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# THE NEW GERMAN SYSTEM OF RESCUING BANKS

Christoph G. Paulus\*

## INTRODUCTION

It is a well known fact that Germany was also hit by the 2008 financial market crisis. Banks, including the IKB Bank and the Hypo Real Estate Bank, tumbled and were on the verge of going bankrupt. Dramatic, overnight rescue operations<sup>1</sup> became necessary. Although these operations were indispensable for the general public's trust in the financial system, and thus, in the economy in general, they were also very expensive. Therefore, a number of "fig leaves"<sup>2</sup> were put in place to mitigate tax payers' displeasure with paying for the losses; yet, losing out on the gains was of only temporary political help. Nevertheless, following the lead of the United Kingdom and Switzerland, the German legislature decided to strengthen its insolvency prevention measures within the banking sector. This new legislation broke new ground, at least for Germany.<sup>3</sup> The already existing control mechanisms were improved; and, more importantly, entirely new mechanisms were introduced.

These innovations may be seen primarily in relation to the general insolvency law. Therefore, in order to fully understand the implications of the newly enacted Restrukturierungsgesetz (Restructuring Statute, henceforth ReSt),<sup>4</sup> it may be useful to describe Germany's insolvency practice<sup>5</sup> as it existed before the enactment of the ReSt (i.e., before January 1, 2011). Indeed, though on its surface the statute is directed towards failing banks, it is also meant to be a test-drive for a number of features which are

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1. Ulrich Seibert, *Deutschland im Herbst-Erinnerungen an die Entstehung des Finanzmarktstabilisierungsgesetzes im Oktober 2008*, in Festschrift für Klaus Hopt 2525, 2529 (Grundmann et al. eds., 2010) (Ger.).

2. See Manfred Obermüller & Karen Kuder, *Die Entwicklung der Gesetzgebung zu Bankinsolvenzen*, 13 ZEITSCHRIFT FÜR DAS GESAMTE INSOLVENZRECHT [ZINSO] 2016, 2016 (2010) (Ger.) (providing a short overview of all such legislative measures). See also Gregor Bachmann, *Das neue Restrukturierungsrecht der Kreditinstitute*, 22 ZEITSCHRIFT FÜR BANKRECHT UND BANKWIRTSCHAFT [ZBB] 459, 460 (2010) (Ger.).

3. This step still needs to be fulfilled on the Eurogroup level. See Christoph G. Paulus, *Ein Regelungssystem zur Schaffung eines internationalen Insolvenzrechts für Staaten*, 25 ZEITSCHRIFT FÜR GESETZGEBUNG [ZG] 313, 319 (2010) (Ger.); Christoph G. Paulus, *A Resolvency Proceeding for Defaulting Sovereigns*, 3 INT'L INSOLVENCY L. REV. [IILR] 1, 1 (2012).

4. Restrukturierungsgesetz [RStruktG] [Restructuring Statute], Dec. 9, 2010, BUNDESGESETZBLATT, Teil 1 [BGBl. I] at 1900 (Ger.) [hereinafter ReSt].

5. See generally Christoph G. Paulus, *The New German Insolvency Code*, 33 TEX. INT'L L.J. 141 (1998); see also Christoph G. Paulus, *Germany: Lessons to Learn from the Implementation of a New Insolvency Code*, 17 CONN. J. INT'L L. 89 (2001) (providing a general description of Germany's insolvency legislation).

intended to be—sooner or later—transferred to the general insolvency law that is applicable to all insolvent entities.<sup>6</sup>

## I. THE PREVIOUS SYSTEM

Under the previous bank insolvency regime, a bank's insolvency would be subjected to the general insolvency law of the Insolvenzordnung (Insolvency Ordinance, henceforth InsO).<sup>7</sup> In theory, a bank would be treated like any other insolvent enterprise. This scenario, however, rarely applied because the right to file a petition was reserved exclusively for the Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Agency for Financial Service Supervision, henceforth BaFin).<sup>8</sup> Furthermore, in addition to this exclusive right, BaFin was entrusted with some instruments designed to prevent a financial institution from going bankrupt. As a result, the application of the general insolvency law was rarely used.

In truth, the hope of applying the rescue option is (and always has been) in vain. Banks and other financial institutions are so dependent on their customers' trust that any contact with an insolvency court would lead to a run on the bank that would immediately destroy the business;<sup>9</sup> this is true at least in jurisdictions like Germany where the stigma of bankruptcy remains paramount.<sup>10</sup> While these facts demonstrate that preventive measures are important,<sup>11</sup> the last financial crisis showed that these instruments are not sufficient. The new legislation seeks to make the necessary improvements.<sup>12</sup>

## II. THE LACK OF A RESCUE CULTURE

The general German insolvency law draws a clear line between a court-driven insolvency proceeding and any out of court rescue. Whereas the former is regulated entirely by the InsO, the latter is not—which means that in practice all measures have to be taken from, for instance, general contract

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6. See discussion *infra* Part II.

7. Insolvenzordnung [InsO] [Insolvency Ordinance], Oct. 5, 1994, BUNDESGESETZBLATT, Teil 1 [BGBl. I] at 2866, as amended Dec. 7, 2011, BGBl. I at 2582 (Ger.) [hereinafter InsO]. See EVA H.G. HÜPKES, THE LEGAL ASPECTS OF BANK INSOLVENCY, A COMPARATIVE ANALYSIS OF WESTERN EUROPE, THE UNITED STATES AND CANADA 57, 117 (2000) (providing a concise description of the previous bank insolvency system); KLAUS PANNEN, KRISE UND INSOLVENZ BEI KREDITINSTITUTEN 113 (3rd ed. 2010).

8. See BUNDESANSTALT FÜR FINANZDIENSTLEISTUNGS-AUFSICHT, [http://www.bafin.de/EN/Home/homepage\\_\\_node.html?\\_\\_nnn=true](http://www.bafin.de/EN/Home/homepage__node.html?__nnn=true) (last visited Jan. 18, 2012).

9. See Daniel Zimmer & Florian Fuchs, *Die Bank in Krise und Insolvenz: Ansätze zur Minderung des systemischen Risikos*, 39 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT [ZGR] 597, 599 (2010) (Ger.) (discussing the interconnectedness of the banking sector); see also Obermüller & Kuder, *supra* note 2, at 2017.

10. See Christoph G. Paulus, *Ein Kaleidoskop aus der Geschichte des Insolvenzrechts*, 64 JURISTENZEITUNG [JZ] 1148, 1149 (2009) (Ger.) (providing a history of the stigma of bankruptcy proceedings in Germany).

11. See Bachmann, *supra* note 2, at 459.

12. See discussion *infra* Part II.

law, commercial law, and some other appropriate bodies of law. This strict distinction has come under criticism in recent years.<sup>13</sup>

Such criticism was not necessarily due to influence from the United States, where the Chapter 11 proceeding represents a kind of archetype for the hybrid character of a prevention and insolvency type of proceeding. Rather, it was the development within the area of the European Insolvency Regulation, where the German jurisdiction was confronted again and again with the insolvency prevention measures of other states. In particular, when German companies started to move their center of main interests (COMI) to England in order to benefit from its Company Voluntary Arrangement, the discussion in Germany intensified. It further intensified in 2011 when German companies started to restructure their financial difficulties by making use of the English Scheme of Arrangement without changing their COMI.<sup>14</sup> Other member states, such as Italy, Greece, and, above all, France, have also developed elaborate pre-insolvency procedures to prevent companies from being forced into a regular insolvency (or liquidation) proceeding.

The discussion in Germany about the benefit or disadvantage of this type of proceeding is still going on even despite the fact that the forthcoming amendment to the InsO is called Gesetz zur weiteren Erleichterung von Sanierungen für Unternehmen (Statute for the Facilitation of Companies' Reorganizations, henceforth ESUG).<sup>15</sup>

### III. SPECIFIC INSOLVENCY-RELATED ISSUES

Finally, there are a number of specific insolvency-related issues in the present InsO, and the way it has been interpreted is the subject of (partly long-lasting) complaints. Suffice it to mention here:

- the lack of any authority to have the insolvent company's shareholders included within the proceeding (the abbreviation here, the debt-equity swap);

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13. See Christoph G. Paulus, *Deutschlands langer Weg in die insolvenzrechtliche Moderne – Auf der Suche nach einer Sanierungskultur (Rescue Culture)*, 65 WERTPAPIER-MITTEILUNGEN [WM] 2205, 2205 (2011) (Ger.).

14. See Christoph G. Paulus, *Das englische Scheme of Arrangement – ein neues Angebot auf dem europäischen Markt für außergerichtliche Restrukturierungen*, 32 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 1077, 1077 (2011) (Ger.); Peter Mankowski, *Anerkennung englischer Solvent Schemes of Arrangement in Deutschland*, 65 WERTPAPIER-MITTEILUNGEN [WM] 1201 (2011) (Ger.); Horst Eidenmüller & Tilmann Frobenius, *Die internationale Reichweite eines englischen Scheme of Arrangement*, 65 WERTPAPIER-MITTEILUNGEN [WM] 1210, 1219 (2011) (Ger.).

15. Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen [ESUG] [Statute for the Facilitation of Companies' Reorganizations], Dec. 7, 2011, BUNDESGESETZBLATT, Teil 1 [BGBl. I] at 2582 (Ger.) (providing exclusively intra-insolvency measures).

- the notorious German problem of having no ability to predict the insolvency administrator because the appointment is left to the exclusive, and jealously kept, power of the insolvency judge; and
- the multiplicity of insolvency courts and the resulting lack of expertise among many insolvency judges.

### A. THE DESCRIPTION

The ReSt is designed to overcome all these deficiencies.<sup>16</sup> It consists of a package of different measures, of which the four most important shall be discussed in this paper. Even though these and several other measures were discussed widely in the European context, and even though the European Commission plans to come up sooner or later with its own rescue instrument,<sup>17</sup> Germany felt the need to expedite the process by setting up its own legislation. It remains to be seen whether the ReSt will need adaptations or amendments once Europe has acted.

#### 1. Reorganization of Credit Institutions

Part 1 of the ReSt contains the abovementioned test-drives; it is called Gesetz zur Reorganisation von Kreditinstituten (Statute for the Reorganization of Credit Institutions, henceforth CIRESt).<sup>18</sup> It consists of two parts, of which the first, Sanierungsverfahren (rescue proceeding),<sup>19</sup> is applicable to all credit institutions, whereas the second, Reorganisationsverfahren (reorganization proceeding),<sup>20</sup> is reserved for those few institutions whose failure and breakdown would create a systemic risk.

##### a. Commonalities

Section 1 of CIRESt is a general statute which applies to both types of proceedings. With respect to CIRESt's applicability, it defines in paragraph 1 which credit institutions are addressed. Accordingly, only those institutions, which fall under the definition in section 1 of

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16. Other issues, particularly taxation issues, remain unresolved. Hans-Jürgen A. Feyerabend, Stephan Behnes & Marcus Helios, *Steuerliche Aspekte des Banken-Restrukturierungsgesetzes*, 64 DER BETRIEB [DB], supplement 4, 30, 30 (2011) (Ger.).

17. See Klaus J. Hopt, *Auf dem Weg zu einer neuen europäischen und internationalen Finanzmarktarchitektur*, 12 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 1401, 1401 (2009) (Ger.). See also Urs Zulauf, *Schweizer Bankensanierungsrecht – geeignet für systemrelevante Banken?: Ein Vergleich mit den Vorschlägen in Deutschland*, 64 WERTPAPIERMITTEILUNGEN [WM] 1525 (2010) (Ger.) (discussing the system in Switzerland).

18. Kreditinstitute-Reorganisationsgesetz [KredReorgG] [Statute for the Reorganization of Credit Institutions], Dec. 9, 2010, BUNDESGESETZBLATT, Teil 1 [BGBl. I] at 1900 (Ger.) [hereinafter CIRESt].

19. See discussion *infra* Part III.A.1.b.

20. See discussion *infra* Part III.A.1.c.

Kreditwesengesetz (Banking Act, henceforth BAct) and which have their seat within Germany, are included. This excludes, for instance, financial service providers, investment trusts, and foreign credit institutions. Section 1, paragraph 3 of CIRESt serves the purpose of accelerating both proceedings by ordering that all judicial decisions be given by judicial resolution (Beschluss) rather than a full-fledged decision; this means that, pursuant to the common terminology of the Zivilprozessordnung (Civil Procedure Ordinance, henceforth CPO),<sup>21</sup> oral proceedings are dispensable. Moreover, the same paragraph decrees that all those resolutions are incontestable, which means that they are binding as soon as they are issued. Taken together with the fact that the Frankfurt Court of Appeal has exclusive jurisdiction, these rules are likely to become a model for commercial insolvency law in general.

There is one more noteworthy commonality of the two types of proceedings that is meant to serve as an incentive to make use of them: If a credit institution petitions for either one of the proceedings, it is relieved from its duty to notify BaFin of its inability to pay or its over-indebtedness.<sup>22</sup>

#### *b. Rescue Proceeding*

Sections 2 through 6 of CIRESt deal with the rescue proceeding. It is, like the reorganization procedure,<sup>23</sup> an optional procedure which was originally intended to be available to all German credit institutions whenever they felt the need for a rescue attempt. This instrument should, thus, have been available at any time, even long before insolvency. In the last minute of the legislative process, however, this unrestricted time requirement was changed by inserting into section 2, paragraph 1 of CIRESt the request that certain requirements of section 45 of the BAct be fulfilled. This set of eligibility requirements reflects the typical German distrust in the responsible handling of legal instruments by private parties;<sup>24</sup> obviously, it was feared that, without such restrictions, the rescue proceeding might be abused. This fear is even more irksome as CIRESt explicitly states: “The rescue plan might contain all sorts of measures suitable for the rescue of the credit institution as long as they do not touch the rights of third parties.”<sup>25</sup>

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21. Zivilprozessordnung [ZPO] [Civil Procedure Ordinance], Jan. 30, 1877, REICHSGESETZBLATT [RGBl.] at 83, as amended Dec. 22, 2011, BGBl. I at 3044 (Ger.) [hereinafter CPO].

22. Under the Kreditwesengesetz (Banking Act), an institution that becomes insolvent or overindebted is required to immediately report this fact to the Federal Banking Supervisory Office. Kreditwesengesetz [KWG] [Banking Act], Sept. 9, 1998, BUNDESGESETZBLATT, Teil I [BGBl. I] at 2776, as amended Dec. 22, 2011, BGBl. I at 3044, § 46b (Ger.) [hereinafter BAct].

23. See discussion *infra* Part III.A.1.c.

24. This distrust can also be described as a lack of a rescue culture in Germany.

25. CIRESt, *supra* note 18, § 2, para. 2, sentence 2 (Ger.) (*translated by author*).

Note that such third parties are, in particular, creditors! But let us go step by step.

The rescue procedure begins with a petition by the credit institution to BaFin. It must (1) indicate the distressed situation, (2) be accompanied by an elaborated rescue plan, and (3) contain a proposal of a qualified rescue adviser. The rescue adviser can even be a member of the board of directors of the institution.<sup>26</sup> It is explicitly provided that an advisor is not disqualified by his or her participation in the drafting of the rescue plan.<sup>27</sup> If BaFin deems this application appropriate, it shall immediately file a petition with the (exclusively competent) Court of Appeal in Frankfurt to open the rescue proceeding. BaFin appends to this petition its own assessment of the rescue plan, in addition to its evaluation of the rescue adviser; both BaFin and the court have the right to propose a different advisor.<sup>28</sup>

The rescue adviser's position and competence is comparable to that of the preliminary insolvency administrator in the commercial insolvency area. The main task of the rescue adviser is to implement the rescue plan.<sup>29</sup> For this purpose, the adviser is granted a number of powers—ranging from the right to enter into an investigation within the credit institution over its right to participate in meetings to the right to give instructions about the management. In addition to these generally existing powers of the adviser, the Court of Appeal can order further measures if required; these may range from inhibiting directors from further action, to obliging the directors to appoint the adviser to the board, to examining the appropriateness of the management's salaries.

This description of the rescue procedure makes it clear that its essential feature is the rescue plan. It may, for instance, provide for increasing equity or adding borrowed capital, reducing the labor force of the institution, or selling certain parts of that institution's commercial enterprise. As aforementioned, this plan, however, must not contain any regulations which would interfere with third parties' rights. Nevertheless, there is one explicit exemption to that, pursuant to section 2, paragraph 2 of CIRESt: the plan may include a clause which grants a super priority to rescue new creditors<sup>30</sup> over existing creditors, provided that, despite the rescue efforts, an insolvency proceeding takes place within the next three years, and that the

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26. *Id.* § 3, para. 3.

27. *Id.* § 3, para. 1. These rules are understandable after considering the predominant, general practice of German insolvency courts, which never appoint an administrator who has had any interference with the debtor before the filing of the petition. The ESUG is now about to introduce rules which will overcome this problem in the general commercial insolvency context.

28. *Id.*

29. *Id.* § 6.

30. It is not entirely clear whether this privilege is applicable also for credits given by shareholders of that credit institution. Pursuant to the general insolvency law, shareholder credits are subordinated. *See, e.g.,* Bachmann, *supra* note 2, at 461; Obermüller & Kuder, *supra* note 2, at 2019.

thus privileged credit frame does not exceed the sum of 10 percent of the equity capital. In light of these restrictions and, even more importantly, in light of the notorious German antipathy against the publicity of one's own financial distress,<sup>31</sup> it is highly dubious that this type of procedure will ever be used by any credit institution.<sup>32</sup>

### *c. Reorganization Proceeding*

The reorganization proceeding is much more elaborate; it evokes, in many respects, the so-called plan proceeding of sections 217 through 269 of the InsO, which itself is a modified version of the U.S. Chapter 11 proceeding. But the reorganization proceeding refines the plan proceeding, in areas where past experience has shown that changes are necessary, by accelerating the proceeding by (1) limiting the option to appeal, (2) including the shareholders, (3) broadening of the debtor-in-possession option, and (4) possibly limiting the proceeding to the main creditors.

Like the rescue proceeding, the reorganization proceeding is just an option granted to German credit institutions. It is up to the institution whether to make use of it and whether to use it instead of a rescue proceeding or thereafter; the proceeding is, accordingly, a voluntary one.<sup>33</sup> This option, however, is very much restricted in its applicability. Pursuant to section 7, paragraph 2 of CReSt, it is reserved exclusively<sup>34</sup> for credit institutions which are, according to section 48b of the BAct, of systemic relevance.<sup>35</sup> The following are required: (1) a threat in the present situation to the further existence of that credit institution<sup>36</sup> which might (2) ultimately lead to a threat to the entire system.<sup>37</sup> Because of the centrality of this "nerve system," special remedies are necessary, and therefore, the debtor is allowed to interfere with third parties' rights in this type of procedure.

31. This particular feature is best visible in the German law of secured transactions.

32. See Gunnar Schuster & Lars Westpfahl, *Neue Wege zur Bankensanierung – Ein Beitrag zum Restrukturierungsgesetz (Teil I)*, 64 DER BETRIEB [DB] 221, 223 (2011) (Ger.). Obermüller & Kuder, *supra* note 2, at 2018 (offering a more optimistic position).

33. See discussion *supra* Part III.A.1.b.

34. This restriction can rightly be criticized, see Bachmann, *supra* note 2, at 463.

35. In Germany, it is somewhat inappropriate to limit the discussion of systemic relevance (and its twin, "too big to fail") to credit institutions. Systemic relevance is not confined to the banking sector. See Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 193 (2008). See also Peter Kindler, *Finanzkrise und Finanzmarktregulierung – Ein Zwischenruf zum 68. Deutschen Juristentag*, 63 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 2465, 2467 (2010) (Ger.). See Zimmer & Fuchs, *supra* note 9, at 600.

36. This requirement is not exactly identical with the commercial insolvency law's "imminent insolvency" of section 18 of the InsO. It is rather a non-compliance with certain fundamental conditions of the BAct; see Schuster & Westpfahl, *supra* note 32, at 225.

37. See Klaus Pannen, *Das geplante Restrukturierungsgesetz für Kreditinstitute*, 13 ZEITSCHRIFT FÜR DAS GESAMTE INSOLVENZRECHT [ZINSO] 2026, 2029 (2010) (Ger.).



The reorganization proceeding, too, begins with a petition by the respective credit institution<sup>38</sup> to BaFin, which again must be accompanied by a reorganization plan. As with the rescue proceeding, here, too, an adviser shall be nominated, and is called the reorganization adviser. The reorganization adviser can be member of the board of directors of the institution, or the drafter of the plan. Pursuant to section 13 of CIRESt, the effect of this petition is that any contractual agreements with the credit institution cannot be terminated until the end of the subsequent business day. It is to be assumed, however, that irrespective of section 13's provision that agreements to the contrary shall be deemed to be void, this protection can quite easily be undermined by adjusting, accordingly, the respective contractual clauses to earlier automatic termination events.<sup>39</sup>

After receiving the petition, BaFin examines whether the requirements of section 48b of the BAct are fulfilled and whether the reorganization proceeding appears to be appropriate. Thereby, BaFin is granted broad discretion, but it is to be assumed that BaFin will decide only after consultation with the Bundesbank (German Federal Bank). If the decision is in the affirmative, BaFin files the petition with the abovementioned Court of Appeal, which itself reexamines the requirements of systemic relevance and the legitimacy of the reorganization plan.

What the legitimacy of the reorganization plan means is regulated in sections 8 through 13 of CIRESt. Accordingly, the plan consists of two parts: a descriptive part and a constructive part, which is similar to section 220 of the InsO. The descriptive part provides information to all stakeholders on the status quo and the effects of the reorganization plan. In contrast, the constructive part is where one finds the interference with the creditors' rights. For instance, "haircuts," a moratorium, securitization, or any other restructuring of existing debts (e.g., by providing for a credit frame for privileging new creditors) will be inserted into this part of the plan.<sup>40</sup> The same is true for a debt-equity swap, the details of which are included in section 9 of CIRESt. Note that there is a duty to adequately compensate the previous shareholders<sup>41</sup> and that a debt-equity swap is dependent on the consent of every affected creditor.

Finally, pursuant to section 11 of CIRESt, the constructive part of the reorganization plan might also provide for a spin-off of the credit institution's means, in whole or in part, in an already existing or newly created entity. This option, however, must be designed in a way that does

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38. If a previous rescue proceeding was unsuccessful, this application has to be made by the rescue adviser.

39. See Schuster & Westpfahl, *supra* note 32, at 225.

40. CIRESt, *supra* note 18, § 12 (Ger.).

41. The adequacy of the compensation can be examined by at least one independent auditor who is selected and appointed by the court. It is debatable whether the adequacy is to be determined on the basis of a going concern or of a liquidation. See Obermüller & Kuder, *supra* note 2, at 2019; Schuster & Westpfahl, *supra* note 32, at 227.

not interfere with existing netting systems.<sup>42</sup> Furthermore, section 23 of CIReSt determines that such a spin-off must not affect any collateral or payment and settlement system.

Creditors of the respective credit institution whose rights are affected by any of the interferences in the plan's constructive part are requested to lodge their claims with the reorganization adviser. In a special examination meeting, these claims are examined and discussed if the adviser disputes their legitimacy. The result of the claims' examination also determines the creditors' voting rights.

With respect to the reorganization's acceptance, the procedure is again familiar as it strongly resembles the commercial insolvency law's plan proceeding. Accordingly, the Court of Appeal holds a meeting at which the plan and the voting rights are to be discussed and at which a vote will be cast.<sup>43</sup> The voting takes place in classes.<sup>44</sup> As a result, only creditors similarly situated can be put together in one class. Insofar as shareholders' rights are affected by the reorganization plan, they are to vote in a prior, separate shareholders' meeting.<sup>45</sup> This is deemed to be necessary because of the European Second Company Law Directive<sup>46</sup> and the respective jurisdiction of the European Court of Justice.<sup>47</sup> The details of both voting mechanisms and their potential cram down are regulated in sections 17 through 19 of CIReSt.<sup>48</sup>

If the end result is acceptance of the plan, the Court of Appeal will double-check the correctness of the procedure and will then ultimately confirm the plan.<sup>49</sup> From there, the provisions of the constructive part of that plan will enter into effect.

## 2. Strengthening the Supervision

Whereas the rescue and the reorganization proceeding, as described in the previous section, are left to the respective credit institutions or their directors, the second part of the ReSt demonstrates a certain distrust of this

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42. See Zimmer & Fuchs, *supra* note 9, at 617 (discussing the insolvency protection function).

43. CIReSt, *supra* note 18, § 16 (Ger.).

44. *Id.* § 8.

45. *Id.* § 18.

46. Council Directive 77/91, 1977 O.J. (L 26) 1 (EEC). See Horst Eidenmüller & Andreas Engert, *Reformperspektiven einer Umwandlung von Fremd- in Eigenkapital (Debt-Equity Swap) im Insolvenzplanverfahren*, 30 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 541, 547 (2009) (Ger.).

47. See cases C-19/90 & C-20/90, *Karella v. Minister for Indus., Energy & Tech.*, 1991 E.C.R. I-2691 (Sixth Chamber); case C-381/89, *Sindesmos Melon tis Eleftheras Evangelikis Ekklesias v. Greek State*, 1992 E.C.R. I-2111 (Second Council Directive); case C-441/93, *Pafitis v. Trapeza Kentrikis Ellados AE*, 1996 E.C.R. I-1347 (Second Council Directive); case C-373/97, *Diamantis v. Dimosio (Greek State)*, 2000 E.C.R. I-1705 (Sixth Chamber).

48. CIReSt, *supra* note 18, § 17, para. 2, sentence 2 (Ger.) (providing for creditors); *id.* § 18 (providing for shareholders); *id.* § 19 (stating that all groups have to agree).

49. *Id.* § 20.

kind of party autonomy. As a consequence of the deficiencies recognized during the financial crisis of 2008, this part increases BaFin's existing arsenal of protective measures to a considerable degree.<sup>50</sup> Accordingly, most<sup>51</sup> of the measures relating to those voluntary tools can be imposed by BaFin if it is of the opinion that those steps should be taken. For this purpose, it can even appoint a Sonderbeauftragten (special adviser) and entrust the advisor with all the authority thought to be appropriate in that particular case. This implies that the abovementioned voluntariness is reinforced by what might be called "gentle force" because the voluntary steps can be imposed anyway by BaFin.

But there are even further reaching instruments that BaFin is now permitted to use. Most noteworthy is the Übertragungsanordnung (transfer order)—the power to transfer a credit institution's capital, in full or in part, to a private bank or a public bridge bank. Such a step will facilitate the stabilization of that institution under the umbrella of the new bank whereas the "bad part" is separated. It is said that similar innovations are planned to be adopted through European legislation; however, the German legislature felt the need for prompt action and did not wait for Europe. The idea behind this approach is to rescue the "good bank" in the hands of the transferee whereas the "bad bank" is left behind with the transferor and doomed to be liquidated.<sup>52</sup> Note that a transfer is admissible just with respect to the "good" assets;<sup>53</sup> it is, thus, impossible to transfer toxic assets or the like to a "bad bank."

The transfer order is only permitted for credit institutions that have their seat in Germany and that are of systemic importance.<sup>54</sup> Beyond this parallel with the aforementioned reorganization proceeding, the scope of the order's applicability stretches to holding companies and other higher-ranked group institutions. Therefore, this tool appears to be more efficient than the voluntary one,<sup>55</sup> but is somewhat hedged by the imposition that a transfer order can be imposed only as *ultima ratio* (i.e., there must be no other equally efficient remedy be available). This is an expression of the proportionality principle.<sup>56</sup>

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50. See Dirk Auerbach & Kirsten Donner, *Änderungen bei den aufsichtlichen Eingriffsinstrumenten des KWG durch das Restrukturierungsgesetz*, 64 DER BETRIEB [DB], supplement 4, 17, 17 (2011) (Ger.).

51. Unfortunately, BaFin has no power to prescribe a credit institution to come up with a reorganization plan. See Bachmann, *supra* note 2, at 463.

52. See Obermüller & Kuder, *supra* note 2, at 2021.

53. See Bachmann, *supra* note 2, at 467.

54. See discussion *supra* Part III.A.1.a.

55. If necessary, BaFin might interrupt a reorganization proceeding and issue a transfer order as it may, the other way round, make the issuance of the transfer order dependant on the credit institution's presentation of a reorganization plan which is apt to overcome the threat of insolvency within six weeks.

56. See Schuster & Westpfahl, *supra* note 32, at 282.

Pursuant to section 48c, paragraph 5 of the BAct, the transferee must be a legal person which has its headquarters within Germany. The transfer is admissible only when the transferee declares its consent in a notarially certified document. It is to be assumed that transfer orders will be issued only in extremely urgent cases; therefore, there might not be enough time to wait for such consent of the transferee. After all, it is an important business measure and, accordingly, the transferee must conduct much due diligence in order to take over an entire credit institution, or just parts of it. Thus, it is likely that the most attractive transferee will be a newly created bridge bank.<sup>57</sup> Its “emptiness” alleviates the problems potentially arising out of the evaluation of the transfer’s consideration. Hence, the creation of stock bridge banks will be an important task.<sup>58</sup>

Since it is the goal of any transfer order to save those parts of the credit institution which are of systemic relevance, the selection of the assets to be transferred is of significant importance. Section 48k, paragraph 2 of the BAct, however, clarifies that here, too, netting systems must not be split and that collateral must not be separated from the secured claim. Once the transfer is perfected, it is insolvency-proof, and the transferee is immune against any avoidance attempts.<sup>59</sup> Its liability is, pursuant to section 48h, paragraph 1 of the BAct, subsidiary to that of the transferor and is restricted to the amount of the transferred liabilities which creditors presumably would have received if the transfer had not taken place. This limitation of risk is to be contrasted with the rule in section 48k, paragraph 3 of the BAct, which provides for non-subsidiary liability (i.e., joint liability of transferee and transferor for the liabilities remaining with the latter). This liability is limited, however, to the amount that the creditors would have received without any transfer.

Judicial remedies against such a transfer order are restricted insofar as there is exclusive authority of the Court of Appeal in Kassel (section 48r of the BAct), which is an administrative law court. This results because a transfer order is an act which is subject to administrative law. Nevertheless, when all of these rescue measures ultimately fail and, in the end, a liquidation of a credit institution is inevitable, legislative measures provide for a closer cooperation between the banking supervision on the one hand and the insolvency court and administrator on the other.<sup>60</sup>

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57. See Bachmann, *supra* note 2, at 469.

58. See discussion *supra* Part III.

59. BAct, *supra* note 22, § 48h, para. 2 (Ger.).

60. *Id.* § 46b, para. 3.

### 3. Restructuring Fund

A further part of the ReSt is the Restrukturierungsfondsgesetz (Statute for the Restructuring Fund, henceforth ReStF)<sup>61</sup> which provides for the establishment of a special fund, called Restrukturierungsfonds (Restructuring Fund). It has a limited legal capacity and constitutes a separate division of an already existing institution—the so-called Bundesanstalt für Finanzmarktstabilisierung (Federal Agency for Financial Market Stabilization, henceforth FMSA).<sup>62</sup> Its purpose is to collect financial resources that are to be used in the future for any restructuring or winding-up measures of credit institutions that are of systemic relevance.<sup>63</sup> In order to relieve the general taxpayer from bailouts, this fund is to be supported by financial contributions from all credit institutions in Germany;<sup>64</sup> the target size of the fund is, pursuant to section 12, paragraph 10 of the ReStF, €70 billion.

The contribution rate, however, is not the same for all those institutions. Rather, the rate is to be calculated on the basis of the institution's particular systemic risk. The determination of the individual institution's risk is influenced by various factors: the size of the institution, its interconnectedness on the financial market, its liabilities, and possibly further elements. This rating serves the additional purpose of functioning as a kind of warning signal for the credit institution as it indicates its potential risk.

The FMSA was established in 2008 in the context of the global financial crisis, and its authority has been broadened by the ReStF. The Restructuring Fund is in charge of avoiding the abovementioned threats for the respective credit institutions and for the financial market system as a whole.<sup>65</sup> For this, it has its own right to examine whether a particular credit institution fulfills the requirements of systemic relevance; however, it is to be assumed that this evaluation will be done in close cooperation with BaFin, which, as previously mentioned, has the same right. If the Restructuring Fund comes to a positive conclusion, the respective credit institution has no claim on its own for support (i.e., it is left to the Fund's discretion as to whether to help). Moreover, in principle, support can be

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61. Restrukturierungsfondsgesetz [RStruktFG] [Statute for the Restructuring Fund], Dec. 9, 2010, BUNDESGESETZBLATT, Teil 1 [BGBl. I] at 1921 (Ger.) [hereinafter ReStF].

62. BUNDESANSTALT FÜR FINANZMARKTSTABILISIERUNG, <http://www.fmsa.de/en/> (last visited Jan. 18, 2012).

63. See discussion *supra* Part III.A.1.c.

64. See Hans-Jürgen A. Feyerabend, Stephan Behnes & Marcus Helios, *Finanzierung des Restrukturierungsfonds durch die Bankenabgabe*, 64 DER BETRIEB [DB], supplement 4, 38, 38 (2011). See also DEUTSCHER BUNDESTAG: DRUCKSACHEN [BT] 17/3024 (Ger.).

65. Pannen, *supra* note 37, at 2029 (recognizing a problem in that all credit institutions are bound to contribute payments to the Restructuring Fund but only the systemically relevant are potential recipients of support). Every financial institution, however, has at least the potential of systemic relevance. *Id.*

provided just for such credit institutions which are transferees of the abovementioned transfer order of BaFin. This excludes, *e contrario*, any support of a failing institution or the transferor.<sup>66</sup>

Pursuant to section 3, paragraph 2 of the ReStF, the Restructuring Fund is granted a pool of four measures, under the ReStF, by which it may fulfill its tasks: the foundation of bridge institutions and acquisition of shares, section 5; guarantees, section 6; recapitalization, section 7; and other measures, section 8. Accordingly, bridge institutions can be founded without any existing particular need in order to keep them in stock. If there is an important interest of the Federal Republic of Germany, the Restructuring Fund is permitted to acquire shares of the transferee. This form of state involvement has its roots in the case of the Hypo Real Estate Holding AG which, in 2009, finally became nationalized and is now held by the Fund. Another way of supporting a transferee is the Fund's ability to issue guarantees for the transferee's debentures for a period of up to sixty months.<sup>67</sup> The ceiling on such guarantees is €100 billion.<sup>68</sup>

Pursuant to section 7 of the ReStF, an important interest of the Federal Republic of Germany is again necessary in order to support the transferee by helping with recapitalization (i.e., improving the credit institution's equity). This help, however, comes with a "bitter pill"<sup>69</sup>: the annual salary of any board member and employee is limited to €500,000.<sup>70</sup> Whether this really sets the right incentives for any credit institution to step in as transferee of a failing bank in a case of highest urgency is highly doubtful.<sup>71</sup> The "other measures" mentioned in section 8 of the ReStF are not meant to be a free ticket for any other imaginable kind of support; rather, they are ancillary measures that complement those aforementioned.

#### 4. Statute of Limitations

The final tool is a seemingly tiny change to the existing law, which nonetheless, is based on insightful psychological considerations. For Aktiengesellschaften (joint stock companies) which are either credit institutions or are listed, the existing five-year statute of limitations for claims resulting from the management's liability is prolonged to ten years. The reasons given for this amendment are (1) that more time is available for investigating respective claims, and (2) that the personal composition of the respective body might have changed within such time. The latter takes into account a possible, if not likely, reason for many companies' past

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66. Schuster & Westpfahl, *supra* note 32, at 287 (providing a justified criticism against this provision).

67. ReStF, *supra* note 61, § 6, para. 2 (Ger.).

68. *Id.*

69. The same is also true for the abovementioned acquisition of shares. *See id.* § 4, para. 3.

70. *Id.*

71. *See* Schuster & Westpfahl, *supra* note 32, at 288.

forbearances to claim damages from their managers—managers and supervisors might have been too closely interconnected. In such cases, the following motto might prevail: One crow does not peck the other's eyes out. Since the regular office period of the supervisors (Aufsichtsrat) is about five years, the chances to claim damages increase when the statute of limitations is extended to ten years.

### B. THE EVALUATION

This new package of legislation should be welcomed in many respects. It renders significant help to enhance rescue culture in Germany, it deviates from trodden paths, and it tries to discipline financial institutions. A number of features are innovative and have the potential to develop into important instruments of future financial markets. And it was—and still is—a highly visible sign that the legislature is ready to do something about banking failures. Insofar as commentators discover (or believe they have discovered) certain deficiencies in the various regulations, it is in most cases justified to be confident that the German judiciary will find ways to get things right—it has done so before in innumerable cases.

Yet, a few features are more fundamental than merely technical; they concern the concept of the new legislation as a whole. Criticism here appears to be serious. This is true for the ReStF's approach to abstain completely from assisting a failing credit institution.<sup>72</sup> The idea that support should be given exclusively to the transferee and never to a transferor might seem theoretically sound; but in practice, it is to be feared that the rigorousness of this concept will work to accelerate crises. This follows from the fact that BaFin has no ability to impose a reorganization proceeding on a tumbling financial institution, and that the Restructuring Fund has to hold back its support until a transfer order has been made and a new institution is taking over. Not only may much precious time be lost by this point, but also the transfer in itself will be viewed by the general public as an eminent warning signal that the affairs of the transferor have certainly gone awry. By this point, it will be clear to everyone on the market that there is a big problem. Accordingly, at least some more flexibility for the Fund would have been preferable.

Another even more fundamental deficiency of the new law is that which it has in common with countless other examples of reactionary legislation—namely, it attempts to solve the problem without addressing its root. In other words, this law, again, cares about the symptoms rather than about the cause. Admittedly, this is easier said than transformed into a legislative reality. Yet, if there is such a strong emphasis on the systemic relevance in this statutory package, one would expect at least some concern about the notorious issue of “too big to fail.” This phenomenon—and in particular,

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72. See Bachmann, *supra* note 2, at 470.

the corresponding moral hazard problem which seduces managers to ignore economic risks—is likely one of the most important roots of the last crisis, and of many earlier ones as well. The ReSt, however, does not address this issue irrespective of the fact that the law’s exclusive concentration on the financial institutions’ sector would have made it somewhat easier to come to grips with this problem. Some might see the abovementioned transfer order by BaFin as a tool to minimize size and thus, to prevent the creation of institutions that are “too big to fail”; but the operation of this instrument comes too late for preventing a credit institution from becoming too big. Zimmer and Fuchs,<sup>73</sup> in contrast, describe three areas (living wills, closeout netting, and clearing through central counterparties) in which regulators could exercise control for the benefit of mitigating the systemic risk. And Schuster,<sup>74</sup> for instance, discusses the (primarily constitutional) legitimacy of regulatory measures in order to avoid the growth of a financial institution into systemic relevance.

These are just a few examples of a much broader discussion in Germany about the ReSt and its effects, but they should suffice to demonstrate that the problems are broader than the law leads one to believe. It is regrettable that the legislature failed to seize this opportunity for reform when, at the same time, the new law already brings with it many innovations.

## CONCLUSION

The new Restructuring Statute is the German reaction to the shock waves of the Lehman bankruptcy and the ensuing financial crisis. It tries to cope with numerous problems which became visible at some German banks, too, in the aftermath of that event. Likely due to the uniqueness of that event, the German legislature decided, at least in part, to enter new ground; in particular, it offered a combination of tools for the relevant institutions to use on a voluntary basis and tools for the regulators. Yet, the main issue in this context—the “too big to fail” phenomenon—is not addressed at all. This is a serious omission as it is very much at the heart of the problem. It is ominous that further crises and much more public discussion will be necessary before this central phenomenon will receive the urgently needed legislative attention that it requires.

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73. See Zimmer & Fuchs, *supra* note 9, at 597.

74. Klaus J. Hopt, Peter O. Mühlert, Arne Wittig & Gunnar Schuster, “*Too Big to Fail*” als Rechtsproblem, 63 DER BETRIEB [DB], supplement Standpunkte, 71, 71 (2010) (Ger.). See generally PATRICK S. KENADJIAN, TOO BIG TO FAIL – BRAUCHEN WIR EIN SONDERINSOLVENZRECHT FÜR BANKEN? (Theodor Baums & Andreas Cahn eds., 2012) (providing a comprehensive discussion of the “too big to fail” issue).