

Chapter 1

Introduction

Does organization matter? Scharpf, Does Organization Matter? Task Structure and Interaction in the Ministerial Bureaucracy, Organization and Administrative Sciences (1977), 149.

In the European Composite Administration, the density of material rules increased in many economic sectors. The application and enforcement of these rules ought to be administered by formal organisations. “*Does organisation matter?*” can be clearly answered favourable. In fact, organisations begin to receive the attention they deserve.

Administrative organisation is no end in itself. In fact it is required for each administrative action. In a multi polar, supranational and administrative surrounding the administrative organisation grows in importance in several economic sectors and life areas. Administrative organisation is regarded as being static and boring—the opposite is the case. Administrative organisations are influential. They take in external influences to react flexible to changes in time. Administrative organisations help to fulfil public services at its best.

Thus, this thesis studies the administration and its organisation. The thesis is based on the “reference area”¹ of banking regulation at national, European and international level. Regulation is one of the youngest dogmatic and most creative tasks of administration and increasingly presents administrative action. Regulation leads to a greater need of information to meet diverse consulting and decision-making situations of administration. This particularly applies to areas of asymmetric information between the administration of regulation and regulated economic sectors. Thereby, administration and its previous organisation are challenged to develop. Organisation matters!

¹Coining of the term Schmidt-Aßmann, Das Allgemeine Verwaltungsrecht als Ordnungsidee, 2nd ed. (Springer, 2004); Ch.1.paras.12 et seq. and Ch. 3. paras. 1 et seq.; with the help of a reference area, a real area of administrative organisation is processed specially to detect the developments at national and European level, Terhechte, Einführung: Das Verwaltungsrecht der Europäischen Union als Gegenstand rechtswissenschaftlicher Forschung - Entwicklungslinien, Prinzipien und Perspektiven, in Terhechte (Ed.), Verwaltungsrecht der Europäischen Union, (Nomos, 2010), § 1 para. 62.

1.1 Subject of the Study

Regulation includes any sovereign interference of administration in an economic sector. Regulation is especially important in the financial markets. Only in October 2008 the business behaviour of financial institutions led to a global collapse of the market. The causes and consequences are diverse and still present.

1.1.1 Introduction

So far, the regulation of the financial markets followed a strategy of self-regulation. States agreed on non-binding standards and thus provided a framework which was put into practice by the financial sector with less government control and without government valuation. As a result, financial institutions set a focus on returns and neglected risks. This particular business behaviour of financial institutions was endeavoured by an expansionary monetary policy of the U.S. Federal Reserve. Cheap money at low interest rates was supposed to boost bank lending to private clients. Through a lack of market discipline, while granting credits against securities (mortgage), a bubble in the housing market emerged. The creditworthiness or liquidity of clients and the value of real estate as collateral were overestimated.² Long-dated loans were bundled by banks and then resold (to regional banks, life insurance companies, pension funds and investment banks).³ So-called Asset-Backed-Securities were structured with graded default risks and varying interest rates were rated positive (AAA-Rating) by rating agencies. Default or liability risks could not be measured reliably,⁴ and loan securitisations were laid with less equity than securities in the balance sheets.⁵ This business behaviour was particularly favoured by commercial and investment banks. They provided false incentives to run risky financial activities and also paid large bonuses to employees.⁶

Increasing defaults in payment by borrowers led to price reductions of credit securitisation. Rating agencies downgraded the ratings and revealed an inadequate availability of capital and liquidity constraints in the financial institutions. The collapse of single financial institutions led, on the one hand, to a huge loss of

²Hellwig, Gutachten zum 68. Deutschen Juristentag, (C.H. Beck, 2010), E12 et seq.; 20 et seq.

³Hellwig, Gutachten zum 68. Deutschen Juristentag, (C.H. Beck, 2010), E12 et seq.; 16 et seq.

⁴Hellwig, Gutachten zum 68. Deutschen Juristentag, (C.H. Beck, 2010), E22 et seq.

⁵Hellwig, Gutachten zum 68. Deutschen Juristentag, (C.H. Beck, 2010), E31 et seq.

⁶R. Fischer in Boos/Fischer/Schulte-Mattler (Eds.), KWG, 4th ed. (C.H. Beck, 2012), Einf KWG (German Banking Act) para.103.

confidence in the soundness of the banking system and, on the other hand, to a liquidity crisis.⁷ Large or specialised credit institutions were about to become insolvent. However, these institutions were deemed to be too big to fail.⁸

Governmental assistance was required to preserve the functioning of the economy.⁹ This idea enjoyed politically a broad consensus but was economically not without controversy. In a market economy, governmental interventions are an exception. If government agencies provide financial assistance to rescue banks, these banks are no longer forced to leave the market, even if they operated poorly. Governmental assistance favours single institutions rather than bringing economic resources to their best use by free market forces. Thus, the competition is distorted and damaged. Supply and demand are no longer allocated efficiently. Market failures occur which were accompanied by insufficient supervision and a lack of regulations to execute bank resolutions and insolvencies. These deficits in regulation and supervision had a systemic effect and lead to government failure.¹⁰ The self-regulation of financial markets failed. Financial institutions are operating across borders at the European internal market. Nevertheless, the supervision of business behaviour takes place at a national level and is subject of widely varying regulations between the Member States.¹¹ The banking crisis has shown that financial institutions engaged in risky speculation while trusting that the government and therefore the taxpayers will give, if necessary, a helping hand. Incentives like taking a higher risk than economically efficient (moral hazard)¹² have a macroeconomic impact and burden the acceptance of the market economy system. In response to the shortcomings and failures of the financial sector a more consistent and comprehensive state regulation developed. Based on the structural causes of the crisis, the Banking Regulation Law tightened the substantive rules at a supranational level. First, the capital adequacy requirements were increased to underpin high-risk positions, also liquidity principles were specified and their implementation monitored by stress tests.¹³ In this way, the risks of a bank solvency are reduced, a new

⁷In particular after the collapse of both the IKB in July 2007 in Germany and the investment bank Lehman Brothers Banking Corporation in the United States in September of 2008.

⁸The term too big to fail describes companies whose insolvency would cost the national economy more than its rescue. According to the Financial Stability Board, 28 banks and nine insurance companies are currently considered to be so large that their collapse would threaten the financial system, Bundesanstalt für Finanzdienstleistungsaufsicht, Systemrelevante Finanzunternehmen, BaFin-Journal 10/2013, 30 (31).

⁹In Germany there is to name in particular the “rescue” of the Hypo Real Estate with guarantees from the government in the amount of 100 billion euros and the participation of the Federal Government as a shareholder of the Commerzbank.

¹⁰Kindler, Finanzkrise und Finanzmarktregulierung, *Neue Juristische Wochenschrift* (2010), 2465.

¹¹Ferber, Die Neuordnung der europäischen Aufsichtsstruktur, *Ifo-Schnelldienst* 64 (2011), 9 (10).

¹²In particular explored in the securities market: Mankiw and Taylor (Eds.), *Economics*, 2nd ed. (South Western Cengage Learning, 2011), 823; Bormann and Finsinger (Eds.), *Markt und Regulierung*, (Vahlen, 1999), 512 et seq.

¹³An overview is provided by Zeitler, Finanzmarktkrise und Bankenaufsicht, in Grieser and Heemann (Eds.), *Bankenaufsichtsrecht*, (Frankfurt School Verlag, 2010), 5.

confidence between banks can be created and the interbank market is stimulated. Moreover, the formally established independent supervisory structure provides sanctions, and combines the supervision at both macroeconomic and microeconomic level.¹⁴ Especially here, the administrative organisation grows in importance.

1.1.2 Framing of the Problem

The administrative organisation creates the structural requirements for the administration.¹⁵ Particularly, the design of organisational units enables a context control. The control of administrative actions by organisations happens within a standardised framework. These frameworks affect the decision-making processes of administrative units, which affect in return the ability to make certain types of administrative actions or decisions.¹⁶ Administrative organisation is attached to a growing importance not only formally, but also materially. The Administrative Organisation Law creates structures in which regulatory decisions are controlled.

The organisational law of the administration of regulation is not recognised appropriately in jurisprudential discussion. It rather runs out in the mere descriptions that only superficially describe its appearance in practice. Due to the Administrative Organisation Law, jurisprudential knowledge of state regulation and the economic approaches of the New Institutional Economics can be related methodologically.¹⁷ Thus, the influence of organisations on decisions of the banking regulation is examined with the aid of approaches from the Institutional Economics. Organisations are all national public regulators, European associations of public regulators and plural regulation actors. They pursue the regulation of markets to secure the common good. The organisation of the actors is done by the appropriate configuration of institutions.¹⁸ Institutions are formal and informal rules (norms); combined they form a system through which the behaviour of organisations can be controlled.¹⁹ The economic concept of institutions means the legal

¹⁴In detail Höfling, Gutachten zum 68. Deutschen Juristentag, (C.H. Beck, 2010), F43 et seq.

¹⁵Schmidt-Aßmann, Einführung, in Schmidt-Aßmann and Hoffmann-Riem (Eds.), *Verwaltungsorganisationsrecht als Steuerungsressource*, (Nomos, 1997), 9 (20).

¹⁶Schuppert, *Verwaltungswissenschaft*, (Nomos, 2000), 547; Weaver and Rockman, Assessing the effects of institutions, When and how do institutions matter, in Weaver and Rockman (Eds.), *Do Institutions matter? Government Capabilities in the United States and Abroad*, (Brookings Institute, 1993), 1 (9).

¹⁷Möllers, *Der vermisste Leviathan*, (Suhkamp, 2008), 83; Ruffert, Begriff, in Fehling and Ruffert (Eds.), *Regulierungsrecht*, (Mohr Siebeck, 2010), § 7 paras. 18, 22.

¹⁸Erlei, Leschke and Sauerland, *Neue Institutionenökonomik*, 2nd ed. (Schäffer-Poeschel, 2007), 22, 65; Richter and Furobotn, *Neue Institutionenökonomik*, 4th ed. (Mohr Siebeck, 2010), 7 et seq.

¹⁹North, *Institutions, institutional change and economic performance*, (Cambridge University Press, 1991), 3 et seq.; Leschke, *Regulierungstheorie aus ökonomischer Sicht*, in Fehling and Ruffert (Eds.), *Regulierungsrecht*, (Mohr Siebeck, 2010), § 6 para. 13.

bases (including laws, regulations, contracts, rules of procedures) of players in the banking regulation. They determine who is responsible for decisions in a particular area and which procedures need to be followed.²⁰ Douglass C. North establishes a link between organisation and institution, after which the development of the organisation depends on institutional frameworks, while organisations themselves affect the development of the institutional framework.²¹

The regulation of financial institutions is based on uncertainties, since the business of the financial sector has to deal with risks which may affect private investors and the economy as a whole. Aim of the banking regulation is both, to reduce information asymmetries between banks as providers and private clients as buyers, and to generate confidence in the financial market. Particularly, economic uncertainties are difficult to regulate. Which institutions are considered systemically relevant? How much capital is needed to cover the risk? What minimum liquidity is required to ensure the solvency of credit institutions? The administration of regulation requires comprehensive information to reduce factual uncertainties²² in the banking regulation. This dilemma is less resolved through a substantive and procedural programme control as through the institutional arrangements of the organisations that programme methods and control decisions.

1.1.3 Overview of the Legal Basis of Banking Regulation

Terminologically this study deals with the administrative organisation of banking regulation. The focus is set on all administrative actors who are entrusted with the supervision, recovery and management of financial institutions. The rules made for the supervision and the rules made for the recovery and resolution of financial institutions deserve special attention. Fundamental impulses emerged at an international level. These impulses embraced directives and regulations at a European level before they were transposed in national law or were applied directly.

With the Declaration on Strengthening the Financial System²³ of the Heads of State and Government (Group of Twenty in April 2009), the Financial Stability Board was established. The board was, among other things, given the tasks to evaluate the stability of the global financial system, to identify systemically important and cross-border financial institutions, and to promote the cooperation

²⁰Arrow, *Essays in the theory of risk-bearing*, (North-Holland Publications, 1971), 224 et seq.

²¹North, *Institutions, institutional change and economic performance*, (Cambridge University Press, 1991), 5, 8.

²²Knight, *Risk, Uncertainty and Profit*, (Harper & Row, 1971), 259 et seq.; for more details about generating knowledge as problem of regulation see Herzmann, *Konsultationen*, (Mohr Siebeck, 2010), 33 et seq.

²³G20 Declaration on Strengthening the Financial System, London Summit, 2 April 2009 (available online, last downloaded 28.02.2015 at http://www.g20ys.org/upload/files/London_2.pdf).

and exchange of information between the Financial Supervisory Authorities to implement regulatory and supervisory measures.

These regulations were supplemented by the Basel Committee on Banking Supervision with the framework “Basel III: A global regulatory framework for more resilient banks and banking systems”²⁴ to strengthen the quality and quantity of equity, broader securitisation of risks with equity, international liquidity and risk management standards and to supervise systemically relevant banks.²⁵ Geographical disadvantages of financial centres can be avoided by worldwide standard rules. The financial crisis has revealed discrepancies between different national regulatory rules and surveillance actors in Europe.²⁶ Fragmented supervisory rules and competences could not be properly coordinated during the crisis.²⁷ There is a tension between government requirements for the provision of equity capital and a fair, private competition in the European internal market.²⁸ Goals of a fundamental reform of the financial regulation were detailed substantive and procedural programmes and extensive regulation *actors* to submit the financial industry to stricter regulation. At the same time, the legislative techniques of the European Union changed its course. Substantive and procedural requirements of the banking regulation were regulated according to Art 288 (3) Treaty on the Functioning of the European Union (TFEU)²⁹ by means of directives that were only binding as to the result to be achieved. Member States were left with the choice of form and method. So the national legislators remained with a little scope for implementation. Under the impact of the financial crisis, a group of experts, under the direction of former International Monetary Fund (IMF) president Jacques de Larosière, came to the conclusion that the national scope of implementation led to an inconsistent European regulatory framework.³⁰ Instead, regulation was recommended as instrument to avoid such scopes in the future.³¹ The interaction of directive and regulation was supposed to create a high level of harmonisation in the banking regulation. Therewith, regulatory forbearance through the Member States and regulatory

²⁴Bank for International Settlements, A global regulatory framework for more resilient banks and banking systems 2010; revised version published in June 2011 (available online, last downloaded 28.02.2015 at: <http://www.bis.org/publ/bcbs189.pdf>).

²⁵For further details see Bundesbankpublikation: Basel III – Leitfaden zu den neuen Eigenkapital und Liquiditätsregeln für Banken, (Deutsche Bundesbank, 2011).

²⁶Wymeersch, The new European financial regulatory bodies, *revue bancaire et financière* (2012), 28 (29).

²⁷Ferber, Die Neuordnung der Europäischen Aufsichtsstruktur, *Ifo-Schnelldienst* 64 (2011), 9 (10).

²⁸Schäfer/Rolker, Bankenaufsicht im Spannungsfeld von Regulierung und Wettbewerb, in Grieser and Heemann (Eds.), *Bankenaufsicht nach der Finanzmarktkrise*, (Frankfurt School Verlag, 2011), 3 (9).

²⁹Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47.

³⁰De Larosière Report, 25 February 2009, paras.99, 102 (available online, last downloaded 28.02.2015 at: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf).

³¹De Larosière Report, 25 February 2009, para.110 (available online, last downloaded 28.02.2015 at: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf).

capture between national supervisory boards and financial institutions were supposed to be avoided.³² As result the substantive provisions of the Basel III framework were implemented through the Capital Requirements Directive IV³³ and the Capital Requirements Regulation³⁴ in the European Union.³⁵ In addition, the European Commission adopted regulatory technical and implementing standards, developed by the European Banking Authority. Under the heading “Single Rule Book” supervisory rules were ought to extend themselves not only to large credit institutes (as planned in Basel III), but also to all credit institutes and investment firms.

Furthermore, the Financial Stability Board designed “Key Attributes of Effective Resolution Regime for Financial Institutions”³⁶ at an international level. This impetus was implemented at a European level by the Directive establishing a framework for the recovery and resolution of credit institutions and investment firms,³⁷ which creates a material framework that harmonises the recovery and resolution instruments. In addition, the Regulation establishing uniform rules and a uniform procedure³⁸ complements the already advanced stage of the development of a uniform European monitoring mechanism.³⁹ The goal is to provide tools, which enable a bank resolution without using the taxpayers’ money.

The Federal Republic of Germany implemented the market-related Regulation in accordance with the German Securities Trading Act⁴⁰ and the institutional

³²Kämmerer, *Bahn frei der Bankenunion*, *Neue Zeitschrift für Verwaltungsrecht* (2013), 830 (831).

³³Directive 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, OJ L 176, 27.06.2013, p.338.

³⁴Regulation (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 321, 30.11.2013, p.6.

³⁵For further details see Höpfner, *CRD IV Regulierungspaket für Banken*, *BaFin Journal* 1/2014, 21 et seq.

³⁶Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, 2011, updated version published October 2014 (available online, last downloaded 28.02.2015 at: http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf).

³⁷Directive 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, OJ L 173, 12.06.2014, p.190.

³⁸Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, OJ L 225, 30.07.2014, p.1.

³⁹In detail Zimmer, *Gutachten zum 68. Deutschen Juristentag*, (C.H. Beck, 2010), G 49 et seq.

⁴⁰*Gesetz über den Wertpapierhandel (Wertpapierhandelsgesetz – WpHG)* as published in the announcement of 09 April 1998 (Federal Law Gazette I, p. 2708), last amended on 15 July 2014 (Federal Law Gazette I, p. 934).

supervision in accordance with the German Banking Act.⁴¹ This is, in terms of recovery and resolution, by the Restructuring Act⁴² and—recently announced—the Recovery and Resolution Act⁴³ coming into force as of 01.01.2015. Formally, the ongoing supervision is performed by the Deutsche Bundesbank, while the German Federal Financial Supervisory Authority shall make supervisory decisions and the Agency for Financial Stability carries out the recovery and regulation of credit institutes.

1.1.4 State of Previous Investigations

A study on the legal assessment of the impact of organisations on decision-making in bank Regulation Law does not exist. The Administrative Organisation Law and approaches of the New Institutional Economics are ought to serve as model for this study.

The research on the influence of organisations on decision-making focuses on socio-economic studies on the use of uncertainties while making decisions. The political scientists Dorothea Jansen and Klaus Schubert raise the question “how interactions and constellations of actors influence the result.” In terms of New Institutional Economics authors to mention are Douglass C. North and Kenneth J. Arrow. Arrow examines an “interest in studying how organisations solve their problems”. North emphasises that “organisations [...] will reflect the opportunities provided by the institutional matrix” as a “fundamental long-run source of change”. The legal research does not go beyond first attempts.⁴⁴ Only William E. Kovacic uses the example of a competition law from an Anglo-American perspective and establishes that “institutional considerations are beginning to receive the attention they deserve”.⁴⁵ A coherent doctrine has not yet developed.

Particularly, the field of Regulation Law, in which organisations clearly define and carry out the substantive law requirements, the relationship between organisation and decision-making in the German and European law is only discussed

⁴¹Gesetz über das Kreditwesen (Kreditwesengesetz – KWG) as published in the announcement of 09. September 1998 (Federal Law Gazette I, p. 2776) last amended on 15 July 2014 (Federal Law Gazette I, p. 934).

⁴²Gesetz zur Reorganisation von Kreditinstituten (Kreditinstitute-Reorganisationsgesetz – KredReorgG) as published in the announcement of 09. December 2010 (Federal Law Gazette I, p. 1900) last amended on 22 December 2011 (Federal Law Gazette I, p. 3044).

⁴³Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen (Sanierungs- und Abwicklungsgesetz – SAG) as published in the announcement of 10 Dezember 2014 (Federal Law Gazette I, p. 2091).

⁴⁴Posner, *Economic Analysis of Law*, 8th ed. (Wolters Kluwer International, 2011), 31, 33.

⁴⁵Kovacic, *Distinguished essay: Good agency practice and the implementation of competition law*, in Hermann, Krajewski and Terhechte (Eds.), *European Yearbook of International Economic Law*, Vol. 4 (2013), 3 (6).

basically. Trends in legal literature tend to describe the organisational forms of banking regulation without discussing their influence on regulatory decisions. Based on these descriptions, the given problem can be viewed systematically.

Given the high practical relevance of the legal assessment of the relationship between organisational forms and decisions in the banking regulation, it appears to be essential to systematically classify and link the multitude of regulatory actors.

1.2 Aim of the Investigation

This study aims to determine the organisation of the administration of regulation in the European Composite Administration at a national, European and international level. Therefore, organisational models are created. In addition, a focus is set on two frameworks: on the one hand, on the legal basis for the organisation of banking regulation and, on the other hand, on the dilemma between monetary policy and banking regulation with regard to regulatory decisions.

Centre of investigation is the question how organisational forms influence decision-making in the banking regulation. Associated with this is the question how the administration of regulation can close the gap between the given and needed information. Given information are already owned or can be gained by the administration of regulation. Information not given but needed is important to know to adequately regulate the markets. This work starts on the administrative organisation of the administration of regulation in the reference area of banking regulation. There are different institutional requirements for equipping organisations. These organisations can generate knowledge and participate in the regulatory decision-making process. Thus, each organisation form has a different influence on decision-making in the European regulatory network. This allows the organisation of banking regulation to serve as a basis for discussions in the regulatory practice.

The aim of the investigation is to come up with theses for the organisation of the administration of regulation to meet the dynamic conditions of the financial sector by organised regulatory actors. The resulting theses can be viewed from two different angles. From one perspective, the effect of different institutional arrangements for the organisational design can be derived. From the other perspective, constructive approaches can be gained by creating models to develop or reform the administration of regulation in other economic sectors.

The investigation will in particular show that the density of regulation within the institutional framework affects the organisational power of the regulatory actors, and that the organisational power is correlated with the influence of regulatory actors on the decision-making process.

1.3 Course of Investigation

The investigation of the relationship of organisation and decision on the example of banking regulation calls for a terminological introduction. Approaching the concepts of administration and organisation enables to work out key elements of the administrative organisation design, which are used in the following to create administrative organisations in the banking regulation. Subsequently, the concept of regulation is defined in the broader sense of the word as used in financial markets and financial institutions. Thus, the functions of banking regulation can be understood. Against the background of this abstract introduction, the unique challenges of banking regulation are outlined. These challenges comprise asymmetric information, actual uncertainties and incomplete knowledge.

Five model types of administrative organisations are set up, based on administrative organisation elements. Particular importance is placed on the institutional arrangements of the organisation, as they define the principles, competencies and relationships between the respective actors. Then, the manifestations of the administration of regulation are classified with a total of eleven actors in an organisational and process sequence of banking regulation. Following this, the organisation models and their respective manifestations in banking regulation are placed in a matrix of institutional organisational power and their respective influence on regulatory decision.

Seven theses on the organisation of banking regulation derive from the systematic analysis of banking regulation actors: the organisation of banking regulation follows no legal foundation in the European Treaties (I), the banking supervision by the European Central Bank (ECB) is incompatible with their contractual mandate for monetary policy (II), the European bank resolution leads to a communitarisation of liability (III), the European banking regulation is incompatible with the determination of the German Basic Law for democratic legitimacy (IV), banking supervision collides with the model of the Union law enforcement (V), the density of regulation of the institutional framework affects the organisational power of the regulatory actors (VI), the organisational power correlates with the influence of regulatory actors on decisions (VII).

Finally, a summary on the organisation of banking regulation is given.



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Wellerdt, A.

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