THE APPLICATION OF THE GERMAN MODEL OF COMPANY LAW TO THE BANKING SECTOR: A PRIVATE LAW MEASURE TO AVERT SYSTEMIC RISK

Martha Okigbo *, Mahmood Bagheri **

* Corresponding author, School of Advanced Study, University of London, London, the UK
** Institute of Advanced Legal Studies, School of Advanced Study, University of London, London, the UK

Contact details: Institute of Advanced Legal Studies, University of London, 17 Russell Square, London WC1B 5DR, the UK

Abstract

Since bank failures and its systemic and contagion effects have become an issue, various ex-ante and ex-post solutions have been contemplated and put forward to tackle the bank failure or and to manage its consequences. Among the ex-ante measures to tackle and avert the excessive risk-taking by banks, regulatory intervention through mandatory capital adequacy as exemplified in the Basel Accords, has been popular. However, even the most recent arrangements for implementing the capital adequacy standards have not been very successful leading to regulatory failures. Bank failures not only inflict costs and losses to the shareholders and depositors of the bank, the managers of which take excessive risk, but also the contagion effects mean the losses are extended to the banking system and the society at large. In this paper, we are proposing an ex-ante private law mechanism through the reform of company law rules to stop excessive risk-taking by the bank managers, and therefore avoiding the systemic risk which has far more ramifications for society as a whole. The solution we are proposing is rather a corporate governance scheme under which a two-tier management regime consisting of a supervisory board and management board. As it has been the feature of German company law, the supervisory board allows stakeholders of the bank including depositors and central banks, employees and creditors, to participate in the management of the company and control the executive members of the board in terms of the level of risk-taking. This ex-ante mechanism as a private law measure is theoretically more effective and less costly compared to regulatory schemes.

Keywords: Company Law, Corporate Governance, Legal Systems, Systemic Risk, Banking Regulation, Stakeholders, Bank Failures, Supervisory Boards, Management Boards

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1. INTRODUCTION

Both democracy and a republic, Germany is a conglomeration of federal states based primarily on the ideals of social justice and the rule of law (Cahn & Donald, 2018). A member state of the European Union, the association of large states, including Germany, the impact of EU law on the development of national law is an increasingly topical issue. As a pioneer of the stakeholder model, Germany was able to contain the impact of the global financial crisis...
affecting the interests of stakeholder groups, taken to include shareholders, employees, depositors, and other groups. One viable solution to tackle the market failure in the banking sector, alternate to banking command and control regulation, is to examine German company law for its merits if nothing else. We suggest that adoption of German company law could be an effective and optimal solution to the banking crisis. This conjecture is to be confirmed after a detailed yet comprehensive examination of company law reform.

The definition of company law in Germany covers a broader remit than the reach of company law in the UK. The definition of company law, Gesellschaftsrecht, includes measures by agreement to handle joint pursuits, with associations taken to include both commercial and non-commercial enterprises dominated in German law (Cahn & Donald, 2018). The affairs of the company are considered in a more literal sense in Germany than the UK company law system. An influential legal regime for German companies, the primary form of company is the public company or Aktiengesellschaft. A private company with limited liability is conventionally known in Germany as Gesellschaft mit beschränkter Haftung (GmbH). A partnership is known as a Kommanditgesellschaft (KG).

The structure of this paper is as follows. Firstly, we examine the historical impact of German company laws. The corporate structures to be discussed include the Gesellschaft mit beschränkter Haftung, or GmbH as a private company, and publicly listed corporations under the Aktiengesellschaft or AG model. Next, we turn to the significance of stakeholder representation in the German two-tier board and differentiate between the management and supervisory board as a more equitable representation of directors, employees, and other stakeholder representatives. The uniqueness of the German two-tier model is examined, for its greater propensity to accommodate the interests of stakeholders, such as employees and managers to the management and supervisory board, signalling a collective representation, spanning a greater degree of stakeholder participation. Where the two-tier board is widely administered throughout Germany, the duties, liabilities, and enforcement of directors evident in ‘outside’ jurisdictions will be compared for its potency in promoting an equitable form of representation touted in Germany. In particular, the evolution of German company law, as shown by history, illuminates our understanding of the roots underlying the present model of company law, making sense of historical and legal connections and modifications over time.

Finally, we examine the relevance of the German model of company law to banks, the merits of which are useful to be the benefit of other jurisdictions. We consider the adoption of the existing German company law to the banking system and determine whether it can be used successfully as an ex-ante corporate control to control excessive risk-taking by banks and avert bank failure.

As far as the methodology is concerned, we adopted a theoretical and analytical framework that is based on legal analyses rather than empirical data. However, in the course of the review of the relevant literature throughout this paper and also court cases, we support our hypothesis that a company law reform and establishing a supervisory board in which stakeholders could sit will prove a more effective and cheaper mechanism to avert excessive risk-taking and ultimately avoid systemic risk in which all close and far stakeholders are represented.

2. LITERATURE REVIEW

Scarcely a day goes by without the media scrutinising the recent poor performance of banks, highlighting not only a societal need for transparency but also calls for financial institutions to benefit from economies of scale and synergies amongst their numerous and diversified lines of business. With the global financial crisis of 2007-2008, the liquidation of Northern Rock and part-nationalisation and bailout of other UK banks including Lloyds Bank and the Royal Bank of Scotland, it is often too tempting to blame the swathe of misdirected regulations, and other ‘regulatory headwinds’ levied to those banks (Bloomberg, 2019). Contrary to public opinion, whilst returns on equity have diminished, so the impact differs greatly amongst individual institutions. For example, why have some universal banks such as J.P.Morgan and Wells Fargo managed to align their operating model more closely in terms of stakeholder inclusion, whereas many other, particularly smaller national banks have not? At present, the model of universal banks is being challenged dramatically, for example, the increase in automation in some banks running without employees present in some branches (Devenney & Kenny, 2012). Nevertheless, the intense media speculation coverage into the health of the banking sector fuels the need for more sustained academic inquiry. The very specific hypothesis of this paper has not been addressed in the literature but some aspects of the research have been touched upon by others in the following areas.

Market discipline

There has been some argument that market discipline is not imposed strongly enough in the banking sector, with directors mismanaging shareholders and depositors’ funds, the result being that they are unable to return their funds by default. If borrowers do not pay back on time and for some reason, depositors want their money back, the bank shall face a liquidity crisis and will fail. As cited in Northern Rock PLC and to a certain extent the part-nationalised Lloyds Bank and the Royal Bank of Scotland for example, a lack of confidence amongst depositors, representing the wider community and taxpayers, leading to a mass withdrawal of deposits as banks were unable to fully commit to the repayment of taxpayers’ money (Devenney & Kenny, 2012). The failure of banks means that a bank has lent more than a rational ratio of capital/assets. Such a systemic failure reveals a lack of organisation, which could have been imposed as a reform of corporate governance as an internal measure of control, or as a set of external regulations stringent imposed by government agencies.
Risk

Primarily, it is argued that banks fail either because the same bank or another bank takes on excessive risk. The credit risk of one bank leads to successive bank runs, becoming a systemic problem afflicting all banks in the market and jeopardises the buoyancy of the wider financial services sector. In one sense, banks operate with significant leverage. Loans and the holding of depositors’ money comprise a major part of a traditional banking business. In enabling businesses and households to grow through the provision of loans, accurate credit analyses are critical. However, the means and evidences to which measures of risk prevail in one bank over another cannot be easily captured or monitored. Where miscalculations occur in semblance with significant and adverse market movement, substantial losses are likely to be incurred. Where loans are provisioned to attract more lucrative business, not only is there a chaotic misuse of funds, in terms of excessive borrowing dependent on creditors, and deposits, supplying surplus money converted to risky loans issued elsewhere outside of the banking sector, to other institutions such as investment trusts, some mortgage companies, and foreign countries, may create severe financial problems, difficult to quell and ultimately causing some banks to fail.

Banks engage in excessive risk-taking because the directors pursue their own interests vis-à-vis the interests of shareholders whom they have a duty to promote, the stakeholders as well as the public at large (Ferran, Moloney, & Payne, 2018). We have identified an intrinsic problem in the banking sector in that the interests of stakeholders or constituents under current regulatory law, with its evident failure in tackling market failure, leading to the systemic collapse of banks both historically and at present. The role of external intervention favoured by regulators has repeatedly failed to prevent systemic crises, thus the government, practitioners, and legislators must look to other areas for solutions in pacifying the grave conflicts and instability. The abject inequalities have a clear negative impact on stakeholders. Demotivated by this negative and isolative treatment, the discrepancy and lack of interest in exceeding customer (depositor) expectations have a ripple or “domino” effect, with contagion spreading throughout the bank and having major repercussions on the functioning of the economy and society.

Regulatory law

Banking regulations in the form of capital adequacy rules such as Basel Accords have been espoused as a remedy for market failure, in the form of asymmetric information and systemic risk as a negative externality, as well as private law failures in terms of contract law to tackle the imbalance of information and tort law (Chiu & Wilson, 2019). Regulation has not been successful in achieving its normative objective of internalising the cost of systemic risk. There is an over- expectation that regulation could prevent future bank failures and illegal activities from occurring such as money laundering to which anti-money laundering legislation needs to be passed as a complementary measure alternative to banking regulation.

Company law

Company law promotes a synergy amongst employees, shareholders, directors as a result of employee representation on the supervisory board and should comprise more stakeholders, not just employees. These reforms have been actioned with varying forms of success in the UK, EU, and the United States (Hannigan, 2018).

The theoretical proof is evident, for example by examining internal regulation vis-à-vis external regulations, as well as the German banks’ record of failure compared to other bank failures in the UK, the US, or France. We go one step further in using a comparative analysis of the system of company law, particularly relating to company law stipulating the board of governance model in corporations, by comparing the two-tier board adopted in public companies in Germany, with the use of the single-tier board of directors in the UK as a stark contrast, and the middle or centralist option to select the one- or two-tier board model implemented in France, evidently a more liberal application of company law pertaining to the board of directors and corporate governance. Admittedly, our methodology, which uses the comparative law approach, is a sub-branch of legal research methodologies (Van Hoecke, 2011).

There is a definite problem that needs to be addressed, with limited solutions offered by scholars thus far. Therefore a requirement is identified to carry out an extended and original analysis, exploration, and investigation of a clearly defined research question. The statement of the main problem this paper seeks to address begins with a recapitulation of themes expressed, namely the protection of the public and bank stakeholders through company law and regulatory reform. An exploration of the banking sector, a case study of Germany, is required also to evaluate the pertinent factors and dimensions associated with this highly interesting, yet complex topic.

3. METHODOLOGY

In order to support our arguments, a selection of appropriate methodologies and research methods will be used. We make use of the legal and economic disciplines and understand it in terms of interpretation, analysis and the construction of an argumentative approach based on an analysis of primary sources taken to include ‘normative’ sources of law such as statutes, treaties, customary and general principles of law, as well as binding precedents (McLeod, 2013). In the hermeneutic discipline, it is evident that texts and documents will be the main object and focus of research, with the interpretation the main activity. Interpretation of the law is at the core of legal research, and our methodology employed in designing and carrying out this research.

However, the state of the art scholarship sways from relatively straightforward descriptions, of new legislation for example on the one hand, and innovative theories constructed on the other. As a variant form of legal research, comparative law, which is the main technique we use here, differs widely from other research principles, but with a few specifics that make it distinct from
other legal methodologies. It is valuable in the sense that the method takes an internal view on the legal systems studied, in the knowledge of the law as inextricably contained in the institutional structure from which the concepts, arguments, and interpretation were derived.

4. THE HISTORICAL EVOLUTION OF GERMAN COMPANY LAW

The historical trajectory of German company law is reputed as the basis upon which modern company law in Germany and throughout the EU is formed. During the nineteenth century in Germany the limited partnership structure, Kommanditgesellschaft, was the dominant and most typical form of business organisation. Bestowing at least one person or member of the company with unlimited liability is desirable; however, in practice, the liability of investors was limited on the basis of their individual investment contributions (Wang, 2014).

The Prussian Act of 1843 comprised the first public company statute. Detailing the composition of joint-stock companies, the General Commercial Code specified the constitution of a single board of directors, although a two-tiered system of corporate structures could be optioned. Thus shareholders could be involved in electing a supervisory board comprising employee representatives, which in turn monitor the activities of the management board. The New Company Acts of 1870 and 1884 revised this setup, mandating that all German corporations have a two-tier board. This effectively meant that the application of public law announced by the state could take the form of a private law measure to be distributed amongst public and private companies. The closest relationships between public and private companies, particularly financial companies, and the early formation of German company law, are traceable to the early years of industrialisation.

With the passage of the Stock Corporation Act in 1884, the supervisory board was given increased responsibility in corporate affairs. The German Stock Corporation Act acknowledged the potential violation of duties by the managing directors. According to this view, stock corporation law in Germany alleges that a director did not conduct themselves with due care. The majority of cases concerning director liability occur in insolvency proceedings (Pennings & Wezel, 2007). Other forms of wrongdoing were also addressed by insolvency administrators.

Whilst serious attention was given to worker participation in corporate life, this was viewed as promoting a new democratic system of government installed up until the assumption of Hitler in 1933. Unionism, as a political ideology favouring the continuation and enlargement of states brought under control, for example in Britain, tended to be a dominant approach in Germany prior to the outbreak of the Second World War. During this period, there was major experimentation concerning the extent of employee participation in companies, permitted under company law rules. Brought to the rest of the German industry between 1952-1976, employees were entitled to personally elect half of the members of the upper-tier board of directors in large companies (Pennings & Wezel, 2007). With this form of co-determination firmly in place, other countries in Europe and Asia have also debated the critical issue of employee participation, recognising employees with minority representation on the boards of the largest public companies. The radical expansion of the system of co-determination in the 1970s was enacted in the European Community’s Draft Fifth Directive of Company Law (1972-1988), the terms of which aimed to extend the German-style of co-determination across Europe (Wang, 2014). A proposal primarily aimed at implementing the rights of employees to vote for the supervisory board in large companies. Despite undergoing three major revisions, the Draft Fifth Company Law Directive did not reach an overall consensus to be ratified.

In reaction to a series of corporate scandals, the formal structure of the Aktiengesellschaft, or a major corporation limited by shares, was firstly defined and accounted for by the Law on Control and Transparency (KonTraG). Focusing mainly on the mandatory “dual board” or “two-tier” system as a measure of internal governance, the reforms conferred tasks to companies to reconsider the auditing process and the swift formulation of auditing contracts (du Plessis, Großfeld, Luttermann, Saenger, Sandrock, & Casper, 2017). The reform also addressed conflicts of interest, arising from the practice of extensive cross-directorships and mandates of banking representatives. This limited the number of supervisory positions that a single person could occupy in more than one company at the same time.

The last decade of the early 2000s signalled a further time of change and renewal to various branches of German company law. With the future of private limited companies hanging in the balance, this was strongly determined by the competitiveness of regulators in the EU common market. Most of the changes to modern German company law were a legislative driven effort to adjust more closely creditor and shareholders’ protection in accordance with evolving business needs. There are also changes from a wider angle, with growing signals for a shift in the traditional structure of German company law towards a ‘market-driven’, determined by and responsive to market and economic forces, as opposed to a ‘principles-based’ approach, based more vaguely on ideas, concepts and attitudes (Wurdinger & Pennington, 1992). This shift towards a market-driven legal system is likely to be of a core concern and for Germany, with a long-term view to further reform.

The German company network was a means of organisation for over the last century. In particular, the 1870s, 1920s, and 1950s represent the eras in which the most significant changes to company law and corporate structures underwent. We next turn to the legal systems underpinning German company law for the light it sheds in averting the onset of systemic risk.

5. GERMAN COMPANY LAW AS PART OF THE GOVERNANCE SYSTEM IN GERMANY

The implementation of corporate law in single German states has undergone multiple revisions. A more flexible approach to company law is applied to German corporations based on their corporate
structures. For example, companies backed and supported by venture capital will require a more liberal and flexible form of company law, than banks requiring a more stringent application.

Moreover, the implementation of relevant legislation incorporates the above recommendations on the nature and consistency of company law in Germany. For example, the government upheld the preparation and submission of draft legislation as part of the Law for the Further Reform of Corporation Law, Accounting Law, and of Transparency and Publicity (Pennings & Wezel, 2007). This piece of legislation was enforced in August 2002. Composed of two elements, this reform of company law and relevant legislation has recently incorporated a principle of “comply or explain”. A more lucid interpretation of the “comply or explain” principle follows that the supervisory and management organs of listed companies should publish more transparent annual financial statements. Such statements should be published and released frequently, alluding to the company’s intentions whether or not to comply with codes of best practice.

Past experience highlights that a more extensive application of company law was put forward prior to the national elections of September 2002. A third measure would be a sweeping reform of company law in Germany, reforms which are heavily based on the Commission’s recommendations.

As a federal state based on social justice and the rule of law, the Basic Law for the Federal Republic of Germany, or Grundgesetz, contains a catalogue of values and fundamental rights to be safeguarded and protected against infringements, ensuring the constitutional guarantee and the principle of equality (du Plessis et al., 2017). Such rights are fundamentally binding as to the executive branch, judicial decision, and legislation with immediate effect. Not only relevant to individuals, but the Grundgesetz also applies to corporations as a legal person. However, there is no specific form of economic concepts instilled, such as a free-market economy; the Basic Law adopts a neutralised stance against the economic policy.

A major part of company law reforms can be gleaned upon an analysis of private and public company law structures, with the direction of private and publicly listed companies determined by the nature of shareholdings.

6. BANKS AS PUBLIC COMPANIES

Bank transactions with commercial or private customers are subject to public law. To date, there is not much legislation directed to banking activities sanctioned by company law, particularly in Germany. This may be a new or emerging field for future research. Recognition of this as a limitation, we counter that banks seem to participate fully in business life as much as other enterprises and merchants, legal structures of private companies with limited liability, Gmbhs, as well as its public counterparts. As defined and in keeping within the German Commercial Code, Handelsgesetzbuch or HGB, this Code contains the core of commercial conduct in Germany, with the majority of banks organised in Germany as public co-operatives (Mee, 2019). Using these general conditions in business transactions, enables banks to engage in a higher volume of credit and other standardised contracts with depositors and other bank customers. Relations between these parties are subject to German Law on General Conditions of Contract, the general conditions of which are issued to protect the customer from enduring unfair and surprising conditions.

Banks play a crucial role in the system of finance and investment, that this system in Germany is often declared outright as a ‘bank-based system’ (Thebault, 2009). Banks providing a complete range of investment and commercial banking services, the term ‘universal banks’ can also be extended to banks maintaining close links with non-banks. To continue with making viable solutions, a thorough analysis needs to make changes in terms of whether German banks, for instance, have seats on company boards as a result of institutional arrangements such as equity holdings. German banks may have strong links with borrowers, as well as informational benefits, render forms of bank finance as more easily available and cheaper.

On the other hand, an entrepreneur considering an AG as a suitable form for her/his business activities should also be aware of the disadvantages surrounding corporate structures. For example, the rules for incorporating and managing an AG and for controlling its management board are stricter and more complex compared to those applicable to the GmbH. The formation process, as well as the decision-making process, will take much longer in the case of an AG and are more expensive. Furthermore, with an amount of EUR 50,000 being the minimum capital for the GmbH.

Moreover, raising additional funds by selling stocks of the AG bears the risk of diluting (or even losing) ownership and control over the AG’s activities. Profits have to be shared among a greater number of stockholders, and a considerable amount of the profits have to be used for the administration of the stockholders’ meeting and the on-going information of the stockholders and the public – since public disclosure of financial affairs is mandatory.

The legal basis of the AG is upheld both in Germany and Austria. It is a special form of association that is bound under civil law (Verein). Under § 19 of the German Code (Handelsgesetzbuch), corporations must specify their legal form by name. Instead of being directed by a single board, the AG legal form splits responsibility across the two-tier management body (management board) and a control body (supervisory board) (Thebault, 2009). Generally controlled by shareholders, the supervisory board may have employees on its seat, dependent on the size of the public company. This issue of the two-tier management and supervisory board will be discussed in more detail later on in this paper. Where the management board is charged with the responsibility of running the company, members of management may be removed by the supervisory board at will, with the supervisory board also determining their remuneration.

Whilst an AG can be established for any purpose allowed by law, it is set up to conduct business. With most of the rules on the formation of
the AG are mandatory, there are strict demands in terms of legal structure, accounting, and organization. As a result, companies undergo a detailed consideration of whether the legal form of an AG should be chosen. Subject to the requirements documented in § 31 of the Civil Code, reaffirming that the public company is liable for actions taken by the bodies, and financial state of the AG’s duties. Having said that, the AG cannot be subject to criminal punishment per se, however, the individual members of the two-tier board may be punished themselves. Instead, the AG is exposed to heavy fines imposed under the Administrative Offences Act (OwStG). Designed as a legal form for companies comprised of a multitude of shareholders, shareholders with a diverse portfolio of shareholdings have variable degrees of influence in terms of the business dealings of the AG. It is left to management to handle the differing interests. The structure of the AG mandates at least five incorporators to be present at the signing of the certificate of incorporation and articles of association. Like the Gesellschaft mit beschränkter Haftung, GmbH, the Aktiengesellschaft the public company denoted by the acronym AG is formally recognised by law.

Adherence to the detailed and complex rules of the Act is mandatory, unlike the private GmbH which has the option of whether or not to implement clauses from the Stock Corporation Act and other relevant legislation. In this capacity, the private company can exercise its right to select the appropriate legal form most conducive to the nature of its business. Fundamentally, enlightened shareholder value refers to the consideration of shareholders and other stakeholders recognised by current German and English law (Merryman & Perez-Perdomo, 2018). Thus the focus is shifted from promoting the sole interests of shareholders towards the inclusion of other stakeholder interests.

A modern interpretation of the German Stock Corporation Act, together with the passing of the Companies Act 2006 in the UK, we document an international discussion over which group of stakeholders is preferred (Steinfeld, Mann, Ritchie, Weaver, Galley, Adair, McLarnon, & Cloherty, 2007). Reference is made to employees and creditors, but the scant reference is made to other stakeholders. The business judgement rule governing German corporate affairs does not recognise stakeholder interests per se, rather towards the best interests of the corporation. By stipulating internal liability, that is the liability of the board of directors and managers towards the company operated from within, as per the clauses and terms of the Stock Corporation Act, managers may in exceptional circumstances, be liable to the creditors or shareholders of the company. Assuming banks are structured as public companies; banks are able to operate more freely within a model that allows them to distribute shares amongst high net worth individuals, small businesses, and large corporations.

A more positive line of inquiry concerns the influence of German universal banks on the creditworthiness, and financial standing of German firms backed by substantial bank investments. Banks have substantial control rights emanating from equity ownership, the concentration of these control rights including cross-shareholdings, complex business structures such as pyramids, as well as stocks with multiple votes attached (Mathis & Shannon, 2009). Subject to an entrenched concentration of equity ownership, firm performance seems to improve in line with the extent of such equity control rights. Furthermore, in bank control rights improve firm performance that goes beyond what banks can achieve exclusively on their own.

Critics of universal banks, however, view the exponential power of banks as poorly conducive to conflicts of interest affecting banks, particularly when it functions as an equity holder, or composed by a multitude of proxy votes, and access to capital markets. Despite the banks being in deficit with a large volume of loans outstanding, banks themselves are also subject to external control, with the power of these banks essentially enabling them to run the bank-invested companies in their own interests. Similarly, banking laws in Germany fail to restrict blocks of equity from being redistributed by commercial banks.

7. STAKEHOLDER SALIENCE IN THE TWO-TIER BOARD: MANAGEMENT AND SUPERVISORY REPRESENTATIONS

The two-tier system dividing the administration of German corporations into a separation of the management and supervisory board is a fundamental company law model. Clarifying the obligation of the two-tier boards, the German Corporate Governance Code (Deutscher Corporate Governance Kodex) outlines recommendations for the continued existence of the enterprise and its value substantiated in conformity with the principles of the market economy. This Code expresses a full commitment to ensuring efficient corporate practices are adhered to by companies, with the European Commission to consult the Code with stakeholders, the general public. Illustrating two forms ensuring the fair contribution of stakeholders are two critical events, the public consultation and annual conference outlining more explicitly the recommendations to an engaged audience.

The management board (Vorstand) manages the stock corporation (AG). Management of the company, however, does not solely mean the conducting of bank affairs, but the administration of company guidelines, including the filing of important decisions and corporate planning and co-ordination. Bound by the allocation of responsibilities, the management board must respect the authorities as stipulated by law and the articles of association. Additionally, the management board also fulfils a control function, for example, in checking whether or not resolutions passed in general meetings. Subject to multiple requirements that are crucial for the cooperation of the management board, it is only obliged to give information to shareholders during the general meeting. Aside from stringent reporting requirements, the members of management are subject to a strict confidentiality clause. Confidential information must not be disclosed to the transacting company, with failure to comply entailing severe liability for damages. It is apparent that the
suggestion of adopting the German company law model for banks would be, it is argued, a favourable structure for running banks, avoiding the negative consequences of banking activities affecting shareholders, stakeholders i.e. depositors, as well as the wider economy.

The supervisory board, the German equivalent to the board of directors, is appointed by the shareholders to promote their interests, as well as to supervise and monitor the executive directors, management, and the Chief Executive Officer. Consisting of members elected by shareholders, half are employee representatives. Further alignment of the existing German model could well meet the requirements for controlling the banks. For example, the supervisory board monitors and appoints the management board, and is also charged with approving and executing major business decisions (Bahar & Thevenoz, 2007). It is intended for a supervisory board to provide a monitoring role. However, current practice questions the validity, accuracy, and consistency of oversight. For example, the appointment of members to the supervisory board has been far from a transparent process and has led in recent times to poor and inefficient monitoring. Directors of banks do often engage in and are consumed by excessive risk-taking practices to further their own interests and profit from. Such actions signal misconduct and liability for which there are severe punishments leading ultimately to their dismissal from office. We discuss the issues of risk management. Rather than relying on the established doctrine of the major risk management principles, the mitigation of directorial risk-taking is viewed from a multidisciplinary angle, drawing on company law internal control mechanisms as contemplated by the devising of the supervisory board.

The board serves to brief board members and give the supervisory board a comprehensive account of the company's situation prior to the execution of a transaction. The primary task of the supervisory board, Aufsichtsrat, is to supervise the company's management. Responsible for appointing members of the management board, the supervisory board is involved in transactions subject to their approval, formulated on the basis of proposals for remuneration passed in the subsequent general meeting. Our proposal, in fact, is to internalise the regulatory controls and delegate these to the supervisory board. Depending to a large extent on the shareholder structure, ten of whom are elected by the shareholders, as well as employees, with another ten nominated and elected to the supervisory board by employees (Blair & Roe, 2017). Pursuant to the Stock Corporation Act, former members of the management board of banks are often represented in the supervisory board of their subsidiaries. In order to avoid potential conflicts of interest, German law provides that the supervisory board must represent the AG in transactions with members of the management board, and in particular, regarding employment contracts. The supervisory board also represents the corporation in retaining an auditor for the annual financial statement, which it must review.

The Federal Banking Act stipulates certain conditions as to the composition of the two-tier board, particularly on the size of the supervisory board of public companies, more specifically the supervisory board of banks, comprised of twenty members. In theory, the supervisory board is meant to provide a monitoring role, although this does not always readily translate into practice. The company's claims may be asserted and challenged by the supervisory board, Aufsichtsrat, which may be perceived as utilising the "internal trusteeship" strategy, where conflicts of interest amongst shareholders are insulated, and that representation of both boards is prohibited (Blair & Roe, 2017). An important concept, "internal trusteeship" effectively deals with serious conflicts of interest.

The two-tier system, at least theoretically, provides a temporary solution to a conflict of interest inherent in the board. This may be with regards to the decision reached to ameliorate the apparent conflicts of interest, which could be avoided and more efficiently handled with than in a one-tier board system. This corporate structure and conflict between the two boards may be streamlined, by employing an 'internal trusteeship' strategy for example, which involves the delegation of control from further conflicts of interest that may arise with the shareholders. 'Internal trusteeship' is the main approach adopted in the German Stock Corporation Act (Aktiengesetz) to tackle conflict of interests in the board (Bahar & Thevenoz, 2007). In theory, however, the approach stipulated in the Act may not be effective. Practical differences remain, inter alia, on the correct method of company law to be applied as well as in determining the most viable model of company law to be achieved and which participants, as stakeholders, to include in the revised model.

Additionally, there are two sets of legal rules applicable to the enforcement of the one-tier and two-tier boards in Europe. The German tradition highlights the strengths associated with the dualism of a supervisory and separate management board. The weaknesses and strengths of dualistic as well as monistic systems, take into account virtually all aspects of the organisation and corporate affairs. Many of the problems, however, fall beyond the scope and remit of this research paper.

As paradigms of the company law system in which ultimate control of the company's decision by the supervisory or management board is the one-tier system of administration in Germany contrasts with the one-tier system implemented in the UK, where directors are at the top of the stakeholder ‘pyramid', defined as the hierarchy of powers and authority held by various stakeholder groups. The effectiveness of both corporate frameworks is ascertained by an analysis of board turnover and the financial performance of the largest companies that are listed on the FTSE and DAX stock exchanges in London and Frankfurt. Both the unitary and duality of both systems are highly effective mechanisms of control. The convergence of the German and British model, together with the bestowal of ultimate superiority to either jurisdiction is questionable (Handschin & Peters, 2012). Upon evaluation of the strength and weaknesses associated with both the one- and two-tier systems, will highlight both the limitations and scope for improvements to be made to both board models. Whilst we have established the overwhelming advantages of the German model of company law, we turn to more constructive criticism. Such criticism alleges that the two-tier structure prevents efficient decision-making and is
too bureaucratic. However, if the banking and financial crises could be avoided by the use of implementation of the Germany model, this could outweigh its disadvantages.

In the two-tier system, restrictions are placed on the supervisory board in passing judgement of the possible remedial actions. Whether or not existing restrictions can question the choices made and even remove members sitting on the management or supervisory board. This series of actions will not affect the current status of the corporation, nor will it seek to enhance its position; rather the possibility of the same mistake happening again is significantly reduced. If, for example, the supervisory board is able to exert influence on ex-ante decisions, a positive solution may have been devised. As a consequence, the predominant monitors of corporate affairs are in fact done by members of the supervisory board. The control mechanisms exercised by shareholders hold true. The duties, liability, and enforcement of directors, highlights the conventional treatment of directors as yielding absolute or majority power in jurisdictions outside Germany. The two-tier board of management and supervisory representation, checks this imbalance of power, in moderating directorial representation on both boards, and minimising its presence. We proceed with an evaluative discussion on the protection of shareholders and depositors by an ex-ante company law scheme in Germany, in particular for the light it sheds in averting future bank failures and the initiatives put in place to curb systemic risk.

8. THE PROTECTION OF SHAREHOLDERS AND DEPOSITORS IN GERMANY THROUGH EX-ANTE COMPANY LAW SCHEMES WITH A FOCUS ON THE SUPERVISORY BOARD

Allocated to them by the German Stock Corporation Act, shareholders are bestowed with specific rights. Circumscribed by the generic principle outlined in § 119(2) arise pertinent issues concerning discussions of the ‘business leadership’ concepts (Agarwal, 2016). Up until recently only executive directors could determine and elect individuals displaying flair and outstanding business acumen. On the other hand, as part of the list of specific rights accorded to them, the voting rights of shareholders are heavily influenced by banks and bank behaviour, effectively as owners. Preferential voting rights are given to shareholders who deposit their share certificates in bank accounts. Regardless of the company law applicable to a bank or corporation, the shareholder voicing concerns about managerial style is effectively faced with the contrasting choices, namely to either voice their concerns more explicitly or sell their shares. The pairing of ‘voice’ with ‘exit’ has not been widely popularised (Cahn & Donald, 2018). From the perspective of the economy as a whole and market regulation, the use of the ‘exit’ option, existent as an exclusive remedy may increase the volume and extent of corporate failure, reducing market efficiency.

The shareholder franchise serves as an ideological underpinning from which the legitimacy of power is sourced. In general terms, shareholders normally have two protections preventing liability for business performance. The shareholders may vote to replace existing board members or sell their stock as discussed earlier. Whether the vote is perceived as lacking in importance, a mere formalism, or as an important and powerful tool of discipline, it is critical that the exercise of power by some stakeholders, for example, directors over managers and employees, are legitimised more explicitly instead of general voting powers for example over property not owned by shareholders (Drake, Joffe, Richardson, Lightman, & Collingwood, 2019). Shareholder ownership lies strictly in the company with which they have invested shares. When surveyed from abroad, institutionalised perspectives however, it can be seen that debates on the integrity of shareholders often includes consideration of the directors exercising delegated power. The scheme under German law helps to exercise control by both shareholders and stakeholders alike, though this system for the stakeholders who do not really have any voting rights may be more helpful. In the case of banks, depositors, and the public at large, whose interests could be more effectively protected by a supervisory board which could include representatives from a regulatory body to protect the interests of depositors.

On the other hand, an alternative argument posits that the scheme under German law helps to exercise control by both shareholders and stakeholders alike, though this system for the stakeholders who do not really have any voting rights is more helpful. In case of the banks, depositors, and public at large, whose interests could be more effectively protected by a supervisory board which could include representatives from a regulatory body to protect the interests of depositors.

Financial instability has a devastating impact on the wider economy. The failure of a bank or other deposit-taking institution renders customers, whether business or individuals, unable to raise finance, access savings, or meet contractual obligations. If the risk of distress is to be minimised at a single bank, this is achieved partly by the provision of extra support and arrangements for depositor protection. Special measures were also devised to cater to the financial difficulties of a failing bank. The legislation was proposed by the German government in 2012, to accelerate transfers and redistribute power to the authorities and a third party, if the protection of depositors is to be facilitated (Schulz & Wasmeyer, 2012). The German authorities considered rigorously the option of designating depositors as a creditor, the preferential class of which would assist the introduction of depositor preference. However, adverse consequences are likely to arise, with creditors potentially becoming embroiled in insolvency proceedings.

As an institution that extends credit by giving another entity permission to borrow money to be paid back at a later date, creditors can be classified as either ‘personal’ or ‘real’, ‘secured’, or ‘unsecured’ (Drake et al., 2019). This definition holds true with depositors as well and can be used interchangeably in this context. As a bank or finance company, real creditors and depositors enter into a legal contract with the borrower, granting the right to claim the debtors’ real assets in the event of default where the lender fails to pay back the loan, either in instalments or otherwise. As a transaction involving
a transfer of funds, a deposit could also be used as collateral, or security, for the delivery of a good. As depositors placing money in banks, customers, depositors, and creditors are effectively lending that money to the bank. In this capacity, depositors function as unsecured creditors. If a bank run occurs, the quantity of deposits is reduced, with other unsecured creditors ranked in order of precedence, according to how much money they are owed.

One component of the shareholder protection argument involves the delegation of equity control rights by banks. If the equity capital of a bank is dispersed widely amongst depositors in the form of interest, each owning a fraction of the total equity available to the bank, then the impetus for the savers to monitor the output and performance of the banks' management will be stronger.

In scenarios where limited liability is absent, an individual deposit cannot lower the risk of their pondeled asset to their holdings across a large number of banks. This is a valid truisum. Regardless of the smallholding in one company, the wealth of depositors could diminish if the bank was unable to pay its debt to them. Thus banks holding the shares for depositors are able to exercise their voting rights attached to the shares under the direction of depositors.

How well legal rules protect the interests of depositors varies systematically across jurisdictions. Whilst common law countries have the strongest set of protections for depositors and shareholders, German civil law countries have weaker protections (Murry & Sturner, 2015). Although comparatively, Germany has stronger protection of depositors and others. This argument is more acceptable than the supposition that some countries opt to protect shareholders whilst others opt to protect the more exclusive interests of creditors.

The historical trajectory of bank failures in Germany, and the impact of these failures throughout the continent, highlights the need for renewed initiatives to dispel the onset of bank runs, reducing its impact and repercussions for the banking sector and entire financial services industry. In considering the historical development of bank failures, we ought to reflect strongly on the shortcomings of the past, as those persons and institutions who fail to lodge a continuous, systematic narrative of past crises are typically condemned to repeat it in the future. This failure means that the potential German company law model related to the supervisory board is not fully exploited. This could be done through appointment of some representatives of the regulators in the supervisory board of banks, to take regulation into the heart of the bank, internal regulation, rather than external regulation.

9. HISTORICAL DEVELOPMENT OF PAST BANK FAILURES

The cooperation of banks in the Weimar Republic could be understood as assimilation of tendencies arising in the 1870-1917 period. This era marked a decisive historical break tending towards non-market driven and organised regulation of banks. As a result, there was a web of entanglement circling among industrial and financial companies also, most notably during the 1923-1924 and 1929-1933 crises (Eberhard, 2005).

Upon the return of Germany to the 'gold' standard, in which the monetary unit of account is based on an affixed and predetermined quantity of gold, the banking sector underwent an expansion during the mid-1920s (Bookbinder, 1996). Owing to the dearth of domestic savings in Germany, the rapid expansion was financially backed by foreign debt. With most of the foreign debt consisting of short-term deposits, lending to Germany decreased in 1928, with GDP growth slowing substantially, to the point that growth was negative in 1929, ushering the beginning of the Great Depression. Falling prices, shrinking money supply, and rising unemployment were factors that galvanised the depression, leading to episodes of financial instability and hyperinflation.

Post World War II, the largest banks in the Federal Republic of Germany were separated into regional banks, whereas the largest trusts such as IG Farben chemical company and Vereinigte Stahlwerke steel conglomerate were not. Notably, the year 1945 did not signal a radical historical break in the access of the public to the financial resources of banks (Wieson, 2003). Rather the state dominance over banks gradually eroded, paving the way for a more reciprocal relationship in which bank control was diffused amongst other banks, effectively creating an interbank market. State authority was waning in favour of a more organisational-led and controlled industry. Steadily, it became increasingly difficult to ascertain which banking institutions were linked with each other. Economic planning in Germany was not widely implemented until the 1950s.

By the end of the twentieth century, bank failures in Germany were limited in comparison to elsewhere in Europe, due to its strong economy and representation on the supervisory and management board. In his recent discourse, Hilferding (2007) argued that banks became more powerful in this era due to their gradually developing financial role in corporations, and dominated decision-making. The first step on the road to a greater power was that cartelisation in banking was matched by cartelisation in industry. This had the distinct advantage that banks were able to leverage the positive effects of cartelisation and domination of the financial services sector. The banks’ profit from their investments in the industry was, according to Hilferding, enhanced by cartelisation, such that reduced competition enhanced profit and enabled price increases. As banks increasingly invested a large proportion of their funds, in effect their investments became ‘industrial productive capital. This capital is what Hilferding coined ‘finance capital’. Industrial corporations became dependent on the ‘finance capital’ to fund their operations, with an increasing base of capital available at the disposition of banks used by industrialists. Thus, it can be argued that banks will tend to collectively work together in order to prevent a crisis by a process of amalgamation, even when against the interests and will of individual manufacturers.

From these perspectives, we can collectively deduce that the amalgamation of banks and industry
versus individual fragmentation emerges as a central topic of debate, issues that need to be discussed further, in order to gain a clearer understanding of the drivers of change, in preventing or ameliorating bank failures in Germany. Moreover, the monitoring of shareholders and depositors needs to be considerably increased if these groups of stakeholders are to be successfully protected under the German company law system.

10. PERIODIC AND CONTINUOUS MONITORING OF SHAREHOLDERS AND DEPOSITORS

As part of consultations on the nature of shareholder protection, the principles of one share-one vote, referred to by some academics as "the oppressed minority", are both valid and efficient arguments (Schwalbach, 2001). The criteria of one share-one vote is accorded the same extent of influence to all shareholders, forming a discrete hierarchy.

As articulated by Meckling and Jensen (1995), this imbalance of dynamics can be accounted for in a variety of ways. Such a change includes a more specific formulation of the legal rules defining and protecting the rights of shareholders; a renegotiation of the powers and duties of the board, as the elected representatives of stockholders; the offering of an opportunity to outsiders to buy in control as well as alter the nature of management, in the market for corporate control, particularly when the bank’s output and productivity are deemed as inefficient; and finally the execution of incentive-based compensation plans.

The transference of all or some business lines to a healthy bank operating in the private sector, the German authorities considered rigorously the option of designating depositors as a creditor, the preferential class of which would assist the introduction of depositor preferences (Harm, 1992). However, adverse consequences are likely to arise, with creditors potentially becoming embroiled in insolvency proceedings.

The possibility of participation of depositors, whose protection is not fully represented by regulatory authorities, will be considered alongside the requests of ordinary unsecured creditors. Recent proposals have been called for representatives to assist them in processing information on depositors early on, rather than relying on post-compensation. The proposition of authorities to issue an order regarding the insolvency procedures of failing companies, and appoint a bank liquidator as an insolvency practitioner, enables the prompt action to take place (Enriques, 2000). Such prompt action will, it is perceived, be taken in order to exclusively protect the interests of depositors.

If depositors are fully informed about the limits and scope of deposit protection, then it is assumed that their investment decisions, i.e. the placing of funds into a deposit account, are based on sound information. However, in practice, the dissemination of information can be flawed and is typically imperfect, such that the welfare cost is driven down by a loss of wealth. Consumer confidence and that of future depositors are likely to decline, with an increase in the perceived risk of failure, widely documented by the media and social commentators, thus entrenching the crisis. Where there is an unexpected increase in demand for deposits, the loss of liquidity will decrease the numbers.

11. EXCESSIVE RISK-TAKING OF DIRECTORS CONTROLLED BY THE SUPERVISORY BOARD

The duties of directors can be expressed in terms of taking charge of corporate affairs, exercising competent judgement, and liable for any damage to the company. Directors are able to appreciate the benefits associated with a business judgement rule, as has been developed significantly by case law (Chirinko & Elston, 2006). If directors act on instructions given in the general meeting, their position is not usually at risk. What is insufficient, however, is the consent by shareholders given to directors on their conduct. As directors must demonstrate how he or she has damaged the economy or has not damaged the company, showing that they have performed competently and with diligence. The director, under the general rules, will need to prove that there are good caveats as to why the loans ex-ante are distributed and explain how this would lower the risk of insolvency when in fact the risk is substantially raised. Additional funds would need to be transferred to the corporation in limiting this risk. Moreover, if the bank defaults on repayments, or if the bank’s assets are not sufficient to counterbalance its liability, directors will have no option but to file for insolvency. In due course, the directors must indemnify the bank for payments made after the date of insolvency, as per Section 64 of the Limited Liability Companies Act (Blair & Roe, 2005).

However, with the concept of capital maintenance and its associated restrictions, protection of credit and debt payments is not de facto linked to insolvency. The legal system in Germany tends to impose more credit-related responsibilities on directors, especially where the bank is in financial distress, culminating in insolvency. The rationale underpinning this behaviour is that once the shareholdings have been eroded, the shareholders are replaced by creditors as "residual risk-takers" (Blair & Roe, 2005).

The control of directors and their excessive risk-taking by the supervisory board consists of many elements. For legal input to the duties of directors to remain relevant and useful, the role of company law must be explicated more clearly by legislators. Directors are also required to communicate regularly with stakeholders and other key parties, establishing priorities and acknowledging their interests. The supervisory board will accept ultimate responsibility for the concerns and complaints of other key stakeholders such as employees, depositors, and shareholders to "ensure a long term succession planning" (Mallin, 2017).

Accountability is a key factor in controlling and mitigating against self-dealing on the part of directors. Regular meetings and presentations are required to balance directors’ interests with other key stakeholders, however by themselves as a remedial measure and control of directors engaging in excessive risk-taking, are inadequate. For example, it is impractical for directors to keep in touch with every stakeholder constituent (Kershaw, 2018).
Rather they are charged with ensuring high-level oversight, control, and accountability on behalf of major constituents in the corporation. On the other hand, a counterviewpoint could be advanced here. It is a given that non-executive and executive board members are expected to spend some time conversing with employees and depositors, making themselves available for comments and feedback. The monitoring task of directors, controlled by the supervisory board, may be enhanced if the relevant duties of skill and care are consistent with a ‘relational’ approach that could be more explicitly documented in legislation (Schwalbach, 2001). A clear statement in legislation would make it very clear to all boards that entrepreneurial authority and freedom come at the expense of ensuring compliance with director-led actions and procedures that encompass relevant constituencies and inhibits self-dealing.

Analogous to the requirements of trustees, directors are not allowed to make personal gains, unless it is allowed in the company’s constitution or agreed in a general meeting. This development is rare, if not negligible in Germany, for the successful running of a bank or public corporation promoting egalitarianism and diversity. Any major transaction executed by the director and a relevant counterparty ought to be approved by shareholders in general meetings, with the director bound to declare their personal interests in a contract executed with the company. Recent recommendations made by the Law Commission maintain that these safeguards should be kept to control the self-dealing interests espoused by some directors. The duty of disclosure and transparency, initiatives borrowed from the main principles of securities regulation is highly relevant to this subsection. If a court is inter alia satisfied that the interests of directors do not give rise “to a significant risk of an actual conflict of interest”, then their actions party to the transaction will be approved (Saenger, 2005).

12. BANK BOARD DECISIONS AS SUPERVISED BY THE STATE, CENTRAL BANKS AND DEPOSITORS

Prior to discussions on the supervision of board decisions by the state, central banks, and depositors, it is perhaps necessary to include a brief discussion of the function and content of the decisions executed by the board of directors. Management representatives, elected to the management board, assume a high degree of autonomy when making high-level policy decisions. The German Corporate Governance Code contains specific provisions dealing with the independence of members of the supervisory board (Quinn, 1997). The corporate structure of the bank depends on the structure of management and the board with distinct functions. For instance, the board responsible for the implementation of the high-level policy decisions must also make decisions on how to manipulate interest rates or inflation targets. In this respect, the board responsible for policymaking often assumes the responsibility of implementation. With board decisions increasingly technical, with a limited pool of qualified resources, the majority could comprise representatives from other groups of stakeholders.

States intervene in banks for a variety of reasons. They may attempt to reduce transaction and information costs. A constructive role for government intervention and regulations may be to strengthen the transparency and accountability of banks. The widely held view that banks are necessary for economic development, and that further government regulation is motivated by negative externalities, justify requirements for the supervision of high-level decisions. This perspective is both valid and feasible. The limits of laws concerning investor protection and the existence of pure informational asymmetries, as well as the scope of the legal system to enforce laws, reduces its effectiveness and raises the profile of government intervention (Talbot, 2014).

A countering perspective draws on the alleged inability of governments to overcome transaction and information costs and focuses instead on the need for regulation and bank ownership for differing reasons. Fundamentally, banks hold the highest volume of monetary funds more than other institutions. Governments are therefore incentivised to impose heavy taxes on banks to generate fiscal revenue. In taxing banks, they can be induced to lend favourably to other politically exposed customers. Similarly, powerful influence can be exerted by banks over regulators and governments, so that they act to promote the binding interests of bankers, as opposed to the more ethical promotion of social welfare. If board decisions are to be exclusively supervised by the government, the less benevolent motivations of banks and government regulators will be revealed.

A core element of the payment system, banks have a major role in the smooth functioning of financial institutions. Mainly due to the deposits taken, banks are also highly leveraged. Several challenges are presented in the field of financial regulation and its relevance to depositors. Where ownership restrictions are imposed on banks or where deposit protection payments result in the board’s limited supervision of depositors, the effectiveness of regulators is overwhelmingly reduced (Talbot, 2014). Accountable for the safeguarding of the rights of depositors, banks must also oversee the strategic decisions of the board concerning the welfare of depositors, and the reduction of systemic risk.

Micro-level data on German bank depositors reveal that bank runs are more likely to occur due to a shock in the solvency of depositors. Depositor withdrawal trends are discernible in response to public and private signals of the bank’s solvency (Kureck, 2018). Responding to publicised announcements on the financial health of the bank, depositors appear with loan linkages and uninsured balances, as well as staff shortages of the banks most likely to run and undergo liquidation. Depositors, however, tend to act on private information communicated within the bank internally. The actions of uninsured depositors are found to substantially weaken the monitoring of board decisions. The results suggest that depositors are heavily reliant on regulatory supervision for its public announcements on the risk of bank insolvency. The quality of information disclosure and regulatory supervision policies could be more important to smaller banks in the future, and may well enhance the quality of depositor monitoring.
Given such developments and assumptions, the applicability of the German model of board supervision to other jurisdictions should be more favourably welcomed for the added degree of stability it brings to the banking sector, and is a potent private law measure.

13. RELEVANCE OF GERMAN COMPANY LAW OUTSIDE THE GERMAN LEGAL SYSTEM

The last two decades have been a time of substantive change in German company law that has extraterritorial applications outside of the domestic legal system. The German law of stock corporations is marked by growing convergence as well as divergence. The convergence of German company law as applied outside the German legal system is noted largely to the approaches of EU Member States owing to internal controls. If we are to reflect on the substantive changes as well as the structure of capital markets, we ought to note a change in approach towards an increasingly market-driven approach of company law.

One advantage of the English public limited company, or PLC, is that it is subject to minimal capital requirements as is the case in Germany (Leyens, 2005). Countervailing this view with the Centros Ltd v. Erhvervs- og Selskabsstyrelsen (1999), for example, in which a number of restrictions to freedom of establishment were dismissed by the European Court of justice, the restrictions imposed on minimum capital requirements were widely applicable.

The decisions of the European Court of Justice made sure that the law applicable to companies in other jurisdictions was to be exclusively determined by the place of incorporation. The merits of the minimum capital requirement remained valid across the EU, yet was firmly held and advocated in Germany (Leyens, 2005). The rising presence of English limited companies in continental Europe appeared to dampen the competitiveness of German private limited companies. The state of the debate suggests that the minimum capital requirement is likely to be restricted or even removed in the future. If this proceeds, an alternative form of creditor protection will need to be ascertained.

The concept of legal transplants has been advocated in recent years, in light of the emerging issue of fiduciary duties to stakeholders, particularly directors that has been developed in the UK and the US company law and has now reached jurisdictions in Germany and other states across Continental Europe (Schwalback, 2001). Research suggests a positive assessment and the growing requirement of comparative research. However, a systematic analysis of company law in Germany is more than relevant, with minor comparisons in outside jurisdictions necessary for highlighting the relevance and applicability of German company law outside the domestic legal system.

Perhaps a current account of the debate would be more useful taking an analytical approach, in surmising whether managers of German banks and other financial institutions are to run the company for the benefit of shareholders, or whether they are required to account more extensively for the interests of other groups of stakeholders. With the comparison focussed on Germany, France, the US, and the UK, important differences are exhibited, differences which can be attributed to variations in stock ownership structures. Prior to the proliferation of divergent ownership patterns, advocates for a stronger focus on the interest of shareholders and a stronger position of management may need to contend with an array of conflicting economic, political and financial issues if they are to secure the substantive changes to company law.

Company law in Germany and the rest of Europe is undergoing fundamental change, leading to an extensive reform of company legislation (Andenas & Woodridge, 2009). Driven by initiatives to remedy significant weaknesses that have recently come to light, the merits of domestic company law reform have been exposed during large banking failures and corporate scandals. Thus European company law reform is more effective. Originally, company law reforms were brought in to alleviate the burden of stringent legislation imposed in particular on small and medium-sized businesses (SMEs) (Krahnen & Schmidt, 2005). In an attempt to facilitate a modern market economy, Member States have also incorporated acquired statutory rights into the full body of European Union law comprised of the accumulated legal acts, court decisions, and legislation. For example, the case-law of the European Court of Justice working as the highest court in the EU facilitates the free movement of capital, people, goods, and services.

For example, Article 293 of the Statute for a European Company (SE), is a source for community measures in company law, with the proviso that negotiations should commence between the Member States, with the securing of benefits of the directive for nationals, as well as mutual recognition of companies applicable at the second paragraph of Article 48, outlining the retention of legal personality in the event of mergers and acquisitions between banks governed by the laws of different Member States (Andenas & Woodridge, 2009). Secondly, the directive refers to the transfer of seats from one country to another. Although Article 48 applies to all forms of companies, the coverage of companies limited by shares is done so by the ‘secondary European company law’, referring also to companies having limited liability (Andenas & Woodridge, 2009). Consideration of these directives relates to the coordinated provisions which are critical to our interpretation of the activities of such companies that typically go further beyond the frontiers of national borders.

The French Commercial Code also promotes the two-tier board system, consisting of management and supervisory board. In France, the dual board system is applicable only if it is provided for in the articles of association, an official document outlining the duties and responsibilities of the company's members as well as the purpose of the company defined and recorded clearly (Andenas & Woodridge, 2009). With the exception of Articles L225-17-L225-56, the rules are applicable to traditional companies having a two-tier board system mandated by statutory law, passed by a legislative body and re-emphasised in the French Commercial Code differences apply in the German and French legal system, however. Collectively responsible for the management of corporate affairs, the directoire, or executive board in France, is the
The relevance of German company law to other legal systems outside its jurisdiction contains many features and is an exemplar of an application of the German model of company law to the banking system, as a potent private law measure to avert systemic risk. As a result of our examination investigating the preferred similarities and avoidable differences of the corporate legal system in Germany, we have ascertained that this company law framework is optimal.

14. CONCLUSION

This research paper has revealed the overwhelming merits of the German model of company law and has explored how this model of company law could be applied to the banking sector which would effectively internalise the regulation and supervision of the banks by the banking regulators.

A measure of private law as opposed to regulatory law, an adaptation of company law may yield favourably during banking and financial crises. In response to the hypotheses presented earlier in this paper, we are now, at least theoretically, in a position to assert that German banks do not and should not fail in the same frequency of banks outside that jurisdiction, particularly in the United Kingdom and the United States. The historical development of bank failures and an analysis of more recent bank runs afflicting sovereign states, illustrates the potential pitfalls of relying too heavily on an external regulatory or legal regime to avert a systemic crisis. There has been too much reliance on the effectiveness of ex-ante regulatory schemes to spot and manage the risks that individual banks take. The mandatory capital adequacy regimes, in addition to the fact that these are expensive and lead to moral hazard, have been lagging behind market developments and therefore incapable to achieve the targets and objectives set for them. The structure of the German company law model as an ex-ante scheme applied to and used in the banking sector, functions as an original solution beneficial as a private law measure to impede systemic risk, with the likelihood of onset significantly reduced. The German company law model of two-tier representation has a role to play as an ex-ante preventive measure as it puts in place a system under which the supervisory board will act as a brake to excessive risk-taking by the bank directors.

Bank stakeholders are considered to be better protected by a company law model allowing internal control of the directors of the bank, given the repeated failings of regulatory law in failing to prevent bank runs and systemic crises. We have sought to consider arguments in favour of a more structured system of stakeholder inclusion, whereby internal and external groups are fully integrated into the existing corporate governance framework. Reform of company law and reform of the way banks are managed is required. The question is the place of company law in dealing with the problems of the agency problem and credit risk, for the benefit of shareholders and stakeholders, and systemic risk for the public at large. Evaluating insightful debates such as these will, it is envisaged, present further dichotomies, to which we offer strong areas of further discussion.
We must also consider the interests of directors, the excessive risk-taking of which, whilst enabling the pursuit of better financial rewards, commonly leads to credit risk and ultimately to systemic risk and financial crisis; this is detrimental to the shareholders and directors of the bank as well as the other banks and the society at large. The interests of depositors whose banks should be monitored regularly alongside those of other bank stakeholders would be realised to the reforms of company law. However, in practice, depositors and stakeholders are dispersed and unable to exercise any control over the directors. Government or central banks as stakeholders of their own, on the other hand, could represent the interests of depositors and control more extensively the decisions of the board from inside. This would favour a system of internal regulation, in contrast to classic external banking regulation, which is enforced by the supervisory board, one that could be ascertained as the best solution to address this problem ex-ante. We could either turn to an implementation of the deposit insurance system, protecting depositors and their funds, or adapt the quintessential German company law model to other state systems, with monitoring and supervision but as a private law measure to avert systemic risk. The robustness and yet flexibility of German company law, applied to bank structures across Europe, is deemed as a more feasible option compared to all other ex-post and ex-ante schemes for dealing with systemic risk. Over time, this paradigm could be an optimal solution to the lacunae traversed by regulation and systemic risk, key factors to a greater imbalance of power amongst stakeholders, leading ultimately to the disintegration of the banking sector.

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