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Summary

Implications of the global financial crisis for international law: corporate and securities law control mechanisms

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1. Today, the classical distinction between private and public law has only limited relevance for Corporate Law and Securities Regulation. The traditional dichotomy is gradually replaced by a convergence of private and public law, even though that convergence varies considerably from jurisdiction to jurisdiction.

2. Disclosure philosophy forms one, or perhaps the most important of the pillars of European Corporate and Securities Law. Disclosure often is accompanied and supported by new regulatory instruments like the "comply-or-explain" mechanism embodied, e.g., in § 161 German Stock Corporation Act.

3. Moreover, in recent years procedural law and supervisory provisions have become more influential as additional tools in order to support the effectiveness of substantive regulation.

4. Whilst the call for international or global rules is comparably new and the quest for worldwide regulation of financial markets and the activities of its participants only recently and in the context of the global financial crisis appears on the agenda of regulators, the search for the proper scope of unification and harmonization of European Company and Financial Market Law has some tradition.

5. Meanwhile, legislators have learned that, in general, duties and standards of conduct, regardless of their nature as substantive duties or mere disclosure obligations need some type of sanctioning (liability) in order to give them sufficient impact. However, legislative attempts to tighten sanctions and liability provisions usually encounter strong opposition from managers and other interest groups.

6. Many of the regulatory reforms set into force recently have been induced by the financial crisis and are designed to address specific problems in particular industries like the banking sector or the stock trading sector. However, it is questionable whether such regulatory emergency measures are going to be repealed after the crisis or whether such "crisis-induced"-regulation will fit for post crisis times or for other industries as well. In general, a creeping tendency can be observed to extend regulatory reform measures beyond the occasion that induced such measures, finally contributing to a steadily growing body of regulatory restrictions.

7. In addition, regulators tend to "import" what is called "legal transplants" from other jurisdictions into the own jurisdiction. This development is closely linked to the phenomenon of "path dependency" of national legal systems and their ability, to integrate foreign concepts into the grown legal framework and culture.

8. Focal starting point for any discussion of the causes of the global financial crisis in the area of internal corporate governance seem to be bank managers, in particular members of the board of troubled banks. Many voices call for tightening their responsibility by changing the compensation scheme.

9. Another discussion turns around improving compliance and risk management. The idea is to make risk management even more independent and to require corporations to establish the position of a chief risk officer at the top management level.

10. A long-term debate centers on corporate governance on the supervisory board. One proposal calls for improving the internal policy regarding the appointment of supervisory board members of banks in order to raise the level of qualification and diversity of managers. It is, however, unsettled whether such diversity in fact contributes to improve internal corporate governance.

11. Another proposal aims at the interests that shall be protected by the supervisory board. Traditionally, the supervisory board shall protect the interest of the corporation and its shareholders. Recently it has been proposed that the board should also take into consideration the interests of other groups, like bank customers and other stakeholders. In addition, some commentators advocate that in cases of substantial or systemic risks the supervisory board should inform the governmental supervisory authorities.

12. The debate on reforming internal governance structures centers around equity capital and securing liquidity of banks. Most commentators agree that in the long run, only a higher equity ratio will bring the necessary stabilization effect. Moreover, a possible risk transfer shall not exclusively depend on internal calculation models but requires effective control through supervisory authorities based on external calculation models.

13. In addition, internal corporate governance shall be improved by establishing a responsibility of bank shareholders for the risk profile of their bank. However, making shareholders in general (not only majority shareholders) responsible for internal corporate governance and the risk profile is hardly in line with the common corporate law concept of limited duty of loyalty of shareholders.

14. In the area of external corporate governance, many commentators plead for replacing fair value-valuation of assets (mark-to-market-valuation) by a less procyclical valuation method. Some propose to return to the "lowest value"-principle under domestic German accounting rules, i.e., to value at the lower of market value and initial costs. In most cases, this will be initial costs which then will provide additional equity capital in the form of hidden reserves. Another idea would be to adjust the (minimal) equity capital quota on a procyclical basis.

15. Another subject for reform is the area of auditing. It is proposed to develop the audit report to a full-fledged report on substantial risks in audited financial institutions submitted to the supervisory authorities and to require those authorities to effectively evaluate and utilize the results produced by the auditors.

16. Rating Agencies have been among the first targets of EU reform regulation in the form of a "Rating Ordinance" providing for a duty to register and an administrative supervision. In addition, the Ordinance sets minimum standards relating to rating agency independence.

17. According to many experts, one trigger of the global financial crisis has been the multi-layer securization of receivables causing the detachment of the receivable from the underlying risk. In many cases, the issuing banks were not liable. Therefore, some commentators have proposed to prohibit multiple securizations entirely. This would allow a higher degree of transparency. The structures of responsibility and liability would become clearly visible. The EU Commission seems to prefer a graduated approach with

national supervisory authorities checking the correctness of the valuation of the risk of the underlying receivable.

18. Another proposal calls for the establishment of a European agency for the examination and admission of financial products. However, this proposal raises a number of difficult questions. It is unclear, how this examination should be performed, under which responsibility, whether a remedy shall be available against a negative result and whether the respective agency shall be held liable in case the examination turns out to be incorrect thereby causing damages to investors who relied on the admission.

19. The regulatory debate on short sale limitation needs some differentiation: In general, short selling is a well-accepted and useful instrument by which a specific evaluation of a certain commodity is communicated to the financial market. The situation is different if speculators by deliberately spreading rumors try to manipulate the market in order to initiate a fall in the market. According to many commentators a complete prohibition of short sales would be an overreaction. Instead a temporary prohibition limited to the duration of the market disturbance appears preferable and sufficient.

Beyond the traditional dichotomy of private and public law, modern corporate law and securities regulation offers a great variety of different regulatory instruments and methods that are applied in order to overcome the global financial crisis. Main areas of regulatory activity are internal and external corporate governance of banks and of corporations in general. Crucial questions turn around the proper level of regulation (domestic, European, international level) and the type of regulation (industry specific and temporarily or comprehensively and permanently, directly through substantive rules or indirectly through disclosure). It becomes evident that regulating corporations and its financial markets in a global world gets rather more complex than easier.