required a preceding lawsuit. Some voices abstained from the request of a lawsuit whenever the creditor was able to prove a lack of funds of the savings bank. Others completely denied the need for a preceding lawsuit due to the wording of a more recent statute.

In practice, the significance of maintenance obligation and guarantee obligation were completely diminished by the "Understanding on the Anstaltslast and the Gewährträgerhaftung between Germany and the EU Commission on 17 July 2001".⁸

In December 1999, the European Association of (private law) Banks (*Europäische Bankenvereinigung*) filed a complaint to the European Commission against the maintenance obligation and guarantee obligation, arguing that they would qualify as unlawful subsidies violating EU competition rules. The European Commission decided in favour of the European Association of Banks on the basis that these instruments constituted a violation of sections 87, 88 of the EC Treaty. On 8 May 2001, the European Commission adopted a recommendation proposing to the German Federal Government so-called appropriate measures in order to make the guarantee system of Anstaltslast and Gewährträgerhaftung compatible with the state aid rules of the EC Treaty. After a long dispute, on 17 July 2001, the Federal Republic of Germany and the European Commission entered into the said Understanding, whereby the German representatives announced that the German authorities accept the proposed appropriate measures. They reached an understanding on the key principles of a solution as well as on the process and the timing. The solution was based on the following principles:⁹

Gewährträgerhaftung had to be abolished. And Anstaltslast had to be replaced by a normal shareholder relationship between the public law owner/shareholder and the public law financial institution concerned.

Germany at least reached a grandfathering regime: liabilities existing at 18 July 2001, the date of acceptance by the German authorities of the Commission's recommendation of 8

⁵ Schmid/Vollmöller, *Öffentlich rechtliche Kreditinstitute und EU-Beihilferecht*, NJW 1998, page 716.

⁶ Jarass, *Zur Subsidiarität der Gewährträgerhaftung bei öffentlich-rechtlichen Banken*, WM 2002, pages 941 et seq.

⁷ Gruson, *Zur Subsidiarität der Gewährträgerhaftung bei öffentlich-rechtlichen Banken*, WM 2003, page 321.

⁸ Press statement after the meeting of Commissioner Mario Monti and Deputy Finance Minister Caio Koch-Weser on 17 July 2001, IP/01/1007.

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May 2001, will continue to be covered by Gewährträgerhaftung until their maturity runs out. During a transitional period, which lasted until 18 July 2005, Anstaltslast and Gewährträgerhaftung could be maintained in their original form. Since the final date of this transitional period, any liability existing by then and created after 18 July 2001 continues to be covered by Gewährträgerhaftung under the condition that its maturity does not go beyond 31 December 2015. These transitional arrangements were meant to allow the financial institutions concerned to restructure their activities and organisations in view of the changed legal and economic environment.

2.1.4 Deposit protection systems

Since the two main principles for creditor protection do not apply anymore, other measures have to be looked at more closely.

Concerning the deposit protection, the German rules distinguish between mandatory and voluntary deposit protection.¹⁰

The mandatory deposit protection is regulated in the Deposit Protection and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz*, EAEG).¹¹

According to section 2 of the Deposit Protection and Investor Compensation Act, the credit and financial services institutions must cover their deposits and liabilities arising from banking business through compulsory membership in a statutory compensation scheme (*Entschädigungseinrichtung*). The creditors have direct claims against the relevant statutory compensation scheme (section 4 of the Deposit Protection and Investor Compensation Act) if the credit institution in question is unable to repay the deposits or to meet its liabilities resulting from securities transactions. The protection is, however, limited to 90 per cent of the deposits and the equivalent of Euro 20,000, and to 90 per cent of the liabilities arising from the securities business and the equivalent of Euro 20,000.

As a direct consequence of the financial crisis, the draft amendment to the Deposit Protection and Investor Compensation Act provides for an increase of the protection ceiling as of June 2009 to Euro 50,000 and from 31 December 2010 to Euro 100,000. At the same time the 10 per cent contribution by the depositor is abolished. The new draft Deposit Protection and Investor Compensation Act provides for a payout within 30 days at the latest.

There are three different kinds of statutory compensation schemes pursuant the Deposit Protection and Investor Compensation Act including the one established by the Federal Association of Public Banks (*Bundesverband öffentlicher Banken Deutschlands*) through a subsidiary (*Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH*).

¹⁰ See also chapter 8 below.

¹¹ BGBl. I 1989, page 1842: incorporates the EU Directive 19/94 and 9/97, last time amended in 2007.

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In addition, voluntary compensation schemes exist. The Federal Association of Public Banks for example established a separate voluntary supplementary cover of a deposit up to the full amount, if the depositor is not sufficiently protected by the statutory compensation scheme.¹²

Banks may be exempted from the duty to join a statutory compensation scheme, if they belong to a different institution, which protects the bank in case of insolvency or illiquidity, which leads indirectly to a protection of the deposits and other liabilities.¹³ According to a statement of the German Central Bank (*Deutsche Bundesbank*),¹⁴ the savings banks' protection system and its support funds (*Stützungsfonds*) constitute such an institution.

The savings banks' protection system is separate from the statutory compensation schemes of the Federal Association of Public Banks.¹⁵ The system is a multi-stage scheme. At the local level 11 support funds exist which are the first to provide help when a bank runs into financial difficulties. These local support funds are connected through a supraregional compensation and joint liability scheme (*Haftungsverbund*). The next level is the support fund of the state banks (*Landesbanken*) and clearing houses (*Girozentralen*). In addition, the public law building societies have their own support funds. All these funds on all the different levels form again a joint liability scheme.¹⁶ This system protects the institutions themselves and in particular safeguards their liquidity and solvency. The customers are indirectly protected through this system. Only if the institution cannot be recapitalised successfully, a compensation of the relevant institution's customers is required. The savings bank scheme provides for a direct compensation right with respect to customers that are private persons, companies, public bodies and investment fund companies regarding their assets.¹⁷

2.1.5 Investments in savings banks

Concerning the participation of private law entities in savings banks, the respective Savings Banks Acts in the relevant state might have to be amended (if this has not yet been done, for example by establishing a hybrid structure involving private law forms) permitting private investors to acquire such participations. The state Savings Banks Acts contain different regulations concerning the nature of possible participations, the person of an investor and approval requirements. Some of the state laws allow for silent partnerships (*stille Beteiligungen*),¹⁸ however restricting their controlling and voting rights or restricting

¹² Articles of Association, section 14 no. 1.

¹³ Deutsche Bundesbank *Monatsbericht* Juli 2000, page 32.

¹⁴ Deutsche Bundesbank *Monatsbericht* Juli 2000, page 32.

¹⁵ Rümker/Keßeböhmer, *Rechtliche Ordnung des übrigen Bankwesens* (*supra* n.4) page 2156.

¹⁶ Rümker/Keßeböhmer, *Rechtliche Ordnung des übrigen Bankwesens* (*supra* n. 4) page 2156.

¹⁷ Dietrich/Giermann, *Bankeninsolvenz und Einlagensicherung in Deutschland*, Kreditwesen 2003, pages 456, 457.

¹⁸ Kost/Geerling, *Rechtliche Vorgaben für Restrukturierung im Sparkassensektor*, BKR 2003, page 690 (693).

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the extent of the participation. Therefore, a direct full acquisition of a savings bank by private law institutions is still not possible.

2.2 State banks (*Landesbanken*)¹⁹

Generally, German state banks are public law institutions.

They are the regional head organisations of the savings banks in the respective state. They are responsible for the administration of assets and the refinancing of their “affiliated” savings banks; they provide central payment and clearing functions and are supposed to serve as international investment arm in particular for the savings banks in their respective state. Furthermore, they administer those assets of the savings banks invested with them, and take care of the liquidity equalisation (*Liquiditätsausgleich*) between the savings banks. They also act as state banks for the respective states and they deal with the banking affairs of this (these) state(s) and its municipalities/regions. Finally, they also provide general banking services like other (for example, private law) banks.

The statutory regulations governing the state banks are contained in their formation acts (*Errichtungsgesetze*) as well as in the Savings Banks Acts of the respective state(s). Moreover, the respective state bank’s statutes have to be considered as well. Due to the savings banks’ participation in the nominal capital of the *Landesbanken* and them functioning as service provider to the savings banks (*Sparkassenzentralbankfunktion*), they are closely connected with each other.

Concerning this structure, one has to distinguish between the state banks that are still public law institutions and those, that are now organised in a hybrid form including private law stock corporations. In the case of public law state banks, as with savings banks, the conduct of business is exercised by a board of managing directors (*Vorstand*), which in turn is supervised by the administrative board (*Verwaltungsrat*). Members of the administrative board are appointed by the state. As a public law institution, they are subject to supervision by both the respective state(s) and the Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, BaFin). In the case of the state banks, which are affiliated with stock corporations, these banks in the form of stock corporations have a structure in line with the requirements under the Stock Corporation Act (*Aktiengesetz*, AktG). This means that they have a board of managing directors, which is elected and supervised by the supervisory board (*Aufsichtsrat*), which in turn is partly elected by the Shareholders’ Meeting (*Hauptversammlung*) and – in the case where the Ger-

¹⁹ The original meaning of *Landesbanken* does not exist any longer, due to the continuing restructuring process among the *Landesbanken* during the last couple of years (for example, the merger of Hamburgische Landesbank and Landesbank Schleswig-Holstein becoming HSH Nordbank AG) with the result that the consistent organisation of the *Landesbanken* crumbled. Whereas, most of the *Landesbanken* are still organised as public law institutions, a few exemptions currently have structures including stock corporations (such as the HSH Nordbank AG and the WestLB AG).

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man Codetermination Act (*Mitbestimmungsgesetz*) is applicable – partly by the employees of the bank.

As for the savings banks, the traditional guarantee obligations and the maintenance obligations of the respective holders of the state banks were abolished following the “Understanding on the Anstaltslast and the Gewährträgerhaftung between Germany and the EU Commission on 17 July 2001”. However, the state banks, as mentioned above, are also part of the savings banks system. A separate cash fund for the state banks was established which again operates in a joint liability scheme (*Haftungsverbund*) with the cash funds of the savings banks and the cash funds of the public law building societies. The membership in this system replaces their membership in a statutory compensation scheme pursuant the Deposit Protection and Investor Compensation Act.²⁰

2.3 Cooperative banks (*Genossenschaftsbanken*)

The cooperative banking sector today has a two-tier structure with the local cooperative banks constituting the basis and with DZ BANK AG (*Deutsche Zentral-Genossenschaftsbank*, DZ Bank) and the WGZ Bank AG (*Westdeutsche Genossenschafts-Zentralbank*, WGZ Bank) as top institutions.

The local so-called Volksbanken and Raiffeisenbanken constitute the first level of the cooperative banks. The basic principle of cooperative banks is bringing people or companies together to achieve their goals.²¹ The first cooperative banks were founded in the 19th century. Friedrich Wilhelm Raiffeisen was initiator of the first rural cooperative banks which later became the Raiffeisenbanken. Their main business originally focused on transactions in commodities focusing on the needs of the rural population. Hermann Schulze-Delitzsch founded the predecessor of today’s Volksbanken, the first loan associations (*Vorschussverein*). He focused on the needs of builders and trades people. Since 1972 Volksbanken and Raiffeisenbanken form an uniform cooperative banking group.²² In both cases, the basic idea was the concentration of powers, which is still the guiding theme today.

The legal form of cooperative banks in Germany is in the majority of cases a registered cooperative society (*eingetragene Genossenschaft*) pursuant to the German Cooperative Act (*Genossenschaftsgesetz*, GenG).

The cooperative banks aim at the promotion of the economic development of their members by means of collective business operations (section 1 of the German Cooperative Act). The membership is acquired through the purchase of cooperative shares. Originally, the shareholder had to be customer of the relevant cooperative bank to become its member, but some cooperative banks’ articles of association grant an exemption from this requirement so that the cooperatives are open to everybody.

²⁰ Rümker/Keßeböhmer, *Rechtliche Ordnung des übrigen Bankwesens* (*supra* n. 4) page 2156.

²¹ http://www.dzbank.com/page_standard.php?id=1490.

²² Aschhoff/Henningsen, *Das deutsche Genossenschaftswesen*, page 57.