MEASURING THE QUALITY OF BANKING SUPERVISION REVISITED ASSESSMENTS BY GERMAN BANKS BEFORE AND DURING THE FINANCIAL CRISIS

Stephan Paul*, Stefan Stein, André Uhde*****

Abstract

This contribution presents and discusses main results of a new survey on the assessment of supervisory quality among German banks. In particular, it is analyzed if and how supervised banks' perception of the quality of supervisory authorities and their instruments has changed due to the financial crisis starting in mid-2007. Subsequently, results from the recent survey are compared with findings provided by a former study carried out by the authors in 2006 (Paul, Stein and Uhde, 2008).

Keywords: Banking Supervision, Quality, Assessment, Banking sector

JEL classification: G21; G28

* *Prof. Dr., Ruhr-University of Bochum, Department of Management & Economics*
Fax: +49 234 32 04508
E-mail: stephan.paul@rub.de
** *Corresponding author, Prof. Dr., BITS Business and Information Technology School Iserlohn*
Fax: +49 2371 776 503
E-mail: stefan.stein@bits-iserlohn.de
*** *Dr., Ruhr-University of Bochum, Department of Management & Economics*
Fax: +49 234 32 04508
E-mail: andre.uhde@rub.de

1. Introduction

In recent years banking supervision in Germany has been heavily discussed among politicians, academics and representatives of all sectors of the banking industry. Next to an increase in the complexity of banking supervisory processes and instruments after having implemented Basel II regulations into German Banking Law, it has especially been discussed if excessive banking regulation and supervision in Germany might lead to a higher regulatory and bureaucratic burden, and hence might distort the level playing field of competition between German and foreign banks. In addition and more specific as regards Germany, it has also been debated, if the allocation of supervisory responsibilities between both supervisory authorities, namely *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin) and *Deutsche Bundesbank* (Bundesbank), may be hindering to an efficient and effective banking supervision.

Banking regulators and supervisors in Germany have replied to this criticism suggesting that they have increased efforts to create more "customer orientation". Thus, in 2006 *Jochen Sanio*, then President of the *BaFin*, declared that prospective banking supervision in Germany should be based on a business partnership between supervisory authorities and banks acting as "clients". Accordingly, accepting that regulation is not only an administrative act but rather that there is "a market for regulation" banks should be considered as "demanders of regulation".

This change in the basic idea of traditional banking regulation and supervision can be explained taking into account that the banks' credit business has become less important while investment banking and "financial engineering" have become more important over time. As a consequence, while the banks' credit risk can be handled through cross-border coordination between regulators and supervisors and harmonized quantitative regulations, a standardization of regulations concerning market risks is less possible. Accordingly, in order to overcome the lack of knowledge as regards the banks' market risk exposures and risks inherent in financial instruments, regulators and supervisors have to learn from banks under the framework of a more "qualitative" banking regulation as implemented by Basel II. Thus, it is suggested that especially supervisors will gain a deeper insight into the banks' overall risk exposures when reviewing and approving the banks' internal risk management models and processes during the *Supervisory Review and Evaluation Process* (SREP).

Against this background, in 2006 the authors of the contribution at hand conducted a survey (henceforth Survey-2006) in cooperation with the *German Federal Ministry of Finance* (BMF) and *Deutsches Institut für Wirtschaftsforschung* (DIW) in order to measure the quality of banking supervision as perceived by the entire banking industry in Germany (Paul, Stein and Uhde, 2008; DIW, 2006). As a main result, findings from the Survey-2006 revealed that supervisory institutions in Germany received a considerably better assessment from banks than the public debate had led to expect at that time. Nevertheless, banks being interviewed also stressed that there is still enough room for optimizing supervisory practices and instruments in Germany. In particular, reducing banking supervision to its core tasks, minimizing bureaucratic burden, increasing transparency and communication between banks and regulators as well as clarifying the allocation of supervisory responsibilities between both supervisory institutions in Germany were the primary points of criticism in this context.

Six years later banking markets around the world are infected with the most severe financial crisis that spread from the United States in mid-2007. As a response, enhancements of the international regulatory and supervisory framework have already been realized and further work is under way. In particular, the *Basel Committee* has finalized its new banking regulatory framework (Basel III) in December 2010 extending single regulations concerning equity capital requirements, the banks' leverage and liquidity positions (BCBS, 2011). Most parts of these recommendations have already been transformed into the *European Capital Requirements Directive* (CRD IV).

Consequently, the importance of reliable supervisory practices and hence, a qualified banking supervision has again moved into the focus of regulators and supervisors. In Germany, the government has recently confirmed the specific system of two coexisting supervisory authorities, a decision that has revived the debate among academics and practitioners about a reasonable organization of banking supervision. At the same time, the *BaFin* has promised to further strengthen the business partnership between supervisory authorities and the banking sector as a response to the global financial crisis (Sanio, 2006, 2011).

Against this background and taking into account main results provided by the former Survey-2006, this paper investigates whether recent actions undertaken by banking regulators and supervisors as a response to the crisis from mid-2007 have improved or worsened the banks' perception of the quality of banking supervision in Germany. Accordingly, changes in the relationship between banks and both German supervisory authorities are analyzed and determinants of the quality of banking supervision are elaborated by means of a new survey.

The remainder of this contribution is organized as follows. Section 2 briefly describes the empirical methodology already employed in the former Survey-2006. Main results of the reassessment by banks in 2010 as well as a comparative analysis considering the evidence provided by the Survey-2006 are presented in Section 3. Finally, Section 4 concludes and outlines recommendations for further optimizing banking supervision in Germany.

2. Methodology

According to an official classification provided by the *Deutsche Bundesbank* nine different banking groups are defined within the German banking industry.[1] Ideally, those German banks being supervised by the *BaFin* should have been object of the survey. However, since there are many small banks operating in Germany, a random sample has been drawn out of the groups of credit cooperatives, savings and commercial banks. With regard to the remaining financial institutions the total number of banks has been too small to draw a sufficient random sample. Instead, these banks were summarized and included in a further group ("others"). Finally, 386 banks were representatively selected (see Table 1).

Following the methodology applied to the former Survey-2006, the selected banks have been interviewed on various supervisory aspects (as discussed in detail in the following) by means of a written questionnaire in October 2010. Due to the fact that questions were only marginally modified for the Survey-2010, there have been no ex ante technical discussions with bank agents as it was the case for the initial survey. This might be a likely reason for a slightly lower but still representative response rate at 20 per cent (in 2006: 25,4 per cent) of the entire population (see Table 1).

1 These groups are Kreditgenossenschaften, Sparkassen, Kreditbanken, Bausparkassen, Realkreditinstitute, Bürgschaftsbanken, Landesbanken, Banken mit Sonderaufgaben and Genossenschaftliche Zentralbanken.

Table 1. Sample of banks and response rates according to bank group membership

Germany 2010	Total	Sample absolute	Sample percent	Response rate
Credit cooperatives	1139	266	68.9%	23.4%
Savings banks	430	35	9.1%	8.1%
Commercial banks	277	36	9.3%	13.0%
Others	73	49	12.7%	68.1%
Total	**1919**	**386**	**100%**	**20.0%**

In order to interpret the results from the survey correctly, one has to take into account that credit cooperatives as well as savings banks usually appeal to their respective associations *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)* and *Deutscher Sparkassen- und Giroverband (DSGV)* as member banks rather than an official supervisory authority. Both the *BVR* and the *DSGV* consult their member banks in regulatory concerns and dispose of their own supervisory departments and instruments that are partially comparable to those used by official supervisory authorities (e.g. annual audits, special audits). However, corresponding to the Survey-2006 it was again impossible to examine the quality of supervisory action provided by the *BVR* and the *DSGV* in the current Survey-2010.

Banks were faced with statements that had to be rated from 1 (“completely untrue) to 5 (completely true). Each grade of this scale was weighted with an index value, ranging from 0 points for the value of “1” to 100 points for the value of “5” while “no assessments” were not allowed for linear transformation. In contrast to the Survey-2006 we do not focus on assessments given by single groups of commercial, savings banks and credit cooperatives but rather compare mean index values from the entire sample of selected banks belonging to these three banking groups for the respective years 2006 and 2010. Accordingly, in a first step means of index values are calculated for the entire sample of banks per group in the respective years 2006 and 2010. In a second step mean index values are weighted with a banking sector-specific factor to ensure representativity and comparability between both surveys.[1] In a final step, we perform a two-sided Student’s t-Test to statistically verify whether the answers given in 2006 differ from those provided in 2010. Results are additionally plotted in respective figures.

3. Main results

3.1. Supervisory strategy

Figure 2 presents mean index values for statements concerning the supervisory strategy pursued by the *BaFin* and *Deutsche Bundesbank*. Bank-specific factor-weighted mean index values are shown for the respective years 2006 and 2010.[2] A mean index value of 70 index points serves as a benchmark provided by a related Norwegian survey (Kredittilsynet, 2006) and also employed in the former Survey-2006. Table 2 presents results from Student’s t-Tests to control for significant differences between respective mean index values. The H_0 to be tested is that mean index values from 2006 equal those observed in 2010.

To begin with, as indicated by Figure 2 and Table 2, the aspect that the supervisory strategy was clear and transparent yields the highest mean index values in both surveys whereas the idea that banking supervisors may positively influence international banking regulation is seen negatively by the entire banking sector in respective years. High scepticism by banks concerning the influence on international banking standard setters may be due to the fact that a flat-rate increase of equity capital requirements as stipulated by the new regulatory framework *Basel III* discriminates the German financial system exhibiting a significantly higher volume of outstanding bank loans (in particular to SMEs) than those financial systems that are based on capital markets like the United States for example. Again, banks are invited to realize regulatory arbitrage as especially those banks will benefit being able to substitute their credit risks by similar market risks, for example by means of securitization. Nevertheless, at least in Germany it was found that insufficient equity capital ratios were

1 Moreover, the sector-specific factor takes into account the banks’ affiliation to a certain banking group and thus reconstructs the proportionality of the random sample in relation to the total number banks in Germany in respective years 2006 and 2010.

2 During the survey from 2010 banks were additionally asked to assess single statements with regard to the time period before the collapse of the U.S. investment bank *Lehman Brothers* indicating the culmination of the financial crises (before autumn 2008) and for the period following this event (after autumn 2008).

not main drivers of the recent crisis for more than 95 percent of the entire number of banks.

Moreover, as shown by Figure 2 and Table 2 most statements provided by the Survey-2010 exhibit significantly lower assessment values by banks compared to the former Survey-2006. In particular, banks are now most sceptical towards the statement that banking supervision may provide "prompt corrective action" in time, supervisors may focus on systematic risk and banking supervision may follow a clear and transparent strategy. However, as expected, the differences between both mean index values for these three statements become smaller for the time period after the collapse of *Lehman Brothers* marking the starting point of numerous bank bailouts that have been enforced in the following. Obviously, supervisory authorities were not able to prevent Germany's banking sector from a spill-over of the financial crisis. In contrast, especially government-owned banks were among those financial institutions exhibiting the most severe financial distress during the crisis. Supervisory authorities themselves admit that micro-prudential oversight was not adequate to recognize the actual extent of systemic risk and (resulting) cross-sectional risks inherent in the banking sector during the crisis (Sanio, 2011). However, macro-prudential oversight, being implemented to protect the entire financial system from threats of instability (Sanio, 2011), yet seems to have been insufficiently perceived by interviewed banks.

Figure 2. Supervisory strategy

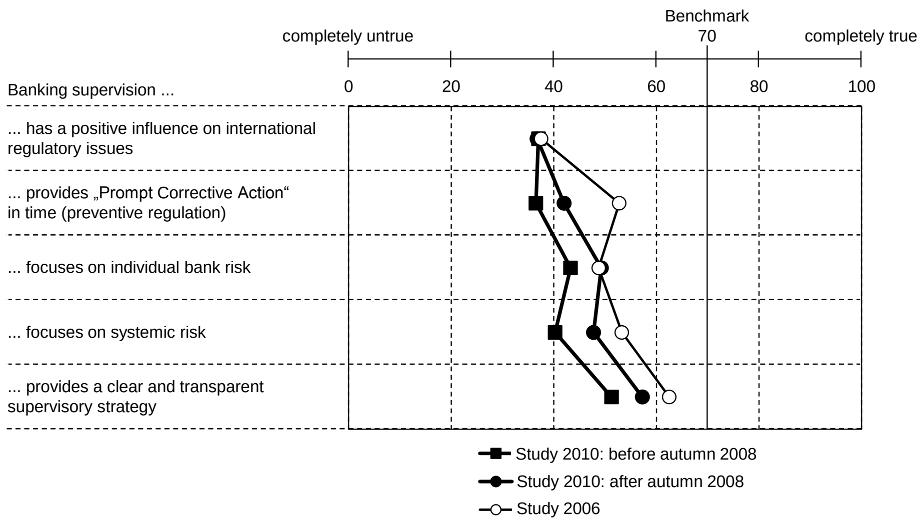


Table 2. Supervisory strategy

	2010 (before autumn 2008)	2006	p-value
Banking supervision…			
…has a positive influence on international regulatory issues	37	38	-
…provides "Prompt Corrective Action" in time	38	53	***
…focuses on individual bank risk	43	49	***
…focuses on systemic risk	40	53	***
…provides a clear and transparent supervisory strategy	51	63	***
	2010 (after autumn 2008)	**2006**	**p-value**
Banking supervision…			
…has a positive influence on international regulatory issues	37	38	-
…provides "Prompt Corrective Action" in time	42	53	***
…focuses on individual bank risk	49	49	-
…focuses on systemic risk	48	53	***
…provides a clear and transparent supervisory strategy	57	63	***
H_0: Mean2006 = Mean2010			
*** significant at a 0,1% level			
** significant at a 1% level			
* significant at a 5% level			

Corresponding to previous findings, statements suggesting that regulatory complexity may be consistent with respective regulatory issues and requirements while formal regulations may be reduced to a minimum receive comparatively low values in both surveys (Figure 3 and Table 3). While mean index values have not notably changed for most statements between 2006 and 2010, interviewed banks now (after autumn 2008) even less observe that they were sufficiently involved in working out regulations. This result is not surprising and might be related to the fact that the Basel Committee as well as national supervisors sought for prompt regulatory response to the financial crisis without involving the banking sector being responsible for the financial turmoil.

Figure 3. Regulations and circulars

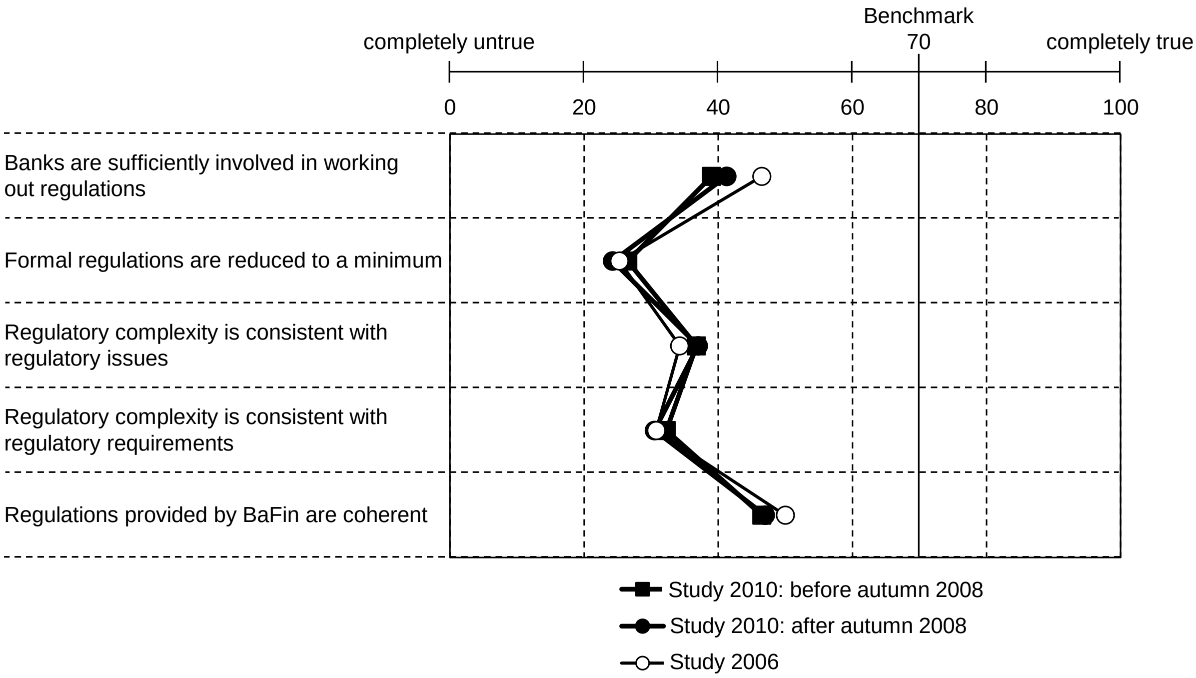


Table 3. Regulations and circulars

	2010 (before autumn 2008)	2006	p-value
Banks are sufficiently involved in working out regulations	39	47	***
Formal regulations are reduced to a minimum	27	25	-
Regulatory complexity is consistent with regulatory issues	37	34	**
Regulatory complexity is consistent with regulatory requirements	32	31	-
Regulations provided by BaFin are coherent	47	50	***
	2010 (after autumn 2008)	**2006**	**p-value**
Banks are sufficiently involved in working out regulations	41	47	***
Formal regulations are reduced to a minimum	24	25	-
Regulatory complexity is consistent with regulatory issues	37	34	-
Regulatory complexity is consistent with regulatory requirements	31	31	-
Regulations provided by BaFin are coherent	47	50	***

H_0: Mean2006 = Mean2010
*** significant at a 0,1% level
** significant at a 1% level
* significant at a 5% level

3.2. Qualitative banking supervision

In late 2005 the *BaFin* announced a framework of minimum requirements concerning the banks' internal risk management ("Mindestanforderungen an das Risikomanagement", MaRisk) to transform the contents of *Basel II, Pillar 2* (Supervisory Review Process, SRP) into German Banking Law. Until today the implementation of the MaRisk as an instrument of a higher level of "qualitative" banking supervision is controversially debated in Germany. In this context main contentious points were the transparency of the MaRisk-framework, the degree of specificity of MaRisk-regulations, the homogeneity of supervisory action according to these regulations and the depth of intervention into the banks rights of disposition (e.g., Paul, 2006).

Findings from the Survey-2006 indicated that regulations were in large parts, but not completely, distinct across the bank-specific risk complexes. In particular, regulations concerning the internal capital adequacy and risk management as well as the banks' credit risk, market risk and even liquidity risk were considered to be most clear. These results were not surprising since detailed regulations on managing credit and market risks had already been implemented within the former *Basel I* accord. In contrast, qualitative regulations concerning the bank's operational risk were less clear-cut due to the fact that *Basel I* did not provide for the management of operational risk at all and hence, supervisors (as well as the banks themselves) were not as familiar with this risk complex as they were with other risk categories. Despite the fact that banks required clarification concerning the management of operational risks, more detailed regulations in the sense of target ideals provided by supervisors were not seen as helpful as regards this risk complex (Figure 4 and Table 4).

Turning to results from the recent Survey-2010, Figure 4 and Table 4 indicate that mean index values become significantly lower for all statements concerning more detailed regulations on qualitative supervision compared to 2006. Qualitative regulations on the internal capital adequacy yield the highest mean index values during the Survey-2010 confirming previous findings that insufficient equity capital ratios have not been the main reason for the spill-over of the crisis to German banks. In contrast, more detailed regulations on the implementation of an internal risk management and the management of liquidity risks are perceived to be less helpful. Significantly lower assessment values might generally be explained by the fact that extensive and detailed regulation will as such be perceived as counter-productive. Moreover, the banks' internal risk management structures and processes may generally been scrutinized during a crisis episode on the banks' own accord. Similarly, as especially liquidity risks played a pivotal role during the spread of the current financial crisis, banks have now started to generate and further optimize more sophisticated management systems concerning liquidity risk on their own. In this context one cannot rule out that heated discussions concerning an adequate regulation of liquidity risks has amplified negative evaluations by interviewed banks. Note however that answers to this question exhibit a high standard deviation of approximately 25 points either indicating significant differences in supervising banks (which would be problematic from the regulatory point of view) or suggesting a different perception of qualitative supervision by banks resulting from different expectations and attitudes towards this issue.

Figure 4. More detailed regulations on qualitative supervision (MaRisk)

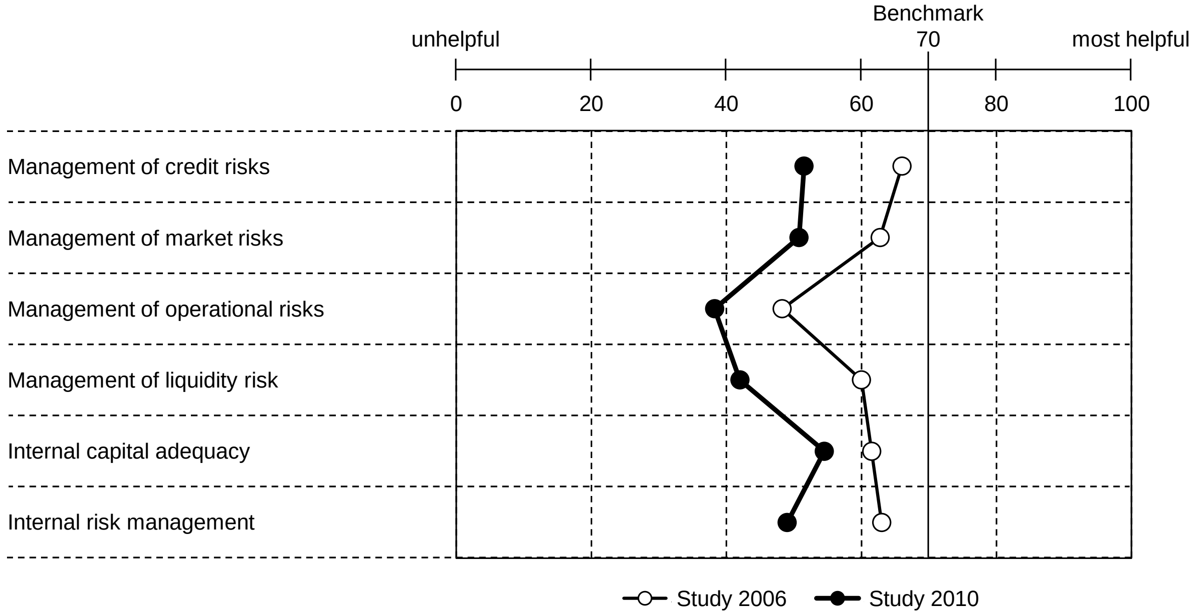


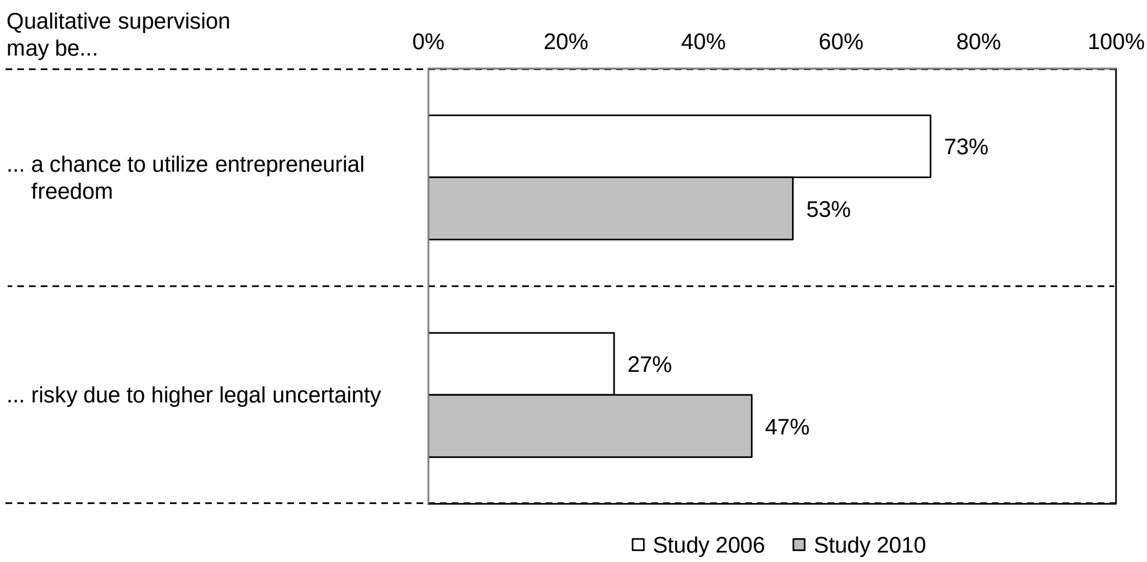
Table 4. More detailed regulations on qualitative supervision (MaRisk)

	2010	**2006**	**p-value**
Management of credit risks	54	66	***
Management of market risks	51	63	***
Management of operational risk	38	48	***
Management of liquidity risk	42	60	***
Internal capital adequacy	55	62	***
Internal risk management	49	63	***

H_0: Mean2006 = Mean2010
*** significant at a 0,1% level
** significant at a 1% level
* significant at a 5% level

In line with this result, statements concerning qualitative supervision during the Survey-2006 already revealed two different types of bank managers. On the one hand, 73 percent of bank managers from all banking groups perceived leeway due to general and unspecific regulations on qualitative supervision as a chance to utilize entrepreneurial freedom. On the other hand, 27 percent of all bank managers interpreted leeway as a potential risk associated with a higher degree of legal uncertainty. Interestingly, as indicated in Figure 5 the number of sceptics has sharply increased while the number of advocates has notably declined during the last 5 years, now almost balancing the two types of bank managers. Thus, empirical results reveal that objections towards the approach of qualitative banking supervision have increased due to the financial crisis independent from the practical application of and the increasing experience with this kind of supervisory approach

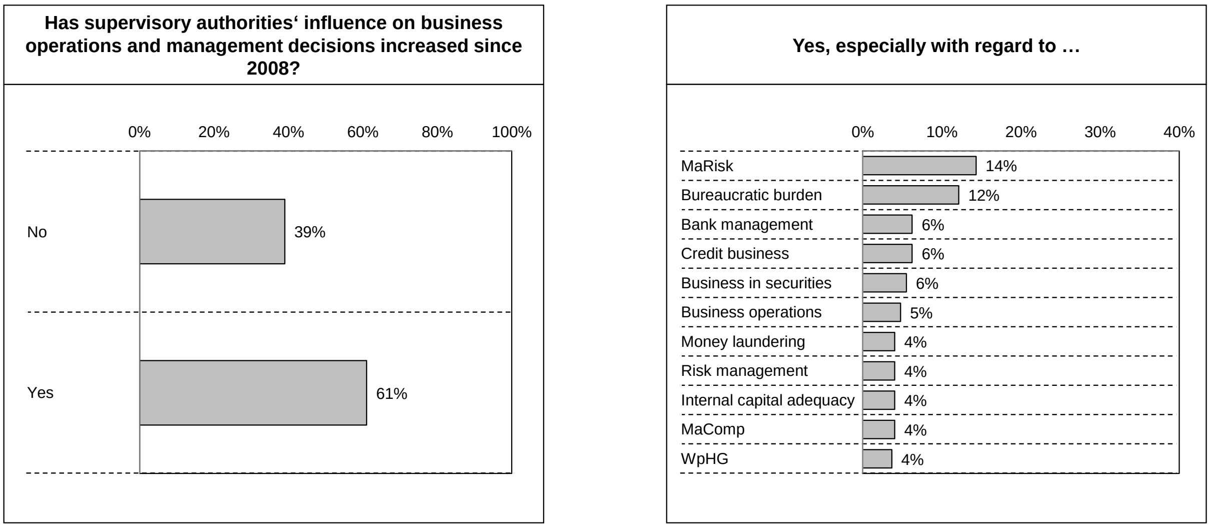
Figure 5. Overall assessment of qualitative supervision



Against the background that the implementation of qualitative banking supervision in Germany has been intensified through the latest amendment of the MaRisk in December 2010 previous assessments by German banks become even more important from the supervisors' point of view. According to the modified MaRisk-regulations German banks are now faced with stronger requirements concerning stress-testing procedures and the management of risk concentration. Moreover, banks are now forced to disclose risk and business strategies in a more comprehensive and detailed manner while the risk-taking capacity of banks gains in importance. Hence, taking into account previous assessments supervisory authorities seem to suffer from a severe lack of communication. It remains to be seen if German banks will really "live" the respective requirements in their daily business and if supervisory authorities will be able to control and appraise the banks' efforts.

Finally, as Figure 6 indicates, German banks perceive a stronger influence of supervisors on management decisions and business operations over time. 61 percent of the interviewed banks confirm this aspect. Nevertheless, arguments supporting this assessment remain vague. At best, the negative perception by banks may result from stronger requirements as regards the MaRisk-regulations as well as an increase in bureaucratic burden.

Figure 6. Supervisory influence



3.4 Supervisory instruments

3.4.1 Supervisory dialogues

Annual supervisory dialogues (on- but also off-site) constitute the main qualitative supervisory instrument. As compared to findings provided by the Survey-2006, these dialogues are still positively assessed by German banks in many aspects (Figure 7, Table 5) without obtaining notable changes.[1] Based on determinants typically used to generally assess the quality of auditing processes (Marten, 1999; Schmidt, 2000), banks in particular stress that supervisory dialogues were performed under strong cooperation with supervisors, supervisors were familiar with the individual bank and dialogues were clearly structured. Each of these aspects has still attained more than 70 index points on the assessment scale. Thus, results indicate a strong relationship between supervisory authorities and banks in Germany which corresponds to findings provided by a related Norwegian study (TNS Gallup, 2010).

However, statements that supervisors were open for the banks' concerns and dialogues would cover important issues receive lower mean index values compared to the Survey-2006. We suggest that global prompt-corrective action has gained in importance during the crisis period to prevent from further distress whereas supervisors might have less regard for the individual bank's specific concerns. Finally, related to the former Survey-2006 assessments of statements concerning benefits and costs emerging from supervisory dialogues remain nearly unchanged. Regarding the assessment of supervisory dialogues in general these statements receive the lowest mean index values while banks still observe higher costs and lower benefits from dialogues.

1 Taking into account that the relationship between supervisory authorities and interviewed banks is not voluntary but rather originates from a sovereign act of administration, one may expect that bank statements were generally assessed with lower scores than assessments that unregulated service providers would have given instead.

Figure 7. Supervisory dialogues

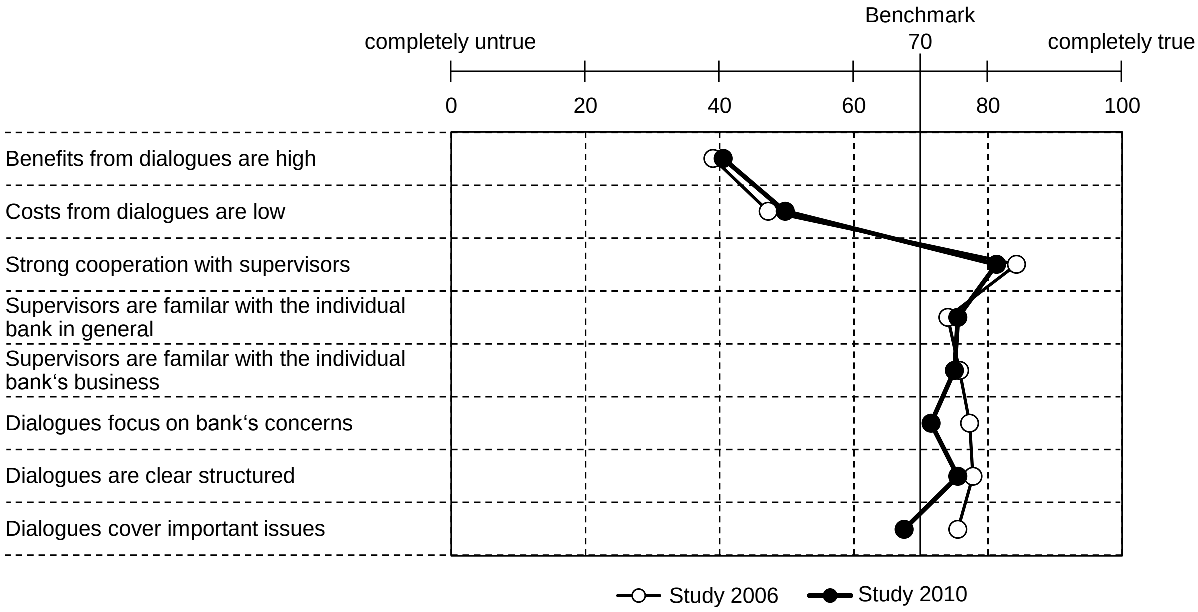


Table 5. Supervisory dialogues

	2010	2006	p-value
Benefits from dialogues are high	39	39	-
Costs from dialogues are low	48	47	*
Strong cooperation with supervisors	80	84	***
Supervisors are familiar with the individual bank in general	75	74	-
Supervisors are familiar with the individual bank's business	74	76	-
Dialogues focus on the bank's concerns	73	77	***
Dialogues are clear structured	75	78	**
Dialogues cover important issues	63	76	***
H_0: Mean2006 = Mean2010			
*** significant at a 0,1% level			
** significant at a 1% level			
* significant at a 5% level			

3.4.2 Special audits

Next to supervisory dialogues and requesting financial reporting information on a regular basis, the *BaFin* can additionally carry out on-site supervisory audits (so called "special audits") according to § 44 (1) of the German Banking Act (KWG). As shown in Table 6, 62 percent of all interviewed banks point out that the *BaFin* has not once exercised its right to request financial information and documents since 2008 by means of special audits. 34 percent of all interviewed banks have been audited once and only 4 percent have been audited two times or more. In this context, the frequency of audits diverges between banking sectors. The proportion of banks audited at least once since 2008 amounts to 60 percent among commercial banks, 29 percent among credit cooperatives and 42 percent among savings banks.

Table 6. Frequency of special audits since 2008

Total banks			Commercial banks	Credit cooperatives	Savings banks
No special audit	62%				
One special audit	34%	At least one special audit	60%	29%	42%
More than one special audit	4%				

Corresponding to findings provided by the Survey-2006, most statements concerning single aspects of special audits in sum yield relatively higher mean index values compared to all other assessment categories (Figure 8, Table 7). In particular, German banks underline the compliance of special audits with the underlying auditing-mandate, the clarity of information requirements ex ante as well as the supervisors' competence during the auditing process. In contrast, banks also stress that auditors were less familiar with the individual bank's characteristics and its business model. Interestingly, statements referring to the adequacy of timeframe exhibit higher mean index values as compared to the Survey-2006 which might be due to the fact that supervisory authorities were forced to accelerate auditing processes during the crisis period.

As compared to other aspects costs and benefits resulting from special audits are perceived more critically. Respective statements show the lowest mean index values in this category. As indicated in Figure 8 and Table 7, while the assessment of costs from special audits has not notably changed German banks perceive higher benefits from special auditing compared to assessments provided by the Survey-2006. Nevertheless, since only 25 percent of interviewed banks anticipate a genuine benefit from special audits at all one may scrutinize if the *BaFin's* strategy to build up a partnership with banks by providing them with consulting services of the highest quality is actually credible.

Figure 8. Special audits (§ 44 KWG)

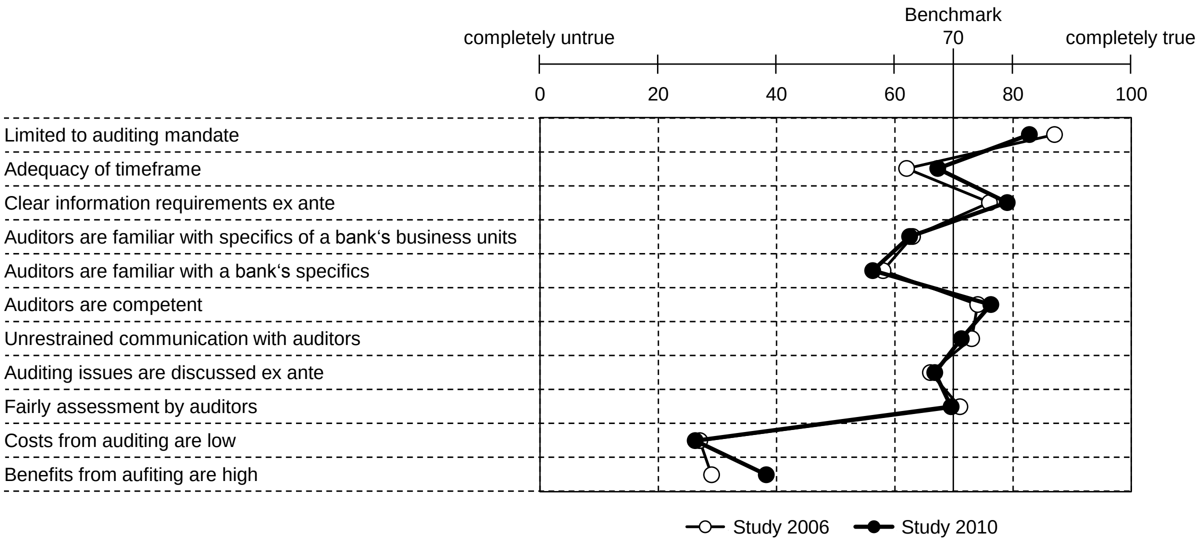


Table 7. Special audits (§ 44 KWG)

	2010	2006	p-value
Limited to auditing mandate	83	87	***
Adequacy of timeframe	67	62	***
Clear information requirements ex ante	79	76	***
Auditors are familiar with specifics of the bank's business units	63	63	***
Auditors are familiar with the bank's specifics	56	58	***
Auditors are competent	76	74	**
Unrestrained communication with auditors	71	73	-

Auditing issues are discussed ex ante	67	66	-
Fairly assessment by auditors	70	71	*
Costs from auditing are low	26	27	-
Benefits from auditing are high	38	29	***
H_0: Mean2006 = Mean2010			
*** significant at a 0,1% level			
** significant at a 1% level			
* significant at a 5% level			

3.5. Supervisory personnel and coordination between supervisory authorities

In line with results from the former Survey-2006 interviewed banks point out that overall satisfaction with the *Bundesbank's* personnel is consistently higher than it is with supervisors from the *BaFin* (Figure 9, Table 8). In fact, this margin has even broadened between 2006 and 2010. Supervisors acting on behalf of the *BaFin* are seen more critically during the recent Survey-2010. Instead, banks particularly emphasize that *Bundesbank's* supervisors are more competent (exhibit more expert and practical knowledge) and act more pragmatically and faster. In sum, results challenge the German Ministry's decision from end 2010 proposing that supervisory responsibilities should not be bundled within one authority but that regulatory power of the *BaFin* should be strengthened instead (Paul, 2010). Taking into account previous assessment results, the more promising strategy would be that the two authorities should not be played off against each other but represent themselves as one independent institution resisting all attempts of bank lobbyism.

Figure 9. Supervisory personnel

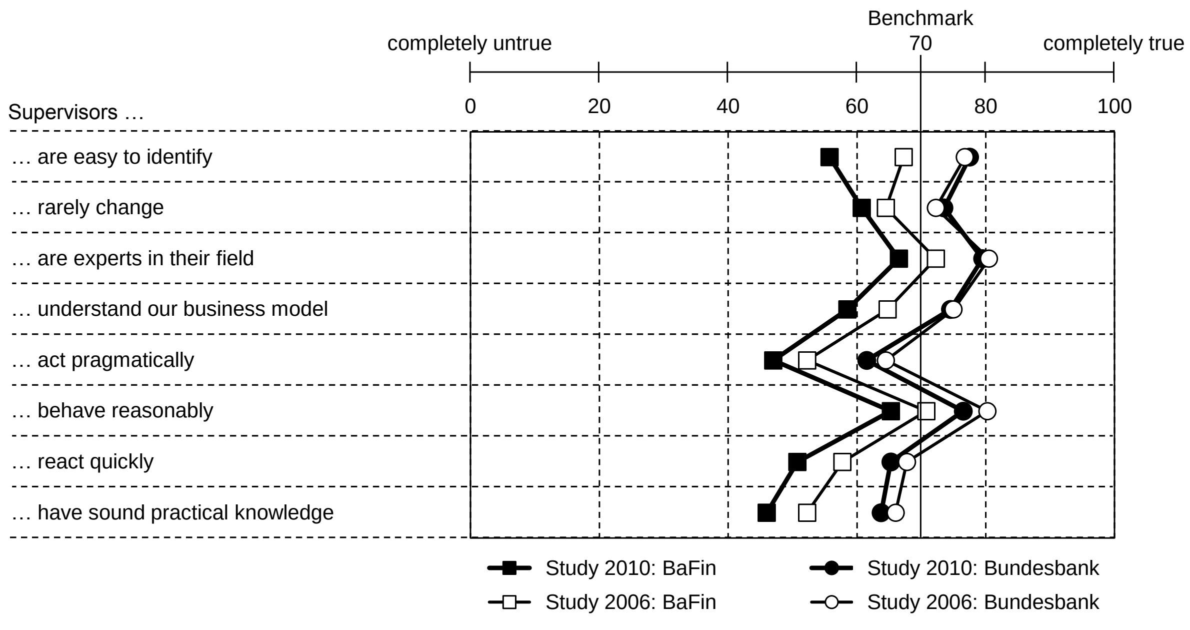


Table 8. Supervisory personnel

	2010	2006	p-value
BaFin			
…are easy to identify	56	67	***
…rarely change	61	65	*
…are experts in their field	67	72	***
…understand our business	59	65	***
…are pragmatic	47	52	***
…behave reasonably	65	71	***
…react quickly	51	58	***
…have sound practical knowledge	46	52	***
Bundesbank			
…are easy to identify	78	77	-
…rarely change	74	72	-
…are experts in their field	80	81	*
…understand our business	75	75	-
…are pragmatic	62	65	***
…behave reasonably	77	80	***
…react quickly	65	68	**
…have sound practical knowledge	64	66	***

H_0: Mean2006 = Mean2010
*** significant at a 0,1% level
** significant at a 1% level
* significant at a 5% level

Finally, related to the Survey-2006 the coordination between *Bundesbank* and *BaFin* is seen more critical by interviewed banks in 2010 (Table 9). This result becomes even more important for Germany as the BMF has commissioned a guideline in February 2008 ("*Aufsichtsrichtlinie*") in order to optimize interaction between both supervisory authorities. Thus, even if there has been any effort to improve interaction between both institutions, our findings suggest that German banks may have not perceived them.

Table 9. Coordination between BaFin and Bundesbank

	2010	2006	p-value
Close coordination between authorities	55	59	**

H_0: Mean2006 = Mean2010
*** significant at a 0,1% level
** significant at a 1% level
* significant at a 5% level

3.6. Overall satisfaction with the quality of banking supervision

Figure 10 and Table 10 indicate that the banks' overall satisfaction with banking supervision quality has decreased from 51 to 46 index points compared to the Survey-2006. The fact that interviewed banks submit a worse assessment concerning banking supervision quality in general whereas they evaluate more specific supervisory dialogues and personnel more positively has also been suggested by related research on consumer satisfaction in banking. Providing evidence that bank customers typically evaluate bank consultants more positively than the bank itself (e.g., Commerzbank, 2010) it is suggested that these evaluation differences may be the result of either a well-functioning social interaction between customer and consultant or possibly the effectiveness of dedicated consultants and their personal engagement.

Figure 10. Overall satisfaction with the quality of banking supervision

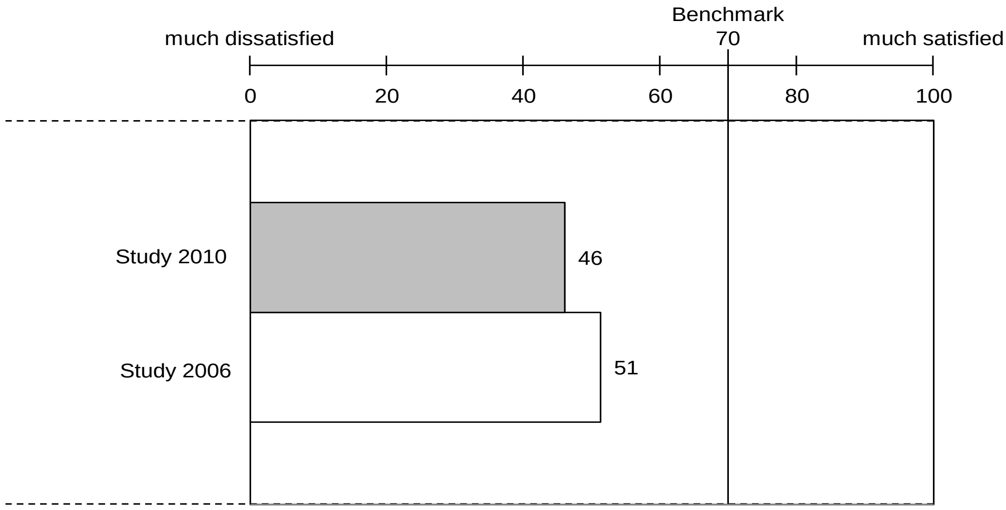


Table 10. Overall satisfaction with the quality of banking supervision

	2010	2006	p-value
	46	51	***
H_0: Mean2006 = Mean2010			
*** significant at a 0,1% level			
** significant at a 1% level			
* significant at a 5% level			

Corresponding to the Survey-2006 we additionally apply a CHAID algorithm provided by Kass (1980) to empirically evaluate statistically significant drivers of the banks' overall satisfaction with banking supervision.[1] Empirical evidence initially suggests that the strongest driver of overall satisfaction is best described by the predictor variable "bank manager's attitude towards the concept of qualitative banking supervision". This result is in line with previous findings (Section 3.2) suggesting that the number of sceptics among bank managers towards qualitative banking supervision according to *Basel II, Pillar 2* has distinctly increased over the last 5 years. Furthermore, the supervisory authorities' focus on individual bank risk and regulatory restrictions concerning management decisions and business operations constitute further significant predictors of the interviewed banks' overall satisfaction with banking supervision in Germany.

4. Conclusion

This contribution presents and discusses main results of a new survey on the assessment of supervisory quality among German banks in 2010. In particular, it is analyzed if and how the supervised banks' perception of the quality of supervisory authorities and their instruments has changed due to the financial crisis starting in mid-2007. Accordingly, comparing results from the recent survey with evidence provided by a former study carried out by the authors in 2006 (Paul, Stein and Uhde, 2008) we initially find that interviewed banks have become more sceptical towards the aspect that banking supervision may provide "prompt corrective action" in time and may clearly focus on systematic risk. Furthermore, evidence reveals that German banks perceive more detailed qualitative regulations on internal risk management systems and the management of

1 See Paul, Stein and Uhde (2008) and Kaltofen, Paul and Stein (2007) for a detailed discussion of the CHAID methodology.

liquidity risks as less helpful compared to findings from 2006. In this context, we also find that a notably higher number of bank managers consider the concept of qualitative banking supervision as a risky element due to higher legal uncertainty. Moreover, German banks still assign a higher quality and competence to *Bundesbank* supervisors rather than *BaFin* personnel and this margin has even broadened between 2006 and 2010. Finally and corresponding to findings from single assessment categories we provide evidence that the banks' overall satisfaction with banking supervision quality in Germany has decreased during the course of the recent financial crisis.

Against the background of our empirical results we suggest (1) that the effectiveness of a system of two coexisting supervisory authorities in Germany has become even more doubtful and (2) that the *BaFin's* effort to set up up a closer partnership between supervisory authorities and the banking sector by providing consulting services of the highest quality is not reflected by interviewed banks' assessments. As a consequence, we stress the necessity to reconsider the German government's decision to further foster supervisory responsibilities of the *BaFin*. Moreover, as German banks perceive a decrease in banking supervision quality since 2006 and preparations of implementing the new *Basel III* framework have already begun, short-term measures have to be taken in order to provide more transparency and efficiency with regard to the supervisory organizational structure and instruments.

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