

BAWe

Bundes-
aufsichtsamt
für den
Wertpapier-
handel

Annual Report 1997

Abridged English Version

ANNUAL REPORT 1997

introduced through the Third Financial Market Promotion Act, which came into force on 1 April 1998.

Preliminary Remarks

The Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel, hereinafter BAWe) is an independent superior federal authority within the ambit of the Federal Ministry of Finance. The BAWe is located in Frankfurt am Main and has as its legal basis the Securities Trading Act (Wertpapierhandelsgesetz, WpHG), which came into force at the beginning of 1995.

The functions of securities supervision – investor protection and the safeguarding of market transparency and market integrity – are increasingly characterised by the internationalisation of the securities markets. In 1997 the BAWe therefore devoted particular attention to co-operation with foreign supervisory authorities.

Another main emphasis of the BAWe in 1997 was the improvement of investor protection. To this purpose the BAWe published guidelines relating to the commission, fixed price and agency transactions of credit institutions.

An amendment to the Securities Trading Act on 1 January 1998 based on the implementation of the European Investment Services Directive substantially extended the BAWe's area of responsibility to a large number of financial intermediaries, i.e. introducing brokers and portfolio managers, and financial products, i.e. OTC-derivatives and commodities. Through this welcome amendment a deficiency in investor protection in Germany was eliminated. Further modifications were

Investor Protection – Rules of Conduct

In the context of the BAWe's market supervision goals, investor protection is of central importance. The rules of conduct set forth in the Securities Trading Act form an essential basis for investor confidence in the proper functioning of the securities market. The BAWe monitors investment services companies' compliance with the rules of conduct.

On 26 May 1997, the BAWe issued guidelines relating to the commission, fixed price and agency transactions of credit institutions. The aim is to ensure fair treatment for investors in order to enable them to make responsible and independent investment decisions. This is to be achieved primarily by means of the greatest possible transparency in the extent of the services offered, the costs involved, and the basic features and risks of the various investment forms. The guidelines also specify the duties of credit institutions in connection with execution of customer orders. Due to the joint efforts of the BAWe and the banking industry, the necessary acceptance required for the application of the rules of conduct in practice has been established.

The BAWe monitors compliance with the rules of conduct primarily by means of annual audits. As regards the 1996 audit period assessed in 1997, particular attention was paid to employee training and the obligation to produce and maintain records. If deficiencies were disco-

vered, the institutions generally reacted quickly and took measures to redress these shortcomings.

In 1998, the BAWe intends to issue guidelines on the organisational obligations of credit institutions. The guidelines will define the core functions of a compliance organisation, indicate various implementation possibilities, and address the organisation of structures and procedures conducive to performance of compliance tasks.

Investor Protection – Deposit of Prospectuses

An important element of investor protection is the deposit and publication of securities sales prospectuses. Pursuant to the Securities Sales Prospectus Act (Verkaufsprospektgesetz), persons offering securities that are not admitted for trading on a domestic stock exchange have the obligation to publish a sales prospectus prior to the first public offer. A copy of the sales prospectus is to be deposited with the BAWe.

In 1997, 341 complete prospectuses, as well as 181 incomplete prospectuses together with 1,171 supplements thereto, were deposited. They covered a total of 5,876 issues which fell under the prospectus publication requirements (1996: 5,133). The distinct increase compared with the year before was largely due to the very brisk issuing activity on the warrant market.

In 74 cases in the year under review, the BAWe instituted monetary fine proceedings for possible breach of deposit and publication obligations; a further 30 cases were still pending from the previous year. In seven cases breaches of statutory

obligations were confirmed, and the BAWe imposed fines ranging from DM 5,000 to DM 10,000.

Of particular interest were the first placements of shares via the Internet, with German private investors being directly invited to purchase securities. While the BAWe encourages the use of new media, investor protection will remain the most important regulatory concern. To the extent that securities are offered directly to private investors through advertising on the Internet, the BAWe will view this as a public offer. The party making the offer is thus obliged to deposit with the BAWe and subsequently to publish a prospectus. In this context it is irrelevant whether a print medium or an electronic medium such as the Internet is used for advertising purposes.

Market Integrity – Prohibition of Insider Trading

Prohibition of insider trading protects the functionality of the securities and derivatives markets. Investor confidence is based above all on the certainty that equal oppor-

tunity prevails in the access to information. An essential precondition for equal opportunity is the prohibition of improper use of insider knowledge by holders of privileged information.

In 1997, the BAWe investigated a total of 71 cases in which unlawful insider trading was suspected. In 22 investigation cases the BAWe found evidence tending to corroborate the suspicion of indictable insider trading offences. The facts uncovered were referred to the competent public prosecutor's office. Convictions followed in three cases relating to offences committed in 1995 and 1996. The largest criminal fine was DM 3,6 million which was suspended on a one-year probation. A civil penalty of DM 1,0 million had to be paid immediately. In six further cases, the public prosecutors discontinued investigation proceedings after the defendants paid civil penalties to charitable organisations and the public treasury.

Since 1 January 1996, all transactions in securities and derivatives must be reported electronically to the BAWe. In the year under review, some 123 million reports were

Insider Investigations of the BAWe

| | Number of investigations | | Investigations concluded in the period under review | | | Open investigations at the end of the period under review |
|------|---|--|---|------------------------------|---|---|
| | Newly taken up in the period under review | Open at the start of the period under review | Total | Result of the investigations | | |
| | | | | Discontinued | Passed on to a Public Prosecutor's Office | |
| 1995 | 24 | 0 | 23 | 16 | 7 | 1 |
| 1996 | 59 | 1 | 44 | 27 | 17 | 16 |
| 1997 | 55 | 16 | 62 | 40 | 22 | 9 |

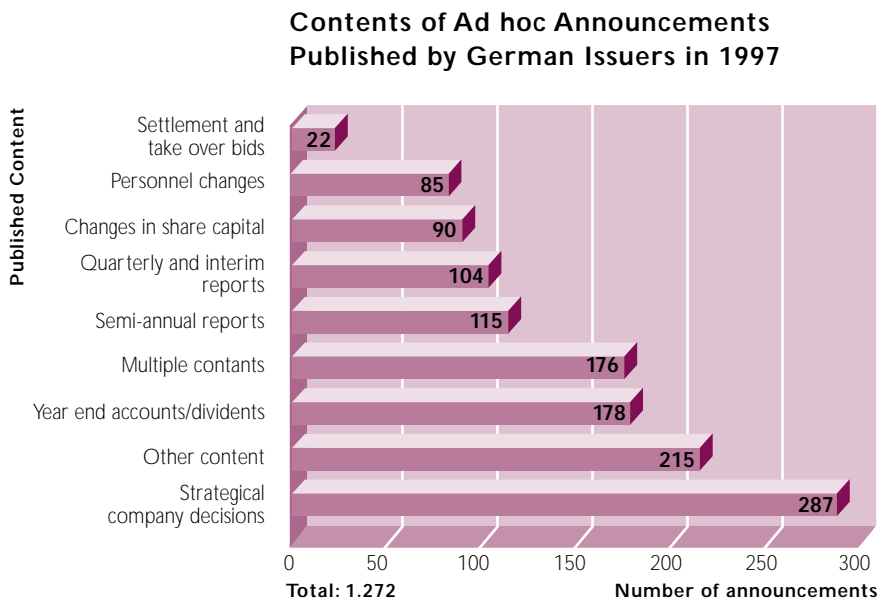
received by the BAWe (1996: 80 million). This corresponds to an average of about 492,000 reports per trading day (1996: 310,000).

The BAWe's market surveillance and analysis are based to a large extent upon high quality data of the reporting system. Analysis of the data supplied was substantially facilitated by optimisation of the BAWe's software applications. Initial steps towards automated evaluation of the data were also taken. The aim is to introduce a comprehensive, automated electronic evaluation system based on statistical analysis, neural network technology and data mining methods.

Market Transparency – Ad hoc Disclosure

Listed companies are obliged to publish immediately any new, non-public price-sensitive information. In the period under review, a total of 1,272 such ad hoc announcements were published by domestic issuers (1996: 1,024).

Over 95 percent of the ad hoc announcements were published electronically, the others in journals for statutory stock market announcements. On its Internet home page, the BAWe has established links to the providers of electronically published ad hoc announcements. Various television stations also provide ad hoc information on videotext. The informational disadvantage of private investors in comparison to institutional investors which had given rise to complaints in the past has thus largely been eliminated. Market transparency has been improved substantially for private investors.



On nine occasions in 1997, the BAWe instituted monetary fine proceedings for possible breaches of the ad hoc disclosure obligations (1996: 16). One proceeding resulted in a fine of DM 60,000 being imposed. A second case was referred to the public prosecutor. In this case there was suspicion not only of a breach of ad hoc disclosure but also of an insider trading offence.

Market Transparency – Disclosure of Major Shareholdings

In order to increase transparency in the securities markets, changes in voting rights in listed companies must be published, and for monitoring purposes, the BAWe must be notified. Since 1 August 1997, the BAWe has provided on its Internet home page an overview of voting rights in German listed companies. The data, which are also available in English, can be downloaded from the BAWe home page, thus providing investors via convenient search tools with up-to-date information

regarding participation ratios. The data are updated twice every month.

In 1997, the BAWe encountered distinctly fewer breaches of disclosure and publication obligations than in the previous year. In the year under review, monetary fine proceedings were initiated in 61 cases, which were added to the 149 cases still pending from 1996. In 17 cases the BAWe imposed fines of between DM 3,000 and DM 20,000. Fines in total amounted to DM 108,000.

Co-operation in Germany

With the implementation of the Investment Services Directive and the Capital Adequacy Directive of the European Union, the functional approach to supervision of the German financial market was reinforced. The diverse statutory tasks of supervisory bodies require diverse decision-making and supervisory strategies. There is thus a demarcation between the activities of the Federal Banking Supervisory Office

Distribution of Tasks between BAKred and BAWe

| Federal Banking Supervisory Office (BAKred) | Federal Securities Supervisory Office (BAWe) |
|--|--|
| <ul style="list-style-type: none"> ◆ Licensing of institutes and the termination of licences ◆ Investigation of the reliability and suitability of company management ◆ Control of shareholders ◆ Supervising the financial situation of institutions including their liquidity and profit situation ◆ Prosecution of unlawful financial services and banking transactions ◆ International co-operation in banking supervision | <ul style="list-style-type: none"> ◆ Investigating insider trading ◆ Supervising ad hoc disclosure ◆ Supervising the disclosure of major shareholdings ◆ Supervising rules of conduct and organisational duties ◆ Depositing securities sales prospectuses ◆ International co-operation in securities and stock market supervision |

(Bundesaufsichtsamt für das Kreditwesen, hereinafter BAKred) and those of the BAWe in accordance with the functional approach. Whereas the BAKred is mainly concerned with licensing, solvency and risk supervision, the BAWe concentrates on market supervision. From 1 January 1998, any company intending to provide investment services commercially must first obtain a license from the BAKred. The companies which have obtained a license are then subject to continuous market supervision by the BAWe.

International Co-operation

The Securities Trading Act grants comprehensive powers to the BAWe as regards co-operation with competent foreign authorities. In 1997, the BAWe made use of the power to exchange information primarily in insider investigations, which led to a total of 45 enquiries being addressed to foreign authorities. In return, the BAWe was able

also have the opportunity to use the European passport. Investment services companies from other countries in the European Union had already made use of this possibility in previous years. The BAWe received in 1997 notification from a total of 108 foreign companies (1996: 695) that intended to provide cross-border investment services or to set up in one case a branch in Germany.

In view of the increasing integration of the European financial markets and the impending introduction of the Single European Currency, the European authorities responsible for supervising securities trading founded the „Forum of European Securities Commissions“ (FESCO) in December 1997. FESCO members comprise the securities supervisory authorities of the fifteen Member States of the European Union, including the BAWe, as well as those of Iceland and Norway as Contracting States of the Agreement on the European Economic

to provide assistance to foreign supervisory authorities in seven cases.

Since implementation of the Investment Services Directive and the Capital Adequacy Directive on 1 January 1998, German companies

| European Passport Notifications | | | | |
|---------------------------------|--|------|---------------------------------|------|
| Country | Notification of cross-border services to be introduced | | Notification of branch openings | |
| | 1996 | 1997 | 1996 | 1997 |
| Denmark | 5 | 3 | – | – |
| France | 1 | 29 | – | – |
| Great Britain | 618 | 54 | 2 | 1 |
| Ireland | 33 | 3 | 2 | – |
| Italy | – | 1 | – | – |
| The Netherlands | 20 | 5 | 1 | – |
| Norway | – | 8 | – | – |
| Sweden | 13 | 2 | – | – |
| Spain | – | 2 | – | – |
| Total | 690 | 107 | 5 | 1 |

Area. The aim of the new organisation is to improve investor protection, increase market transparency, and ensure fair treatment of investors. In May 1998, the BAWe president was elected chairman of FESCO for a two years term.

The BAWe placed great emphasis on the strengthening of bilateral co-operation in 1997. The BAWe signed agreements with two European supervisory authorities: the Spanish Comisión Nacional del Mercado de Valores (CNVM) and the Italian Commissione Nazionale per le Società e la Borsa (CONSOB) relating to the mutual exchange of information. For the first time three agreements were concluded with non-European supervisory authorities: the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) in the USA, and the Securities and Futures Commission (SFC) in Taiwan.

For multilateral co-operation the International Organisation of Securities Commissions (IOSCO) represents the most important platform. The BAWe plays an active role in all work undertaken by the IOSCO and represents German interests in its committees.

BAWe – Internal affairs

At the end of 1997, the BAWe had 119 staff members. Its organisational structure was adjusted in 1997 in order to fulfil its newly extended supervisory tasks with the same number of staff.

BAWe expenditures were approximately DM 13,8 million in 1997, more than DM 1,0 million less than

in 1996. Personnel costs amounted to DM 6,9 million, and material costs and investments also amounted to DM 6,9 million, of which DM 3,7 million was spent on information technology. Ninety percent of BAWe costs are to be reimbursed to the Federal Republic of Germany by market participants and issuers.

Since the beginning of 1997, the BAWe has had its own Internet home page (www.bawe.de) with the aim of making available to the public all information directly connected with its activities. Most of the information is also available in English.

Perspectives

The implementation of the Investment Services Directive and the Capital Adequacy Directive into German law represents a comprehensive revision of the statutory regulations governing bank and securities supervision. The BAWe's jurisdiction has thus been substantially extended.

The innovations improve above all else investor protection. On 1 January 1998, supervision was extended to a large number of companies on the capital market which were hitherto not supervised or supervised only in accordance with the provisions of the Commercial Code. These companies, defined as financial services institutions, include primarily investment brokers and portfolio managers. Financial services institutions now require the authorisation of the Federal Banking Supervisory Office (BAKred); until now, this authorisation was applicable to credit institutions only. Whether these companies provide investment services alone or in connection with non-core invest-

ment services, they will be supervised within the range of BAWe's market oversight activities, in particular with regard to compliance with the rules of conduct.

The Third Financial Market Promotion Act which came into force on 1 April 1998 amended 18 statutes. The main points of emphasis were the amendments to the Exchange Act and the Securities Trading Act, the Securities Sales Prospectus Act, the Investment Companies Act, and the Equity Investment Companies Act. Due to the changes in the Securities Sales Prospectus Act and the Securities Trading Act the supervisory and investigative powers of the BAWe were extended.

Organisational Structure



As per 1 October 1998

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(For extensions see boxes)

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