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**BaFin**

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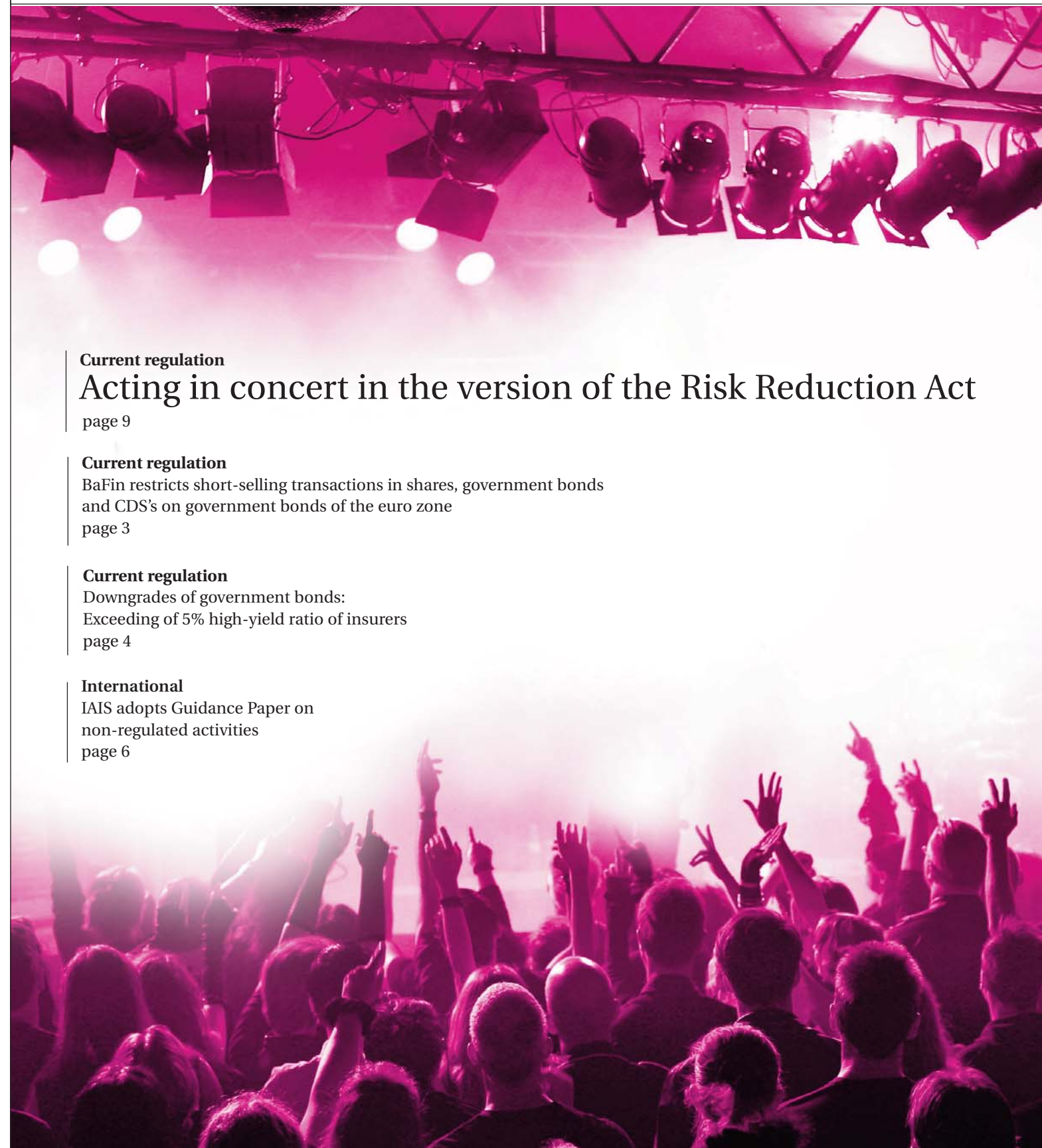
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## Foreword

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"Economists set themselves too easy, too useless a task", wrote John Maynard Keynes, "if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again." In recent months, as yet another severe storm swept over the financial markets, BaFin could not sit idly by and wait for it to pass. It moved to prohibit naked short-selling transactions and naked CDS's on government bonds in the euro zone, as well as naked short sales in shares of selected financial enterprises. For more detailed background information in relation to this action, please refer to [page 3](#).

A storm in the truest sense of the word, as well as other natural catastrophes, can reduce a person's livelihood to rubble in the blink of an eye. Often, the hardest hit are people living in poverty in the world's poorly developed regions. They can scantily rely on any social security regime of their country. Microinsurance can help people living in poverty to cover the most basic of risks for a minimal contribution. More than 100 high-ranking representatives of government ministries, insurance supervisory authorities and insurance companies from 16 countries gathered together on 3 May 2010 to discuss ways of fighting poverty and creating social security through microinsurance schemes. Read more about this on [page 7](#).

Crowds usually storm the concerts held on Bonn's Museumsplatz Square. Young artists and veterans of rock and pop take to the stage to delight their audience with debut performances and old favourites. Often, fans of classical music find that a beloved work takes on a somewhat sour note – where composition and interpretation are meant to enchant them, they hear dissonance and cacophony. Can this be a matter of taste? At any rate, acting in concert can also occasionally lead to discord – usually when the target company or shareholders are not given the opportunity to attune their conduct in unison. In August 2008, the legislature defined the term "coordinated conduct" (abgestimmtes Verhalten) in greater detail through the Risk Reduction Act. BaFin has drawn up a situation report after 600 days and presents the administrative principles it has developed over that time on [pages 9 to 11](#).

Wishing you pleasant reading,



Dr. Sabine Reimer, Head of Press  
and Public Relations



## Current regulation

### SUPERVISORY LAW

## BaFin restricts short-selling transactions in shares, government bonds and CDS's on government bonds of the euro zone

On 18 May 2010, the Federal Financial Supervisory Authority (BaFin) temporarily prohibited naked short sales of debt securities of euro zone countries admitted to trading on the regulated market of a German exchange. It also temporarily prohibited the conclusion of credit default swaps (CDS's) if at least one reference liability is a liability of a euro zone country and the CDS's are not used to hedge default risks (naked CDS's). Moreover, BaFin once again prohibited naked short-selling transactions in the shares of the following ten financial enterprises: Aareal Bank AG, Allianz SE, Commerzbank AG, Deutsche Bank AG, Deutsche Börse AG, Deutsche Postbank AG, Generali Deutschland Holding AG, Hannover Rückversicherung AG, MLP AG and Münchener Rückversicherungs-Gesellschaft AG. The bans entered into force on 19 May 2010, 0.00 hrs., and will run until 31 March 2011, 24.00 hrs. Under a grandfather provision, all bans grant protection for naked positions entered into by market participants prior to 19 May 2010.

A naked short-selling transaction exists when the seller sells shares or government bonds which he does not own or for which he does not have a plea-proof claim to transfer of title to securities of the same class at the time of the transaction. However, restrictions arise not only for the financial stocks concerned but also for other financial instruments such as put options or short certificates. Although

the sale or purchase of such instruments continues to be permissible, the common practice of hedging risk positions arising from such transactions with a naked short-selling transaction is no longer possible. A covered and thus permissible CDS within the meaning of the General Decree exists if, based on an economic view, a more than insignificant reduction of the credit risk is achieved for the protection buyer. For cases in which the buyer is in possession of such government bonds, the prohibition thus does not apply. Such CDS protection purchase is also permissible even if based on an economic view a loss or default in the government bond serving as the underlying of the CDS may lead to financial losses or defaults in another financial instrument which is to be hedged using the CDS on the government bond. This is for example the case if, in order to hedge a risk position arising under a bond of a financial institution whose performance also depends on the performance of the government bond of the country of domicile, CDS's on government bonds of the financial institution's country of domicile are purchased. However, BaFin will not publish case groups or thresholds as to when a CDS on a government bond is to be regarded as a more than insignificant reduction in the credit risk for bonds of financial institutions of such country. What is decisive is that the more than insignificant reduction in credit risk is documented in a plausible and comprehensive form.

BaFin expects market participants to comply with the Decrees. There is no additional obligation on the part of banks to monitor whether their clients adhere to the bans. However, BaFin does assume that institutions will draw their clients' attention to the Decrees and notify BaFin of any indications of violations.

Naked short-selling will now be permanently prohibited by law. The corresponding act will enter into force shortly. You will find more information on the General Decrees of BaFin [here](#).

## SUPERVISORY PRACTICE

### Downgrades of government bonds: Exceeding of 5% high-yield ratio of insurers

In the context of the market turmoil over government bonds seen in recent weeks and the rating downgrade for Greece, BaFin has reviewed the classification of Greek government bonds and loans within the restricted assets of German insurers. The objective of this review was to reduce and, if possible, prevent a pro-cyclical behaviour in the decisions being taken by insurers in what is still a very difficult market environment. In the currently prevailing environment and given the support measures adopted, BaFin until further notice will not object from a supervisory viewpoint if the 5% high-yield ratio is exceeded by downgraded Greek bonds.

If an investment of restricted assets is downgraded by a rating agency during the investment period to such an extent that the investment-grade rating no longer applies or if such downgrade is imminent, the insurer must review whether such investment can be classified as a high-yield bond (at least speculative-grade rating of B- according to Standard & Poor's and Fitch, or B3 according to Moody's) or assigned to the opening clause. The high-yield ratio for such investments, however, covers only 5% and represents a mixed ratio that can already be used up by other high-yield bonds such as corporate bonds. Thus, the possibility of the high-yield ratio being exceeded in the case of certain insurers cannot be excluded. The opening clause, too, is limited to 5%. With this clause, securities may be allocated to the restricted assets which are not specified in the list of investments, do not meet the requirements of such list or exceed the mixed ratios of the German Investment Regulation (Anlageverordnung – AnIV). To reduce pro-cyclical effects, promote financial market stability and limit losses with the insurers concerned, BaFin will not require emergency sales for reducing the high-yield ratio. As long as the ratio is exceeded, insurers may not make any new investments within the high-yield category.

In the event of further selected European countries undergoing similar rating measures, it is expected that these will proceed accordingly. However, BaFin points out that the qualitative requirements (Requirements for Risk Management in Insurance Undertakings – MaRisk VA) to be met by insurers in terms regularly reviewing investments as part of their internal risk management and control processes are not affected by this.

### BaFin publishes guidance notice on model changes regarding internal market risk models

Banks and insurance companies frequently use mathematical risk models for internal control of counterparty, market or operational risks. When certain supervisory requirements are observed and a corresponding confirmation of suitability is issued by BaFin, they may use these models – instead of the standard methods which are also possible – to determine their capital charge required under supervisory regulations.

After being authorised for the first time, however, a market risk model must be regularly adjusted, for example to take account of any changes in the institution's business activity, organisational structure or other external factors. The purpose of the "Merkblatt zur Behandlung von Modelländerungen bei internen Marktrisikomodellen" (Guidance Notice on the Treatment of Model Changes regarding Internal Market Risk Models, available in German and a non-binding English translation) published by BaFin together with the Deutsche Bundesbank on 19 April 2010 is to assist institutions in continuously further developing these models whilst ensuring that their suitability status remains unchanged, as well as to facilitate an administrative proceeding to this effect.

#### Supervisory review of suitability

Before authorising a market risk model for the first time, the supervisory authority examines whether the risk model chosen by the company is suitable for measuring the risk in question. As part of the examination, quantitative requirements to be observed by all model types of a certain risk type are reviewed for the existing portfolio (e.g. forecast horizon, likelihood of occurrence, length of historical observation period). In addition, the company's individual orientation and in particular risk strategy used in determining the risks entered into must be taken into account. By authorising an internal risk model for determining an institution's capital charge relevant under supervisory regulations, BaFin establishes that the model satisfies the requirements under supervisory regulations in terms of its specific design and the particular form in which it is integrated into the risk management organisation of the bank or insurance company at the time of the review. In this regard, one key supervisory requirement for the model used to determine the capital charge required under supervisory regulations is that it must also be used for internal

risk control. That means that deviations between the model's internal application and application under supervisory regulations are permissible only within narrowly defined limits.

### Various categories of model changes

Any change in the risk model would as a rule, based on the establishing character of the suitability confirmation, require a new confirmation of suitability and prior thereto possibly also a new review of the model. On the other hand, the institution, to ensure the model is suitable for use in practice, must adapt its risk identification systems to the multiple changes in the risk environment at all times.

To resolve this conflict between the scope of the suitability confirmation, on the one hand, and the principle provided for by supervisory regulations requiring the risk model to be constantly optimised, on the other, the supervisory authority in April 2010 published the Guidance Notice on the Treatment of Model Changes regarding Internal Market Risk Models. In this Notice, the supervisory authority distinguishes between different categories of model changes. With these categories, which are illustrated by practical examples, banks are provided with a transparent and reasonably graduated method of making changes to their market risk models. This method addresses both BaFin's supervisory interests in being informed of relevant model changes before they are implemented and of being able to prevent their implementation where appropriate, as well as the interests of banks in being allowed to make necessary and sensible changes to their model within a short time.

The different categories of model changes described in the Guidance Notice and supplemented by numerous examples enable banks to prepare an internal guideline on the treatment of model changes tailored exactly to their particular risk model and to proceed according to such self-established requirements. BaFin analyses the guideline submitted to it for suitability and monitors the institution's notification obligation provided for therein for the different forms of model changes. Particularly within the scope of banking audits, the supervisory authority examines compliance with the requirements of the Guidance Notice.

### Method also useful for planned Solvency II rules

The methods chosen for the area of the capital charge required under supervisory regulations and

their underlying supervisory considerations are also, to the extent comparable, to be applied to the models of insurance companies according to the planned Solvency II rules. This also shows the advantages of an integrated financial supervisory regime that is able to gather cross-sector information and insights from the various supervisory subjects of the individual organisational units or Directorates and use them for the purposes of integrated financial services supervision.



## International

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### REPORTS

## Germany amongst the leading countries in the regulation of remuneration systems

Germany is among the leading countries when it comes to creating new regulatory and supervisory framework conditions in the area of remuneration systems. This is a conclusion reached in a study by the Financial Stability Board (FSB), which, acting on behalf of the G20, developed **principles** and **standards** for sound remuneration practices. At the G20 Summit in Pittsburgh in September of last year the leading industrialised nations had pledged to implement the FSB's requirements for appropriate remuneration systems for financial institutions. It is fortunate that such a broad international consensus on the application of the FSB requirements was reached. Fierce competition for the best talent is a prime feature of the employment market affected by these provisions. International imbalances in the regulation of remuneration systems would result in a competitive disadvantage for firms in jurisdictions that apply tighter regulation. This would in turn lead

to regulatory arbitrage which would undermine the remuneration requirements.

In order to ensure that such imbalances do not arise when the FSB requirements are implemented in the various countries concerned in future either, the FSB reviews the implementation of its requirements by conducting peer reviews of the countries concerned. The FSB published the **results** of the first such peer review on 30 March 2010. According to this peer review, Germany is among the leading countries in the implementation of the FSB requirements.

Germany is managing the implementation of the FSB requirements in a three-stage programme. The first stage was a voluntary undertaking signed in December 2009 by the eight most important banks and the three largest insurers in Germany, in which they undertook to implement the FSB requirements. The second stage was the publication of two Circulars – one for **credit institutions** and one for **insurers** – regarding the requirements for their remuneration systems. In a third stage the material core of these Circulars is to be transposed into two regulations. The necessary authorisation to issue the regulations will probably come into force in October 2010.

## IAIS adopts Guidance Paper on non-regulated activities

In early April the International Association of Insurance Supervisors (IAIS) published a Guidance Paper dealing with the treatment of non-regulated entities of insurance groups. In this paper the IAIS suggests that regulation should be designed in such a way that it covers all the risks stemming from all entities of an insurance group that might influence its risk profile or financial position. Supervisors are also in favour of the widest possible international standardisation of regulation.

According to the IAIS, insurance groups are becoming increasingly complex in both nature and operation. A major risk in insurance groups and financial conglomerates, it writes, is contagion risk: for instance, parts of a group that are not subject to supervision could create numerous risks for other entities or even for the whole group. The financial crisis, especially the case of the US insurer AIG, has shown how non-regulated entities can lead to the breakdown of a whole group, it says in the Paper, which was drawn up by the IAIS Insurance Groups and Cross-sectoral Issues Subcommittee (IGSC) and

which is chaired by a BaFin representative. The Guidance Paper distinguishes between two types of non-regulated entities in insurance groups: holding companies that do not engage in operational activities – referred to in the Paper as “non-operating holding companies (NOHCs)” – and operating entities that are not subject to supervision – referred to as “non-regulated operating entities (NROEs)”. The document highlights several variants of supervision of NOHCs and NROEs. For instance, it describes the direct and the indirect approach, as well as a hybrid form of both approaches, and compares the advantages and disadvantages of the different approaches.

A lack of transparency in the group structure, the Paper goes on, can make it difficult for group management and supervisors to get a comprehensive knowledge or understanding of the actual risk situation. This is particularly true if most of the risks are concentrated in non-regulated parts of the group. One of the most important requirements (key features) that supervision of insurance groups should satisfy is, therefore, to have due regard for the complexity of the structure of a group. To that end, supervisors must consider all risks arising from the whole group if they may affect other parts of the group or the group as a whole. Furthermore, steps should be taken to ensure that group management is able to assess how complex the group structure is, in order to then establish a risk control system commensurate to it. Another key feature of effective supervision, according to the IAIS, relates to the measurement of the capital adequacy of the group, which should also include in the calculation the risks arising from its non-regulated entities. All in all, the Paper describes eight key features of effective group supervision. The key features are also to be incorporated into the IAIS’s Insurance Core Principles (ICPs), which the Association is currently overhauling. The ICPs are used by the International Monetary Fund (IMF) and the World Bank (WB) as a rating benchmark for their Financial Sector Assessment Programme (FSAP) with which it evaluates the regulatory framework and resistance to crises of the financial sectors of member countries.

The Paper has been adopted in a new fast-track procedure which the IAIS has established in response to the financial crisis and the resultant demands of G20 governments. The new procedure enables the IAIS, as and when required, to also take decisions outside the ordinary Annual General Meeting and without the physical presence of its members.

## BMZ and BaFin hold Microinsurance Conference

Many people living in the world's poorly developed regions – usually in deep poverty – cannot rely on a social security regime of their country, nor do they have access to an insurance market providing coverage for at least the most basic of risks. For this reason, more than 100 high-ranking representatives of government ministries, insurance supervisory authorities and insurance companies from 16 countries gathered together on 3 May 2010 for a conference entitled "Enabling Microinsurance Markets" to discuss ways of fighting poverty and creating social security through microinsurance. The results of the discussions held at the invitation of the German Federal Ministry for Economic Cooperation and Development (BMZ) and the German Federal Financial Supervisory Authority (BaFin) will be included by the BMZ in the current G20 negotiations. The organisers of the conference were supported to a decisive extent by the just recently established "Access to Insurance Initiative" as well as by the company Inwent.

The Access to Insurance Initiative was established in the autumn of 2009 during the Annual Conference of the International Association of Insurance Supervisors (IAIS) in Brazil. In addition to the IAIS, its founding members are the German Federal Ministry for Economic Cooperation and Development (BMZ), the Consultative Group to Assist the Poor (CGAP), FinMark Trust and the International Labour Organization (ILO). The Initiative was born from the cooperation of the IAIS with the Microinsurance Network (MIN) and initially set itself the goal of speeding up the microinsurance process and promoting the establishment of microinsurance, particularly in emerging market and developing countries, within the next seven years. Its focus lies in supporting the supervisory authorities in those countries by providing information, by specifically examining the markets concerned and by developing training materials for the supervisors. The Initiative thus supports the IAIS in the development of microinsurance-specific guidelines and in their dissemination, e.g. through the translation of such

materials. The German Agency for Technical Cooperation (GTZ) manages the secretariat of the Initiative.

Microinsurance can help people living in the world's poorly developed countries to secure their livelihood on a sustainable basis. That is because for them, the death of the family breadwinner, the loss of a farm animal, or even a relatively harmless illness can threaten their very existence. The urgency of this task can be shown by the fact that in India approx. 24% of people released from hospital are impoverished by the costs of their hospital stay.

### No fair-weather task

"Microinsurance is an example of efficient development policy", said Gudrun Kopp from the BMZ in her presentation. BaFin President Jochen Sanio explained in his speech that combating poverty and insecurity was not the responsibility of individual countries alone. "Providing for dignified living conditions, i.e. ensuring that as many people as possible have access to microinsurance, is a transnational and – above all – a common task", Sanio pointed out. It was by no means a fair-weather task, especially in times of crisis when scaling back support for microfinance projects might seem the obvious course to take. He was therefore very pleased that – commensurate with the importance of this subject – the G20 Leaders had taken it upon them to address these questions. At their Pittsburgh Summit in September 2009 they had established the "Financial Inclusion Experts Group" (FIEG) in whose subgroup "Access through Innovation" the BMZ also collaborates.

At the 2009 G20 Summit in Pittsburgh, the heads of state and government decided on the establishment of the "Financial Inclusion Experts Group" (FIEG).

The FIEG pursues the objective of

- spreading new financial services that reach poor people and help such people on a sustained basis giving due regard to all interests involved, and
- helping to disseminate successful financing models for small- and medium-sized enterprises (SMEs).

The FIEG is chaired jointly by the USA, Canada and South Korea. They perform its overall coordination, with the specific subject matters being dealt with in two sub-groups:

- the Access Through Innovation Sub-Group (ATISG), and
- the SME Finance Sub-Group.

Austria and Brazil jointly assume the chair of the ATISG, whilst Germany and South Africa chair the SME Finance Sub-Group.

The ATISG prepared a report on the current regulatory approaches being taken for financial inclusion and presented it to the next G20 summit in June 2010 in Canada. This report will be accompanied by the draft of nine "Principles for Financial Inclusion". In addition, a framework for the development of country-specific approaches is to be drawn up for the summit in Seoul (November 2010). It will contain, among other things, proposals for country analyses and further cooperation with standard setters.

The joint nature of this task is something that was made abundantly clear right at the outset of the conference: in their discussion on the subject of "Challenges and Impact of Microinsurance", high-ranking representatives from the IAIS and the BMZ came i.a. to the conclusion that governments had an onus to create the legislation framework for effective supervision so as to ensure a stable environment and thus effective protection of policyholders' interests. Even if countries have different framework conditions, all share the common objective of protecting the interests of policyholders and making sure that insurers are capable at all times of fulfilling their obligations under the insurance contracts. Proactively shaping the market is one of the decisive tasks of regulators and supervisory authorities in underdeveloped and developing markets. The particular challenge lies in integrating what are referred to as informal microinsurance providers not yet subject to any state insurance supervision, since such providers account for a large share in almost all developing countries or may even be the only providers in a given region, and usually enjoy a good standing with the population.

"What we have to do is to find the right balance between more insurance for poor people and more

confidence in insurance companies", explained Thomas Schmitz-Lippert from BaFin. That is because the population must trust such insurer to be ready and able to perform its obligations, as that is a vital prerequisite for the success of any insurance company. This rings true all the more for microinsurance since policyholders have to work hard for every cent of their insurance premium. On the other hand, supervisory authorities should exercise care and circumspection in implementing these rules on the market in such a way as to enable existing providers to adjust gradually to the higher requirements of state supervision. Otherwise, many suitable and highly committed providers would end up being removed from the market which are ready and able to cooperate with supervisors in the interest of stable solvency and products giving due regard to all interests involved.

### Various supervision approaches discussed

One of the ways of appropriately shaping the scope and intensity of supervision is the creation of supervisory regulations proportional to microinsurance. As a high-ranking representative from the South African Financial Services Board has reported, such an approach is currently about to be implemented in South Africa. However, such an approach must not depart from the scope of insurance principles of the IAIS and may not place microinsurance under "light" supervision. "Highly successful" was how one executive member of the Indian Insurance Regulatory and Development Authority (IRDA) assessed that country's model under which insurers, already on being licensed, had to undertake to generate a certain share of their premium revenues with microinsurance. However, the risk involved in such an approach is of microinsurance in the long term being supported as a secondary, subsidised business and a necessary evil at the expense of the remaining insurance business and its policyholders. And this cannot be its goal. Rather, the product should be viable and worthwhile for providers. As a high-ranking representative of the IAIS emphasised, the statement made by Nobel Peace Prize laureate and pioneer of microfinance, Professor Yunus, also holds true for microinsurance: "This is no charity, this is business; business with a social objective... if it is business, it should be fairly regulated."

### Awareness creation and innovative practices of key significance

In the presentations and discussions between representatives from the industry and supervisors it



also became clear how important it is to make the consumer aware of the microinsurance offering and its significance as a protective instrument. For example, the Department of Finance of the Philippines has launched a large-scale campaign to help its population better understand insurance products. Whereas, for instance, the supervisor from Ghana is designing posters in which microinsurance is explained in the form of comics, one representative from the insurance industry reported on awareness campaigns based on the theme of a "microinsurance party", explaining the product in a fun and entertaining way. Also of significance are innovative practices enabling the insurer to provide microinsurance policies on a cost-coverage basis. This starts with distribution channels and local contacts in sparsely populated regions, and also includes paying premiums by text message or by attaching them to power bills, since many microinsured persons do not have their own bank account.

## Issue

### REPORT

## Acting in concert in the version of the Risk Reduction Act

– A situation report after 600 days –



Christa Hoppe, BaFin



Marion Michel, BaFin

With the Risk Reduction Act of 2008 parliament amended the wording of section 22 (2) of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) and section 30 (2) of the Securities Acquisition and Takeover Act (Wertpapiererwerbs-

und Übernahmegesetz – WpÜG).<sup>1</sup> Of particular importance is the more detailed definition now contained in the Act of the German term "abgestimmtes Verhalten" translated as "coordinated conduct". Furthermore, in the legislative intent underlying the law the government considered for the first time the term "individual case" contained in both pieces of legislation. BaFin is taking this and its first practical experiences as an opportunity to describe the administrative principles that it has developed thus far on the basis of the legislative statements.

### Amended legal basis since August 2008

If a case of coordinated conduct is deemed to exist, section 22 (2) WpHG and section 30 (2) WpÜG prescribe a mutual attribution of voting rights for all parties involved. Both legal norms on attribution were amended with a common form of words by the Risk Reduction Act on 19 August 2008 and continue to be interpreted by BaFin in the same way.

The original intention for the amendment of the Acts was to eliminate problems of interpretation and proof with regard to section 22 (2) sentence 1 WpHG and section 30 (2) sentence 1 WpÜG (previous version).<sup>2</sup> In particular, it was meant to be a response to the restrictive Federal Supreme Court adjudication of 18 September 2006, according to which coordinated conduct had to manifest itself in the exercise of voting rights at the General Meeting.<sup>3</sup>

The amendment of the legal norms was the subject of disagreement in the legislative procedure. As a result, the Finance Committee revised the government draft.<sup>4</sup> The Bundestag then passed the Risk Reduction Act in the version proposed by the Finance Committee on 27 June 2008. The legal provisions governing the revision of the definition of coordinated conduct have been in force since 19 August 2008.

### Coordination of conduct on the basis of an agreement or in another manner...

Section 22 (2) sentence 1 WpHG and section 30 (2) sentence 1 WpÜG stipulate that the voting rights of any third party shall also be attributed to the

<sup>1</sup> Federal Law Gazette I 2008 p. 1666.

<sup>2</sup> Section 30 (2) of the WpÜG in the version before its amendment by the Risk Reduction Act.

<sup>3</sup> Federal Supreme Court ruling of 18 September 2006, Ref. No. II ZR 137/05; Bundestag Official Records 16/7438, p. 11.

<sup>4</sup> Bundestag Official Records 16/9778.

notifying party/offeror if the notifying party/offeror or its subsidiary coordinates with such third party, on the basis of an agreement or in another manner, its conduct in respect of the issuer<sup>5</sup>/target company. Agreements in individual cases shall be excluded. According to BaFin's understanding, section 22 (2) sentence 1 WpHG and section 30 (2) sentence 1 WpÜG govern only the form of the coordination. Accordingly, conduct can be coordinated on the basis of an agreement or in another manner. In BaFin's opinion, the concept of agreement has to be interpreted narrowly and comprises only legally binding agreements, for which as a general principle any civil law form of contract qualifies. Coordination of conduct in another manner comprises forms of concurrent intent for which no formal contract is concluded (e.g. a gentlemen's agreement).

### **...on the exercise of voting rights or with the aim of bringing about a permanent and material change in the company's business strategy...**

Section 22 (2) sentence 2 WpHG and section 30 (2) sentence 2 WpÜG now define the term "coordinated conduct" as reaching a consensus regarding the exercise of voting rights or as collaborating in another manner with the aim of bringing about a permanent and material change in a company's business strategy. Irrespective of its content and meaning, any voting rights agreement is a consensus regarding the exercise of voting rights. The criterion of collaborating in another manner with the aim of bringing about a permanent and material change of a company's business strategy was inserted into the revised legal norm in order to be able in future to make collaborating outside the General Meeting subject to the attribution rules as well.<sup>6</sup>

The term "business strategy" is not described in any more detail in the Finance Committee's statement of legislative intent. In BaFin's view, the term covers at least the company's object as set out in its articles of association. In addition, BaFin also understands by the term "business strategy" a company's corporate policy. Corporate policy in this sense is the formulation and implementation of objectives and measures affecting the company as a whole. Corporate policy thus lays down the essential features of the company's business activities for the future.

<sup>5</sup> Issuer whose home country is the Federal Republic of Germany within the meaning of section 21 (2) in conjunction with section 2 (6) WPHG.

<sup>6</sup> Bundestag Official Records 16/9821 p. 11.

According to the wording of the Act, the change must be "permanent and material". The "permanent" criterion, as a time component, must relate to the change – as must the "material" criterion. Consequently, a permanent change regarding the issuer/target company exists when it is not possible to foresee the effects coming to an end. Accordingly – and quite apart from the question of materiality – any exercising of influence by shareholders resulting in the departure of one or more executive directors would in all events be a permanent change. The materiality of changes can be assessed only in relation to the parameters of the company itself. Accordingly, a change may be material for an economically small company and of rather a minor nature for an economically larger company. The question of materiality makes it necessary to take a holistic view of the changes with regard to the company, since an abstract differentiation – in the sense that, for example, mergers would always be material but capital increases, on the other hand, would never be – is not possible.

### **Exclusion of individual cases**

Expressly excluded from the attribution of voting rights on the basis of coordinated conduct, however, are agreements in individual cases.

In the literature and legal precedents, when it came to defining "individual case" a formal and a material approach to the previous version of the legal norm had developed. The Finance Committee's statement of legislative intent is cited as confirmation of their view by advocates of both the formal and the material concept of individual case, even though the legislature, in amending the legal norm, had not come out clearly in favour of either opinion.

BaFin now defines the concept of individual case on the basis of the statement of legislative intent underlying the law, leaving aside the formal and the material approach. Key terms in the statement of legislative intent are "longer-term strategy" versus "exercising selective influence". The legislature at any rate do not see cases of changing the business strategy of the company as being covered by the concept of individual case, since this has to be regarded as the application of a longer-term strategy.<sup>7</sup> What is crucial here is not whether this change of strategy is the result of a single General Meeting or is based on many individual resolutions. Strategies are decisions of principle which determine the direction of the course the company takes in

<sup>7</sup> Bundestag Official Records 16/9821, p. 12.

principle. Strategies consist of a multiplicity of interlocking individual activities.

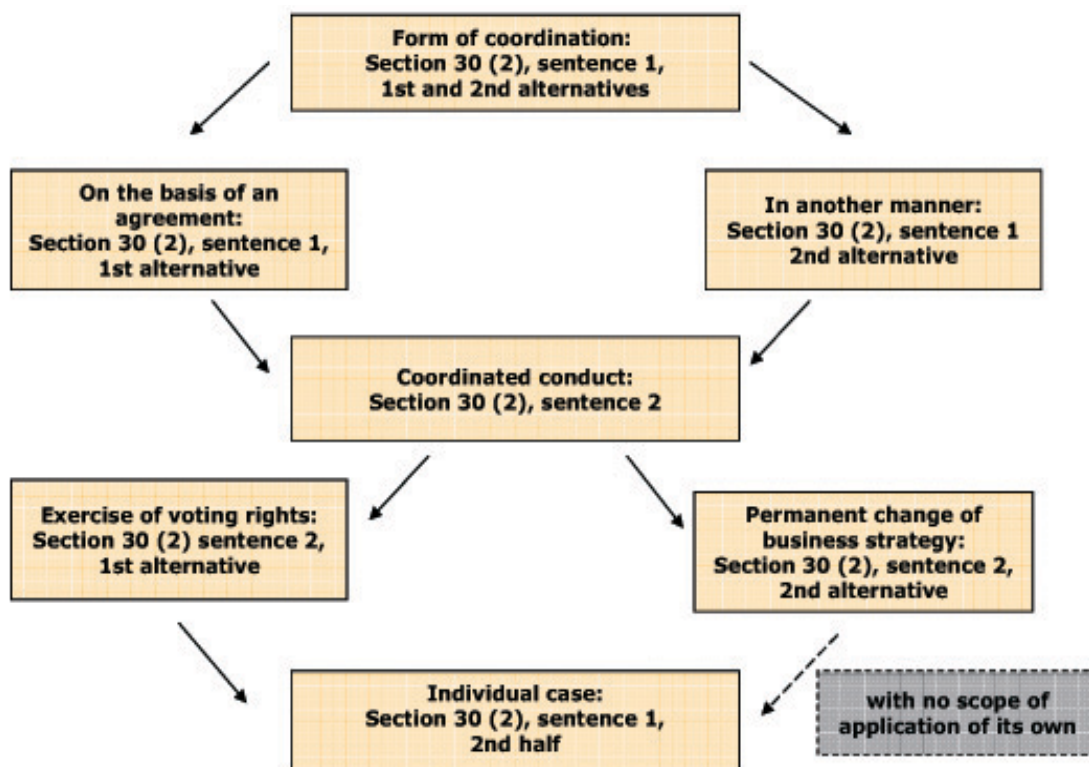
The Finance Committee's statement of legislative intent further describes the concept of individual case in the form that the exercising selective influence is not to be regarded as coordinated conduct. According to the Finance Committee's statement of legislative intent, such exercising selective influence is to be deemed "regular" if single coordinated actions are taken on different subjects or repeated coordinated actions are taken on the same matter. In particular, coordinated action on a number of General Meeting resolution subjects, it says, will "not alone" result in the attribution of voting rights. By using the terms "regular" and "not alone", the legislature makes it clear that each case has to be judged on its own merits by assessing the effects on the company. This means that it is not possible to make a decision of whether a case is an "individual case" when only the abstract subject of a coordination of conduct (for example, a merger, a squeeze-out, an appointment to the Supervisory Board etc) is known. As starting points for the question of the scale of the effects on the company, the following criteria, for example, may be applied: the company's object, sales, profit, indebtedness, number of employees, appointments to Boards,

business areas, marketing areas (regional/national/global) etc.

Logically, the Finance Committee's statement of legislative intent stipulates that any coordination of conduct that opposes a reshaping of the business strategy (i.e. maintains the status quo) by rejecting the proposed corporate measures, such as, for example, the utilisation of authorised capital or the buyback of the company's own shares, does not result in an attribution of voting rights.<sup>8</sup> The legislature has thus made it clear that cases of maintaining the status quo are not based on a longer-term strategy, since preventing changes does not shape or play a part in shaping corporate policy. Votes to prevent changes do not interlink, but are individual decisions on individual points.

A permanent and material change of a company's business strategy within the meaning of section 22 (2) sentence 2 WpHG and section 30 (2) sentence 2 WpÜG cannot be of only an individual nature either within the meaning of the word or according to the description of the concept given above; accordingly, there remains no scope of application for the exclusion of individual cases in this configuration.

<sup>8</sup> Bundestag Official Records 16/9821, p. 11.



## Agenda

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### DIARY

<b>23.08.2010</b>	<b>BCBS</b> Meeting, Basel
<b>9.-10.9.2010</b>	Joint conference of the European Central Bank and the Journal of International Economics, Frankfurt am Main
<b>14.-15.09.2010</b>	<b>CESR</b> Meeting, Paris
<b>20.-21.09.2010</b>	<b>BCBS</b> Meeting, Singapore
<b>21.09.2010</b>	<b>JCFC</b> Meeting, Frankfurt am Main
<b>27.-28.09.2010</b>	Thirteenth Conference of the ECB-CFS Research Network, Frankfurt am Main

<b>30.09.-1.10.2010</b>	<b>IOSCO</b> Meeting, Chennai (India)
<b>6.-7.10.2010</b>	<b>CEBS</b> Meeting, London
<b>13.10.2010</b>	<b>BSC</b> Meeting, Frankfurt am Main
<b>21.10.2010</b>	<b>CESR</b> Meeting, Paris
<b>24.-26.10.2010</b>	<b>IAIS</b> Triannual Meeting, Dubai
<b>27.-29.10.2010</b>	<b>IAIS</b> Annual Conference, Dubai





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