



MAX-PLANCK-GESELLSCHAFT

MPI Collective Goods  
Martin Hellwig



# German Banks and Bank Supervision: Problems and Perspectives

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# Overview over Problems



- Banking system: flawed structure, excess capacity, barriers to exit
- Politics: Parafiscal funding objectives, promotion of "champions", protection of special interests
- Supervision: Extremely passive, subordinated to Finance Ministry, dominated by legalistic thinking, lack of professional competence in modern finance, hampered by unclear divisions of responsibilities

# Banking System Structure



- Three pillars: publi, cooperative, private
- Public: Local (savings banks) regional/global (Landesbanken)
- Cooperative: similar separation
- Private: „Great Banks“ + specialized institutions (covered bond finance, real estate; portfolio management,...)
- With exit of Dresdner, „Great Banks“ are reduced to Deutsche, Coba, and Unicredit, the former HVB

# Business models



- Local public and cooperative: retail deposits and SE lending – very profitable
- „Great Banks“ traditionally: retail deposits plus money market funding, lending to larger firms – profitable until the mid 1990s, not so profitable since then
- Landesbanken: deposits from local savings banks plus money market/bond market funding, lending to larger firms, international project finance, serving the Ministerpräsident, never very profitable

# Erosion of the old world



- Mid 1990s: Margins disappeared – due to r going down and due to intensification of competition, perhaps money market fund admission, perhaps scale economies
- 2001: Agreement D – COM calls for end of state guarantees to public banks by 2005

# Escape strategies



- Landesbanken: Fill up on guaranteed funding by 2005, invest in toxic assets
- Deutsche: Take over Morgan Grenfell (1989), Bankers' Trust and let the investment bankers rule
- Dresdner: Take over Kleinwort and kick the investment bankers out
- Commerzbank: Acquire Eurohypo and go into covered bond finance
- HRE, Westimmo: Conquer Europe for German covered bond finance

# And the supervisor



- Was largely passive, accepted banks' risk assessments, hailed cooperation with banks
- No interference with creation of SIVs and conduits, treated SIVs as if they were independent firms
- No interference with shotgun acquisition of Hypo Alpe Adria by Bayern LB
- Legalistic practices and fears
- No interference with Cum-ex
- No interference with WireCard
- ...

# Politics and Crises



- Exit by Sachsen LB, taken over by LBBW,
- Exit by Dresdner Bank, taken over by Coface,
- Exit by West LB, imposed by COM;
- Bailouts of LBBW, Bayern LB, HSH Nordbank, HRE (nationalized then in small part reprivatized)
- Shutdowns of Eurohypo (due to COM) and Westimmo (due to COM)
- More recently further bailouts of HSH Nordbank and Nord LB

# Is there scope for reforming structure



- Political resistance from the heads of governments of the Länder
- Federal Government has little power over the issue and does not want to offend these heads of government anyway – too important politically (second chamber)
- Scholz was in charge of what happened to HSH Nordbank
- COM is the only player who might do something, but has become more passive recently (Nord LB)

# Reform Needs of BaFin



- Objectives: reduce systemic risks, protect consumers/investors – These objectives run counter to the desire to have cooperation with banks (quoted in proceedings before the Constitutional Court)
- Give more weight to consumer protection – either by having a separate agency, or by having a separate division inside BaFin

# Reform Needs: Governance



- Remove banks from administration council
- Reduce dependence from Finance Minister, e.g. by legislating independence in decisions on individual cases,
- At the same time create transparency about Finance Ministry interference, e.g. by requiring general directives to be published.
- ... on the model of the Cartel Office and the Regulatory Authority for Network Industries

# Reform Needs: Operating Procedures



- Improve deterrence by allowing for larger penalties (as in competition policy)
- ... and by strengthening protection of whistleblowers and the like.
- Introduce more economics and more of a system focus into analyses, reduce legalisms (if possible – the courts might object)
- Improve the quality of personnel by having more attractive career patterns
- Create a sense of ownership of supervision as an independent activity

# Reform Needs: Accountability



- Eliminate the thicket of competing competences
- ... of federal and Länder institutions (important in WireCard, where BaFin thought the district of Lower Bavaria was in charge and that district thought BaFin was in charge)
- Reduce the authority of the Bundesbank, make bank supervisors more clearly accountable to BaFin.

# Concluding Remarks



- A major reform of the German financial system is probably infeasible. The heads of the regional governments (plus mayors etc.) are too powerful.
- Even so, significant improvements in the status, the vision and the operations of BaFin might be attainable if the political will can be created.
- However, some of the people in charge of things under the new government have been involved with problems in the past.