

The House of Finance • 1st Quarter 2012

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IMPRINT

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DESIGN:

Novensis Communication GmbH
Bad Homburg

12th Edition

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Printed in Germany

NEWSLETTER SUBSCRIPTION

The House of Finance integrates Goethe University's interdisciplinary research on finance, monetary economics, and corporate and financial law under one umbrella. Ten academic research and training units work together in the House of Finance.

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REGULATING SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS IS VITALLY IMPORTANT

Safeguarding financial intermediation in the economy and protecting taxpayers are two cornerstones of financial stability policy. Both objectives intersect when it comes to systemically important financial institutions or “SIFIs” for short. These institutions’ size, interconnectiveness, complexity, lack of substitutability and/or global scope may lead market participants to take government support for granted. This can cause negative externalities, leading to more risk-taking, reduced market discipline and competitive distortions. Furthermore, an unexpected denial of a bailout can have grave consequences. Thus, the regulatory framework must make a SIFI’s failure a credible option, i. e. it must undermine market participants’ widely held belief that SIFIs are “too big to fail”. Simultaneously, regulators need to enhance the resilience of SIFIs, reducing both the probability and the impact of a possible failure.

To increase their loss absorbency capacity, individual SIFIs will be required, starting in 2016,

to hold additional capital in accordance with their systemic importance. The buffer will be initially set at between 1.0 and 2.5 percentage points. While currently only banks are the focus of the SIFI surcharge, other systemically relevant institutions will have to be covered, including financial institutions of domestic relevance, financial market infrastructures, insurance companies and other non-bank financial institutions.

Tackling the implicit government guarantee is at the heart of a solution to the SIFI problem. Therefore, special resolution regimes for the financial sector are important tools to enhance systemic stability. They enable regulators to force ailing financial institutions to be restructured or resolved, irrespective of their size. Progress in this regard has already been made, both at the international and national level. The Financial Stability Board has proposed key attributes for resolution regimes, which have been

endorsed at the G20 level as a new international standard.

German lawmakers acted quickly following the financial crisis: the Restructuring Act adopted in 2011 has established a procedure for the restructuring of banks under private law while, at the same time, strengthening the rights of the German financial services regulator, BaFin, which now has comprehensive powers to restructure and resolve banks. The act additionally requires the banking sector to contribute to a Restructuring Fund in order to help bear the costs of stabilizing the financial system. This framework is a new and promising approach to the SIFI problem, but it will still have to prove its effectiveness. Nevertheless, Germany is setting a good example in this regard on an international level.

National resolution regimes, however, presently cannot fully cope with globally operating SIFIs. These regimes, therefore, need to be compatible

with one another in order to enable cross-border bank resolutions. At the European level, the European Commission will soon publish draft legislation on an EU resolution framework and thus ensure a harmonized implementation across Europe. The ongoing regulatory initiatives are a major step in the right direction. However, more progress toward internationally consistent solutions still needs to be made, since solving the SIFI problem constitutes the litmus test of the international reform agenda. We at the Bundesbank will continue pushing for “better” macroprudential regulation at the international level.



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INTERNATIONAL PORTFOLIO DIFFERENCES: ENVIRONMENT VERSUS CHARACTERISTICS



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The subprime crisis in the US and the ongoing fiscal crisis in Europe highlight the importance of documenting and understanding differences in the financial behavior of households across the Atlantic and within Europe. Are asset or debt levels different mainly because of differences in population characteristics or in market conditions that affect the behavior of similar households across countries? In the latter case, there is more scope for institutional harmonization, policy and process coordination of the type currently envisaged in the European policy debate.

Our paper, forthcoming in the *Review of Economics and Statistics*, uses newly available micro data on older households (aged 50 and above) from the US, 11 European countries, and England, to document some surprising differences in household wealth levels and composition across countries. In addition, we use advanced counterfactual analysis techniques to show that such differences mostly arise from the behavior of similar people in different economic environments. We combine three micro-level

data sets sharing a common design: the US Health and Retirement Study (HRS), the English Longitudinal Study of Ageing (ELSA), and the Survey of Health, Ageing and Retirement in Europe (SHARE).

The table documents net household wealth levels and participation rates in stocks, homeownership, and mortgages, as well as holdings at the 25th, 50th and 75th percentile of the distribution of the asset or debt in question.¹ “Stocks” are those held, directly or indirectly, in mutual funds and retirement accounts.² “Home” and “Mortgage” refer to primary residence. All amounts are in thousands of (2004) dollars, adjusted for differences in the purchasing power of money across countries.

The first panel shows net wealth levels, i. e. the total value of financial and real assets net of all debts, collateralized and uncollateralized, at different percentiles. Mainly because of more widespread homeownership, households in fiscally troubled countries (Greece, Italy and Spain) had, prior to the fiscal crisis, higher net wealth levels at the lower end and at the medi-

an of the distribution than households in Germany as well as, on average, those in the other European countries considered. This suggests a limited potential for using liquid wealth to smooth the consequences of protracted unemployment spells, wage cuts, and tax increases.

POTENTIAL FOR HARMONIZATION

Participation in each asset and debt category is more limited on average in Europe than in the US, but with substantial variation. Except for Sweden, the home is the asset most typically held. Close to 40% of older US households were carrying mortgage debt prior to the subprime crisis, almost three times the European average. Within Europe, stockholding participation ranges from above 70% in Sweden to 10% in Austria; and homeownership from 87% in Spain to roughly 50% in Germany. Belgium, Spain and Greece have higher homeownership rates than the US, but very few older southern Europeans have mortgages. Dutch, Swedish and Swiss older households exhibit even greater participation than those in the US in the period leading up to the subprime crisis.

¹ The paper also reports data on private businesses.

² Stocks held in occupational defined-contribution pension plans are excluded, as data are not available across our countries.

Country/Region	NET WORTH			STOCKS			HOME			MORTGAGE					
	Quantiles			Prevalence (%)	Quantiles among owners			Prevalence (%)	Quantiles among owners			Prevalence (%)	Quantiles among holders		
	25	50	75		25	50	75		25	50	75		25	50	75
United States	40.0	162.1	437.0	49.7	11.0	49.5	169.0	77.3	80.0	150.0	250.0	38.3	32.0	70.0	125.0
Midwest	52.0	178.2	428.1	54.5	10.0	45.0	150.2	80.9	82.0	132.0	200.0	39.3	30.0	65.0	105.0
Northeast	39.7	193.5	475.9	54.7	11.0	52.0	172.5	70.6	92.0	190.0	340.0	32.5	32.0	70.0	124.0
South	29.9	113.0	326.0	42.6	10.0	43.9	153.0	78.3	63.0	100.0	180.0	36.5	28.5	58.0	102.0
West	53.0	228.5	582.0	52.1	14.0	53.3	182.5	76.9	140.0	250.0	400.0	46.0	50.0	100.0	178.7
Europe	27.3	140.6	294.6	26.0	3.3	10.4	29.2	67.6	104.9	168.7	275.6	14.7	12.4	36.7	79.0
Sweden	21.5	86.4	201.1	70.8	3.8	12.1	34.5	68.9	51.2	92.1	153.5	40.2	15.2	30.7	57.0
Denmark	12.8	100.6	242.6	56.1	2.7	8.2	23.0	69.2	90.8	136.2	204.2	44.3	28.4	56.7	90.8
Germany	11.8	95.4	272.6	25.4	3.1	9.7	26.2	51.2	136.3	209.7	314.6	14.8	12.6	36.7	83.3
Netherlands	9.6	140.4	336.4	24.9	4.0	15.2	42.8	55.2	192.3	253.0	374.4	43.1	23.8	54.6	110.4
Belgium	96.6	199.4	370.0	37.7	5.1	20.3	70.7	80.0	127.4	173.6	254.8	11.9	5.2	14.4	32.7
France	49.4	177.1	348.9	43.0	2.8	8.0	26.6	72.2	124.1	186.2	310.4	11.9	7.9	23.7	51.7
Switzerland	35.5	193.4	414.4	36.3	7.2	25.6	80.5	54.8	229.5	317.4	459.1	45.3	51.0	104.6	201.3
Austria	9.4	112.5	244.5	10.2	3.1	8.1	27.4	56.7	108.0	162.0	270.0	9.2	1.9	10.8	43.2
Italy	46.4	149.5	297.2	10.4	4.7	14.3	32.9	75.1	95.4	168.7	281.2	5.6	9.6	27.0	56.2
Spain	73.2	140.7	254.1	12.8	4.0	11.0	24.6	86.9	84.1	131.3	219.7	9.7	9.5	30.2	58.6
Greece	55.8	111.7	215.6	10.6	1.1	4.3	12.4	84.3	62.0	95.5	148.9	5.5	5.0	18.6	37.2
England	75.7	257.4	443.3	39.4	4.6	15.6	52.1	76.1	191.5	275.7	398.3	16.8	10.7	27.6	63.3

Note: All amounts are in thousands of 2004 US Dollars, adjusted for purchasing power, unless otherwise indicated; 25, 50, 75 refer to percentiles of the distribution of holders. Computed using the 2004 waves of the US HRS, the UK ELSA, and the European SHARE databases.

Table 1: Ownership rates and amounts by quartiles

Despite their size, international differences in participation rates (or in the levels of holdings) do not necessarily imply differences in economic environment. To draw an analogy to the labor literature, finding that the wages of one group are on average below those of another group is not sufficient to establish discrimination: the relevant characteristics of the underlying populations also need to be controlled for. The paper introduces to household

finance the counterfactual analysis employed in the labor literature. It controls for population differences (as regards age structure, marital status and number of children), health (objective and subjective), and relevant attitudes (such as the tendency for bequests or social interactions).

Our findings suggest that international differences in owner characteristics are not the

main drivers of measured differences in asset and mortgage holdings, often pointing in the opposite direction from the patterns found in the data. In contrast, differences in economic environment dictate observed differences and are more pronounced among European countries than among US regions, suggesting considerable potential for further harmonization.

In most European countries considered, households are less likely to participate in stocks than their US counterparts with similar characteristics. Exceptions are Sweden, Denmark, and France. Retirement systems play an important role in the first two, overcoming the fact that the US has the lowest transactions costs, the highest spending on information and communications technology, and the greatest level of stockholder protection.

EUROPE IS MORE DIVERSE THAN THE US

US stockholders hold greater amounts of stocks across the distribution of stockholdings compared with any European country. With the exception of Sweden, Switzerland and (to some extent) Spain, this difference is mainly attributable to differences in market conditions affecting the behavior of similar people across countries. Differences between the US and European countries tend to be larger when we focus on homeowners, consistent with the view that Europeans regard the home as a partial substitute for stocks.

European homeowners typically invest larger real amounts in their home than US homeowners: only in Sweden, Greece, Denmark and Spain are for higher quantiles the amounts smaller. However, controlling for characteristics, only Swedish households tend to invest significantly less in the home than their US counterparts. To be sure, US homeowners have larger homes on average, while Europeans face higher real estate prices.

This European tendency is not associated with greater mortgage availability. Prior to the crisis, mortgages were substantially larger in the US than in practically any European country considered. US households were more exposed to the risk of negative home equity in 2004/5 than European ones sharing similar characteristics: they tended to both own less expensive homes and hold larger outstanding mortgages.

Finally, we find telling results on the limited extent to which economic environments are harmonized within Europe, with Germany as the base case, at least regarding aspects relevant for asset and debt behavior. The striking differences in holdings within Europe, even after controlling for characteristics, are not matched by differences across US regions. This indicates further potential for harmonization of economic environments across European countries.

The full article is available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1963894

OPTIMAL ASSET ALLOCATION IN RETIREMENT WITH OPEN-END REAL ESTATE FUNDS



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In the course of the recent turmoil in the financial markets, several open-end real estate funds (OREFs) froze redemption of their units, resulting in unanticipated and unprecedented liquidity and performance shocks for investors. Against this background, we analyze the long- and short-term risk and return profiles of open-end real estate funds and their role in efficient multi-asset retirement portfolios under different liquidity regimes. To this end, we introduce the Retirement Efficient Frontier, describing those investment strategies that minimize the lifetime probability of ruin (LPoR) for specific levels of periodic withdrawals from a given retirement wealth.

Open-end real estate funds are the predominant form of securitized real estate investment in Germany. These funds are regulated collective investment schemes, which are primarily invested in income-producing commercial properties. By the end of 2009, more than 87,000 million euros were invested in this fund category, almost 15% of total assets under management (AuM) in

the German mutual fund industry. Usually, they are characterized by a conservative risk and return profile, i. e. they generate low but stable returns (usually above inflation rates), display low correlation to stock markets, and exhibit high autocorrelation. Consequently, these funds are predestined for moderately to highly risk-averse investors. OREFs are categorized as ‘open’ because the number of issued fund units is not fixed, and fund units

can both be purchased and surrendered to the fund for redemption (normally) on a daily basis at current net asset value prices. Hence, OREFs try to offer a performance closely linked to the relatively illiquid asset class of real estate combined with the permanent redeemability of traditional investment funds. This liquidity transformation, however, makes OREFs vulnerable to shocks in liquidity demand due to the



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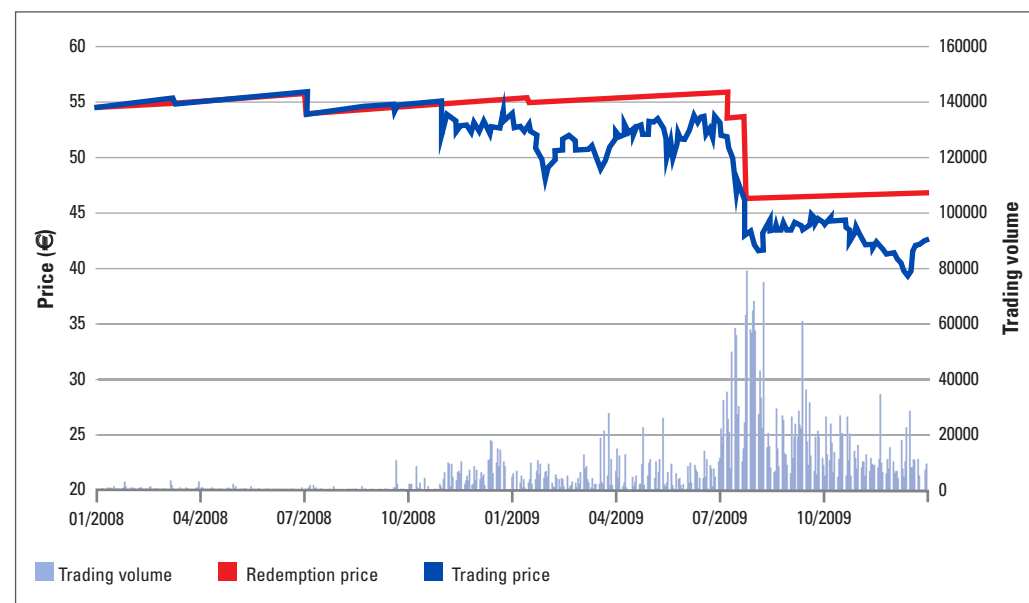


Figure 1: Morgan Stanley P2 Value – Trading prices and volumes 1/2008 to 12/2009

duration mismatch between long-term illiquid assets and daily callable liabilities.

LIQUIDITY CRISIS

In 2005, the first liquidity crisis hit the OREF industry. Two major fund managers had to suspend redemption of their units for several months due to unexpectedly large cash outflows. This first crisis was mostly driven by fundamental reasons, i. e. investors expected the depreciation of properties held by the funds. In the wake of the global financial crisis, starting in October 2008, many OREFs were forced to freeze redemptions as panicking German investors, particularly large institutional investors, massively withdrew funds. Some of those frozen funds even had to substantially depreciate the value of their property portfolios. While investors were not able to redeem units in frozen funds at net asset value prices, they still had the opportunity to trade their fund units through organized secondary markets, although at discounted and comparably volatile prices (see Figure 1 for details on one such OREF, the Morgan Stanley P2 Value fund).

IMPACT ON RETIREMENT PORTFOLIO CHOICE

We study the impact of the danger of OREFs being frozen in the context of private investors' optimal portfolio selection. Taking a shortfall risk approach in line with previous studies on retirement portfolios (see Milevsky

Withdrawal rate (%)	No fund freezes		Fund freezes		Fund freezes & devaluation shocks	
	LPoR (%)	Portfolio weight (%)	LPoR (%)	Portfolio weight (%)	LPoR (%)	Portfolio weight (%)
0.48	0.00	85	0.00	75	0.01	25
0.50	0.01	70	0.02	65	0.06	20
0.52	0.08	60	0.11	55	0.18	0
0.54	0.53	40	0.59	10	0.59	0
0.56	1.16	5	1.16	0	1.16	0
0.58	2.10	0	2.10	0	2.10	0
0.60	4.43	0	4.43	0	4.43	0

Table 1: LPoR and risk-minimizing OREF portfolio weights for alternative liquidity regimes

et al. 2006), we analyze the asset allocation implications of OREFs' liquidity issues by comparing risk-efficient investment strategies for withdrawal plans under three alternative price dynamics for OREF units: first, where fund units can at any time be surrendered for redemption at net asset value; second, where redemption may temporarily be suspended and fund units may only be sold through secondary markets at a time-varying discount on net asset value; and, third, where in addition to a possible freeze, unit prices may drop due to devaluation shocks. We derive the Retirement Efficient Frontier (REF), which

quantifies the relation between the level of the monthly withdrawal rate and the probability of assets being exhausted during the retiree's lifetime. We find that for low to moderate periodic withdrawals, efficient portfolios consist of up to 85% real estate fund investments in case fund units are continuously redeemable. Moreover, we show that, even if there is a monthly probability of 2.5% that redemption of fund units is temporarily suspended, the allocation into real estate funds in risk-efficient portfolios is only slightly affected. Yet, if funds additionally face a high risk of having to depreciate their

property portfolio during a liquidity crisis, their share in efficient retirement portfolios is reduced significantly. (See Table 1 for the LPoR and risk-minimizing OREF allocations for the three alternative liquidity regimes.)

POLICY IMPLICATIONS

Our results have several implications relevant to financial intermediaries designing products for the payout phase of pension plans and to professional financial planners helping clients to make retirement investment choices. OREFs can add value to the retirement portfolios of private investors and can be a reasonable part of drawdown products like programmed withdrawal plans or investment-linked payout annuities. Financial advisors as well as OREF managers should, however, increase awareness among investors that OREFs are not virtually riskless. There is considerable selection risk when deciding which OREF to invest in.

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www.zfb-online.de/index.php?do=show&id=21271&alloc=185&uid=&ip_id=

SHAREHOLDER SUITS IN GERMAN COMPANY LAW – AN EMPIRICAL STUDY



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The German version of often vexatious and sometimes frivolous shareholder suits is to challenge conclusions taken by the majority of the shareholders of public companies before the courts. To become effective, important decisions like, for example, capital increases, squeeze-outs, mergers etc., need the approval of the shareholders and do not become effective before registration in the commercial register. If a shareholder files a suit against such a decision taken by the majority of shareholders, the registrar will suspend the registration until the civil court has decided on the merits of the contesting action. Very frequently however, these suits are settled by an agreement between the plaintiff and the company, which will usually have a strong interest that the measure becomes effective without further delay. The settlement will provide for an indirect and often lucrative compensation for the plaintiff.

The German legislator has several times tried to amend the respective rules in order to limit

the abuse of the hold-up situation created by the registration requirement. Legislative interference in this area is difficult because one does not want to destroy the incentives of investors to take justified actions and weaken the control of dominant shareholders and/or the management by smaller investors. The last amendment of the Stock Corporation Act in this regard became effective in September 2009. One goal of this amendment was to speed up the registration process when suits with low chances of success have been tabled or when the plaintiff asserts only minor defects in the shareholders' conclusion. We have tried, following up on similar studies carried out by us earlier, to analyze the development of shareholder suits before and after the enactment of the reform bill of 2009 and its empirical effects.

METHODOLOGY AND FINDINGS

We have conducted a complete, exhaustive descriptive survey of all shareholder suits against German public companies (with shares traded on the regulated market) for the period from July 2007 to July 2011. The data have been collected from the (electronic) Official

Gazette, the (electronic) commercial registers and the courts. Our main finding is that shareholder suits have significantly decreased since 2009. This cannot however be traced back solely to the reform bill of 2009. Economic activities requiring shareholder approval which then may be subject to contesting actions also decreased during the period investigated. However, the percentage of suits tabled by "frequent litigants" (as measured by certain criteria) stayed at the same level. Furthermore, the total number of frequent litigants increased. Within the group of the "top 20 professional litigants" the settlement amount was higher than 500,000 euros in about 50% of cases. In our last study of 2007, this had been the case for 73.2% of lawsuits.

Looking at the type of resolutions that were contested, one can see a significant increase in "discharge" decisions in the years 2007 and 2008 (board members need to ask shareholders for a formal discharge annually). Thereafter, these figures decline again. The number of suits against squeeze-outs and reorganizations declined significantly relative to the development of the total number of

Year of shareholder meeting	Squeeze-outs	Mergers/spin-offs/changes of form	Group agreements	Increase/reduction of stated capital	Shareholder suits (minimum figures)	Suits in % of listed transactions
2003	57	51	179	499	135	17.2%
2004	35	70	137	672	172	18.8%
2005	38	43	145	719	281	29.7%
2006	32	49	189	794	357	33.5%
2007	30	47	187	760	403	39.3%
2008	24	38	231	719	554	54.7%
2009	27	44	173	653	286	31.8%
2010	22	30	170	690	162	17.8%
2011 (until July 31)	9	27	127	430	66	11.1%

Figure 1: Selected economic activities requiring shareholder approval/suits

Source: Baums/Drinhausen/Keinath (2011)

claims, but increased relative to the frequency of squeeze-outs and reorganizations. Looking at the reasons for contesting action, alleged infringements of the right to information decreased. Non-compliance with reporting duties has been asserted more frequently. Moreover, the loss of the voting right of a major shareholder because of his/her breach of securities laws (a breach of reporting duties regarding major holdings in listed companies) is a frequent complaint. Violations of the “comply or explain” rule under Section 161 of

the German Stock Corporation Act are also put forward.

Our findings show that the duration of lawsuits has decreased considerably since the reform bill of 2009 came into force. Lawsuits have ended with a settlement less often than in the past. If a sentence is passed, the action is dismissed in most cases (fully in 63% of cases and partially in 17% of cases). The Stock Corporation Act provides for an injunctive relief allowing a shareholders’ conclusion to

be entered into the register before the civil court has decided on the merits of the claim made. The number of such preliminary actions has decreased by half since 2009. On average, injunctive reliefs can be obtained within 100 days of a petition being filed.

POLICY RECOMMENDATIONS

Although the reform bill of 2009 has shown a significant effect, further reforms in this area are still required. We recommend considering the following amendments:

1. The incentive for frequent litigations is the (indirect) compensation in the case of a settlement. The plaintiff’s attorney and the plaintiff him/herself are remunerated depending on the agreed “value” of the settlement. This value should be subject to a judicial review, precisely as it is being reviewed and fixed by the court when the judicial procedure concludes with the judicial decision of the case.
2. The federal states of Germany are authorized to concentrate judicial competences in company law matters. This could professionalize courts and speed up legal procedures. Up until now, only a few states have made use of this. We recommend taking advantage of this opportunity.
3. A further question is whether violations of notification requirements under the

Securities Trading Act should lead to the loss of the voting right ipso iure. One possible solution could be that the Federal Financial Supervisory Authority (BaFin) would have to take a decision on that before. An elegant solution would be to require that the plaintiff holds a minimum percentage of shares in the company concerned.

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CONSTITUTIONAL RULING ON COURT OF AUDITORS' REVIEW OF BANKS



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In its decision of December 13, 2011, the Constitutional Court of the state of North Rhine-Westphalia (NRW) ruled that a State Court of Auditors is granted by the constitution a broad scope of powers not only to control the immediate state administration but also entities outside the direct state administration, as far as they exercise financial responsibility for the state. This holds especially with regard to banks organized under public law, if their activities affect the state budget. This is generally the case when the state is liable for the obligations of such an entity, be it by statutory law or by contracts. This ruling may have serious implications for the capital guarantees extended by EU Member States to the newly established institutions on the European level, as for instance the European Stability Mechanism (ESM).

Governments frequently transfer some of their tasks to third parties. Often, these third parties will be legal entities that belong to the government. This is especially true for legal entities

organized under public law, such as the majority of financial institutions in Germany. Transferring tasks to an external entity leads to an effective loss of control and information. This raises the question to what extent parliaments and courts of auditors are constitutionally entitled to and maybe even obliged to exercise guidance and control over these entities which basically remain an indirect part of the administration.

Technically, the case was a dispute between the NRW Court of Auditors as plaintiff and the state government as defendant over the scope of control of the state government. The state government was represented by the Minister of Finance, as an agent of the state on the board of the NRW.BANK and the Minister of the Interior, as administrative supervisor of the bank as an entity of administrative law. Indirectly it was also disputed whether the bank, like numerous other banks in Germany which are organized more or less as government entities (e.g. the Landesbanken and almost all municipal savings banks), is subject to the control by the Court of Auditors.

THE RULING

The admissibility of the case already posed the first problem: Does the Court of Auditors have standing to sue the state government and its members in the Constitutional Court? The answer had never been treated by a constitutional court and cannot simply be derived from the wording of the statutes. The decision thus had to pave the way for new legal territory. As a result, the court took a clear stand and affirmed at least for the state of North Rhine-Westphalia: The constitution itself vests rights and powers in the State Court of Auditors. Therefore, it has standing in the Constitutional Court of the state to argue these rights and powers.

On the merits of the case, the court emphasized that the control exercised by the Court of Auditors plays a crucial role for enabling the parliament to discharge its budgetary responsibilities. It comprises not only the immediate budgetary process of the state, but also includes a comprehensive control of measures by other entities which have a direct or indirect effect on state finances. *The court argues*

**Professor Siekmann was counsel to the Court of Auditors and represented it in the Constitutional Court.*

that any fiscal responsibility without a corresponding right of control for the Court of Auditors is not admissible from a constitutional point of view.

Such a fiscal responsibility can be the result of all business transactions of the NRW.BANK. The state is directly liable for any deficit of the bank and the Minister of Finance gave an explicit guarantee on behalf of the state for obligations of the bank. This has to be judged in light of the volume of its balance sheet which exceeds by far the state budget's volume. This fiscal responsibility has to be considered alongside the loss of control on the side of the parliament, because important decisions that might substantially affect the state budget are made by the bodies of the NRW.BANK. Even though the Minister of Finance is a member of the decision-making bodies of the NRW.BANK, he refused to submit to the control of the Court of Auditors, as did the Minister of the Interior. Incidentally, he also refused to disclose details to the state legislature when it asked for them.

In view of the ongoing crisis of the banking system, the court's stance on other means of control which are applied on the bank is espe-

cially interesting. It rejected plainly the argument of the government, that the activities of the bank are sufficiently controlled by accountants and the general banking supervision by the Bundesbank and the (federal) financial services authority (BaFin). According to the decision, the scope of the information and supervision rights vested in the Court of Auditors is generally unlimited and is determined only by the Court of Auditors itself and not by the controlled entities.

OUTLOOK

The court's ruling will result, in the first place, in a comprehensive control of the NRW.BANK itself, but might also be extended to other bodies with budgetary responsibilities. Judging from the developments of the last years, this decision can be interpreted as evidence for potential constitutional supervision and control duties in the case of implicit guarantees for financial institutions; an important question for the responsibilities that governments took on for the banking sector in the past.

The full article is available at:

www.hof.uni-frankfurt.de/policy_platform/Ruling_on_Banks_Review

SELECTED POLICY PLATFORM PUBLICATIONS

Böcking, H.-L., Gros, M., Wallek, C. and Worret, D. (2011)
"Analysis of the EU Consultation on the Green Paper 'Audit Policy: Lessons from the Crisis'", White Paper, Policy Platform at the House of Finance, Goethe University Frankfurt

Haliassos, M. (2011)
"Prodigal Italy Greece Spain?", Policy Letter, Policy Platform at the House of Finance, Goethe University Frankfurt

Remsperger, H. (2011)
"Ordnungspolitik gegen Systemrisiken", Policy Letter, Policy Platform at the House of Finance, Goethe University Frankfurt

Issing, O. (2011)
"Der Weg in die Knechtschaft", Policy Letter, Policy Platform at the House of Finance, Goethe University Frankfurt

Schefold, B. (2011)
"Europa – wohin?", Policy Letter, Policy Platform at the House of Finance, Goethe University Frankfurt

Krahnen, J. (2011)
"Kluge Finanzarchitektur zur Begrenzung des systemischen Risikos", Policy Letter, Policy Platform at the House of Finance, Goethe University Frankfurt

Wieland, V. (2011)
"Stellungnahme zum Antrag der SPD-Fraktion auf Einführung einer Finanztransaktionssteuer in Europa", Policy Letter, Policy Platform at the House of Finance, Goethe University Frankfurt

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http://www.hof.uni-frankfurt.de/policy_platform

“INFORMATION DOES NOT NECESSARILY LEAD TO UNDERSTANDING”



Michael S. Barr
University of
Michigan Law School

Michael S. Barr, Professor at the University of Michigan Law School, conducts research on financial regulation and financial services. From 2009 to 2010 he served as Assistant Secretary for Financial Institutions at the US Department of the Treasury and was a key architect of the Dodd-Frank Wall Street Reform and Consumer Protection Act. On January 20, he gave a speech at the IMFS/LEMF-Retail Finance Conference at the House of Finance (see p. 14)

Prof. Barr, in your research, you distinguish between regulation by changing procedural rules versus regulation by scoring. Can you please elaborate on this?

A behavioral perspective allows one to account better for how individuals make decisions and is thus a useful corrective to the rational-agent model. At the same time, a framework is required that takes into account firms' incentives with respect to individual behavior. The psychological biases of individuals can be either aligned with or opposed to the interest of firms that market products or services to them. When firms have incentives to overcome a psychological bias, as

for example in the context of saving, regulation can take the form of rule changes, such as changing the starting point or default. For example, workers can automatically be signed up for a retirement saving plan unless they opt out.

When firms have incentives to keep the bias in place, for example, in forcing disclosure of hidden or contingent prices of credit, the regulator often faces non-cooperative firms, whose interests are to find ways to undo interventions. In that instance, the regulator may need to change the scoring of the game, by increasing liability to offset the gains to the firm from engaging in the disfavored activity. Typically, changing the rules of the game (without changing the scoring) maintains the firms' original incentives to help or hurt consumer bias, while changing the scoring of the game can alter those incentives.

As a reaction to the financial crisis, the US legislation aims to provide financial consumers with more information. Does more information always lead to more rational behavior?

More information is not always better. The amount of information people can and do

attend to is limited. Moreover, to the extent that consumers find themselves in challenging situations that are unfamiliar, distracting, or tense, all of which consume cognitive resources, less focused attention will be available to process the information that is relevant to the decision at hand. This, in turn, can render decision-making even more dependent on situational cues and peripheral considerations. Information does not necessarily lead to understanding, nor understanding necessarily to behavior.

The Dodd-Frank Act sets a huge amount of new rules. In Europe, we found that often there is no lack of rules but rather a lack of obedience to these rules. What makes you confident that the new legislation will bring better results?

The US had gaping holes in our system of regulation and supervision that permitted the financial sector to become over-leveraged, opaque, and risky. Regulatory reforms will now permit the financial sector to rebuild on a firmer foundation. At the same time, one needs to be humble about the ability to predict future crises, and one needs to remain vigilant about implementation, supervision and enforcement under the new framework.

SELECTED HOUSE OF FINANCE PUBLICATIONS

Baums, T., Schmidtbleicher, R. (2012)

“Neues Schuldverschreibungsrecht und Altanleihen”,
ZIP Zeitschrift für Wirtschaftsrecht, Vol. 5,
pp. 204 ff

Binder, M., Bröck, S. (2011)

“On the Relation between Investment and Economic Growth: New Cross-Country Empirical Evidence”,
de La Grandville, O. (Ed.), *Frontiers of Economics and Globalization*, Vol. 11: Economic Growth and Development, pp. 43-86

Faia, E., Rossi, L. (2012)

“Unions Power, Collective Bargaining and Optimal Monetary Policy”,
forthcoming in *Economic Inquiry*

Georgarakos, D., Pasini, G. (2011)

“Trust, Sociability, and Stock Market Participation”,
Review of Finance, Vol. 15, Issue 4, pp. 693-725

Haar, B. (2012)

Art. *Banking Law, European Banking Market, Corporate Group Law, Consumer Credit – Regulatory Principles*,
forthcoming in Basedow/Hopt/Zimmermann (Eds.), *Max Planck Encyclopedia of European Private Law*, Oxford University Press

Höring, D., Gründl, H. (2011)

“Investigating Risk Disclosure Practices in the European Insurance Industry”,
Geneva Papers on Risk and Insurance, Vol. 36, pp. 380-413

Inderst, R., Ottaviani, M. (2012)

“How (Not) to Pay for Advice: A Framework for Consumer Financial Protection”,
forthcoming in *Journal of Financial Economics*

Langenbucher, K., Bliesener, D., Spindler, G. (2012)

“Bankrechts-Kommentar”,
C. H. Beck (forthcoming)

Luckner, S., Schröder, J., Skiera, B. et al. (2012)

“Prediction Markets – Fundamentals, Designs, and Applications”,
Gabler Verlag

Mattes, J. A., Steffen, S., Wahrenburg, M. (2012)

“Do Information Rents in Loan Spreads Persist over the Business Cycles?”,
forthcoming in *Journal of Financial Services Research*

Maurer, R., Schaefer, A. (2012)

“Does Size Matter? Scale and Scope Economies of German Investment Management Companies”,
forthcoming in *Schmalenbach Business Review*

Puri, M., Rocholl, J., Steffen, S. (2011)

“Global Retail Lending in the Aftermath of the US Financial Crisis: Distinguishing between Demand and Supply Effects”,
Journal of Financial Economics, Vol. 100, Issue 3, pp. 556-578

Schmidt, S., Wieland, V. (2012)

“The New Keynesian Approach to Dynamic General Equilibrium Modeling: Models, Methods and Macroeconomic Policy Evaluation”,
forthcoming in Dixon/Jorgenson (Eds.), *Handbook of Computational General Equilibrium Modeling*, North-Holland/Elsevier Science

Siekman, H. (2011)

“PPP-Finanzierung und Haushaltsrecht”,
Balensiefen/Merten (Eds.), *Public Private Partnership*, pp. 43-55



THOMAS LAUBACH TO ADVISE THE FEDERAL RESERVE BOARD



Thomas Laubach, who has been Professor for Macroeconomics at the House of Finance since April 2008, will be starting a new job at the Federal Reserve Board in Washington DC in February 2012.

He will become a Senior Advisor in the Research and Statistics Division. His responsibilities will include providing advice and support to the Board of Governors chaired by Ben S. Bernanke as well as the Federal Open Market Committee (FOMC). Current topics of interest include the FOMC's communications strategy and the connection between interest rate policy and financial stability. Before coming to Goethe University, Laubach had already worked at the Fed for eight years, at the end as Senior Economist. Laubach obtained his Ph.D. at Princeton University in 1997, with Ben Bernanke acting as his thesis advisor.

CHRISTIAN SCHLAG ELECTED TO A DFG REVIEW BOARD



Christian Schlag, Professor of Derivatives and Financial Engineering at the House of Finance, has been elected to the Review Board for Business Administration of the Deutsche Forschungsgemeinschaft (DFG, the German Research Foundation). One of the main tasks of review board members, who serve in an honorary capacity, is to ensure the overall quality of the DFG's review process.

CONFERENCE ON "RETAIL FINANCIAL SERVICES AFTER THE CRISIS"



On January 20 and 21, the Institute for Monetary and Financial Stability (Prof. Roman Inderst) and the Doctorate/Ph.D. Program Law and Economics of Money and Finance (Prof. Brigitte Haar) held a conference on retail financial services. A panel discussion on policy questions with regulatory experts from the European Commission (Jacqueline Minor, Director of Consumer Affairs), the BaFin (Michael Sell, Executive Director), the FSA (Peter Edmonds, Risk Division), the Federal Ministry of Food, Agriculture, and Consumer Protection (Christian Grugel, Head of Department), and a bank representative (Martin Krebs, Executive Board, ING-DiBa) provided for a lively kick-off. Thereafter, the leading researchers in European capital market law and finance – such as, on the law side, Michael Barr (Michigan Law), Niamh Moloney (London School of Economics), Susanne Kalss (Vienna University of Economics and Business) and, on the finance side, Mark Armstrong (Oxford), Luigi Guiso (European University Institute), Paul Heidhues (ESMT), and Marco Ottaviani (Bocconi) – explored the foundations of investor and consumer protection and their implementation in regulatory practice in stimulating presentations of their research findings to a large number of interested participants from all over Germany.

ACKERMANN, STEINBRÜCK AND ISSING AT THE OPEN SEMINAR



What lies at the heart of the current European financial crisis – deficiencies in the banking sector or excessive government debt and political mismanagement? This question was discussed by Josef Ackermann, the departing head of Deutsche Bank, Peer Steinbrück, a former Federal Minister of Finance and a key figure in Germany's SPD party, and Otmar Issing, the President of the CFS and former chief economist of the ECB, together with academic scholars in Berlin on December 15. The Open Seminar was organized by the House of Finance, the European School of Management and Technology and the Hertie School of Governance. A major point of discussion was whether or not the banking sector should incur liability for credit defaults. The legitimacy of political decisions is being confronted by urgent refinancing needs. Representatives of the institutions behind the event, including Prof. Helmut Siekmann from the Institute for Monetary and Financial Stability at the House of Finance, enriched the discussion with well-founded and original explanatory approaches.

NEWS IN BRIEF



- The House of Finance has started a page on **Facebook**. If you are interested in more frequent information about the House of Finance, please visit www.facebook.com/houseoffinance.
- The Deutsche Forschungsgemeinschaft (DFG) has assigned a grant to **Holger Kraft** as principal investigator. His research team will work on the project "Life-Cycle Consumption-Portfolio Choice with Housing: Borrowing Constraints and Incompleteness".
- **Thomas Kaiser** has been appointed Honorary Professor at the Department of Finance. Kaiser, Director at KPMG Germany, is offering lectures and seminars about risk management.
- The first **musical** held at the House of Finance was a great success: from 27 to 29 January, about 550 visitors came to the House of Finance to see "Euro Crash", an entertaining and thought-provoking musical written by David Shirreff (a correspondent for "The Economist"), with a score composed by Russell Sarre.



QUARTERLY EVENT CALENDAR

APRIL		MAY			
Tuesday, 3 rd 8 am – 10 am	ILF Breakfast Series “Mittelstandsthemen der Anwaltschaft”	Thursday, 3 rd 12 pm	House of Finance Brown Bag Seminar “Who Benefits from Building Insurance Groups? A Welfare Analysis based on Optimal Group Risk Management” Speaker: Helmut Gründl, Goethe University	Thursday, 24 th 9 am – 5.30 pm	Conference “Corporate Finance Summit 2012” Organization: Institute for Law and Finance in cooperation with Commerzbank
Wednesday, 4 th 6 pm – 10 pm	ILF Panel Discussion “Infrastruktur, Recht und Finanzen”	Thursday, 3 rd 9 am – 5.30 pm	ILF Conference “The Crisis Management Directive: Europe’s Solution for Too Big to Fail?”	Tuesday, 29 th 5.15 pm	Finance Seminar Speaker: Lorenzo Gerlappi, University of British Columbia
Thursday, 12 th 12.15 pm	Frankfurt Seminar in Macroeconomics Speaker: Barbara Rossi, Duke University	Friday, 4 th 3 pm – 12 pm	ILF Panel Discussion and Dinner “10 years Celebration”	JUNE	
Tuesday, 24 th 5.15 pm	Finance Seminar Speaker: Mathijs A. van Dijk, Rotterdam School of Management	Saturday, 5 th 8 am – 6 pm	ILF Alumni Event “10 years Celebration”	Monday, 4 th 5 pm	EFL Jour Fixe “Security Risks of Cloud Computing in Financial Services” Speaker: Olga Wenge, Deutsche Bank
Tuesday, 24 th 9 am – 5.30 pm	Conference “Islamic Banking and Finance” Organization: Institute for Law and Finance in cooperation with Clifford Chance & Institute for Islamic Banking and Finance	Monday, 7 th 5 pm	EFL Jour Fixe “Supporting Intraday Investment Decisions Using Text Mining and Sentiment Analysis” Speaker: Michael Siering	Tuesday, 5 th 5.15 pm	Finance Seminar Speaker: Magnus Dahlquist, Stockholm School of Economics
Wednesday, 25 th 8 am – 10 am	ILF Breakfast Series “Mittelstandsthemen der Anwaltschaft”	Tuesday, 8 th 5.15 pm	Finance Seminar Speaker: Fabio Trojani, University of Lugano	Wednesday, 6 th 6 pm – 10 pm	ILF Panel Discussion “Infrastruktur, Recht und Finanzen”
Thursday, 26 th 12.15 pm	Frankfurt Seminar in Macroeconomics Speaker: Berthold Herrendorf, Arizona State University	Tuesday, 22 nd 5.15 pm	Finance Seminar Speaker: Mark Schroder, Michigan State University	Tuesday, 12 th 5.15 pm	Finance Seminar Speaker: Amit Goyal, University of Lausanne
Thursday, 26 th 5.30 pm	IMFS Distinguished Lecture Speaker: Choongsoo Kim, Governor of the Bank of Korea	Tuesday, 22 nd 8 am – 10 am	ILF Breakfast Series “Mittelstandsthemen der Anwaltschaft”	Thursday, 14 th 12 pm	House of Finance Brown Bag Seminar Speaker: Volker Wieland, Goethe University
		Thursday, 24 th 12.15 pm	Frankfurt Seminar in Macroeconomics Speaker: Michelle Rendall, University of Zurich	Tuesday, 19 th 8 am – 10 am	ILF Breakfast Series
				Tuesday, 26 th 5.15 pm	Finance Seminar Robert Kosowski, Imperial College London

Please refer to www.hof.uni-frankfurt.de/eventlist.html for continuous updates of the event calendar.
Please note that for some events registration is compulsory.

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