

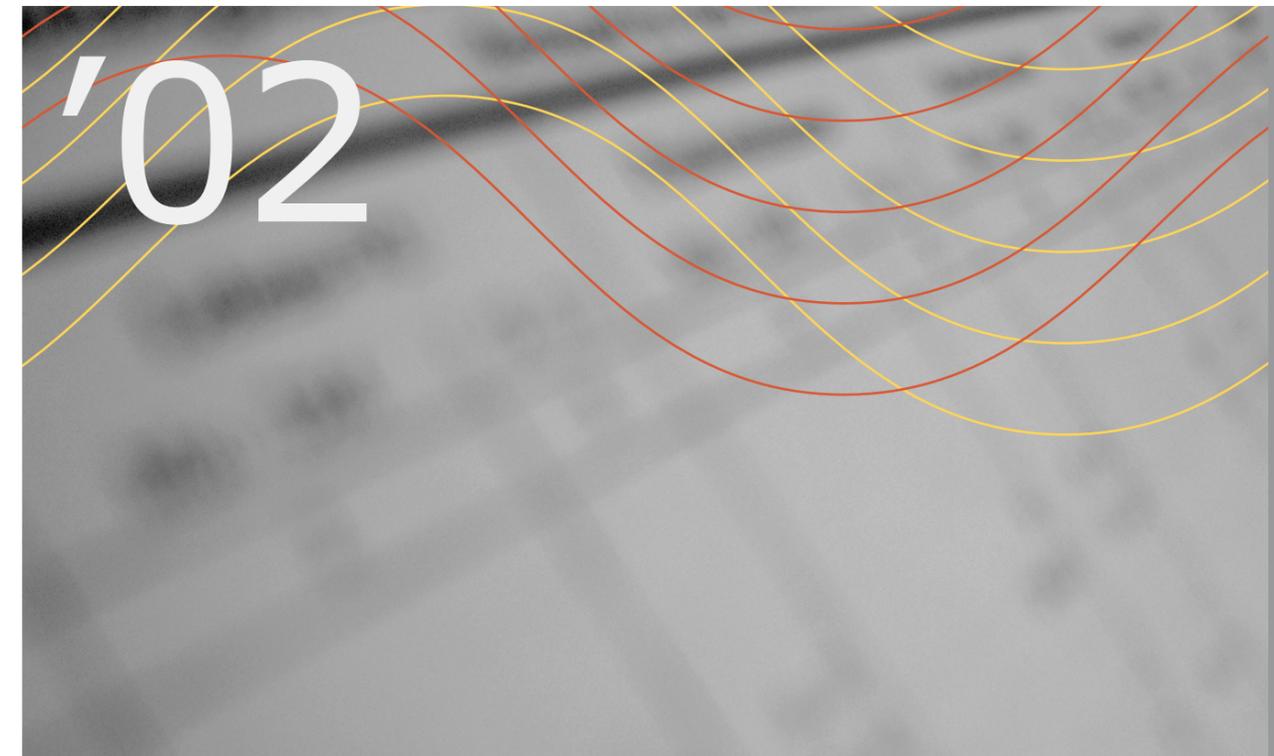
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Annual Report Bundesanstalt für Finanzdienstleistungsaufsicht

Annual Report  
Bundesanstalt für Finanzdienstleistungsaufsicht



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Following the amalgamation of the former Federal Banking Supervisory Office, Federal Insurance Supervisory Office and Federal Securities Supervisory Office, the newly established Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin) introduced its very own corporate design.

The word/picture mark constitutes a central element of BaFin's new corporate design. The image chosen presents thin undulating lines which are interwoven (so-called "Guillochen" engraving patterns). These are frequently used within the financial sector, e.g. on banknotes and share certificates. This element is complemented by the inclusion of the word "BaFin" in a traditional typeface. The shading chosen for the design is based on Germany's federal colours.

This Annual Report is BaFin's first publication to feature the new corporate design.

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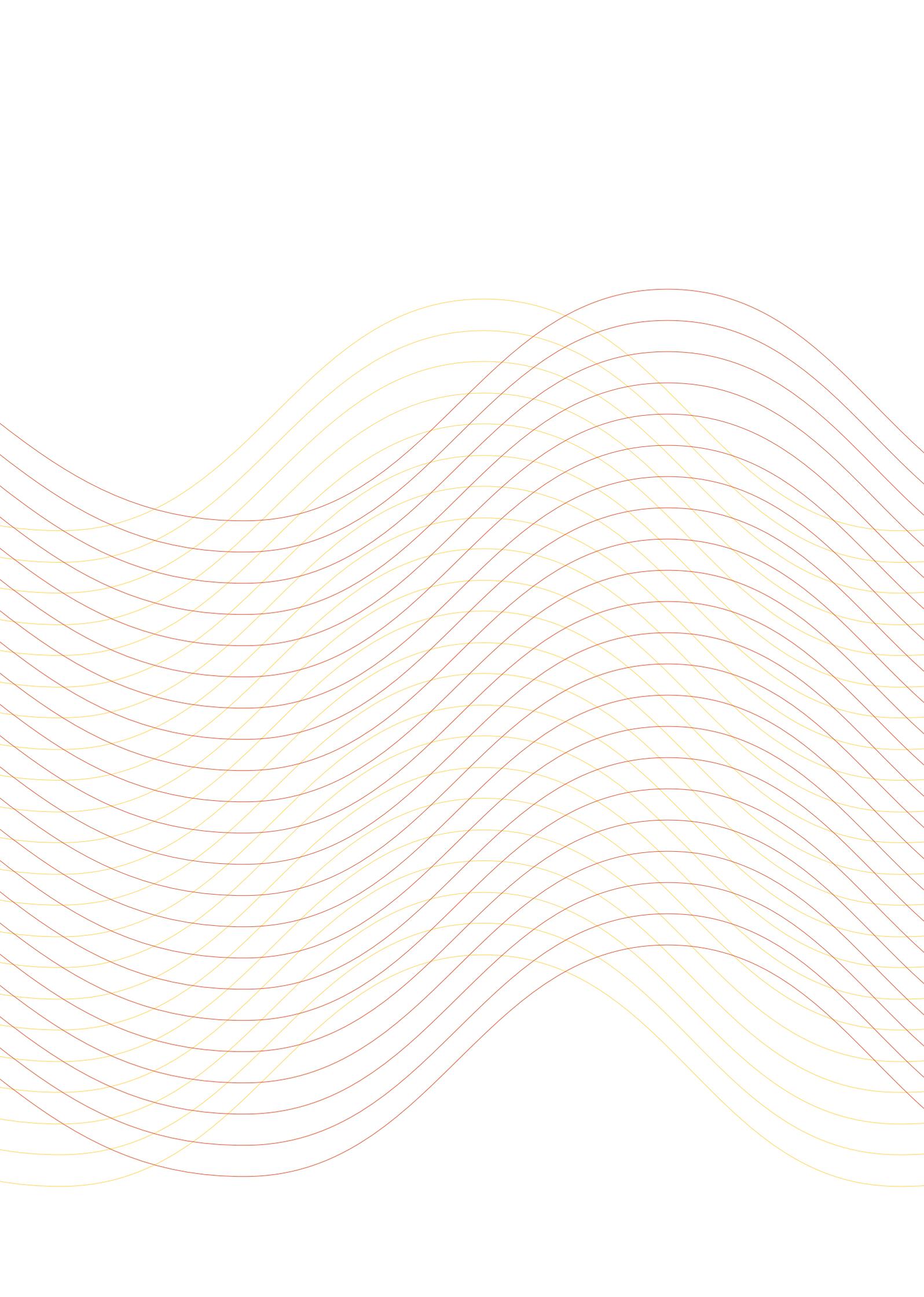
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**Annual Report**  
**Bundesanstalt für Finanzdienstleistungsaufsicht**

**2002 | Part A**

until 30 April 2002:

Bundesaufsichtsamt für das Kreditwesen  
Bundesaufsichtsamt für das Versicherungswesen  
Bundesaufsichtsamt für den Wertpapierhandel



## President's Statement



The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin), located in the German cities of Bonn and Frankfurt/Main, was established on 1 May 2002. It evolved from the former supervisory offices responsible for banking (Bundesaufsichtsamt für das Kreditwesen), insurance (Bundesaufsichtsamt für das Versicherungswesen), and securities (Bundesaufsichtsamt für den Wertpapierhandel), all of which operated as autonomous entities. It gives me great pleasure to present the first Annual Report of the newly established BaFin.

The conditions faced by the nascent supervisory authority could not have been more unfavourable. BaFin had just been launched when it found itself in troubled waters. The downward spiral of share prices and the devastating terrorist attacks of 11 September 2001 wrought havoc on the financial markets.

As one can imagine, BaFin had been hoping for a more tranquil maiden voyage. And yet the storms buffeting the Federal Financial Supervisory Authority in recent times show just how far-sighted legislators were when they decided to merge and unite the individual supervisory offices. Germany's financial industry spans many sectors, and the constituent elements within this structure are inextricably linked. Therefore, an integrated supervisory authority is essential when it comes to keeping pace in the fast-track financial arena.

The first eight months placed immense strain on BaFin and its crew. Nevertheless, BaFin has accomplished a great deal. The first combined Annual Report proves beyond doubt that BaFin has plotted a successful route and shall continue to do so, despite recent adversities. Our path is clearly mapped out: to safeguard the solvency of operators, to protect consumers, and to ensure stability within the financial markets.

A handwritten signature in black ink that reads "Jochen Sanio". The signature is written in a cursive, flowing style.

Jochen Sanio  
President



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# I The Federal Financial Supervisory Authority

Efficient supervision engenders confidence and trust among investors and others participating within the financial markets. Ensuring the solvency of financial institutions and protecting the interests of investors are guiding principles upon which contemporary supervisory legislation is built. Effective supervision in accordance with international standards creates stability within domestic and global financial systems.

The boundaries between banks, insurers, and financial services providers have become blurred.

The financial markets have undergone major changes in recent years. Indeed, the boundaries between banks, insurers, and financial services providers have become blurred. Increasingly, these companies are competing in the same markets, offering products which are similar or almost identical. Furthermore, the BaFin is witnessing a growing trend towards the establishment of integrated financial groups among banks, insurance enterprises, and financial services providers. This form of integration of products and risks also calls for an integrated approach within the field of financial services supervision.

The integrated supervisory authority BaFin contributes substantially to the stability of Germany as an international financial centre.

The German government reacted to these changing circumstances by pooling all available resources and expertise. Following the adoption of the Law on Integrated Financial Services Supervision (Gesetz über die integrierte Finanzdienstleistungsaufsicht -FinDAG), also referred to as the Act Establishing the Federal Financial Supervisory Authority, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) was established on 1 May 2002. The Federal Financial Supervisory Authority is responsible for the supervisory activities formerly carried out by the Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen – BAKred), the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV), and the Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel – BAWe). As such, BaFin will make a valuable contribution to the stability of Germany as an international financial centre.

## Benefits of integrated supervision

Furnished with comprehensive powers and supported by its ability to monitor the entire financial sector, the newly established Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) is in a position to make consistent and efficient decisions aimed at maintaining stability within the financial arena. BaFin is designed as a central coordinating body for all market participants in Germany. Moreover, the new structure facilitates cooperation with foreign supervisory bodies. Indeed, the voice of Germany's financial regulator will now carry more weight in international supervisory forums.

Essentially, BaFin comprises three supervisory directorates, which now perform the supervisory tasks of the three formerly separate supervisory offices. The first directorate, Banking Supervision, has been assigned all regulatory powers as regards solvency-oriented supervision of credit institutions. The second directorate is responsible for supervising insurance undertakings, both in terms of solvency and conformity with legislative requirements. The principal area of responsibility of the third directorate, Securities Supervision/Asset Management, consists of regulating the respective markets in accordance with the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) and the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG). Thus, the industry-specific peculiarities seen within the banking and insurance sectors have been taken into account as regards the organisational structure of the new supervisory body. Interdisciplinary issues, such as the supervision of financial conglomerates, financial market research, complaints management, or the prosecution of unlawful financial transactions, are addressed by cross-sectoral departments.

## Two locations with a common purpose

BaFin supervises more than 2,500 credit institutions, over 800 financial services providers, and roughly 700 insurance companies.

BaFin is a federal institution governed by public law. It has legal personality and operates within the portfolio of the Federal Ministry of Finance (Bundesministerium der Finanzen – BMF). The supervisory body is located in the German cities of Bonn and Frankfurt am Main and currently employs around 1,300 people. BaFin supervises more than 2,500 credit institutions, over 800 financial services institutions, and approximately 700 insurance undertakings. It is headed by the President and the Deputy President.

The Administrative Council supervises the executive level of BaFin and approves the budget.

The Administrative Council supervises the executive level of the Federal Financial Supervisory Authority and supports management in its specific duties. In addition, it is responsible for deciding on the budget of BaFin, which is funded completely by the companies it supervises. The Administrative Council is composed of representatives of the Federal Ministry of Finance, the Federal Ministry of Economics and Labour, the Federal Ministry of Justice, as well as Members of the German Bundestag (Lower House of Parliament) and representatives of the companies that are subject to BaFin supervision. The Administrative Council is chaired by the Federal Ministry of Finance. An Advisory Board with representatives of the banking and insurance sectors, financial academia, and consumer protection associations is responsible for supporting BaFin in its efforts to develop and enhance supervisory practice.

## II Challenges of integrated financial services supervision

- 1 The Fourth Financial Market Promotion Act
  - 1.1 Enhancing the integrity and transparency of capital markets
  - 1.2 Changes in the area of investment law
  - 1.3 Amendments to the Banking Act and the Insurance Supervision Law
- 2 Specific cross-sectoral issues
  - 2.1 Certification of pension contracts
  - 2.2 Combating money laundering and the financing of terrorism
  - 2.3 Prosecution of unauthorised financial services
  - 2.4 Consumer complaints
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- 3 International cooperation
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    - 3.1.4 FATF
    - 3.1.5 Other groups
  - 3.2 European cooperation
    - 3.2.1 Regulations and Directives
    - 3.2.2 CESR
    - 3.2.3 Other projects and groups
  - 3.3 Bilateral cooperation with supervisory authorities

### 1 Fourth Financial Market Promotion Act

The Fourth Financial Market Promotion Act (Viertes Finanzmarktförderungsgesetz – 4th FMFG), which came into force on 1 July 2002, is to be seen as an important step forward in terms of enhancing Germany's position as a premier financial centre. The 4th FMFG is aimed at improving investor protection, while at the same time eliminating potential gaps in the regulatory defence mechanism against money laundering.

As a so-called "Artikelgesetz", the 4th FMFG amends a number of regulations governing the entire financial services sector, particularly the Exchange Act (Börsengesetz – BörsG), the Securities Trading Act (Wertpapierhandelsgesetz – WpHG), the Investment Companies Act (Gesetz über Kapitalanlagegesellschaften – KAGG), the Foreign Investment Act (Auslandinvestment-Gesetz – AIG), the Banking Act (Kreditwesengesetz – KWG), and the Insurance Supervision Law (Versicherungsaufsichtsgesetz – VAG).

This chapter provides a brief summary of the key changes to the legal framework; these aspects are then discussed in more detail in the subsequent chapters III to VII.

## 1.1 Enhancing the integrity and transparency of capital markets

New legislation implemented within the area of securities trading has seen major changes to the way in which the issue of market manipulation is to be dealt with by the competent authorities. Regulations governing ad hoc disclosure have also been redefined. In addition, investors have been afforded the right to claim compensation from companies for omitted or incorrect ad hoc disclosure of information. Any dealings by so-called primary insiders and their close relatives (Directors' Dealings) in a company's own shares are subject to mandatory disclosure. Furthermore, the legal framework now contains rules of conduct for investment services enterprises as regards the preparation and dissemination of financial analyses. These amendments are aimed at enhancing market integrity and transparency.

### Price and market manipulation

Fines of up to 1.5 million euros can now be imposed for price manipulation.

BaFin has been responsible for prosecuting price and market manipulation since 1 July 2002. In accordance with the newly introduced Section 20a WpHG, market participants are prohibited from making incorrect statements about price-sensitive facts, such as information about profits, revenues, or capital-related measures of exchange-listed companies, or from withholding such information. Moreover, any actions associated with the spreading of rumours within this area are in contravention of German law. At the same time, enforcement of the above-mentioned regulations has been made more practicable. When it comes to assessing whether a criminal offence has been committed, the onus is on the authorities to prove that the alleged manipulation had a concomitant effect on the price in question. In other cases, BaFin is authorised to impose fines of up to 1.5 million euros for administrative offences.

In its supervisory capacity, BaFin is responsible for assessing all transactions and ad hoc disclosures.

In order to analyse the markets in terms of potential manipulation as well as insider dealing, BaFin assesses all reported securities transactions. As part of its assessment, BaFin also draws on information provided by investors or the press, the respective trading surveillance offices, or the authorities responsible for prosecution. In the case of suspected insider dealing, the main emphasis is on analysing whether there is a connection between the disclosure of previously unknown, price-sensitive information and actual developments within the market. As regards suspected price manipulation, the prime objective is to identify circumstances or events which may have a material effect on the prices of securities. This also includes investigating fraudulent actions, such as pre-arranged, fictitious orders that are aimed at deceiving potential investors about the true performance or liquidity of a security, or any actions associated with the spreading of unfounded rumours.

### Financial indicators in ad hoc announcements

The financial indicators specified in publications must conform to standard financial terms used in business and must allow comparability with indicators previously employed within this context.

Germany's legislative body has amended the provisions connected with ad hoc announcements issued by exchange-listed companies by specifying that all financial indicators published must conform to standard financial terms used in business and must allow comparability with indicators employed in the past. If companies publishing ad hoc

announcements employ financial indicators that are aimed at presenting the company's state of affairs, this information must be in line with financial terminology generally used within the field of business. Moreover, the financial indicators used within this context must provide a basis for comparison with indicators employed in previous publications. In its Circular of 26 November 2002, BaFin outlined details about the data to which the above-mentioned provisions apply. As a result of these provisions, investors are able to gain more insight into company data and can utilise this information as a basis for comparison.

### Securities analysis

Securities analysis must be performed conscientiously, and possible conflicts of interest must be disclosed.

For the first time, the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG) now includes rules of conduct pertaining to the preparation and publication of securities analyses (Section 34b WpHG). In line with these provisions, investment services enterprises are obliged to conduct the analysis of securities with the requisite degree of care and conscientiousness and to disclose possible conflicts of interest. This applies, in particular, if the investment services enterprise in question holds an interest in the company to be analysed or if the enterprise is a member of a syndicate underwriting the most recent issue of the company's securities. At the beginning of 2003, BaFin published an official announcement specifying the requirements to be fulfilled when preparing securities analyses as well as the criteria to be observed as regards conflicts of interest and disclosure of such information.

## 1.2 Changes in the area of investment law

The 4th FMFG also prompted major changes to Germany's investment law. On the one hand, these amendments are designed to bolster Germany's position as an investment centre. On the other hand, the legal reforms are also aimed at enhancing the level of protection afforded to investors. The key amendments are as follows:

- Investment companies (Kapitalanlagegesellschaften – KAGs) are now permitted to market units issued by other enterprises. As a result, investors are now in a position to select various units from a single source. In addition, KAGs may now offer investment advice.
- KAGs are now permitted to launch funds with differing investment structures, e.g. accumulation funds that reinvest income automatically as well as distributing funds.
- The scope of investment for securities-based funds has been extended. As a consequence, funds are now in a position to track a range of indices – not just stock indices.
- The investment limits for open-ended real estate funds outside the European Economic Area (EEA) have been extended by a substantial margin.

## 1.3 Amendments to the Banking Act and the Insurance Supervision Law

### Principles of the Basel Committee on Banking Supervision

As part of the 4th FMFG, all twenty-five Core Principles for Effective Banking Supervision, as developed by the Basel Committee on Banking Supervision in 1997, have been incorporated within Germany's Banking Act (Gesetz über das Kreditwesen – KWG).

In future, loans to managers and governing bodies may only be granted on the basis of standard market terms and conditions. BaFin is entitled to define upper limits, and any excess is to be backed by liable capital. The organisational obligations defined as part of these legal provisions now also apply at a consolidated group level. Pursuant to Section 25a KWG, credit institutions are obliged to install appropriate systems aimed at combating money laundering and fraudulent actions that may adversely affect their own activities. In the case of foreign credit institutions establishing banks in Germany, the competent supervisory authorities of the home country must give prior approval. In future, companies that issue credit cards are subject to supervision.

On 1 April 2003, Germany's new legislation governing automated online access to account details came into force. Thus, BaFin has been equipped with a highly effective tool to uncover the flow of specific funds, with the express purpose of combating money laundering and the financing of terrorism.

### Implementation of e-money Directive now concluded

The 4th FMFG brought about the full implementation of the European e-money Directive. In anticipation of the upcoming Directive, in 1998 the German legislative body placed all services associated with transactions using e-purse (Geldkarte) or network money under the supervision of the regulatory authorities. However, prior to full implementation a number of special regulations had to be incorporated within the German Banking Act, particularly as regards capital adequacy and lending business. In addition, EU provisions regarding the redeemability of electronic money were incorporated within German legislation. Thus, the German Banking Act now contains an effective standard aimed at protecting the interests of consumers.

### Closer monitoring of shareholders

Legislation governing the monitoring of groups with ownership interests in credit institutions and insurance companies has been realigned and tightened. In effect, the definition of a so-called "bedeutende Beteiligung" (qualified participating interest), i.e. a significant holding, is now the same for insurance undertakings (Section 7a (2) VAG) and credit institutions (Section 1 (9) KWG). What is new to both areas is the reversal of the burden of proof, which is aimed at combating money laundering. In future, parties acquiring a qualified participating interest are responsible for proving that their ownership interests have been financed by lawful means. If in doubt, BaFin is authorised to prohibit purchases. Moreover, BaFin may prohibit

those involved from acquiring an interest if the ownership structure of the future group is deemed to be obscure or ambiguous.

### Supervision also extends to reinsurers

Financial supervision of reinsurers now extends beyond the requirement to disclose pertinent information.

The 4th FMFG has given the regulatory authorities more extensive powers when it comes to supervising reinsurance companies. The new regulations in force since 1 July 2002 extend far beyond the previous disclosure requirements for reinsurers.

In line with these newly introduced regulations, managers of reinsurers are now also obliged to prove that they are of good repute and qualified within their field. Furthermore, the choice of legal forms available to reinsurance companies – i.e. the type of enterprise they can establish – has been limited. Investments effected by these companies must be based on the principles of security, profitability, liquidity, mix, and diversification. As regards diversification of investments, the specific risk status of the reinsurance company must be taken into account. BaFin may intervene in order to ensure that the prevailing laws are observed (legal supervision) and that a company's ability to perform as a going concern is maintained at all times (solvency supervision). The provisions regarding the legal form of reinsurers and investments come into force in 2005, thus allowing those involved to make the requisite structural adjustments.

Table 1

#### Applications for certification

Type of Certificate	Certificate for Standard Contract submitted by Central Organisation	Individual Certificate for Provider of Services	Certificate for Provider of Services based on Standard Contract	Certificate for Standard Contract submitted by Central Organisation as Authorised Representative	Total
<b>Processing fee</b>	€5,000	€5,000	€500	€250	
<b>Basis</b>	Section 4 (2) AltZertG	Section 4 (1) AltZertG	Section 4 (1) AltZertG	Section 4 (3) AltZertG	
<b>Applicant</b>					
<b>Life insurers</b>	6	290	0	0	296
<b>Credit institutions</b>	12	5	0	3,240	3,257
<b>Investment-enterprises</b>	1	15	4	9	29
<b>Housing sector</b>	1	0	0	28	29
<b>Total</b>	20	310	4	3,277	3,611

## 2 Specific cross-sectoral issues

### 2.1 Certification of pension contracts

Official certification signifies that the terms and conditions outlined within a specific retirement provision contract (also referred to as a "pension contract") fulfil the requirements of the Act Governing the Certification of Retirement Provision Contracts (Altersvorsorgeverträge-Zertifizierungsgesetz – AltZertG). Within this respect, BaFin merely assesses whether contracts are eligible for state support in terms of receiving tax incentives. This assessment is conducted on the basis of eleven statutory criteria. However, certification does not imply that the pension contract is economically viable. The main suppliers of such investment vehicles are life insurance companies, credit institutions, as well as investment firms.

In 2002, BaFin granted 123 certificates in total.

Compared with a total of 3,511 certificates granted in 2001, demand for certification fell substantially in the year under review. BaFin granted 123 certificates in the course of 2002, of which 74 were Individual Certificates, i.e. for products of separate financial services providers. In total, 49 certificates were granted to companies that had lodged their applications via an association. The competent authorities did not issue so-called "Musterzertifikate" in the year under review. Owing to the fact that a number of financial services providers waived their rights to certificates, the total number of certificates at the end of the year under review was 3,611.

One of the main issues addressed was that of clarifying specific points within the Act Governing the Certification of Retirement Provision Contracts (Altersvorsorgeverträge-Zertifizierungsgesetz – AltZertG) which had been open to interpretation. In addition, BaFin cooperated closely with central organisations and ministerial departments. Pension insurance is a case in point. In concert with the Federal Ministry of Finance (Bundesministerium der Finanzen – BMF), BaFin has allowed insurers to pay policy holders a one-off amount of up to 20% of the capital involved with the commencement of systematic pension payments. This payout is subject to the proviso that it can be funded from the existing surpluses (ongoing or terminal bonuses). The certificates granted are published in the Federal Gazette (Bundesanzeiger) as well as on the Internet.

The Federal Financial Supervisory Authority is also responsible for revoking certificates and imposing fines for administrative offences committed by companies that fail to fulfil the requisite disclosure requirements.

## 2.2 Combating money laundering and the financing of terrorism

Money laundering, the financing of terrorism, and serious fraud may have an adverse effect on the stability of financial institutions and are therefore considered to be detrimental to Germany's reputation as a premier financial centre. It falls within the remit of BaFin to combat the potential abuse of Germany's financial systems, by enjoining companies subject to financial supervision to take preventive action and by monitoring the implementation of such measures.

Anti-money laundering is an interdisciplinary issue addressed by cross-sectoral departments within BaFin.

The Federal Financial Supervisory Authority marks a new dawn in Germany's efforts to combat money laundering and to prevent the financing of terrorism. Indeed, the cross-sectoral responsibilities within this area are reflected in BaFin's internal organisational structure. In future, the group will monitor the full range of financial transactions that are considered to be of direct or indirect relevance to the issue of money laundering. In addition, it will supervise the areas of money transmission services, foreign currency dealing, and credit card business. Owing to the increased risk associated with these transactions, operators within this segment have been placed under permanent financial supervision. The inherent risk attributable to such transactions is mainly due to the fact that processing is relatively difficult for external parties to monitor. In many cases there is no written documentation, e.g. records listing those involved, and there

are hardly any details regarding the origin or subsequent use of funds. In the aftermath of the terrorist attacks of 11 September 2001, transactions involving money transfers, in particular, have come under close scrutiny, the rationale being that such transactions may point to the possible financing of terrorist groups. In addition, this unit is also responsible for prosecuting companies that conduct the above-mentioned services without an official licence.

Cross-sectoral financial supervision to combat money laundering and prevent the financing of terrorism enhances the overall quality of the regulatory authorities and creates additional synergies. Similar measures aimed at tackling the issue of money laundering and terrorist financing are also required within the field of banking, insurance, and financial services. Fully integrated financial supervision provides a solid basis for developing consistent standards and monitoring compliance. Moreover, it should be borne in mind that legal and illegal financial structures are often interwoven. For instance, companies and persons conducting money transfer services without the necessary licence often have collective or pool accounts with German-based credit institutions.

### **Changes to the Money Laundering Act**

In 2002, the German parliament approved a number of bills aimed at combating money laundering and the financing of terrorism. The prime objective of this new legislation is to create an effective regulatory framework that is capable of preventing the misuse of legitimate services provided by financial institutions which are subject to the Authority's supervision.

The amendment to the Money Laundering Act has resulted in changes to requirements regarding the identification of parties involved in transactions.

The amendment to the German Money Laundering Act (Geldwäschegesetz – GwG) came into force on 15 August 2002. The amendment involves key changes to requirements regarding the identification of the parties conducting transactions as well as the identification of the primary economic beneficiary. It also focuses on the obligation to report transactions which may be conducive to the financing of terrorist organisations, as well as outlining specific details of internal security measures to be implemented by banks and insurance companies. In addition, upon concluding contracts with customers, insurance brokers offering life insurance or casualty insurance policies equipped with a premium refund are henceforth obliged to identify the customer by means of official documents and forward all records to the insurance company in question. At the same time, the reform has resulted in palpable benefits to the companies involved, e.g. when it comes to identifying customers withdrawing funds in cash but also in regard to documentation requirements. The amendment also creates a more favourable legal framework within the area of outsourcing, which has become particularly popular among smaller financial institutions.

### **Changes to the Banking Act**

Credit card transactions are closely monitored to uncover possible money laundering activities.

The 4th FMFG extended the catalogue of financial services requiring regulatory approval. As a result, credit card business is subject to an official licence and therefore falls within the remit of the supervisory authority.

Official online access to account details was introduced on 1 April 2003. As a result, BaFin is now able to identify the bank at which a person suspected of money laundering has an account.

The German Banking Act (Gesetz über das Kreditwesen – KWG) has now also introduced regulations governing online access to bank account details (Section 24c KWG). Pursuant to the KWG, every credit institution is obliged to maintain a separate and up-to-date file containing details of all bank accounts and safe custody accounts held in Germany. This file must include specific master data related to the customer, as well as to persons authorised to draw on the account and, if applicable, other economic beneficiaries. It does not contain information on balances or account transactions. BaFin is empowered to retrieve this data at any time. Online access represents a new tool to identify the flow of funds, particularly when it comes to money laundering and the financing of terrorism. It also facilitates prosecution of banking and financial services conducted without an appropriate licence. The particularly time-consuming process of requesting information from around 2,500 credit institutions is a thing of the past. Furthermore, other regulatory bodies such as German and foreign tax authorities may approach BaFin for information whenever speedy action is required.

Based on the “know-your-customer” principle, banks must implement adequate security measures to identify any business or financial transactions that pose particular risks.

Following the introduction of the 4th FMFG, banks are obliged – not only in accordance with the Money Laundering Act but also pursuant to the Banking Act – to implement internal security measures aimed at combating money laundering and fraud (Section 25a (1) no. 4 KWG). Accordingly, BaFin has the authority to initiate regulatory proceedings if those subject to supervision fail to meet the above-mentioned statutory requirements. Thus, the “know-your-customer” principle has been enshrined in German law. Credit institutions are obliged to obtain comprehensive information about their customers and customer activities; they must also undertake to identify the origin of specific assets and monitor risk-related accounts on a continual basis.

Credit institutions are also expected to implement adequate security measures in order to identify within their retail business – this is mainly conducted anonymously and electronically – any financial transactions of an illegal nature. Within this context, the first step is to filter out all business relationships and transactions that are deemed suspicious in terms of money laundering or terrorism, as well as those which meet certain criteria (“Research”). During the second phase, the credit institution analyses the business relationships and transactions in more detail (“Monitoring”). In the case of well-founded suspicions, the credit institution is obliged to report said transactions to the appropriate authority.

Banks must fulfil special organisational requirements within the area of cashless payments.

In the year under review, special organisational requirements regarding cross-border cashless transactions were incorporated in Section 25b KWG, aimed specifically at credit institutions conducting giro business and money transfer services. In future, credit institutions may only use data records that contain full and accurate details as regards the name, address, and account number of the person or entity transferring the funds. This requirement also applies to intermediary credit institutions. Moreover, the credit institution carrying out the transfer on behalf of the customer should endeavour to obtain missing information. This approach is designed to ensure that suspicious transactions can be traced back to the party actually responsible for transferring the funds, thus supporting the investigation unit or regulatory authorities in charge of the case.

### Circulars issued by BaFin

The FATF regularly publishes lists identifying non-cooperative countries and territories within the field of anti-money laundering.

In 2002, the Federal Financial Supervisory Authority published the current reviews provided by the Financial Action Task Force on Money Laundering (FATF), which identify non-cooperative countries and territories<sup>1</sup> (so-called NCCTs). Recently, the FATF removed four countries from its NCCT list; the reforms promised by these countries are now being closely monitored. In contrast, the FAFT urged its members to take further measures against Ukraine due to the fact that Ukrainian legislation failed to comply with international standards on anti-money laundering. After Nauru, this was the second country cited as non-cooperative<sup>2</sup>. Germany's Federal Financial Supervisory Authority published the FATF's request to take appropriate countermeasures in its Urgent Circular 1/2003 (Q) dated 8 January 2003. The Circular urges credit institutions and insurance undertakings to monitor closely any transactions to or from Ukraine. In the meantime, the sanctions imposed have been withdrawn in view of the fact that Ukraine has begun to improve its system of anti-money laundering.

Banks and providers of financial services are obliged to check whether they have business relationships with persons or entities with a terrorist background.

Committed to supporting the international war against terrorism, the Federal Financial Supervisory Authority issued several Circulars to credit and financial services institutions with registered offices in Germany. These publications listed the names of persons, organisations, or entities who, in the opinion of the intelligence authorities, are closely linked to terrorist attacks. The institutions in question are obliged to check whether they have business relationships with such persons, organisations, or entities; if so, they must report such activities to the investigating authorities. Additionally, they must inform BaFin about any measures taken.

BaFin Circular 16/2002 specified detailed requirements to be fulfilled by credit and financial services institutions when outsourcing business operations to external service providers. Furthermore, BaFin informed market participants that regulations specifying the identification and recording of transactions within the area of money transmission services and foreign currency dealing continue to apply to amounts in excess of 2,500 euros (Circular 18/2002). Moreover, when interpreting obligations related to anti-money laundering, those involved must adhere to the minimum standards defined by the Basel Committee on Banking Supervision. BaFin provided the institutions under its supervision with pertinent information on these standards as part of its Circular 25/2002 (Q).

### Combating money laundering in the banking sector

Some banks still underestimate the danger that money laundering offences pose to their corporate image.

Many of the credit institutions operating in Germany have made excellent progress when it comes to implementing federal legislation. Having said this, there are still certain shortcomings as regards full implementation of the German Money Laundering Act, particularly within the areas of organisation and security. Moreover, some operators within the market are understaffed within the area of anti-

<sup>1</sup> cf. BaFin Circulars 13/2002, 15/2002, and 21/2002 (Q).

<sup>2</sup> Prior to this, Nauru had been listed as an NCCT, as published at the end of 2001; cf. Annual Report BAKred 2001, page 62.

Table 2

**Measures taken against unlawful activities within the capital markets**

Company	Number of Investors	Total Investment (€)	Category
Gerald Bohne, 24109 Kiel	unknown	approx. 360,000	Principal broking services
Thomas Dworzak, 92699 Irchenrieth	49	340,000	Investment broking, own-account trading
Karl Götz Handelshaus für Finanzdienstleistungen, 70839 Gerlingen	approx. 20	approx. 664,680	Deposit business
IMS International Marketing Services GmbH, 47226 Duisburg	unknown	approx. 280,000	Investment broking
InnoSelect AG, 76131 Karlsruhe	unknown	approx. 613,000	Own-account trading
Akzenta AG, 83026 Rosenheim	67	247,900	Deposit business
Bernstein GmbH, 47228 Duisburg	approx. 13	approx. 76,000	Investment broking
Eurotrading Vermögensberatung GmbH, 40210 Düsseldorf	unknown	unknown	Investment and contract broking
Michael Zimmermann, 09567 Hilbersdorf	188	approx. 1,53 million	Deposit business
IFKo. Internationale Franchise Konzepte Unternehmensberatungs- und Beteiligungs-GmbH, 15806 Groß Schulzendorf	63	approx. 475,000	Deposit business
A & D Vermögensanlagen-Beratungs GmbH, 40211 Düsseldorf	80	unknown	Investment and contract broking, portfolio management
Wonsei AG, 61279 Grävenwiesbach	approx. 200	approx. 1,342,000	Deposit business
Helmut Schmid, 91183 Abenberg	1	approx. 20,500	Principal broking services and safe custody business
Klaus Heinze, 14193 Berlin	2	unknown	Non-EEA deposit broking
Andreas Fischer, 83536 Gars am Inn	6	approx. 39,800	Principal broking services and safe custody business
Goran Kuzmanovic, 40215 Düsseldorf	25	approx. 350,000	Investment broking
Erol Akdogan, 10559 Berlin	unknown	unknown	Investment broking, principal broking services as a branch
Eberhard Dallüge, 52072 Aachen	approx. 140	approx. 1,8 million	Deposit business as a branch
Helmut Kiener, 63743 Aschaffenburg	unknown	unknown	Portfolio management
Hubert J. R. Werner, 95182 Döhlau/Hof	unknown	unknown	Investment broking
Klaus Heinze, 14193 Berlin	unknown	unknown	Non-EEA deposit broking
Fastnet Radio AG, 22297 Hamburg	unknown	750,000	Own-account trading
Markus Nowaczyk, 44379 Dortmund	unknown	over 500,000	Principal broking services
ConRatio GmbH, 50129 Bergheim	approx. 140	approx. 1,8 million	Non-EEA deposit broking
Treukapital Treuhandverwaltung GmbH 55270 Klein-Winternheim	unknown	unknown	Involved in portfolio management of third parties
Contigo Beteiligungs-GmbH, 37077 Göttingen	40	unknown	Deposit business
Horst Bohlig, 77975 Ringsheim	unknown	unknown	Investment broking
Euro Asset Management GmbH i.Gr., Peter Ratte, 44379 Dortmund	unknown	unknown	Investment broking, portfolio management
Michael Drawa, 45279 Essen	approx. 15	over 120,000	Principal broking services and safe custody business
Serkan Izmirioglu, Deutsche Mentor für Finanzen e.K., 36037 Fulda	unknown	unknown	Principal broking services
Fons Salutis AG, 90429 Nürnberg	unknown	approx. 2,4 Mio.	Principal broking services
Johann Pertschy, 73571 Göggingen	unknown	unknown	Investment broking
Euro-Vermögensverwaltung EVV AG 59519 Möhnesee-Körbecke	unknown	unknown	Deposit business
Dr. Hansjörg Landes, 87435 Kempten	unknown	unknown	Involved in deposit business of third parties
Wkmedia GmbH, 47239 Duisburg	unknown	unknown	Deposit business
German Asset Managers AG 60325 Frankfurt/Main	unknown	unknown	Own-account trading

money laundering. Indeed, it seems that some of Germany's credit institutions still fail to recognise the danger posed by money laundering offences, both in terms of financial damage and loss of reputation.

In 2002, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) installed internal IT-based systems aimed at identifying money laundering and financial fraud. From a supervisory and regulatory perspective, the alignment of research systems to the specific business and risk structures of the credit institution in question is of prime importance.

In four cases, BaFin asked auditors to perform special investigations; in one case, BaFin conducted its own audit. However, some of the Audit Reports proved to be insufficient due to the fact that the auditors in charge had failed to investigate fully the specific risks to which the companies were exposed. Therefore, BaFin has decided to deploy more of its own staff to conduct investigations into money laundering. In addition, BaFin shall place greater emphasis on the need for preventive measures. This includes, among other things, implementation of the know-your-customer principle, deployment of IT-based research systems, increased diligence in relations with correspondent banks, more stringent identification requirements with regard to electronic transactions, as well as implementation of countermeasures in relation to NCCTs.

### Combating money laundering in the financial services sector

As regards the area of financial services, BaFin focused on ensuring full compliance with the standards already implemented throughout the banking sector. Despite palpable improvements, many operators within the financial sector have still not implemented the full range of measures to combat money laundering, terrorist financing, and financial fraud.

In its capacity as a supervisory authority, BaFin assessed the year-end financial statements of companies by analysing the auditors' statements on money laundering. In addition, BaFin instigated a special audit to be carried out in close cooperation with BaFin staff. Within this sector, the number of audit reports, as issued by auditors and certified public accountants, that failed to meet the requirements of the Audit Reports Regulation (Prüfungsberichtsverordnung – PrüfbV) was even higher than in the banking sector. In many cases, BaFin was also forced to request licensed institutions to provide pertinent information in order to investigate possible offences against the Banking Act. In 14 cases, the Federal Financial Supervisory Authority ordered financial institutions to eliminate shortcomings within the area of anti-money laundering prevention.

In view of the fact that federal legislation governing the identification of contracting parties now applies to all financial services institutions, BaFin expects to see a pronounced increase in the number of reports about suspicious transactions, particularly reports forwarded by portfolio and asset managers.

Regulatory measures
Prohibition
Prohibition
Prohibition, liquidation order
Prohibition
Prohibition
Prohibition, liquidation order
Prohibition
Prohibition
Liquidation order
Appointment of liquidator
Prohibition, appointment of liquidator
Instructions as part of liquidation
Prohibition, liquidation order
Prohibition
Prohibition, liquidation order
Prohibition order
Prohibition, appointment of liquidator
Prohibition, appointment of liquidator
Appointment of liquidator
Prohibition, liquidation order
Prohibition
Prohibition
Prohibition, liquidation order
Prohibition, instructions
Prohibition, liquidation order, instructions
Liquidation order
Prohibition
Prohibition
Prohibition, appointment of liquidator
Liquidation order
Prohibition, liquidation order
Prohibition
Instructions as part of liquidation
Instructions as part of liquidation
Instructions as part of liquidation
Prohibition

### Combating money laundering in the insurance sector

Insurers offering life or casualty insurance policies with premium refunds now also receive Circulars on combating money laundering.

Life insurance policies with contribution deposits, i.e. a type of feeder plan, as well as policies with substantial lump-sum payments are particularly susceptible to money laundering activities.

Having merged the internal sections responsible for combating money laundering and terrorist financing, BaFin defined a consistent administrative approach within this area. Insurance undertakings offering life or casualty insurance policies with premium refunds now also receive BaFin Circulars. As part of the next phase BaFin commenced work on a new Guideline for insurance undertakings, which will be published in the course of 2003.

In the year under review, BaFin assessed the level of compliance with anti-money laundering requirements as part of two special audits conducted by auditors in accordance with Section 81 VAG. In the majority of cases, statutory requirements regarding the identification of customers, as described within the Money Laundering Act, were observed by the companies audited. Additionally, BaFin received copies of numerous reports concerning suspicious transactions, all of which were forwarded by the insurance companies to the investigating authorities in line with Section 11 (1) GWG.

### Unauthorised money transfer services and foreign currency dealings

Money laundering and the financing of terrorism is often supported by "underground banking" systems.

Efforts to combat money laundering and the financing of terrorism must also include the prosecution and elimination of so-called underground banking systems. These systems are often maintained by persons or entities operating without the necessary licences, i.e. without authorisation and thus unlawfully.

By definition, underground banking lacks any form of transparency and is operated predominantly by alienated groups within ethnic minorities. Relying on a relatively simple approach, they are able to transfer substantial funds of several billion euros a year to and from Germany. The origin (or destination) of such transfers tends to be countries such as Russia, Iran, Kosovo, Albania, India, Pakistan, Afghanistan, Sri Lanka, the Philippines, or geographical regions such as Africa or Latin America. Underground banking plays a pivotal role in money laundering and the financing of terrorism, a fact which has been well documented by national and international authorities.

The Federal Financial Supervisory Authority aims to license a select group of suitable transmitters, with the express purpose of channelling the flow of funds and thus supervising and controlling these transactions. In parallel, the illegal transmitters identified as part of this incisive approach are to be prosecuted accordingly.

In the course of 2002, BaFin instigated 120 proceedings in connection with unlawful foreign currency dealing and money transfers. In six cases, BaFin conducted on-site investigations into company transactions. In 13 cases, BaFin issued prohibition orders; in one case, the company in question was warned that a fine would be imposed due to the fact that it had failed to comply with orders to discontinue operations.

## 2.3 Prosecution of unauthorised financial services

The prevailing weakness seen within the capital markets seems to have had no adverse effect on unlawful banking, financial services, and insurance operations. In fact, in the year under review the Federal Financial Supervisory Authority dealt with 619 new cases within this area. At the end of the year, a total of 1,642 cases had yet to be concluded.

BaFin has increased its staffing levels to facilitate the prosecution of illegal operators within the banking, insurance, and investment sectors.

The prospects for accelerated prosecution of illegal operators are very positive indeed. Since its inception, BaFin has gradually been recruiting new members of staff, thus strengthening its human resources within the area of prosecution. Towards the end of 2002, BaFin introduced a third section dealing with the area of prosecution, as well as an external auditing section, which is responsible for coordinating audits, searches, and the collection of evidence on site.

In its efforts to prosecute unauthorised financial services and insurance business, the Federal Financial Supervisory Authority is empowered to demand the disclosure and presentation of company documents; it may also conduct on-site investigations as well as searches of company premises in order to obtain evidence. Since July 2002, BaFin has also been authorised to investigate persons or companies suspected of being involved in initiating, concluding, or executing unlawful banking and financial services, even if there is no conclusive evidence to suggest that the aforementioned parties have effected such transactions themselves. This may, for example, apply to trustees, lawyers, or Internet service providers. Within this context, BaFin now has the same powers to take action as it has in the case of the primary operators of such unauthorised systems. Equipped with more extensive regulatory powers, BaFin is authorised to close down Internet websites and to freeze bank accounts if such action is deemed necessary to secure funds that have been invested via unlawful channels.

Reports about possible unlawful transactions are usually provided by investors and employees, but also by competitors and other authorities.

When it comes to identifying unlawful financial transactions, BaFin also relies on information provided by investors, employees, competitors, associations, or other prosecuting authorities.

In 2002, there were 138 cases of suspected unauthorised transactions; BaFin took appropriate action by requesting pertinent information and conducting investigations. Search warrants were granted in eight cases, and the companies investigated on site were found to have been involved in unauthorised financial transactions. Fines were imposed in 34 cases. It should be noted that these figures do not include the cases of unauthorised money transmission or foreign currency dealing investigated as part of BaFin's efforts to combat money laundering and the financing of terrorism.

In the cases in which investigations established conclusive evidence of unauthorised banking, financial services, or insurance transactions, BaFin ordered the immediate discontinuation of such business. In the year under review, BaFin issued 37 prohibition orders and 15 orders to discontinue operations. In seven cases a liquidator was appointed; BaFin uses experienced administrators and liquidators to perform these tasks.

main focus is on prosecuting unlawful banking and financial services, particularly unauthorised deposit business and principal broking services.

Registering 571 new cases, the main focus of BaFin's activities within this area was on prosecuting unauthorised banking and financial services. Unauthorised deposit business and principal broking services pose a particular danger to investors. These systems are designed to accumulate substantial funds, and therefore the risk of a total loss of investment is considerable. Investigations into such transactions are generally very complex and protracted. Therefore, BaFin is not usually in a position to initiate swift countermeasures in order to secure the funds involved. However, by intervening, BaFin is able to prevent further accumulation of funds, thus limiting the overall loss suffered by investors. Therefore, the amounts lost by investors, as outlined in Table 2 for cases reported in the course of 2002, are relatively small.

Those affected by regulatory measures instigated by BaFin are entitled to take legal action, and this is an approach often used within this context. This generally involves protracted and highly complex legal proceedings, going through every court within the system of administrative jurisdiction; in some cases, Germany's Federal Constitutional Court (Bundesverfassungsgericht) becomes involved in such proceedings. In the year under review, BaFin dealt with 135 proceedings reviewing an objection to an administrative act and 37 lawsuits in connection with unauthorised transactions within the area of financial services.

### **Unauthorised insurance services**

Supported by information received from external sources, BaFin investigated 48 new cases of alleged unauthorised insurance services in the year under review. In total, 72 cases were concluded over the course of 2002. The main focus within this area was on clarifying specific statutory requirements and legal aspects, rather than prosecution of unlawful operators.

### **Assessing the scope of operators' statutory requirements**

In addition to prosecuting unauthorised business transactions, BaFin is also responsible for assessing whether new products launched by those operating in the marketplace are considered to be financial instruments or insurances, as outlined by supervisory legislation (KWG, WpHG, VAG). If this is the case, these activities require an official licence.

The main issue addressed in the year under review was the distinction between so-called guarantee business, which is not subject to supervision, and insurance business, which requires an official licence.

### **Guarantees and warranties in the used-car market**

Following the reform of Germany's Law of Obligations at the beginning of 2002, there was an increase in the number of guarantees and warranties posing specific problems from a regulatory perspective, particularly within the used-car market. In principle, the Act to Modernise the Law of Obligations (Schuldrechtsmodernisierungsgesetz) has not affected the general approach used by the supervisory authorities to determine whether insurance products and services require an official licence.

Guarantees and warranties are only subject to financial supervision if they are granted as part of the statutory warranty in connection with a contract of sale.

A guarantee or warranty is only considered to be a transaction that is subject to official supervision if the seller has guaranteed, for a specified period, the quality and durability of a motor vehicle – or any other object to be sold – as part of the statutory warranty requirements. This guarantee only applies to the condition of the vehicle at the point at which the risk passes to the buyer, not to any subsequent risks, e.g. theft or damage caused by external forces. In addition, the guarantee or warranty may only be granted as a dependent subsidiary agreement and not as an independent part of the contract. These legal provisions remain unchanged following the reform of the Law of Obligations. The amendment of Section 443 (2) German Civil Code (Bürgerliches Gesetzbuch – BGB) is limited to defining the onus probandi by incorporating a provision in favour of the buyer, namely an assumption that the rights under a guarantee shall exist in specific circumstances.

The term “Versicherung” is protected for products and operators under the supervision of the Federal Financial Supervisory Authority.

The guarantee or warranty granted by a car dealer may also be executed by a third party. However, this third party may not bear the risk of implementation of the guarantee. Therefore, a service agreement between the executing party and the dealer, a common occurrence within the used-car industry, must encompass predefined services. A guarantee or warranty may not be described as a “Versicherung”, i.e. an insurance. It is imperative that one distinguishes between these terms. This also applies if the dealer covers his risk of implementation of a guarantee or warranty by taking out a policy with an insurer. In this case, only the dealer – not the customer – has a possible claim against the insurer.

In those cases in which operators conducted insurance business subject to supervision, BaFin intervened accordingly and ensured that the contracts of sale were in line with statutory requirements.

### Certificates in Climate Protection

In the year under review, BaFin assessed whether so-called Certificates in Climate Protection (Klimaschutzzertifikate) are considered to be financial instruments within the meaning of the German Banking Act.

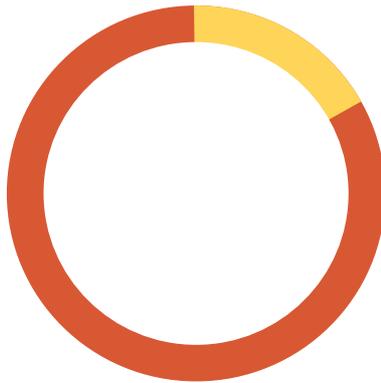
BaFin has determined that “Klimaschutzzertifikate” are securities.

In accordance with the European Union Directive of December 2002<sup>3</sup>, a trading scheme for such Certificates will be introduced in all 15 EU Member States from December 2005 onwards. Based on absolute emission controls, the Certificates are initially to be allocated free of charge to operators of power plants and specific industrial facilities. The purchase and sale of emission certificates is to be open not only to end consumers – those producing CO<sup>2</sup> – but to all investors<sup>4</sup>. According to a preliminary assessment, BaFin is of the opinion that Emission Certificates are to be categorised as securities pursuant to the Banking Act and the Securities Trading Act. However, their status can only be established fully once the EU Directive has been incorporated within German law. Futures contracts already established in connection with Emission Certificates have been categorised as derivatives in the meaning of the German Banking Act. Therefore, any services related to such derivatives are subject to official authorisation.

<sup>3</sup> Directive of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowance trading within the Community.

<sup>4</sup> Article 19 (2) of the Directive.

Fig. 1  
Consumer queries in 2002



18 % Banks  
82 % Insurers

Consumer complaints have become a prime source of information.

BaFin received 18,834 insurance-related complaints in the year under review.

## 2.4 Consumer complaints

In the period under review, 25,648 customers of insurance undertakings, credit institutions, and financial services institutions approached BaFin or the three former supervisory offices that have now been combined to form BaFin. This figure is roughly 2% lower than that recorded in the preceding year (26,303 complaints).

Consumer complaints are the source of valuable information about possible shortcomings within companies that are subject to BaFin supervision. They form the basis for investigations into potential breaches of statutory rules of conduct and are also of key importance when deciding whether regulatory measures are to be taken. Consumer complaints are of immense importance within the area of insurance supervision, particularly in view of the fact that official authorisation of general terms and conditions for insurance policies is no longer required in Germany.

The key objective of many consumer complaints is to secure some form of legal back-up from BaFin in order to support a possible claim for compensation. However, BaFin discharges its duties solely in the public interest. Therefore, in the case of grievances related to contractual issues, BaFin is merely in a position to advise consumers of their rights to seek legal representation or to approach an official arbitration board or a consumer complaints office operated by various associations.

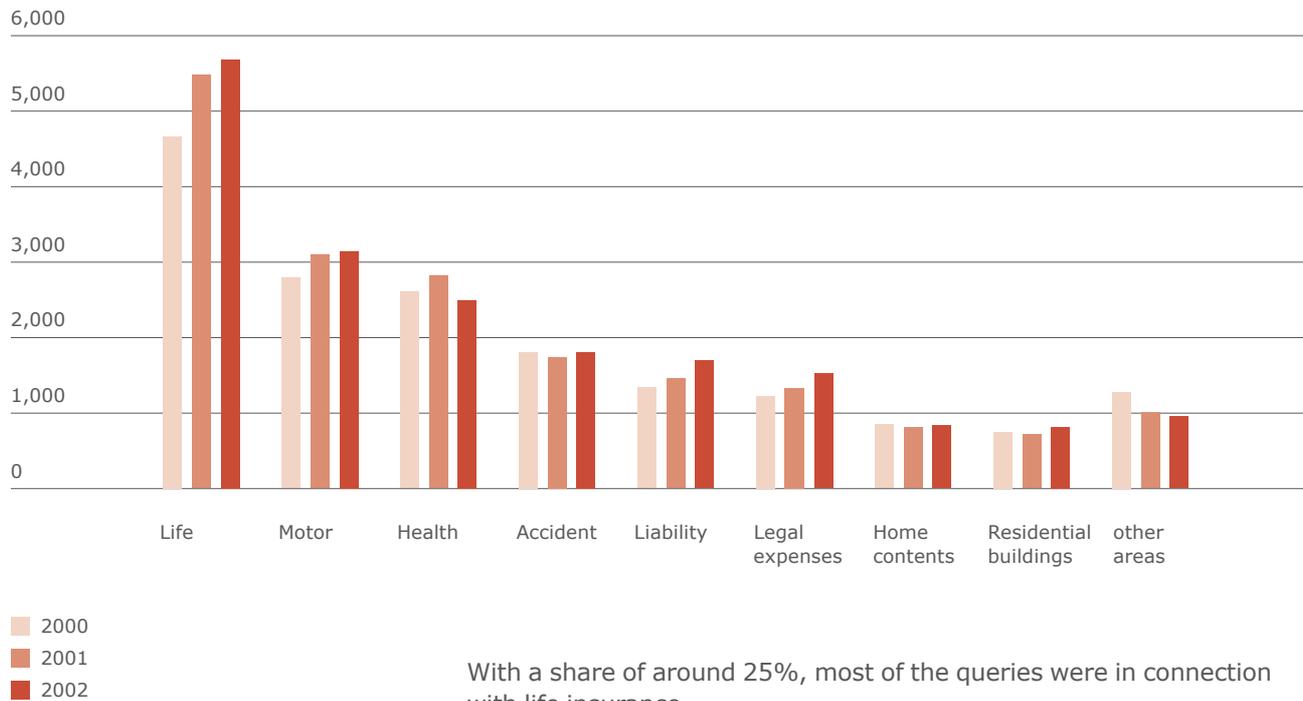
### 2.4.1 Complaints in the insurance sector

The majority of complaints were related to the insurance sector – 18,834 as opposed to 18,463 in the previous year, a year-on-year increase of around two per cent. In total, the Insurance Complaints Section processed 21,132 queries, of which 2,179 were general non-complaint enquiries and 119 were petitions.

The unit responsible for insurance supervision has divided its Complaints Statistics into four categories: “justified – redressed – unresolved – unfounded”. A complaint classified as “justified” or “redressed” means that the consumer has been successful. Within this respect, “justified” points to a complaint that is well founded, whereas “redressed” implies that although a complaint is not fully justified the insurer has been accommodating. Complaints that cannot be categorised as “unfounded” are defined as “unresolved” if the department was unable to redress the grievance in question. This includes cases in which the consumer issuing the complaint is advised about his or her rights to take legal action.

In the year under review, 24.5% (previous year: 26.1%) of all cases processed were concluded in favour of the party submitting the complaint; 5.7% of these cases (previous year: 6.1%) were justified. Approximately 14%, i.e. one in seven complaints, was categorised as “unresolved”; most of the cases were unfounded or beyond the regulatory scope of the Federal Financial Supervisory Authority (61.2%).

Fig. 2  
Complaints in the insurance sector (by segment)



The most frequent complaints are related to the settlement of claims.

With a share of around 25%, most of the queries were in connection with life insurance.

The reasons for complaints in the period under review were very similar to those witnessed in the preceding year. Yet again, claims processing was the dominant issue in 2002, accounting for 36% (2001: 35%) of all complaints received. With a share of 31%, complaints regarding the termination of contracts were in second place, followed by issues related to the subsequent course of an insurance policy (25%), and grievances regarding business conduct when negotiating contracts (13%).

A summary outlining the total number of complaints about specific insurance undertakings, as received in the course of 2002, can be found in the Appendix of this report<sup>5</sup>.

### Selected cases within the insurance sector

In the case of life and casualty insurance, policies with minors, e.g. school-leaver trainees or apprentices, are often concluded without the consent of the guardianship court (Sections 1634, 1822 BGB). BaFin has specified (VerBAV 1990, p. 129) that the statutory representatives of minors should be informed upon applying for a policy that said contract is provisionally invalid; likewise, the policyholder should be informed about this fact when he or she attains majority, i.e. comes of age. If these provisions are not observed, the policy remains provisionally invalid, despite the payment of premiums. In this case, the progressive payments do not constitute consent or approval because, due to the lack of information provided, the policyholder was not in a position to know that the policy was provisionally invalid.

<sup>5</sup> cf. appendix 4

Within this context, BaFin is responsible for advising insurers of any shortcomings.

As regards accident insurance, also referred to as casualty insurance, one of the key issues relates to insurers' disability payments following an accident, which are often considered to be too low. Owing to the fact that the degree of disablement is based on official medical reports, BaFin is usually not in a position to offer policyholders further assistance in these cases.

Personal liability insurers only settle claims if the policyholder is culpable. This also applies to cases in which relatives are involved.

Within the area of private personal liability insurance, one of the most contentious issues arises when the policyholder is related to or acquainted with the aggrieved party. If the policyholder has not acted culpably, he or she is not deemed liable for damages caused. In this case, the insurer will not accept the claim of the aggrieved party, even if the policyholder feels that he has a moral duty to pay for damages. BaFin can merely inform the complainant about the legal position.

Telemarketing activities for insurance coverage are not permitted without the prior consent of those contacted.

Often the method of selling and marketing insurance policies also gives rise to complaints. In the year under review, two insurance companies telemarketed so-called "Riester" products, i.e. insurance as part of pension provision supported by government grants and incentives, without having informed those contacted by phone about their legal rights within this area (Section 10a, D VAG). Similar complaints were submitted with regard to long-term care insurance (Germany's so-called "Pflegeversicherung"). In one case, a company collected names and addresses by means of so-called "Info Vouchers for Spouses and Partners" and subsequently used this information for telemarketing purposes aimed at selling long-term care insurance policies. Contracts negotiated on the basis of such telesales are invalid, as they are based to a large extent on taking consumers by surprise. BaFin considers these approaches to be unacceptable within the meaning of Section 81 VAG and advises insurance companies that such behaviour cannot be tolerated.

#### **2.4.2 Complaints about credit institutions and providers of financial services**

Within this area, which does not include complaints regarding securities transactions, the total number of complaints received in the year under review amounted to 3,317 (previous year: 3,163) and 573 general enquiries (1,057); in addition, there were 5,115 telephone enquiries. BaFin submitted 67 official statements to the Petitions Committee of the German Bundestag in connection with petition proceedings (2001: 54).

The majority of complaints proved unsuccessful. Consumer grievances were resolved in 205 cases, i.e. 6.5% of all complaints processed in this area, once BaFin had requested the parties involved to provide pertinent information. In 105 cases, the banks addressed the issues *ex gratia*. In 127 cases, BaFin criticised the behaviour of the institution involved.

### Selected cases within the banking and financial services sector

Complaints were often in connection with the return of cheques and direct debits, the size of redemption penalties, and the disclosure of customers' financial details.

Complaints within this area were mainly in connection with the fees charged for the return of cheques and direct debits, the extent of redemption penalties for the early repayment of loans, and the requirement to disclose financial details in line with Section 18 KWG.

Complaints related to the introduction of the euro were mainly centred around the issue of cash currency exchange. Owing to strong demand in the first few days of 2002, most customers were faced with long queues. The conversion of bank accounts and automated teller machines (ATMs) was performed without any major problems.

BaFin also received an increasing number of queries about the so-called "Konto für Jedermann" (an account for everyone) in connection with business accounts. However, the recommendation put forward by the Central Credit Committee (Zentraler Kreditausschuss – ZKA) only applies to private accounts. Therefore, BaFin has no authority to take action.

As from 2002, there is no longer a statute of limitations as regards the right to performance in connection with immature claims arising from "Sparbücher"; the term for deposits for

BaFin received several queries regarding the statute of limitations in connection with "Sparbücher" (German savings account books). Following the Act to Modernise the Law of Obligations, which came into force in 2002, the legal provisions regarding the statute of limitations have been redefined. In fact, there is no longer a statute of limitations as regards the right to performance in connection with immature claims arising from "Sparbücher". If notice of withdrawal of funds is given, the statute of limitations is three years, effective from the date on which the notice of termination comes into force. There can be no claims in the case of credit balances dating back to the period prior to Germany's Currency Reform (Währungsreform) of 21 June 1948. In these cases, the deadline regarding applications for conversion ended in December 1976. Furthermore, there can be no claims in connection with credit balances denominated in GDR marks (currency of the German Democratic Republic) due to the fact that the conversion deadline ended in 1993.

BaFin received several complaints from customers of building and loan associations, contending that they had received inaccurate advice regarding their contracts. The complainants pointed out that the targeted amount of savings was too high in relation to the instalment payments, thus resulting in an excessive completion fee. In those cases in which the contract in question failed to provide pertinent details about the targeted amount, e.g. in the case of special payments, BaFin approached the building and loan associations and requested further information. In several cases, the associations in question cancelled the agreements free of charge. Intervention by BaFin also prompted several building and loan associations to revise their application forms: they incorporated new sections regarding the schedule for regular deposits or amended their existing provisions accordingly.

As regards the financing of so-called "junk property", buyers will only be able to reverse the contract of sale under certain conditions because the loan agreement and the contract of sale are usually unrelated transactions.

The main focus of complaints regarding so-called "junk property", offered to investors as a tax-saving scheme, was usually centred around the possibilities of reversing such transactions. According to rulings by the European Court of Justice of 13 December 2001 (C-481/99) and the German Federal Court of Justice of 9 April 2002

(XI ZR 91/00), credit institutions are obliged to inform a borrower about his right of revocation insofar as the loan agreement was concluded as part of a so-called doorstep transaction (Law Regarding Revocation of Door-to-Door Dealings (Haustürwiderrufsgesetz – HWiG), now Section 312 (1) BGB). If this information is not provided, the borrower's right of revocation does not cease until one month after the last instalment (Section 2 HWiG). The law stipulates that the loan agreement shall be reversed if the customer is able to prove that the contract was concluded as part of a door-to-door transaction and if he was not informed about his right of revocation. However, according to the German Federal Court of Justice, such loan agreements and contracts of sale do not constitute related transactions, and therefore the fact that the loan agreement is null and void does not necessarily mean that the buyer can reverse the loan-financed purchase of real estate and request the bank to approach the seller of real estate for the repayment of the loan.

Credit institutions can demand special repayments if the amount insured as part of a life insurance policy is insufficient to cover repayment.

Owing to declining returns from endowment policies, in some cases borrowers with loans to be repaid in full upon maturity of the insurance policy were faced with problems. In those cases in which the amount to be repaid had been calculated on the basis of the projected, non-guaranteed benefits of the policy upon maturity – i.e. including profit participations – full repayment of the original loan is no longer guaranteed. If a credit institution asks the borrower to make special repayments, there can be no objection to this practice from a supervisory and regulatory perspective.

As of July 2002, bank charges for cross-border electronic credit transfers of up to €12,500 must not be higher than those for internal transactions. From July 2003, this provision also applies to standard transfers.

Once again, bank charges for cross-border payments proved to be a contentious issue in the year under review. Pursuant to Parliament and Council Regulation (EC) No. 2560/2001 of 19 December 2001, effective from 1 July 2002 bank charges for cross-border electronic payments (card transactions and electronic transfers) up to €12,500 must be the same as those for internal transactions effected within a Member State. From 1 July 2003 onwards, this regulation also applies to standard transfers within the euro area.

Some customers complained about the lack of information about charges in the case of withdrawals at automated teller machines (ATMs), i.e. cash dispensers, of third-party credit institutions. As of July 2002, in accordance with Regulation (EC) No. 2560/2001, charges for the use of third-party ATMs are to be based on the fees determined by the customer's bank rather than those of the third-party bank. In view of these provisions, customers using the ATMs of a different bank will have to approach their own credit institutions for pertinent information regarding bank charges.

### 2.4.3 Complaints regarding securities transactions

The majority of the 559 complaints regarding securities transactions were in connection with the execution of orders and the duty to provide information.

In the year under review, BaFin received 559 complaints about private credit institutions, savings banks, cooperative banks, as well as financial services enterprises, all of which were in connection with securities transactions. In addition, BaFin received numerous telephone calls from investors wishing to complain about specific credit institutions. Consumers also asked BaFin to provide information and assistance as regards securities transactions. The year-on-year decline in written complaints – roughly 33% fewer than in the same period a

year ago (780) – is mainly attributable to weaker business within the securities sector, which in turn is the result of the prevailing economic malaise.

As in the previous year, most of the complaints were associated with the execution of orders and the duty to provide information. Cold calling also gave rise to complaints. In addition, many investors complained about the weak performance of their investments in shares and funds, implying that this had been due to the inaccurate advice given by their banks. In actual fact, however, the unfavourable performance of investments was mainly attributable to the downward spiral witnessed across all segments of the financial markets. Consumers also pointed out on numerous occasions that they had been offered investment opportunities which were beyond their scope of expertise or their financial means.

Some investors complained about the lack of information provided with regard to the potential risks associated with knock-out certificates.

In the year under review, BaFin received several complaints in connection with so-called "Knock-out-Zertifikate" (knock-out certificates). Many investors felt that they had not been sufficiently advised about the nature of these investment vehicles. "Knock-out-Zertifikate" are securities which expire, i.e. become worthless, as soon as the underlying shares, indices, or even currencies have reached a specific price level. The financial market has seen the emergence of a vast array of certificates within this field, and in many cases similar products are marketed under different names. Investors should note that the issuers of such certificates generally provide very detailed information about the associated risks of such investment vehicles in their respective prospectuses. The same applies to so-called "guarantee products", which were also the subject of consumer enquiries. The guarantee component outlined in the prospectuses is only applicable if the security is held to maturity. A loss may be incurred if investors decide to dispose of the securities prior to the date of maturity.

Over the course of 2002, several operators within this sector raised their fees for securities transactions in order to enhance their overall earnings performance. In some cases this gave rise to complaints, as did the practice of charging separate fees for the partial execution of orders. However, as long as operators ensure that their terms and conditions are transparent, e.g. by publishing details in their price lists, there is no need for BaFin to intervene.

On occasions also received complaints about the time needed to process the transfer of safe custody accounts, particularly when closing an account. However, this was usually due to the fact that foreign custodian banks were involved in processing the transfers.

## 3 International cooperation

Within the global arena, domestic supervisory and regulatory systems are responsible for monitoring financial markets and operators with interlinked cross-border structures. Therefore, close international cooperation is of paramount importance. BaFin is represented in a host of international working groups<sup>6</sup>, with the express purpose of actively contributing to the development of effective global standards and highlighting the specific characteristics of the German market. In addition, BaFin issued numerous statements regarding EU Directives that have yet to be enacted. The following sections provide a brief overview of some of the Directives and working groups that have particular significance for financial supervision. It goes without saying that regular meetings and a thorough exchange of information with supervisory authorities from other countries are essential prerequisites in terms of monitoring companies and developing effective supervisory and regulatory strategies.

### 3.1 Global cooperation

#### 3.1.1 IOSCO

The International Organization of Securities Commissions (IOSCO) was established in 1983. Today, the organisation has 168 members from over 100 states. One of its key objectives is to exchange information on members' respective experiences within the area of securities supervision. In areas of particular international importance, the IOSCO is committed to promoting high standards of regulation in order to maintain just, efficient, and sound markets.

BaFin is represented at all IOSCO levels. Indeed, it is a member of the Presidents' Committee and the Executive Committee, as well as the Technical Committee, which is responsible for drafting standards and putting forward recommendations. BaFin representatives are also members of all five Working Committees, responsible for assisting the Technical Committee. These representatives are directly involved in compiling IOSCO reports and putting forward resolutions.

In May 2002, IOSCO members endorsed a Multilateral Memorandum of Understanding (MoU) for securities regulators. In line with these provisions, regulatory bodies who are signatories to the MoU are entitled to participate in the thorough exchange of information between authorities. Exchange of information may, for instance, relate to the names of parties responsible for initiating securities transactions or the name of parties with ownership interests in companies. Prior to this, however, the authorities are obliged to undergo a multi-stage verification process in order to ascertain whether they meet the requirements specified for the receipt and exchange of confidential information. The MoU has already been signed by several states. Germany's application to become a signatory is currently in preparation.

In 2002, the IOSCO endorsed a Multilateral Memorandum of Understanding, which has already been signed by a number of states.

<sup>6</sup> cf. Appendix 7 for details about international bodies.

### Reacting to Enron and Worldcom

IOSCO sub-committee establishes new standards covering auditor independence and oversight.

To coordinate and focus the IOSCO's response to the securities regulatory issues highlighted by business failures such as Enron and Worldcom, the IOSCO set up a sub-committee comprised of long-standing experts within the capital markets. This group published three reports in the year under review: Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence, Principles for Auditor Oversight, and Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities. The IOSCO will be responsible for monitoring to what extent the principles regarding auditor oversight are actually implemented at a national level.

### Analysts Project Team

Quality and objectivity of securities-related analyses are considered to be of immense importance when it comes to protecting investors. The capital markets are dependent to a large extent on the integrity of securities analysis. Towards the end of 2001, the IOSCO established a special Project Team to investigate possible conflicts of interest among analysts<sup>7</sup>. The Project Team was also responsible for compiling a comprehensive report on legal regulations covering the issue of "conflicts of interest" and analysing the scope of sanctions imposed in IOSCO Member States. By the end of 2002, the group had concluded its investigation and submitted a report. A high-ranking IOSCO committee is expected to put forward and pass a range of specific recommendations within this area in the course of 2003.

### Trading halts – a consistent approach

The IOSCO is committed to establishing a consistent approach in the case of trading halts.

In the year under review, the IOSCO published a report<sup>8</sup> which discusses the issue of trading halts in the case of securities with multiple cross-border listings. The rationale behind this publication is to achieve a consistent approach within this area: if trading in securities is halted on one exchange, trading should also be discontinued on other exchanges. Within this context, one of the key aspects is that trading should be halted by the exchange which initially listed the securities and which regularly has the highest turnover. Furthermore, the competent listing authorities will be responsible for requesting issuers to inform other exchanges on which they are additionally listed as soon as trading in the issuer's securities has been halted.

In the case of market closure, e.g. that implemented on 11 September 2001 by the US Securities Exchange Commission (SEC), the IOSCO recommends that market operators and regulators have adequate arrangements so that they can communicate with each other effectively, with the express purpose of taking appropriate decisions in as timely a manner as possible.

IOSCO compiles market report on short selling.

Following the events of 11 September 2001, so-called "short selling" has become a hotly debated topic. The IOSCO is currently working on a

<sup>7</sup> Analysts Project Team.

<sup>8</sup> Report on Trading Halts and Market Closures.

report<sup>9</sup> that is to provide further details about short selling. The report will outline the main operators within this area, in addition to discussing specific regulatory aspects and the call for greater transparency as regards such transactions.

### 3.1.2 Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (BCBS), was established by the central-bank Governors of the Group of Ten (G-10) countries at the end of 1974. The Committee, whose Secretariat is provided by the Bank for International Settlements, is responsible for formulating broad supervisory standards and guidelines within the area of banking supervision. The BCBS is also committed to promoting collaboration between the respective national regulatory bodies. The standards promulgated by the Basel Committee on Banking Supervision have also been endorsed by numerous countries outside the G-10.

Since 1999, one of the key objectives of the Basel Committee on Banking Supervision has been to establish a new capital adequacy framework, specifying minimum requirements to be fulfilled by credit institutions with regard to risk management (New Basel Capital Accord, also referred to as "Basel II"). The New Accord is to consist of three pillars, which are to provide the foundation for a stable international financial system.

The main issue discussed in Germany with regard to Basel II relates to so-called credit risks and operational risks within banking book assets (Pillar 1: Minimum Capital Requirements). In addition, the newly revised version of Basel II contains a set of principles regarding the supervision of credit institutions (Pillar 2: Supervisory Review Process – SRP), as well as disclosure requirements aimed at strengthening market discipline (Pillar 3: Market Discipline).

New Basel Capital Accord with concessions for SMEs.

In the year under review, a major breakthrough was achieved with regard to banks and savings banks that offer loans to small- and medium-sized enterprises (SMEs). In recognition of the different risks associated with SME borrowers, this segment is to be subject to special requirements. In accordance with the new provisions, credit institutions with SME exposures may apply retail standards with lower capital requirements. Loans of up to one million euros may be classified as retail business with a lower capital requirement. Within this context, the total exposure of a banking group to an individual SME is to be seen as the basis of calculation.

Credit institutions with long-term loans to SMEs may not have to incorporate maturity adjustments.

Under the IRB approach (internal ratings-based approach), credit institutions with corporate lending activities (loans to larger enterprises with annual sales of up to €50 million) may receive a lower capital requirement of between ten and twenty per cent. Moreover, risk weighting for long-term exposures has been modified. In future, under the so-called advanced IRB approach there will be an option of exempting smaller domestic firms, defined as those with consolidated sales and consolidated assets of less than €500 million, from the requirement to incorporate maturity adjustments in the case of corporate lending. The maturity framework does not apply to the area of retail lending.

<sup>9</sup> Transparency in short selling.

Table 3

**Capital requirements – today and in the future**

Probability of default	Capital requirements for exposures in the area of ...				
	Currently	According to future Basel II-regulations			... retail lending
		... corporate lending			
		sales of less than €50m	sales of €20m	sales of €5m €	
		in %			
0.03	8	1.2	1.0	0.9	0.4
0.7		6.7	5.8	5.4	3.6
1		7.8	6.7	6.2	4.2
2		10.2	8.7	8.0	5.5
3		11.6	10.0	9.2	6.2

Under the IRB approaches, the risk weights for residential mortgage exposures have been reduced from 50% to 40%. In addition, a new IRB risk-weight curve has been created specifically for the treatment of unsecured revolving retail exposures, e.g. for a range of credit card transactions.

Operational risk is to be covered by capital.

The Basel Committee on Banking Supervision has also reaffirmed its intention to proceed with a Pillar One approach to operational risk, i.e. the incorporation of a capital requirement. Against the background of substantial progress made within the area of operational risk analysis, the BCBS has decided to offer credit institutions significant flexibility in the development of operational risk measurement and management systems when applying the AMA (Advanced Measurement Approaches). The Committee intends to work closely with the industry and monitor its progress in regard to operational risk approaches.

**New approach to calculating overall capital**

Based on the results of prior impact surveys conducted by the Committee, one of the main concerns identified with regard to capital requirements relates to the potential gap between the capital required under the foundation and advanced IRB approaches. Therefore, the Basel Committee on Banking Supervision has decided to adjust its regulatory parameters in order to narrow the gap between the respective approaches.

The average maturity assumption in the foundation approach will be modified from 3 years to 2.5 years, and the majority of the supervisory loss-given-default (LGD) values in the foundation IRB approach will be reduced by five percentage points, e.g. from 50% to 45% in the case of senior unsecured exposures. These adjustments will be combined with offsetting changes to the IRB risk-weight function for corporate lending.

Furthermore, under the new approach there will be a single capital floor for the first two years following implementation of Basel II at the end of 2006, aimed at safeguarding the capital base. This floor will be based on calculations using the rules of the existing Accord (Basel I). In the first year following the implementation of Basel II, IRB capital requirements for credit risk together with operational risk capital charges must not fall below 90% of the current minimum required. In the second year, the minimum will be 80% of this level. Should problems emerge during this period, the floor will be kept in place beyond 2008 if necessary.

An impact study has revealed substantial benefits to banks operating in the retail sector, including those serving SMEs.

In the fourth quarter of 2002, the Basel Committee on Banking Supervision launched its Third Quantitative Impact Study (QIS 3) in order to gauge the impact of the Basel II proposals on minimum capital requirements before finalising its consultative paper containing all the key parameters. In Germany the study included a number of regional banks, as well as credit institutions with international operations. Based on a preliminary assessment of the QIS 3 results, the objective of reducing the overall impact on SMEs has been achieved. The adjustments to Basel II have led to a palpable reduction in capital requirements of banks operating in the retail segment, which includes loans to SMEs.

### **Supervisory standards for cross-border banking**

In the year under review, the “Working Group on Cross-Border Banking” developed a number of supervisory standards for cross-border banking services. The Working Group published reports on “shell banks”, i.e. banks with no physical presence in the country in which they are incorporated and licensed, and so-called “booking offices”. It also compiled a report on “parallel-owned banking structures”. In these cases, the main objective is to distinguish between legitimate structures and those which are of a dubious nature, thus jeopardising cross-border supervision. At the same time, the Committee decided to review the document on “The Supervision of Cross-Border Banking”, originally published in 1996. As a result, global standards governing the supervision of international banking groups as well as the relationship between home-country and host-country supervision are to be realigned to take into account current market conditions. Within this context, cooperation is deemed immensely important in the case of subsidiaries and branches which, due to their size, are considered to be of particular significance in the host country, irrespective of whether this degree of influence also applies to an entity's parent in the home country.

#### **3.1.3 IAIS**

Established in 1994, the International Association of Insurance Supervisors (IAIS) represents more than 160 insurance supervisory authorities, as well as approximately 70 professional bodies as so-called observer members. The main objectives of the IAIS are to promote cooperation among insurance regulators, to set international standards for insurance supervision, to coordinate work with regulators in the other financial sectors and international financial institutions, and to provide training to members.

Although the papers compiled by the IAIS are not legally binding, members are advised to adhere to or incorporate these recommendations within their national legislation. IAIS publications are of particular importance to assessments conducted by the International Monetary Fund (IMF) and the World Bank, who use principles and standards defined by the IAIS as a basis for their work. For instance, the Financial Sector Assessment Program, which is a joint project established by the IMF and the World Bank, assesses the observance of relevant financial sector standards and identifies the strengths and vulnerabilities of a country's financial system. The

rationale behind this approach is to pinpoint supervisory shortcomings and structural deficiencies within the financial sectors, with the express purpose of maintaining or enhancing the stability of the international financial system. As a result, the onus is on member states, including Germany, to observe the standards and principles outlined in IAIS papers and to incorporate them within the national legislation insofar as this is feasible.

In the year under review, the IAIS published two official papers of major importance. One of these publications explored the risks associated with electronic commerce<sup>10</sup>. The rapid emergence of electronic commerce, particularly via the Internet, has created a number of new risks to insurance undertakings. The IAIS document outlines potential risks, e.g. strategic risks and transaction risks, and provides insurance supervisory authorities with a general guideline on how to identify these risks.

IAIS calls for supervision of all reinsurers.

In addition, the IAIS adopted principles regarding the reinsurance sector<sup>11</sup>, thus calling for the supervision of all reinsurers and defining minimum requirements to be fulfilled within this area. The principles identify elements of a supervisory framework that are common to primary insurers and reinsurers, such as licensing, fit and proper testing, and on-site inspection. In addition, the IAIS has endorsed the introduction of principles tailored specifically to the field of reinsurance supervision.

### 3.1.4 FATF

Established in 1989, the Financial Action Task Force on Money Laundering (FATF) is the foremost international body responsible for combating money laundering and the financing of terrorism. It is housed at the headquarters of the Organisation for Economic Co-operation and Development (OECD). The FATF has more than 31 members. In mid-2002, the Federal Republic of Germany took over the FATF Presidency for the period of one year. The position of President of the FATF is held by the President of the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin), Germany.

Committed to addressing issues of particular importance, the FATF is currently revising its Forty Recommendations. The Recommendations were originally drawn up in 1990 and represent a basic framework for anti-money laundering efforts. This project is to be completed by June 2003, i.e. before Germany's FATF Presidency comes to an end. In the year under review, the FATF – in association with the International Monetary Fund (IMF) and the World Bank – agreed on a common methodology to assess compliance with the FATF Recommendations for the world's anti-money laundering systems.

Moreover, the FATF drew up guidance notes for the eight "Special Recommendations on Terrorist Financing", originally published in 2001. The Task Force also sent a self-assessment questionnaire to non-FATF

<sup>10</sup> Risks to Insurers posed by Electronic Commerce.

<sup>11</sup> Principles on the Minimum Requirements for the Supervision of Reinsurers.

members in order to gauge the level of compliance with these “Special Recommendations”. The aim is to ensure that FATF measures are implemented on an international scale, thus combating the abuse of the world's financial systems by terrorist organisations.

### 3.1.5 Other groups

#### Financial Stability Forum (FSF)

Established in 1999 by the Finance Ministers and Central Bank Governors of the G7 countries, the Financial Stability Forum is committed to promoting international financial stability through information exchange and international co-operation in financial supervision and surveillance. The Forum convenes on a regular basis, bringing together representatives from treasury departments, central banks, and supervisory authorities, including members of BaFin.

In the year under review, the FSF focused on risks associated with the reinsurance market and the impact of such risks on banks and the economy in general. In a joint effort, the FSF and the IAIS established the Task Force on Enhancing Transparency and Disclosure in the Reinsurance Sector, which is incorporated within the IAIS structure. The Task Force is responsible for putting forward recommendations to improve transparency within the reinsurance market and to establish a more risk-oriented reporting and disclosure system among major reinsurers. Some of the key issues relate to disclosure requirements for corporate activities among reinsurers, as well as their business relationships with primary insurers and banks; the Task Force is also focusing on the issue of risk indicators. Rather than establishing a completely new system of reporting and disclosure, Germany is in favour of using data provided by insurers' risk reports.

#### OECD Insurance Committee

The first body devoted to insurance issues was created in 1955. Twice a year, the Insurance Committee brings together representatives from 30 member countries. Convening in Paris (France), the Insurance Committee is committed to promoting international cooperation in the insurance field with a view to improving the functioning of insurance markets and encouraging countries to adopt policies for promoting international trade in insurance. The Insurance Committee's activities are built around four areas: liberalisation of insurance markets, financial solvency, cooperation within the areas of primary insurance and reinsurance, and analysis of regulatory and structural developments.

In 2002, the Insurance Committee put forward a draft version of governance principles for insurance companies<sup>12</sup>. The 16 Principles focus on the structure, duties, and responsibilities of companies' executive and Supervisory Boards. They also establish standards for the activities of actuaries and auditors. The issue of shareholder rights and influence is also addressed. The final version of these Principles is to be published by 2004.

<sup>12</sup> Principles of Insurance Companies Governance.

In addition, the OECD has been given the mandate to investigate the economic effects of terrorist attacks. It has already compiled a report outlining solutions for insurers in Australia, Germany, the Netherlands, the United Kingdom, and the United States who offer coverage for terrorism-related activities.

### **OECD Horizontal Health Project**

The OECD analyses the operation and performance of private health insurance systems.

As part of the OECD Horizontal Health Project, BaFin provided information on Germany's private health insurance system. Several working groups have been appointed to conduct the OECD project, which is aimed at analysing the operation and performance of health insurance systems in member countries. This analysis will extend to both public and private health insurance. As part of the first phase of this project, the working groups prepared a range of questionnaires in order to gain an insight into existing regulations as well as private insurance products on offer in the member countries.

### **International Network of Pension Regulators and Supervisors (INPRS)**

The INPRS was established with a view to promoting best practices and principles for the supervision of private pensions.

Established in 2001, the International Network of Pension Regulators and Supervisors (INPRS) brings together representatives from national supervisory and regulatory authorities responsible for the area of private pensions. The INPRS is comparable to the IAIS, which is responsible for international insurance supervision. It is responsible for developing principles and best practices for supervision within the area of private pensions, e.g. standards relating to the licensing of pension funds, technical provisions, and investments. The International Network is also in charge of preparing pension-related statistics using a wide range of data to be compiled by a special Task Force.

## **3.2 European cooperation**

In 2000, European heads of state and government leaders agreed on implementing an action plan aimed at developing a single financial market by the year 2005. An integrated European securities market is to be achieved by the end of 2003. In its Seventh Progress Report the European Commission announced that sustained progress had been made in adopting new legislation since the previous report. Several draft Directives were put forward, and some proposals – e.g. the Market Abuse Directive – were approved and adopted in the year under review. Based on these accomplishments, the European Commission remains firmly committed to stepping up its efforts within this area. The "Financial Markets Section" established as part of Germany's Permanent Representation at the EU is also made up of BaFin staff, who are responsible for making a committed contribution to European legislation by providing professional input within the area of financial supervision.

### 3.2.1 Regulations and Directives

#### IAS Regulation

EU Regulation on the application of International Accounting Standards adopted.

In July 2002, the European Parliament and the Council of the European Union adopted a Regulation on the application of International Accounting Standards (IAS). In accordance with this Regulation, from 2005 onwards the accounting standards established by the International Accounting Standards Board (IASB) are to be applied to the consolidated financial statements of all exchange-listed companies within the EU.

Supported by this Regulation, the IAS can now be incorporated directly within EU legislation by means of the so-called comitology procedure<sup>13</sup>. Within this context, the Commission will submit its detailed proposal to the Accounting Regulatory Committee (ARC), which is composed of representatives from Member States. In addition, the European Financial Reporting Advisory Group (EFRAG) will provide the Commission with expert advice on issues related to the implementation of IAS.

#### Modernising Directive

Appropriate accounting standards also envisaged for smaller companies.

In the year under review, the Commission endorsed the Proposal for a Directive amending the Fourth and Seventh Council Directives on annual and consolidated accounts, as well as the Directives on accounts and consolidated accounts of banks and insurance undertakings. As part of this proposal, non-listed companies, particularly SMEs, who prepare their financial statements in line with European legislation, are to be included within an appropriate framework of accounting standards. In order to implement this proposal, specific differences between EU accounting legislation and International Accounting Standards will have to be eliminated. This is to be achieved by means of "options" granted to Member States. The Directive is expected to be adopted by mid-2003, following a full debate by the European Parliament.

#### Market Abuse Directive

The Directive of the European Parliament and of the Council on insider dealing and market manipulation (Market Abuse Directive) was adopted on 3 December 2002. In addition to addressing the issue of market manipulation and insider dealing, the Directive also focuses on ad-hoc disclosure requirements. Whereas European legislation already contained statutory requirements on ad-hoc disclosure and insider dealing, pan-European regulations governing market manipulation represent a new feature within the EU's legal framework. The implementing provisions for this framework directive (Level 2 of the comitology procedure) are currently being discussed by the Commission, based on recommendations put forward by the Committee of European Securities Regulators (CESR). They are likely to be adopted at the beginning of 2004.

<sup>13</sup> cf. 3.2.2 for details on the comitology procedure.

### UCITS Directive

EU Directive relating to undertakings for collective investment in transferable securities.

On 13 February 2002, two Directives<sup>14</sup> relating to harmonised unit trusts/common funds (Undertakings for Collective Investment in Transferable Securities – UCITS) came into force. The first Directive, amending the previous Council Directive 85/611/EEC, is aimed at harmonising money-market and index funds, as well as fund-of-fund and derivative instruments; it also defines limits previously specified for securities-based funds which are now also to be applied to other types of collective investment undertakings.

The second Directive within this area focuses on providing a harmonised framework for management companies. Thus, the European Union has established harmonised provisions regarding the authorisation of operators within this field, including requirements in connection with qualifications and internal control mechanisms. In addition, the regulations contain details regarding initial capital and the obligation to review specific requirements to take account of market developments. In line with the new provisions, the scope of activities which management companies may perform has been extended. For instance, they may now be authorised to engage in the management of portfolios for private and institutional investors, and they may also offer non-core services such as investment advice and safekeeping in relation to units of collective investment undertakings. In addition, the Directive clearly specifies that activities may be outsourced. The rationale behind this approach is to harmonise European outsourcing regulations within the financial investment sector. As a complement to the full prospectus, the Directive has also introduced a so-called simplified prospectus, designed to provide investors with key information in a clear, concise, and easily understandable way. Finally, the Directive is also aimed at promoting cross-border investment services by introducing a so-called EU passport for management companies.

The new Directives are to be incorporated into German legislation by August 2003 and are to be applied from February 2004 onwards.

Member States are obliged to adopt the laws, regulations, and administrative provisions necessary for them to comply with the Directives by 13 August 2003. The measures must be applied from February 2004 onwards; the process of implementing the Directives commenced in 2002.

### Prospectus Directive

In May 2001, the European Commission put forward a proposal for a Directive on prospectuses which are to be published when securities are offered to investors and/or when they are to be admitted to trading on exchanges. This Directive also envisages the introduction of a “single passport for issuers”. This means that once approved by the authority in one Member State, a prospectus would then have to be accepted everywhere else in the EU. This new approach is designed to assist European companies in raising capital. In order to ensure investor protection, approval will only be granted if prospectuses meet

<sup>14</sup> Directive 2001/107/EC as well as Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

common EU standards for what information must be disclosed and how. In November 2002, the Council reached a political agreement regarding the Directive on prospectuses.

### **Directive concerning institutions for occupational retirement provision**

In November 2002, the Council adopted a Common Position with a view to adopting a directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision. The Directive is aimed at establishing a European supervisory framework for institutions operating on a funded basis and established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity.

Planned Directive on pension funds will apply to institutions for occupational retirement provision and, optionally, to life insurance undertakings.

The above-mentioned Common Position outlines the key elements of the proposal put forward by the Commission. The Directive is to be applied to institutions for occupational retirement provision and – optionally – to direct life insurance undertakings, referred to within the EU as direct life assurance (Articles 2 and 4), however not to social security schemes. Other key elements of the Directive relate to the conditions of operation of such institutions (Article 9), information to be given to members and beneficiaries (Article 11), technical provisions (Article 15), investment rules, management and custody, as well as cross-border activities. In addition, the Directive outlines the terms of cooperation between Member States and the Commission (Article 21).

In November 2002, the Common Position was presented to the European Parliament for a second reading. The Directive concerning the activities and supervision of institutions for occupational retirement provision is expected to be adopted by the European Council in mid-May 2003.

### **Investment Services Directive**

In November 2002, the EU Commission published its proposal for an amended Directive on investment services and regulated markets. The new Directive will constitute an integral part of Europe's single financial market. The new Investment Services Directive is to include specific provisions relating to so-called "Alternative Trading Systems". Moreover, "investment advice" is to be recognised as a core ISD service, and transparency rules are to be introduced with regard to internalised client orders. The new Directive is expected to be adopted in 2004 at the earliest.

### **Reinsurance Directive**

The EU Insurance Committee (IC) is a regulatory and legislative policy body bringing together representatives of European governments and supervisory authorities. In addition to acting as a forum for the exchange of opinions and information among Member States, the IC discusses European standards aimed at harmonising insurance supervision within the European Union.

In 1998, the Insurance Committee set up a "Reinsurance Subcommittee", responsible for examining the full range of aspects related to the preparation on an EU directive within the area of reinsurance. At the same time, these bodies are responsible for carrying out simulations and calculations in order to determine appropriate levels of solvency within the reinsurance sector. One of the prime objectives is to enhance the level of protection for policyholders and to introduce the principle of "supervision by the country of origin". Harmonisation of the disparate supervisory systems will pave the way for a single market.

EU Directive planned for reinsurance supervision.

The draft version of the new Directive is to be put forward at the end of 2003. In order to speed up the process, the Directive is to contain many of the provisions already specified for primary insurers – with pertinent adjustments. Furthermore, the new Directive is to contain standards that go beyond the supervisory framework currently deployed in Germany. Advanced regulatory solutions, such as the inclusion of risk models, are to be taken into consideration once the Solvency II project has been concluded.

### **Directive concerning environmental liability**

Proposal for environmental liability Directive is based on "polluter pays" principle.

On 21 February 2002, the European Commission put forward a proposal for a Directive on environmental liability with regard to the prevention and remedying of environmental damage. The proposed Directive is based on the so-called "polluter pays" principle, whereby the operator who has caused the environmental damage or who is faced with an imminent threat of such damage occurring must ultimately bear the cost associated with restorative measures. Under the Directive, private parties are not given a right of compensation for any economic loss sustained in consequence of environmental damage or of an imminent threat of such damage. The proposal does not encompass a new form of compulsory insurance. The European Commission favours an approach whereby Member States are to decide whether compulsory insurance is deemed necessary.

### **Directive on insurance mediation**

The Directive of the European Parliament and of the Council of December 2002 on insurance mediation is to be incorporated into German legislation by 15 January 2005. The new EU Directive specifies a set of minimum requirements to be fulfilled by insurance intermediaries as regards the provision and disclosure of information. Furthermore, insurance intermediaries are obliged to hold professional indemnity insurance and must be able to prove that they meet the minimum requirements regarding professional qualifications if they are to be registered with a competent authority.

### **Directive on financial conglomerates**

The Directive on financial conglomerates will be in force by 2005.

On 20 November 2002, the European Parliament adopted the Directive<sup>15</sup> on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglom-

<sup>15</sup> Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

merate. The Directive is aimed at enhancing the stability of the financial system and improving the level of protection for individual depositors, insurance policyholders, and investors. The main focus is on solvency supervision: for the first time, solvency is to be assessed on a group basis. As a consequence, multiple gearing of own funds, an approach currently often used between banks and insurers within the same group, is to be eliminated completely. Moreover, the Directive specifies the scope of responsibilities of the supervisory authorities.

Member States are obliged to bring into force the laws, regulations, and administrative provisions necessary to comply with this Directive within a period of 18 months. The provisions will apply to the supervision of accounts for the financial year beginning on 1 January 2005 or during that calendar year. In Germany, the amalgamation of the three formerly independent supervisory offices to create the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) represents a major step forward in terms of compliance with the new directive.

### **Directive concerning the distance marketing of consumer financial services**

The Directive concerning the distance marketing of consumer financial services was adopted in September 2002 and is to be incorporated into the national legislation of Member States by 9 October 2002. The object of the Directive is to approximate the laws, regulations, and administrative provisions of the Member States by addressing the issue of consumer protection and defining legal standards with regard to the marketing of credit card contracts or units in collective investment undertakings, either by telephone, facsimile, or the Internet. The Directive also prohibits marketing activities that are deemed unfair, i.e. those forcing a consumer to consent to services offered on an unsolicited basis. Furthermore, consumers must receive full information prior to concluding a contract; they also have the right to cancel a contract within a specified period.

### **3.2.2 CESR**

The Committee of European Securities Regulators (CESR) was established by the European Commission decision of June 2001, as an independent committee and the successor to the Forum of European Securities Commissions (FESCO). The CESR brings together representatives of national public authorities competent in the field of securities, with the express purpose of exchanging information and developing supervisory standards for securities trading throughout the European Union. In addition, the CESR acts as an advisory group to assist the European Commission, particularly in its preparation of draft implementing measures in the field of securities (so-called comitology).

### **Comitology**

Comitology has been in place since 1987 and is aimed primarily at facilitating and speeding up the process of lawmaking. The Council or European Parliament is responsible for developing a proposal for a

Established as a formal EU committee, the CESR operates within the framework of the comitology procedure.

Directive or a Regulation (legislation). Subsequently, this proposal is discussed in depth by the respective committees (hence the term “comitology”), which consist of representatives from Member States. It then comes into force once Parliament or the Council have adopted it. The committees are also responsible for monitoring compliance with legal provisions. The procedure of comitology has been applied on several occasions, e.g. in connection with agricultural policy or health protection.

In 2000, the Council of Ministers appointed a group chaired by Baron Alexandre Lamfalussy, the former President of the European Monetary Institute, to instigate a procedure that would facilitate the completion of a single market for securities by 2003 and for the financial sector by 2005. One of the main objectives was to accelerate legislative processes. The result: a four-level process, based on the comitology framework and referred to as “the Lamfalussy Process”, as a tribute to the Chairman of the group.

### Expert Groups

The Committee of European Securities Regulators (CESR) has established various Expert Groups responsible for discussing specific topics in depth.

In the year under review, the CESR Expert Group on Market Abuse prepared a consultative paper detailing specific areas of interest within the Market Abuse Directive. This concept was published in July 2002 and debated within both the national and international arena; more than 100 official comments were received from interested parties throughout Europe. Towards the end of 2002, the CESR submitted the revised consultative paper to the Commission, which will discuss and define the exact wording for the specific issues raised by the CESR.

In October 2002, the CESR published a consultative paper compiled by the Expert Group on Prospectuses, addressing specific issues related to the future EU Directive within this area. A revised version of this paper was published in December.

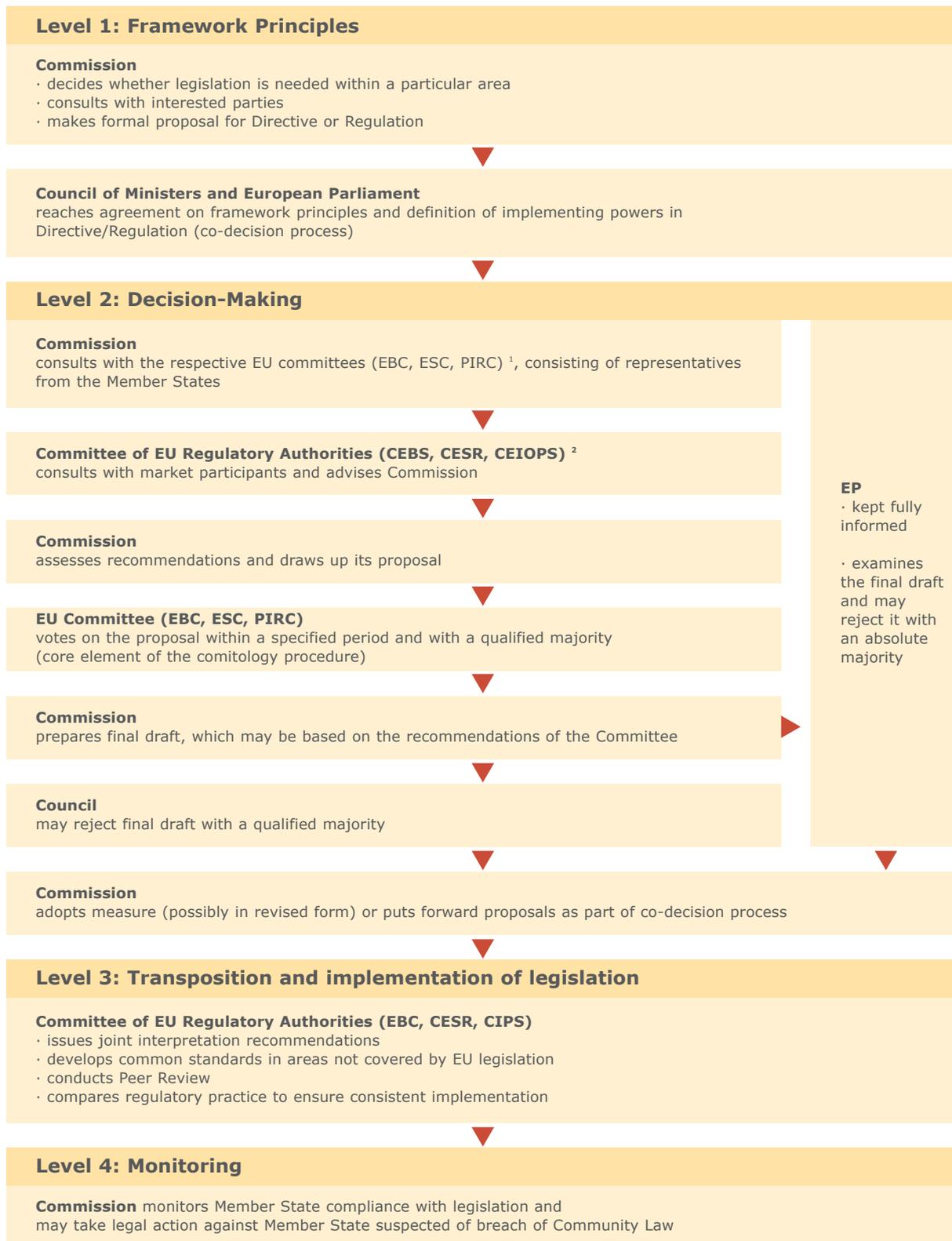
Within the area of investor protection, a CESR Expert Group discussed harmonised conduct-of-business rules for parties engaged in investment services. Within this context, the main focus was on the provision of pertinent consumer information, disclosure requirements, best execution, and standards to be fulfilled within the area of portfolio management.

CESR-Pol, a permanent CESR Expert Group that was established in 1999, is a forum in which senior officials of the respective European supervisory authorities are able to exchange confidential information related to enforcement. Following the terrorist attacks of 11 September 2001, the supervisory authorities within the European Union conducted in-depth investigations into suspected financing of terrorism via securities markets. CESR-Pol provided a basis for the efficient exchange of information between the competent authorities. The Group did not identify activities related to the financing of terrorism.

CESR-Fin, a permanent Group within the CESR, put forward proposals for a harmonised approach when it comes to monitoring compliance

Marginalie: CESR consultative paper on Market Abuse Directive.

Fig. 3

**Comitology**

<sup>1</sup> EBC: European Banking Committee; ESC: European Securities Committee  
PIRC: Pensions and Insurance Regulators Committee

<sup>2</sup> CEBS: Committee of European Banking Supervisors; CESR: Committee of European Supervisory Regulators  
CEIOPS: Committee of European Insurance and Occupational Pension Supervisors

with accounting standards throughout Europe. The Group conducted in-depth discussions within this area, which included official meetings held at a national and European level.

CESR develops framework for Alternative Trading Systems.

Based on the current Investment Services Directive, the CESR Expert Group on Alternative Trading Systems (ATs) developed a framework for the consistent treatment of so-called Multilateral Trading Facilities. In addition, a Group established by the CESR and the European Central Bank (ECB) will be responsible for developing common standards related to securities clearing and settlement systems. Other Groups discussed aspects related to the stability of securities issue, the enhancement of market transparency, as well as the development of investor protection within the area of portfolio management.

### 3.2.3 Other projects and groups

#### Brussels II project

CESR develops framework for Alternative Trading Systems.

The review of EU capital requirements for credit institutions (Brussels II project) continued in parallel with that of the Basel Committee on Banking Supervision. The Third Consultation Paper of the European Union will not be based on a separate impact study: data on credit institutions that do not operate internationally has already been compiled as part of the Basel impact study.

At the same time, the European Commission liaised with those affected by the new framework on capital requirements, including national and European banking associations, consumer protection groups, and trade associations representing small- and medium-sized enterprises. This dialogue was concluded at the end of January 2003 and will form the basis for the Commission's future activities within this area.

#### Solvency II project

In December 1998, a "Solvency Sub-committee" was set up by the Insurance Committee of the European Commission. One of the key objectives is to establish a new solvency system that is better matched to the true risks of an insurance undertaking. The analyses conducted by the sub-committee will form the basis for a future European Directive which addresses the issue of solvency.

A risk-based approach is needed in determining the solvency margin requirement for insurers.

In the year under review, the Committee discussed differences and similarities between the internal risk models deployed by various insurance undertakings; it also debated the impact of the Lamfalussy concept on European legislative procedures. In mid-2002, the consultancy KPMG presented its report – as prepared for the European Commission – regarding the solvency and risks of insurance undertakings. One of the conclusions of the KPMG report is that a risk-based approach is needed in determining the solvency margin requirement for insurers. In addition, two working groups set up by the Commission presented their final reports on technical provisions of life insurers and non-life insurers. The Committee discussed the reports in depth and gave market participants the opportunity to assess the conclusions outlined by these reports.

The European Commission is currently compiling a paper that will discuss the possible framework of a new solvency system. The next phases within this project are to be defined as part of a Project Management Paper. A draft directive is not expected until 2005 at the earliest.

### **Groupe de Contact**

Within the multilateral framework of the European Economic Area (EEA), Germany's Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) is a member of the Groupe de Contact (GdC). Established in 1972, the GdC allows members to exchange confidential information about credit institutions, with the express purpose of identifying potential crises among banks with pan-European operations. Furthermore, the exchange of information is also aimed at aligning the various supervisory approaches and activities, thus creating a level playing field within the banking sector.

In the year under review, the GdC focused on the so-called Supervisory Review Process (SRP), in line with the New Basel Capital Accord, i.e. the newly introduced ongoing supervision of credit institutions (second pillar of Basel II). The GdC agreed on a common approach to the new supervisory framework. Furthermore, the GdC contributed substantially to the future directive (Brussels II project), which specifies the transposition of Basel II into national law.

A sub-committee of the GdC discussed issues related to General Electric Capital, the financial subsidiary of US-based General Electric Company. Within this respect, the GdC acts as an interface between the New York State Banking Department and GE's banking activities in Europe. BaFin has held the chairmanship since November 2002.

### **Conference of EU Insurance Supervisors**

Within the area of insurance supervision, BaFin is a member of the Conference of EU Insurance Supervisors, which brings together the insurance supervisory authorities of all EU Member States, as well as those of Norway, Iceland, and Liechtenstein as signatories to the EEA Agreement. The Conference first convened in 1957. In 2002, it mainly focused on issues related to the Solvency II project, pension funds, the liquidation and internal control of insurance undertakings, the Lamfalussy Process, as well as the performance of securities markets and the effects on the insurance sector. It also compiled reports on capital investments, unisex insurance policies and premiums, and suretyship insurance.

A special working group within the Conference of EU Insurance Supervisors is responsible for addressing issues related to the application of the Directive concerning insurance groups. At the same time, one of its key objectives is to establish a framework for efficient cooperation between the competent EU supervisory authorities. In order to ensure an effective and comprehensive exchange of information regarding insurance groups operating on an international scale, the respective insurance supervisors were given the opportunity

to take part in so-called coordination meetings. The group also discussed to what extent Member States should be able to exempt specific insurance undertakings from supplementary supervision if such supervision is performed by another Member State.

### 3.3 Bilateral cooperation with supervisory authorities

International cooperation is of prime importance to BaFin's supervisory activities.

Committed to a concerted approach within the area of global financial supervision, Germany's Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) has established a comprehensive network of contacts and agreements. Bilateral agreements between BaFin and foreign regulatory authorities form the basis for so-called Memoranda of Understanding (MoU)<sup>16</sup>, which are designed to facilitate the exchange of information and extend BaFin's scope of supervisory influence in other countries. The supervisory bodies discuss general issues and exchange pertinent information as part of bilateral meetings held on a regular basis. Approximately fifty meetings of this kind were convened over the course of 2002. In addition, the respective directorates within BaFin liaised directly with their foreign counterparts in order to address issues of particular importance within their area of expertise.

Indeed, the host of cross-border investigations into insider dealing bears testimony to the importance of international cooperation among supervisory and regulatory authorities. In 89 cases, BaFin requested assistance from foreign supervisory authorities in connection with investigations into insider dealing. In turn, it received 18 requests from foreign supervisory authorities.

### Integration of applicant countries from Eastern Europe

BaFin is a member of the EFSSAC, a group responsible for assessing progress made by EU applicant countries within the area of financial services supervision.

BaFin is a member of the Working Group on Effective Financial Services Supervision in Accession Countries (EFSSAC). The Group conducts peer reviews in order to assess the extent to which applicant countries from Eastern Europe have implemented the EU framework for financial services supervision; it also pinpoints measures that have yet to be executed. In the year under review, the applicant countries submitted action plans to be reviewed and evaluated by the EFSSAC. In view of the accession of applicant countries in 2004, the Group plays a pivotal role within the European Union. Particularly when one considers that applicant countries will be joining most of the banking supervisory bodies as early as 2003, in the capacity of observers.

BaFin is well positioned when it comes to cooperating with applicant countries. In fact, the banking supervisory authorities of Estonia, Latvia, Lithuania, Slovakia, Slovenia, the Czech Republic, and Hungary have already signed Memoranda of Understanding (MoU). Furthermore, negotiations are currently being conducted with the National Bank of Poland (NBP) as regards possible forms of cooperation. Malta and Cyprus have also been approached.

<sup>16</sup> cf. Appendix 8 for a list of MoU signed with other countries.

An insight into the mechanisms of established regulatory and supervisory systems is of great benefit to countries whose financial markets and supervisory systems are still in a nascent state. Committed to honing their skills, representatives of the supervisory authorities of the Czech Republic and Poland took part in special training programmes spanning periods of several weeks and months, the main focus being on BaFin directorate of securities supervision/asset management.

BaFin also acts as a professional advisor to applicant countries within the area of insurance supervision. In 2002, a member of BaFin participated in several peer reviews in Lithuania and Bulgaria, as part of the Expert Group on "Effective Financial Supervision in Applicant Countries" set up by the European Commission.

BaFin also advises applicant countries within the field of insurance supervision.

Furthermore, BaFin established bilateral contacts with countries such as Poland, Hungary, the Czech Republic, and Slovakia. In the year under review, BaFin also took part in an international conference in Kazakhstan and organised an Eastern European seminar in Berlin covering the topic of third-party motor vehicle liability insurance. BaFin's scope of activities also included the coordination of consulting services for the Hungarian insurance supervisory authority as part of a European Union project. Within this context, provided professional advice on how to conduct on-site investigations. Moreover, discussed the implementation of the Directive on insurance groups as well as the processing of consumer complaints. As part of a consulting project with Gesellschaft für technische Zusammenarbeit (GTZ), BaFin also took part in an evaluation of the Macedonian proposal for legislation governing insurance supervision.

# III Supervision of credit institutions

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## 1 Solvency supervision

### 1.1 Basis of supervision

#### 1.1.1 Amendments to the Banking Act

#### **Implementation of Basel Supervisory Principles in the KWG**

With the help of the Fourth Financial Market Promotion Act (Viertes Finanzmarktförderungsgesetz – 4th FMFG), the legislature has now concluded the implementation of the twenty-five Core Principles for Effective Banking Supervision drawn up by the Basel Committee on Banking Supervision.

Loans to managers and governing bodies may only be granted at market conditions; credit institutions must put in place suitable systems to guard against money laundering.

Additionally, a number of changes were made to the Banking Act (Kreditwesengesetz – KWG). For instance, credit institutions may only grant management and governing body loans (Section 15 KWG) on the basis of prevailing market conditions. Furthermore, the Federal Financial Supervisory Authority (Bundesanstalt für

Finanzdienstleistungsaufsicht – BaFin) may set upper limits on such loans, and any amounts in excess of these limits must be secured by liability capital. Credit and financial services institutions must also observe the special organisational requirements of Section 25a (1) KWG, and a credit institution is now also obliged to install commercial and client-related systems to combat money laundering and fraudulent acts against themselves (Section 25a (1) no. 4 KWG). If necessary, BaFin may also order that suitable mechanisms are put in place (Section 25a (1) sentence 2 KWG).

If a foreign bank applies for a German licence on behalf of a subsidiary, BaFin will refuse to grant the licence if the competent home country supervisory authority does not consent to it.

The legislature has also broadened its definition of the circumstances under which BaFin may refuse to grant a licence for the operation of banking or financial service businesses. From now on BaFin will seek the consent of the competent foreign supervisory authority in the home country when foreign credit institutions apply for a banking licence for a German subsidiary to operate in Germany. If this consent is not forthcoming, the licence must be refused (Section 33 (1) no. 8 KWG).

According to the amended version of Section 44 (1) sentence 1 KWG, BaFin and the German Bundesbank (Deutsche Bundesbank – DB) possess comprehensive powers to demand information and the submission of documents not only from the institutions under their supervision and the members of their governing bodies but also from all employees of the bank or financial services provider in question.

### Regulating electronic money

“The issue and management of electronic money” embraces the previous fields of e-purse (Geldkarte) business and network money business.

The 4th FMFG also provides for the incorporation of the EU Directives on electronic money into national law. Via Section 1 (1) sentence 2 point 11 KWG, the legislature has made the issue and management of electronic money a field of banking business. This new field of banking business embraces the previous fields of e-purse (Geldkarte) business and network money business. Electronic money is defined as value units existing in the form of claims against the issuing e-money institution; e-money is stored on electronic storage media and is accepted by third parties as legal tender. Furthermore, Section 22a KWG provides for the redeemability of electronic money required by the EU, whereby a holder of electronic money can demand its redemption in cash or as a credit to an account provided the redeemable sum exceeds ten euros.

Special rules apply to e-money banks, for instance with respect to capital adequacy.

Electronic money institutions are subject to supervisory body control. However, they are also subject to a range of specific conditions. For instance, when commencing business they must be able to demonstrate initial capital of at least one million euros; additionally, when calculating the own funds to be held for current business, different parameters are applied than those for normal credit institutions (Section 33 (1) sentence 1 no. 1e and Section 10 (10) KWG). Finally, BaFin has the option of not applying particular supervisory rules, for example shareholder monitoring (the procedures governing who can and cannot become a shareholder – Anteilseignerkontrollverfahren), various duties of disclosure, and rules applying to capital. Until March 2003 neither was any e-money institution operating on the German market nor had BaFin received any applications for a corresponding licence. However, many German

deposit-taking credit institutions offer their customers a service of this kind. If electronic money institutions wish to operate across borders, the European passport guarantees access from one Member State to the market of another Member State.

### Shareholder controls

BaFin may forbid the acquisition of significant holdings if there are grounds to believe that the funds used for the acquisition stem from a criminal act.

To harmonise the rules of the KWG and VAG regarding shareholder controls, the 4th FMFG amends the provision of Section 2b KWG. In so doing, the legislature is reflecting the fact that both Acts are pursuing the same purpose, to wit the protection of the German financial marketplace from untrustworthy owners of insurance undertakings and credit institutions. At the same time the supervisory body now has the power to block the acquisition of significant holdings, referred to as “qualified participating interests”, if there are grounds for believing that the funds for the acquisition of the holding stem from a criminal act, thus reversing the usual burden of proof.

### Other amendments to the Banking Act

In order to simplify the current disclosure system and increase the informative value of the data gathered, the 4th FMFG also amends the rules for the disclosure of large exposures (Section 13 KWG) and loans of 1½ million euros or more (Section 14 KWG). Furthermore, it is now possible to make an enquiry to the Central Credit Register (Evidenzzentrale) regarding planned loans of less than 1½ million euros.

In the event of the outsourcing of significant parts of a credit institution BaFin may now investigate this company too.

BaFin powers to take measures against a credit institution and issue instructions to its management (Section 6 (3) KWG) have been extended to also apply to financial holding companies and their management. In the event of the outsourcing of significant parts of a credit institution, BaFin may now investigate this company too (Section 44 (1) and (2) KWG).

#### 1.1.2 Amendments to the Pfandbrief laws

##### New business opportunities for Pfandbrief institutions

Pfandbriefe (secured or covered bonds) may now also be secured against local authority loans in the USA, Canada, and Japan.

The 4th FMFG significantly extends Pfandbrief institutions' options for obtaining security as provided for in the Mortgage Bank Act (Hypothekbankgesetz – HBG) and the Act relating to Pfandbriefe and Similar Instruments issued by Public Credit Institutions (Gesetz über die Pfandbriefe und verwandten Schuldverschreibungen öffentlich-rechtlicher Kreditanstalten – ÖPG). Previously, only state loans to other European OECD full member states and also regional and local bodies in EEA countries were recognised as collateral. Now, local authority loans to the USA, Canada, and Japan and also their regional governments and local authorities have been added to the list. Furthermore, mortgage banks have now been permitted to make other transactions in relation to real estate and real estate financing. The purpose of the amendments to the HBG is to reinforce mortgage banks' profitability.

There is still insufficient experience regarding the acceptability of real estate loans as collateral in the USA, Canada, and Japan.

BaFin has made certain recommendations to accompany the legal reforms. As regards the issue of the acceptability as collateral of real estate loans in the above-mentioned countries, BaFin remains adamant that credit institutions should first gather sufficient experience in evaluating risks in these markets before a decision is made in this respect.

### The present value method for securing Pfandbriefe

Pfandbriefe now also have to be secured according to the present value method.

To enhance the security of Pfandbriefe, the HBG and ÖPG provide that, alongside the provision at all times of security according to the nominal value, they must now also be secured according to the present value method (Section 6 (1) HBG and Section 2 (1) ÖPG). Furthermore, derivatives will be given only limited recognition as covering assets (Section 6 (6) HBG and Section 2 (5) ÖPG). Details of the method for calculating present value may be prescribed by Regulation. The Federal Ministry of Finance (Bundesministerium für Finanzen – BMF) has transferred the power to issue administrative regulations to BaFin. The additional requirement of present-value security will contribute significantly to the strengthening of collateral assets and thus to the protection of Pfandbrief creditors.

The draft Regulation provides for three different ways of calculating the present value.

BaFin's draft Regulation sets out rules for the calculation of the present value and the simulation of interest and currency changes. As regards the simulations of interest changes, several methods are cited, as well as some rather conservative parameters designed to protect the Pfandbrief creditors' interests. The draft Regulation provides for three different approaches:

1. The simple approach involves the static parallel displacement of the interest curve either upwards (increasing interest rates) or downwards (decreasing interest rates).
2. The dynamic approach involves calculating the necessary level of safeguarding/security on the basis of past observations of interest rate changes plus a number of control parameters (observation period, level of confidence, and holding period). For each interest rate curve, base points are calculated for a set number of bond term bandwidths, and these determine the extent to which the interest rate curve is displaced upwards or downwards at these points.  
This approach represents a first step towards modern risk control of credit institutions, since open positions are not simply penalised arbitrarily. Instead, depending on the portfolio structure, an individual stress test is required.
3. Alternatively, credit institutions may have recourse to their own pre-existing risk models, provided BaFin has confirmed their suitability in writing. However, if these models do not match up to the requirements of the dynamic approach, they must be modified accordingly.

Where not already covered by the existing (if necessary modified) in-house risk model, the draft provides for two methods of currency risk simulation. Firstly, once again, a static approach laying down different premiums or discounts on the exchange rates for the various currencies, and secondly a dynamic approach whose parameters correspond to those of the approach used to determine the risk of interest rate changes.

### 1.1.3 Minimum requirements in relation to lending business

Increased write-downs are often attributable to organisational deficits in the area of lending business.

In 2002, BaFin had to confront a series of problems, including two cases of insolvency among credit institutions, all triggered by an increased level of write-downs. However, the flagging general economic situation is not the sole cause of the write-downs witnessed in the lending business sector. Indeed, organisational deficits within the institutions were also to blame.

To supplement the quantitative supervision rules, new qualitative rules will apply to credit business from now on.

In Circular 34/2002 (BA), dated 20 December 2002, BaFin published its "Minimum requirements for the credit business of credit institutions" (Mindestanforderungen an das Kreditgeschäft der Kreditinstitute – MaK) based on Section 25a (1) KWG. The MaKs supplement the hitherto primarily quantitative supervisory rules with qualitative requirements concentrating on the soundness of credit processes.

The MaKs came into force on publication, but their implementation will take place in two stages. During the first stage up until 30 June 2004, the MaKs will be implemented in the credit institutions, while the second stage gives the banks until 31 December 2005 to make the necessary adaptations to their computer systems. During these periods BaFin will take no action under banking supervisory law in the event of non-compliance with the above-mentioned MaKs. However, from 31 December 2003 onwards and in the two subsequent years, credit institutions' external auditors will be required to report separately on the state of implementation of the MaKs.

#### The design of the minimum requirements

The MaKs provide a framework within which each individual credit institution can itself structure its credit processes.

The new rules have been conceived as qualitative requirements. Accordingly, the MaKs simply provide a framework within which credit institutions can design their organisational and operational structures on their own responsibility. Since the structure, orientation, and extent of credit business varies greatly from institution to institution, the Circular contains numerous "escape clauses" (Öffnungsklauseln), also referred to as saving clauses, taking into account the actual size and commercial focus of the credit institution in question and also the degree of risk inherent in its credit business. Thus, BaFin has put in place the possibility of flexible implementation geared to credit institutions' individual situations.

The purpose of the MaKs is to increase risk awareness and the transparency of credit business. The key points include the development of a credit risk strategy and a robust organisational structure.

The principal purpose of the MaKs is to improve the quality of banks' internal processes. They aim to enhance risk awareness within banks and also to improve transparency. In light of the future Basel capital adequacy requirements (Basel II), the MaKs are neutral in terms of their choice of wording so that they can be applied by all credit institutions irrespective of whether they will be using the standardised approach or the advanced approach enshrined in Basel II. The Minimum Requirements offer banks the opportunity to undertake important preliminary work towards the implementation of the Basel II project. Among the key points here are the development of a credit risk strategy, the organisation of credit business in terms of structure (separation of functions) and process design, as well as risk classification procedures and rules governing credit risk controlling.

## Core principles

Before granting risk-relevant loans, a second opinion must always be obtained from a part of the bank not related to the market (back office).

The credit risk strategy should ensure that credit institutions put in place systematic and targeted procedures governing the granting of loans. After the process of granting a so-called risk-relevant loan has been initiated by the sales department (front office), before the final decision is made a second opinion must be obtained from a department which, right up to managerial level, is independent of the front office. Each institution may decide for itself, applying factual and objective criteria in line with the credit risk strategy, under what circumstances a loan transaction is risk-relevant. Objective processes must also be put in place regarding other credit business. However, in these cases a strict separation of functions may be dispensed with.

When monitoring loans, suitable procedures must be installed for the prompt identification of greater than average risk potential and for appropriate management of risk.

The risk classification procedure calls for systematic processes for the initial and also ad hoc assessment of the counterparty risk. No further terms of reference are laid down, and particularly not with regard to the future internal or external rating procedures provided for by Basel II.

Finally, BaFin notes the importance of procedures for the early identification of risks as well as for credit risk management and controlling. These procedures should ensure appropriate management of risk and the early identification of greater than average risk potential. Objective procedures for risk monitoring and limitation must also be in place. A credit institution's reporting systems must be designed in such a way as to ensure that management staff and the supervisory and Management Boards are kept continually informed, thus achieving the maximum possible degree of internal transparency.

The dialogue on the practical implementation of the MaKs will continue.

The dialogue that has been started concerning the practical implementation of the Circular is being continued in an MaK advisory committee. Under BaFin's direction, representatives from associations, the banking industry, auditing companies, and the German Bundesbank will work towards a basic understanding of the MaKs.

### 1.1.4. Exceptions from the Building and Loan Association Regulation

The restrictions relating to building and loan association investments in interim and bridging loans have been relaxed. However, exceptions are only permitted if the building and loan association maintains a simulation model for liquidity planning and control.

Section 1 of the Building and Loan Association Regulation (Bausparkassenverordnung – BspkV) restricts investments in interim and bridging loans in order to prevent excessively lengthy investment of the money available to the saver in the interim. In a letter dated 12 March 2002 the former Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen – BAKred) authorised the relaxing of this provision in light of the possibility of exemption provided for in Section 1 (4) BspkV. This allows for exemptions if the building and loan association uses a simulation model for liquidity planning and control purposes. The model must satisfy the following requirements:

- The model's structure, procedures, assumptions, and parameters must be set out in a memorandum;
- there must be a security buffer that increases with the duration of the forecast;
- the simulation results must be evaluated (quality assurance); and
- the model must be assessed by an auditor.

The first building and loan association applications for exemptions have now been approved by BaFin.

## 1.2 Statistical data

At the end of the year under review, BaFin was supervising 2,521 credit institutions with 50,867 branches. Of these, 12,667 branches belonged to Deutsche Postbank AG alone.

Table 4

Credit Institutions by type of institution	Number
Credit banks (in the sense of complex groups)	73
of which: <i>Land banks</i>	12
Savings banks	520
Cooperative banks	1,480
Branches of foreign banks	89
Mortgage banks and ship mortgage banks	23
Building and loan associations	28
Credit institutions with special functions	12
Other private, regional, and guarantee banks	132
Housing enterprises with savings facilities	41
Investment companies	81
Securities trading banks	42
<b>Total</b>	<b>2,521</b>

During the year under review, BaFin granted banking licences to 22 credit institutions, including one investment company. In total, 29 licences expired (excluding mergers of savings banks and credit cooperatives, as well as the discontinuation of banking business by mixed-activity credit cooperatives).

Table 5

### Breaches of supervisory law and sanctions imposed

Type of institution	Serious objections	Sanctions		
		against management personal	Fines	in case of danger (pursuant to Section 46 KGW)
Foreign banks and complex groups	3	2	0	0
Other private banks	15	1	0	2
Savings banks	38	4	0	0
Cooperative banks	268	49	0	2
Mortgage banks	6	0	0	0
Building and loan associations	3	0	0	0
Credit institutions with special functions	0	0	0	0
<b>Total</b>	<b>333</b>	<b>56</b>	<b>0</b>	<b>4</b>

The number of serious objections filed in relation to credit institutions rose slightly from 290 cases in 2001 to 333 cases in 2002. The great majority of the objections filed by BaFin were due to breaches of the

Banking Act (Kreditwesengesetz – KWG) or other supervisory regulations (268) once again related to the cooperative sector.

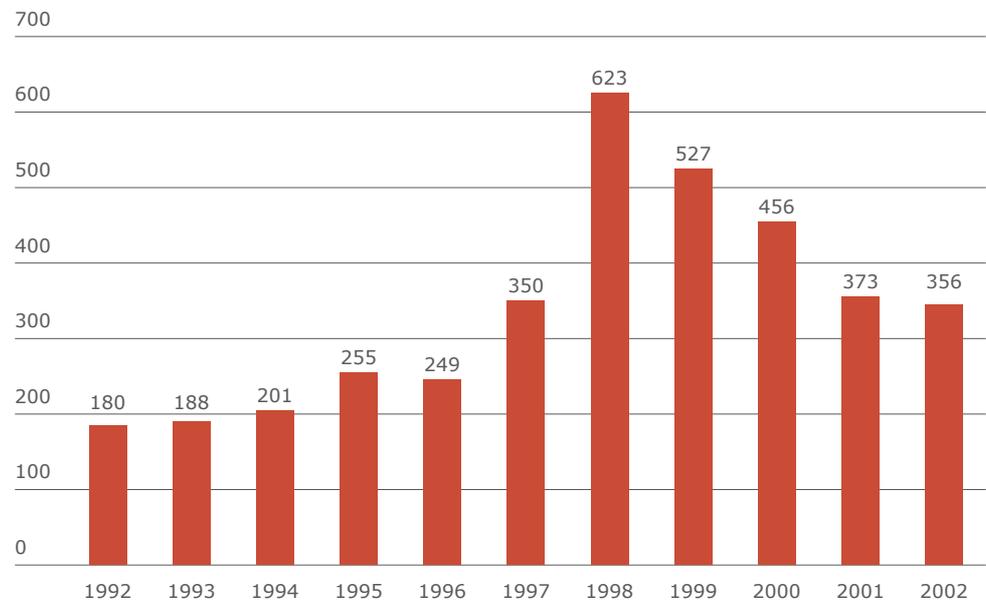
In 56 cases BaFin took action against management personnel.

In 56 cases the serious objections filed by BaFin led to sanctions against the management of credit institutions. These included warnings and, in particularly severe cases, the dismissal of managers.

Pursuant to Section 44 (1) KWG, BaFin is entitled, with or without any special reason, to subject supervised institutions to special audits, either carried out by BaFin or commissioned by it, in order to gain a better insight into the financial state of affairs of the institution in question. During the past year 356 special audits were ordered. These audits paid particular attention to the institutions' lending business, the appropriateness of its organisation, and the suitability of its risk management. Furthermore, in the case of five mortgage banks, audits were conducted as regards the security available for their covered mortgage bonds (Hypothekenpfandbriefe) and covered public bonds (Öffentliche Pfandbriefe).

Fig. 4

#### Audits pursuant to Section 44 KWG



BaFin normally appoints auditing companies for its special audits. However, in the field of risk models, unauthorised financial services business, and money laundering, teams from the German Bundesbank and BaFin perform the audits.

#### European passport

In 2002, five German credit institutions issued seven notices of the establishment of branches in other Member States of the EU or EEA, and there were 22 notices relating to the exercise of the freedom to provide services. BaFin also received five notices from foreign supervisory authorities concerning the establishment of branches in

Germany by credit institutions with their registered offices in other EU/EEA Member States, as well as 25 notices in exercise of the freedom to provide services.

At the end of 2002, 1,176 (2001: 953) investment services enterprises (also referred to as investment firms), i.e. both banking and financial services institutions, were operating in Germany, either via branches or via cross-border activities conducted by an enterprise with its registered office in another EEA Member State. These 1,176 enterprises are only subject to limited supervision by BaFin in accordance with Section 53b (3) and (4) KWG, being primarily subject to country-of-origin supervision. These credit institutions originate from 16 European countries, and more than two thirds of them are from the United Kingdom.

### 1.3 Financial situation

In 2002, the German banking industry was struggling against the backdrop of strained economic conditions and enduring structural problems. Against the background of a weak global economy and in some cases major collapses within the financial markets, increasing unemployment, and record numbers of corporate bankruptcies (37,579 in 2002 as against 32,278 in 2001), the poor profitability of the entire German banking industry significantly worsened in the period under review.

The fall in net interest income continued almost unabated in 2002.

On the earnings side, the gradual decline in net interest income continued. Owing to the weak economy and the national budget deficit, the demand for credit fell in both the private and public sectors. Meanwhile, interest income also came under pressure due to the decline in corporate loans in favour of bond financing and also the continuing low interest margins connected with increasingly fierce competition. On top of this, the downgrading of major banks by rating agencies led to higher refinancing costs.

In contrast, more retail-oriented credit institutions were able to prop up their low interest income thanks to rises in low-interest deposits made in response to the increasing uncertainty within the financial markets.

Net commission income also fell last year.

Net commission income also fell significantly last year, albeit from a very high level, due to lower revenues generated on the stock exchanges and a sharp drop in services related to mergers, takeovers, and initial public offerings (IPOs). The decline in net commission income was particularly noticeable in the case of major banks operating in the investment field.

The bottom line continues to be dominated by net interest income.

The proportion of net commission income in relation to total profit from operations was around 32% in the case of major banks, as opposed to 18% for savings banks and credit cooperatives. With an average of around 70%, net interest income continues to represent the most important source of income for all credit institutions. This average ranges from approx. 60% among major banks to around 80% in terms of savings banks.

High fixed costs affect profitability. Last year this was exacerbated by high expenditure on risk provisions.

On the cost side, credit institutions' profitability was hit by high staff costs and climbing administrative expenses, including large blocks of fixed costs. Risk provisions for losses on loans also rose sharply in all types of credit institution. In addition, write-downs to market value on participation interests and securities holdings, i.e. impairments, had to be greatly increased as a direct result of the stock market slump, thus eating into credit institutions' hidden reserves and in some cases even their other reserves. On top of this, real estate transactions proved particularly unprofitable for savings banks, cooperative banks, and mortgage banks, especially in the new Bundesländer, i.e. former East Germany.

Credit institutions responded to the difficult economic situation by initiated consolidation and rationalisation programmes. By international standards, German banks' cost-income ratios are very high, and to improve them, the credit institutions implemented massive job cuts and slimmed down their branch networks, as well as outsourcing certain activities or shelving planned IT investments.

The major banks are aiming to improve their profitability by concentrating on strategically important lines of business and on profitable clients.

The major banks have been concentrating on strategically important lines of business. Other areas which do not qualify as core activities are either experiencing sharp cutbacks or being discontinued altogether. In addition, considerable hidden reserves have been realised. In the search for better returns, the major banks are also now devoting themselves to the in-depth analysis of their client relationships, focusing specifically on their profitability. In the past, this area had not received a great deal of attention, but once the sector's profitability began to deteriorate it was soon found that flaws and shortcomings in the underlying calculation methods had in some cases led to loss-making client relationships.

Savings banks and cooperative banks took the opportunity to engage in cost-reducing mergers.

Despite turbulence on the financial markets and ratings downgrades, there is no threat to the banking sector's existence.

All in all, circumstances have become significantly more difficult for the German banking industry. Nevertheless, in BaFin's view there is no question of a banking crisis. Despite the turbulence on the financial markets and downgrades of individual major banks by international rating agencies, there is no sign of any threat to the existence either of the banking sector or individual parts thereof. Although German banks' capital ratios are traditionally low by international standards, with the exception of a few company restructuring cases both their equity ratios and their core capital ratios are above the minimum required under supervisory law.

The restructuring measures undertaken should improve credit institutions' profitability.

BaFin expects the wide-ranging restructuring measures undertaken to have a positive effect on credit institutions' earnings and profitability. Increased risk orientation when granting loans plus improved risk control should make a decisive contribution to the stabilisation of the banking industry. However, in the short term BaFin is expecting continuing severe pressure on bank profitability due to high risk provision requirements, write-downs on investments, and unrelentingly fierce competition.

## 1.4 Ongoing solvency supervision

### 1.4.1 Complex groups

In 2002, BaFin carried out a total of 31 special audits at 22 of the 73 credit banks classified as complex banking groups.

The special audits focused on lending business as well as internal risk management and controlling procedures.

The audits focused on lending business, the extent of risk provisions, and also the internal organisation, with special reference to procedures within the credit institutions. The rationale behind this emphasis on processes is that well-organised and efficiently implemented internal risk management and controlling procedures enable credit institutions to identify problematic exposures at an early stage and ensure that they can be handled with suitable sensitivity by the bank's management before they lead to significant losses.

In the course of the special audits and evaluation of the reports on the annual financial statements, BaFin identified a series of infringements of varying gravity against the Banking Act. Three serious objections had to be filed, in two cases including formal censures of the management.

Through its ongoing supervision activities, BaFin aims to assess the risks inherent in credit institutions' major exposures as early as possible.

In the course of the ongoing supervision process BaFin directed a range of enquiries of highly diverse content at credit institutions. This enabled BaFin to gather comprehensive and up-to-date information about the extent, nature, term, and unsecured portion of specific loans and also about the security furnished and its valuation. Enquiries were also made about the extent of any risk provisions in relation to loan exposures and also the assessment of the state of affairs of the borrower, particularly in cases where it became clear that the borrower was experiencing financial difficulties. Within this context, BaFin's prime objective is to be able to assess risks to which individual credit institutions are exposed as early as possible in order to take suitable countermeasures.

Some credit institutions underestimate the danger of concentrating risk in their lending business.

As a result of its audits and enquires BaFin was able to establish that, during the year under review, some credit institutions failed to take adequate account of the concentration of risk in their lending business. Every institution today has in place the necessary organisational mechanisms for internal risk management, and in 2002 not a single institution was in breach of relevant legal provisions, for instance the rules governing large exposures (Section 13 KWG). However, the risks inherent in such exposures do appear on some recent occasions to have been underestimated. BaFin is working to counteract this state of affairs via qualitative-preventative supervisory measures.

### Kirch exposures

Since the beginning of 2002, BaFin has paid increased attention to German banks' loan exposures to the Kirch Group. In an initial step, questions on the matter were directed to the banks; subsequently the main focus of the annual financial statement audit was defined for banks with Kirch exposures. In view of the fact that the evaluation of audit reports left some questions unanswered, BaFin instructed auditors to conduct a special audit.

The special audit of Kirch exposures focused on such matters as the impairment levels of the collateral furnished, the adequacy of the risk provisions, and the appropriateness of the loan granting procedures.

The audits focused on the banks most heavily affected by the Kirch Group's problems, banks whose exposures made up a good 85% of the loans from German credit institutions to the Kirch Group. BaFin instructed the special auditors to pay particular attention to impairment levels of the collateral furnished, the adequacy of risk provisions, and the appropriateness of the loan granting procedures in the various credit institutions. Contrary to initial expectations, some credit institutions were forced to significantly increase their risk provisions. Additionally, in several cases the audit prompted non-official objections due to shortcomings in the lending business.

#### 1.4.2 Land banks (Landesbanken)

After the ruling by the European Court of Justice, deposits by a Bundesland in its own *Land* bank represent incompatible aid and must be repaid. However, further consultation is required regarding the extent of the aid.

In 2002, supervision over the 12 *Land* banks (Landesbanken) and DekaBank Deutsche Kommunalbank, the central institution of the savings bank system, was influenced by the strategic realignment undertaken by the savings banks. This process was initiated after the European Commission ruling on capital adequacy in relation to public banking institutions. The Commission has ruled that the method whereby a public "Förderbank" (a form of development bank, also referred to as a "promotional bank") invests in a *Land* bank involved in competitive banking business by means of an equity-increasing contribution in kind represents incompatible aid, and as such violates European competition law. At the beginning of 2003 the European Court of Justice ruled that the incompatible aid should in principle be repaid. However, the question of the extent of the aid provided remains open, given that the statement drawn up by the Commission was based on calculated returns found to be implausible by the European Court of Justice.

In response to the above, in 2002 some Bundesländer (German states within the federal system) amended their *Land* bank legislation and either modified their guarantee and maintenance obligations or abandoned them altogether. To date, the *Land* banks have developed two different models:

1. The first model involves splitting the *Land* bank into one institution which exclusively operates the development business and chiefly refinances itself through the issue of debt securities and a second institution (generally in the legal form of an Aktiengesellschaft) which operates as a commercial bank. The development institution would remain a body governed by public law, but would no longer enjoy the protection of the guarantee and maintenance obligations. This model has been implemented by Landesbank NRW and WestLB AG. The new *Land* bank was duly granted the necessary banking licence.
2. The second model involves placing over the *Land* bank a privately-owned holding bank, which would at a later date be able to mobilise additional capital – beyond the financial resources available to previous shareholders –, thus ensuring a broader equity basis. This model has been implemented by Bayerische Landesbank.

Most *Land* banks have not yet completed the process of adapting to the new legal situation.

The other ten *Land* banks have not yet completed the process of adapting to the new legal situation. Instead of opting for one of the two models outlined above, it is conceivable that credit institutions could develop alternative models, which would then entail a need for further clarification of the position in supervisory law. Independent of the

reaction to the abolishment of the guarantee obligation, BaFin responded to the plans initiated at the end of last year to merge and privatise two *Land* banks by examining the question of how the Pfandbriefe issued by these institutions and currently in circulation should be treated.

In response to the findings of the audit reports on the annual financial statements and of the special audits thereupon ordered pursuant to Section 44 KWG, BaFin undertook a series of supervisory measures.

### 1.4.3 Savings banks

As a result of numerous mergers over the course of the year under review, the number of savings banks declined from 537 to 520.

The inadequate profitability of savings banks is marked by high risk provisions, write-downs, and lower net interest income.

Last year's unsatisfactory profitability in the savings bank sector continued unabated. Risk provisions on lending business had to be increased, in some cases dramatically, and write-downs on securities business were also necessary. Meanwhile, net interest income continued to fall, and credit institutions were unable to compensate for this decline via their net commission income. The savings banks have attempted to reduce costs through mergers and outsourcing, thus improving profitability.

The audits focused on lending business, trading business, and internal auditing.

During the year under review, BaFin audited 71 savings banks pursuant to Section 44 KWG. The audits focused on lending business, concentrating here on particularly high-risk fields, to wit loans to enterprises in the housing and real estate sector and also the construction industry, as well as loans which had not been investigated in the course of the audits of the annual financial statements. Further key points addressed by the audits were the savings banks' organisational structures, the minimum requirements for the trading activities and for the internal audit function of credit institutions, the management of interest rate risks, as well as information technology and the overall running of the bank.

BaFin formally warned four Management Board members pursuant to Section 36 (2) KWG. In six cases the audit procedure had not been completed by the end of 2002. 38 cases led to severe censure and on several occasions management personnel had to resign after the evaluation of a special audit or annual financial statement audit report showed that they were professionally unsuitable.

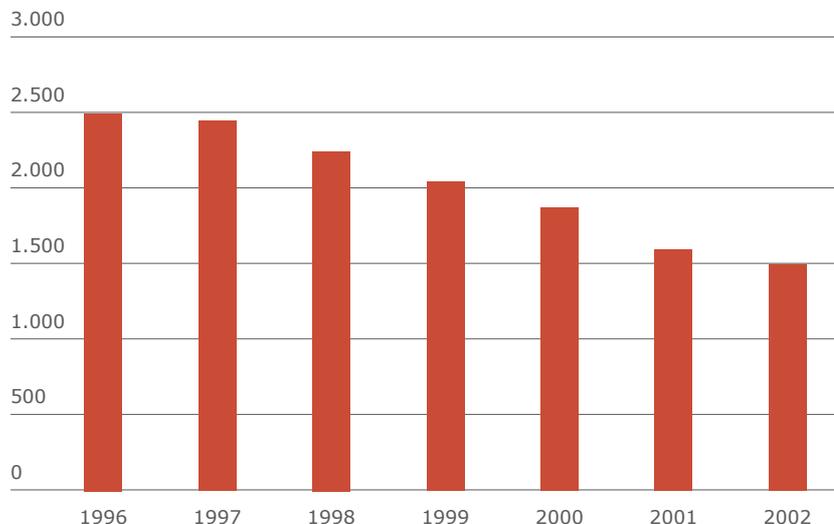
### 1.4.4 Cooperative banks

2002 was a difficult year for the entire banking industry. The cooperative banks reacted by implementing the "concerted approach" originally initiated in 1999. The visible sign of this strategy was the high rate of mergers witnessed in the year under review: of the 1,627 banks in existence at the beginning of the year just 1,480 remained by the end.

The profitability of banking groups is to be increased by larger operational units, outsourcing, and also a new universal control system for banks.

Larger operational units created by mergers lead to reduced costs, while also lessening the degree of competition among cooperative banking groups. Further streamlining potential can be leveraged by outsourcing tasks within the cooperative association. Meanwhile, the

Fig. 5  
**Number of cooperative banks**



implementation of the “VR-Control” universal bank control system is currently under way, and resultant improvements in commercial and risk management are aimed at improving the profitability of individual institutions.

Low revenues, substantial expenses, and increased risk provisions mean that the economic situation facing many credit institutions was far from satisfactory. Accordingly, BaFin is making greater efforts to ensure that critical and high-risk situations are promptly identified so that credit institutions can take suitable countermeasures at an early stage.

The cooperative auditing associations' reports on the audits of annual financial statements represent a major source of information. In view of the difficult economic situation, the supervisory authorities ordered audit reports on the great majority of banks organised on cooperative lines. Including preliminary audit reports, a total of 2,145 reports were submitted.

BaFin ordered general audits of 200 cooperative banks under a general audit mandate.

In 2002, BaFin also ordered seven special audits pursuant to Section 44 KWG in order to gain specific information about the situation at unsettled cooperative banks. Additionally, BaFin ordered general audits of 200 cooperative credit institutions under a general audit mandate. The credit institutions subjected to a general audit were selected at random. The audit investigated their lending business as well as the value of specific loan exposures. In cases where the auditors identified a need for additional risk provisions, the requirement was generally met from operating income. However, one credit institution had to seek assistance from the guarantee scheme.

Despite the falling numbers of cooperative banks, BaFin had to order more supervisory measures than the year before. Letters of severe censure were written to 268 cooperative banks, while BaFin issued warnings to 49 management personnel at 26 banks or demanded the dismissal of Management Board members.

### Management personnel

In view of the continuing large numbers of management personnel and the changes in Management Board structures occasioned by the various mergers, investigations into the professional suitability and reliability of managers in the cooperative sector are of particular importance. As required under the Banking Act, BaFin conducted numerous assessments as regards the suitability of new Management Board personnel at banks. Modern methods of risk management and control, the growing importance of innovative banking products, and ever-changing regulations within the area of supervisory law mean that ongoing training of Management Board members and senior managers is indispensable. BaFin is following with interest the efforts being made by the cooperative sector, especially as regards the introduction of the "VR Control" universal bank control system.

### The cooperative guarantee scheme

After a number of restructuring cases, contributions to the credit cooperative's guarantee scheme have been increased, and a risk-oriented contribution system has been introduced.

In 2002, the cooperative guarantee scheme had to deal with several restructuring cases, and as a result contributions will have to be increased in 2003. A classification system is to be introduced throughout the cooperative sector in order to reduce the cost of risks. Thus, financial difficulties at individual institutions could be identified at an early stage, allowing effective countermeasures to be taken. In December the meeting of members of the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), the central organisation of the German cooperative banking group, voted to introduce the classification system, and in March 2003 the credit institutions also decided to introduce a graduated contributions scale based on the results of the classification.

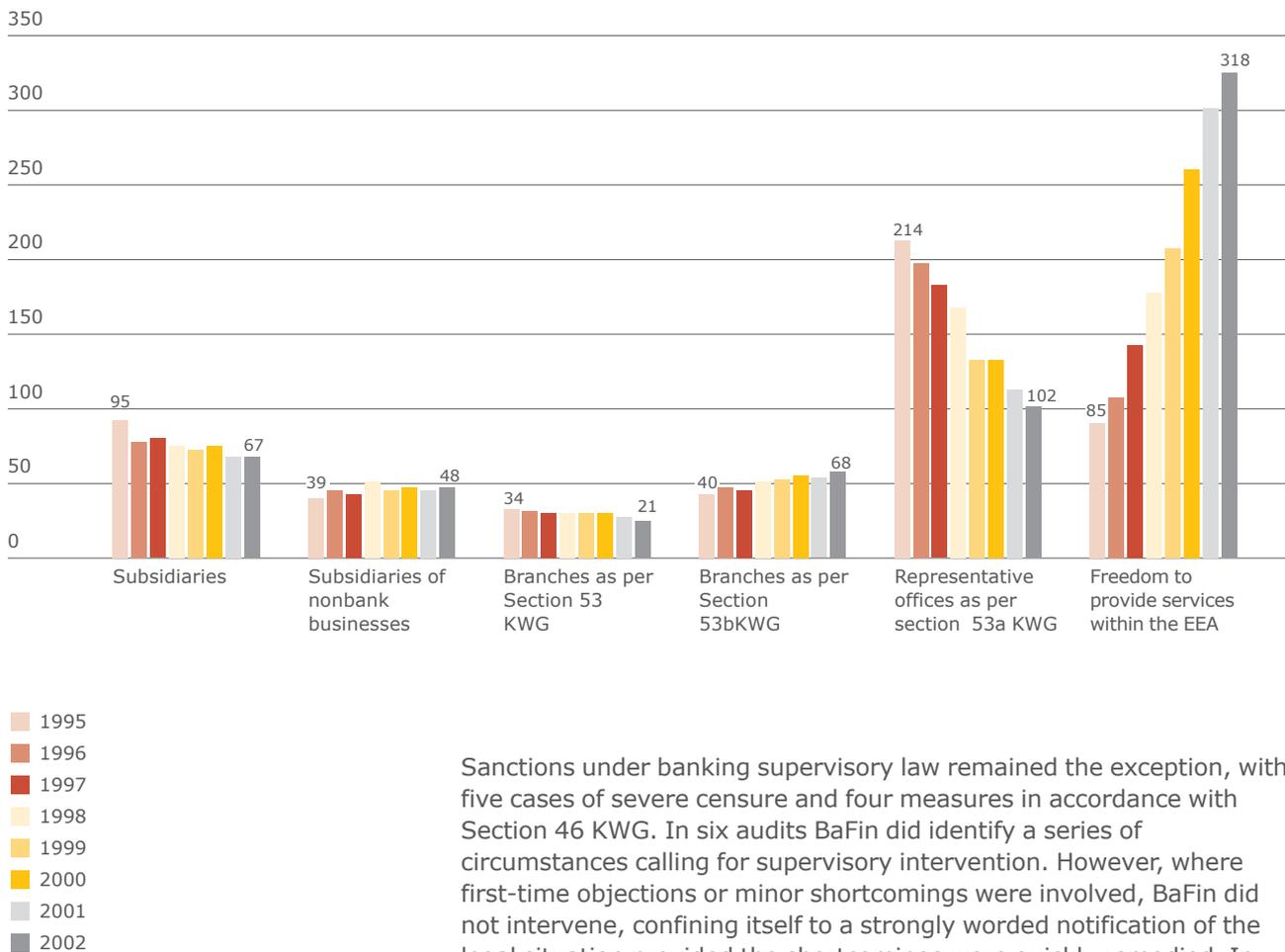
#### 1.4.5 Foreign banks

Overall, 2002 also proved to be a year of mixed fortunes for foreign banks. Whereas some banks suffered losses of revenue – in some cases severe – due to the weakness of the German economy and the German stock market malaise, other foreign banks suffered little or no ill effects since their business was more strongly aligned to the economies of their home countries.

The number of foreign banks operating in Germany has hardly changed at all in recent years.

The number of foreign banks trading in German as at 31 December 2002 was virtually unchanged, at 89 as opposed to 88 the previous year. However, there was a fall in the proportion of foreign banks whose core line of business was traditional "foreign bank business", i.e. financing imports and exports with their home countries. This was offset, though, by increased takeovers of German credit institutions, a strategy facilitated by Germany's weak domestic economy. Meanwhile, BaFin also granted banking licences to a number of subsidiaries of foreign investors, though the final decision on some of the applications received during 2002 was delayed until 2003. Once again, the number of representative offices fell. In contrast, numbers of notifications (also referred to as "reports") by providers of cross-border services from EEA Member States rose.

Fig. 6

**Foreign banks operating in Germany**

Sanctions under banking supervisory law remained the exception, with five cases of severe censure and four measures in accordance with Section 46 KWG. In six audits BaFin did identify a series of circumstances calling for supervisory intervention. However, where first-time objections or minor shortcomings were involved, BaFin did not intervene, confining itself to a strongly worded notification of the legal situation provided the shortcomings were quickly remedied. In addition, in some cases impending action by BaFin was averted by personnel changes at management level. In the case of one institution with a long history of commercial difficulties BaFin did not need to withdraw the banking licence since the shareholder was expressly notified of the legal situation and responded by winding up the bank. Particularly in this case BaFin's close rapport with foreign supervisory authorities paid off. In one other case prompt intervention by BaFin succeeded in preventing the insolvency of a foreign financial services group from having unbridled repercussions for their German operation, thus allowing this institution to be wound up in a controlled manner.

Regular discussions and on-site visits by BaFin promote the efficient solution of banking supervision problems.

Regular communications with banks' Management Boards and Supervisory Boards as well as visits to their premises by BaFin staff promote the rapid and efficient solution of supervisory problems. Particularly important here is notification of intended appointments of management personnel. Where candidates do not fulfil the statutory quality requirements, a prophylactic warning from BaFin is more efficient than a formal dismissal procedure.

### 1.4.6 Other private, regional, and special banks

The highly heterogeneous group of 132 private, regional, and special banks experienced extremely varied business in the year under review. Although a few credit institutions succeeded in registering healthy figures despite the poor economic climate, the majority of banks had to struggle with severe earnings-related problems. The strategies employed to increase income were as varied as the credit institutions themselves. Whereas the automobile banks extended their range of services, other banks reduced their lending business and concentrated on investment business with wealthier private clients.

The special audits chiefly focused on lending business.

In response to poor profitability, which in some cases gave cause for concern, BaFin ordered 18 special audits focusing on lending business in order to identify hidden risks early and demand the allocation of adequate risk provisions. A further focal point of the audits was on the implementation of the special organisational obligations of a credit institution (Section 25a KWG). In one case severe breaches of these obligations led to supervisory sanctions being taken against the management personnel of the bank involved.

Once again ongoing supervision gave special attention to the many outsourcing projects under way. BaFin has placed great stress on compliance with the provisions of Circular 11/2001 on Section 25a (2) KWG, which laid down precise guidelines governing the outsourcing of business.

Within the framework of shareholder monitoring, BaFin has the authority to bar the acquisition of major bank holdings if the purchaser does not meet the requirements for the reliable running of a credit institution.

During the year under review, the general consolidation process continued as numerous credit institutions were taken over. BaFin's shareholder monitoring activities to assess the reliability of the purchasers found that, alongside some solid establishments, some of the interested parties were attempting via a takeover to obtain a banking licence that they would not have been granted through the standard licensing procedure. In these cases BaFin did not allow the acquisition due to the fact that the potential shareholders failed to meet the requirements for the sound and prudent running of such an institution. Should the holder of a qualified participation interest in a bank prove unreliable at a later date, BaFin has the power to prevent the party in question from exercising the voting rights in relation to this holding. Although such measures did not have to be taken during the year under review, a series of potential purchasers did abandon their plans to acquire holdings after the initiation of ownership assessments.

Gontard & Metallbank was a victim of its imbalanced commercial policies geared towards the Neuer Markt.

One victim of imbalanced policies geared towards the Neuer Markt segment of the stock exchange was Gontard & Metallbank AG. The bank had already encountered economic difficulties in 2001. After restructuring attempts proved unsuccessful and a new shareholder could not be found, in May 2002 BaFin had to impose a moratorium on the bank before initiating insolvency proceedings soon afterwards.

BaFin had to withdraw BkmU Bank's banking licence due to numerous violations of bank supervisory rules.

Another bank that had to close was BkmU Bank AG of Berlin. Initially, the former BAKred withdrew BkmU's banking licence in spring 2001 due to numerous violations against bank supervisory regulations. Then in May 2002 BaFin stepped in and ordered the discontinuation of all monetary transactions since the bank had suffered massive losses within its lending business; BaFin has now initiated insolvency proceedings.

For the first time, investors in an insolvent bank only received the minimum statutory guarantee.

In 1998, the statutory deposit guarantees of deposit-taking credit institutions were transferred by Regulation pursuant to Section 7 of the Deposit Guarantee and Investor Compensation Act (Einlagen-sicherungs- und Anlegerentschädigungsgesetz – ESAEG) to the Compensation Scheme of German Banks (Entschädigungseinrichtung deutscher Banken – EdB). Having dealt with its first compensation case in 2001, the EdB was approached on two further occasions in the year under review. Owing to the lack of a supplementary guarantee scheme, for the first time, investors only received the guaranteed statutory minimum compensation of 20,000 euros, with a ten per cent retention<sup>17</sup>.

The Compensation Scheme stepped up its audits of member banks.

In 2002, the EdB stepped up its deposit guarantee audits of member banks. These comprehensive audits were carried out by Prüfungsverband deutscher Banken e.V. on behalf of the EdB. The audits focused on banks which did not belong to the supplementary private compensation scheme run by the Association of German Banks (Bundesverband deutscher Banken – BdB).

#### 1.4.7 Mortgage banks

At the end of the year, 21 mortgage banks and two ship mortgage banks were under BaFin's supervision. Here too the consolidation process continued, with the establishment of one new mortgage bank being offset by two mergers. Eurohypo Aktiengesellschaft Europäische Hypothekenbank der Deutschen Bank merged with RHEINHYP Rheinische Hypothekenbank AG to create Deutsche Hyp Deutsche Hypothekenbank Frankfurt-Hamburg AG. The new institution trades under the name Eurohypo AG, and is categorised as a mortgage bank with extended business activities, i.e. a mixed-activity mortgage bank. Furthermore, Schleswig-Holsteinische Landschaft Hypothekenbank AG merged with Deutsche Genossenschafts-Hypothekenbank AG.

The mortgage banks have suffered a significant decline in new business.

The mortgage banks have suffered a serious downturn in new business, with mortgage lending business falling by 17% and state lending business by 11.4%. Refinancing business underwent a decline of 4.7%, among other things because sales of unsecured debt securities dropped by no less than 33% as a result of a significant widening of spreads.

Faced with an increasing squeeze on profits, some credit institutions have taken on additional risks.

Pressure on profits has increased among the mortgage banks. Statutory restrictions on business operations have now induced many credit institutions to take on additional risks or to penetrate niche markets in order to generate additional income. A few credit institutions have brought income forward at the expense of future periods. Accordingly, the future prospects of some institutions are being jeopardised in the interest of short-term gains. If such activities exceed a certain level and become contrary to principles of good business practice, BaFin will step in and take suitable regulatory action.

<sup>17</sup> cf. BAKred 2000 Annual Report, Chapter IV, for general information on deposit guarantees.

Interest rate risks are being closely monitored.

As in previous years BaFin is paying close attention to the interest rate risks incurred by mortgage banks. Almost without exception, the key figures reported were within prescribed limits. However, BaFin is aware that the true interest rate risk to which a bank is exposed may be downplayed via skilful positioning vis-à-vis individual loan terms.

Investments in high-interest bonds are only permissible if the money invested is actually available rather than being borrowed for this purpose.

BaFin has identified a further increase in risks at a number of banks. To increase earnings, some mortgage banks have partially substituted their interest rate risk for counterparty risk, or have exposed themselves fully to this additional area of risk by investing funds in high-interest bonds. In some individual cases this has led to the establishment of significant positions in the field of so-called emerging market bonds, for instance ones issued by South American states. The acquisition of this kind of debt security is only permitted (cf. Section 5 (3) no. 3 HBG) if the funds invested in them are actually "available", rather than being borrowed for the purpose of buying the bonds. In at least one case a bank was demonstrably in breach of these provisions, and as a result BaFin took decisive action and issued a warning – including a general one to the Verband deutscher Hypothekenbanken (VDH) e.V. -, demanding compliance with the regulation. BaFin expressly welcomes the undertaking made by the association's member banks that in future they will only acquire securities with a certain minimum rating.

For the first time, a "pure" mortgage bank has been classified as a trading book institution.

A further issue addressed in the year under review was mortgage banks' status as trading book institutions. Some credit institutions were turning over parts of their positions with ever greater frequency and at relatively short intervals. BaFin views this practice as constituting trading activity within the meaning of Section 1 (12) no. 1 KWG. Accordingly, these banks should be deemed trading book institutions, which are thus required to secure the market price and counterparty risks they enter into against their own equity (Principle I). Previously, all mortgage banks with the exception of Bayerische Hypo- and Vereinsbank AG have classified themselves as non-trading book institutions. However, at BaFin's instigation one "pure" mortgage bank has now bindingly classified itself as a trading book institution in view of the holding period and turnover frequency of transactions and the resultant income generated. Where suitable grounds exist, BaFin will more closely monitor mortgage banks which continue to classify themselves as non-trading book institutions.

During the year under review, BaFin assessed the security held for mortgage Pfandbriefe and public Pfandbriefe at five banks, and in addition to this special audits pursuant to Section 44 KWG were carried out at six mortgage banks. The principal issues investigated were the adequacy of the risk provisions, the banks' current and future profitability, and also the management of their derivative transactions. BaFin registered a total of six cases of severe censure and took appropriate action.

### 1.4.8 Building and loan associations

In 2002, the number of building and loan associations fell from 29 to 28 due to the merger of Allianz Bauspar AG and Dresdner Bauspar AG. In total, 17 of these are private institutions and 11 are Land building and loan associations. Additionally, LBS Westdeutsche Landesbausparkasse was converted from a dependent department of a Land bank into an independent body under public law<sup>18</sup>.

Building and loan associations' new business benefited from the decline of the stock market.

Despite the weakening economy, new business at building and loan associations was surprisingly buoyant. This was because investors responded to the adverse stock market situation by putting money which would otherwise have been invested in shares and investment funds (i.e. unit trusts/covered funds) into building and loan association accounts and real estate. The banks' concerns about falling deposits in the wake of the introduction of the Riester pension have thus far proven groundless. In contrast, however, demand for interim and bridging loans has fallen. It should be noted, however, that the average share of savings and loan business in relation to overall business (investment ratio) remains below 50%.

Despite Germany's flood disaster, risk expenditure on home savings and loan business remained low. However, once again a number of risks from non-collective business, some of them significant, have materialised at some building and loan associations.

Building and loan associations are also attempting to reduce cost-related pressures. Alongside process optimisation and job cuts, outsourcing and the centralisation of specific functions are effective measures in this respect.

#### Individual savings schemes

Due to the low interest rates, building and loan associations have applied for a series of changes to their savings schemes.

Last year BaFin once again approved all the applications it received in relation to price structures of savings schemes offered by building and loan associations. Overall, it received two new product applications (new savings schemes) and 84 applications for product changes (altered savings schemes). In some cases the applications led to intensive discussions between BaFin and the institutions concerned. The desire for new or altered savings schemes related to the changing interest rate situation: building and loan associations are increasing their efforts to offer loans at attractively low interest rates in order to compete with mortgage offers from other sources. Naturally, the low loan interest rates have led to correspondingly low deposit interest rates, which are now hovering around the one per cent mark. However, for customers who do not want to take out a loan under a savings contract, products are available which offer nominal deposit interest rates of over four per cent. Also in increasing demand are products which combine particularly low loan interest rates with unusually short repayment periods. Currently BaFin is considering whether the approval process should be put on a new, more up-to-date basis, with the aim of taking building and loan association's individual operational factors more strongly into account than in the past.

<sup>18</sup> this body was already included in the figures when it was a dependent department, the conversion did not change the number of banks considered here.

The audits focused on risk control and risk management as well as the minimum requirements for trading activities.

In 2002, BaFin audited ten building and loan associations, and one institution was audited on the instigation of the deposit guarantee scheme. The audits focused on the rules governing the management, control, and monitoring of risks and also on the minimum requirements in relation to trading transactions. In three cases grounds were found for severe censure.

Problems with some individual building and loan associations' sales operations were brought to BaFin's attention through customer complaints. In future BaFin will devote greater efforts to ensure compliance with the provisions of the joint Declaration of Building Society Associations on the Reliability and Quality of Advice Offered by Sales Personnel of 18 September 1996.

#### 1.4.9 Credit institutions with special functions

There has been a trend towards the divestment or reorganisation of public development banks, which in some cases are legally dependent departments of Land banks.

At the end of 2002, BaFin was responsible for the supervision of 12 public or private credit institutions with special functions. BaFin has noted a trend towards the divestment or reorganisation of development banks (Förderbanken), which hitherto have often been legally dependent departments of Land banks. These credit institutions perform a structural policy role in furtherance of national economic interests, in pursuit of which they distribute funds to specific regions or economic sectors. As well as providing support for small- and medium-sized businesses, these funds are used to support residential building, agriculture, forestry, and environmental protection initiatives. In some cases these credit institutions also fulfil special functions in the interests of other banks and similar institutions. The public development banks either grant loans themselves or do so on behalf of a Bundesland or the federal government, as well as assuming liability and providing advice to the companies or organisations receiving the funds.

The development banks' trading volume has continued to grow but profitability has suffered.

Over the past year development banks' trading volume has continued to grow despite adverse economic trends. However, corporate bankruptcies, low interest rates, volatile stock markets, and write-downs on investments have led to falling profitability. Because the federal government and Länder have cut the funds available for economic aid, as in previous years credit institutions have become more reliant on partly or wholly self-financed programmes.

During the year under review, BaFin ordered special audits in accordance with Section 44 KWG at three development banks. The Compensation Scheme audited two credit institutions.

### 1.5 Market risk models

Credit institutions may not apply their own risk models until BaFin has given its consent.

Since the amendment of Principle I in 1998, as an alternative to standard procedure credit institutions may also use their own risk models. However, said models must first be approved by BaFin, and this calls for adequate on-site auditing. For both the credit institutions themselves and for BaFin these audits are of particular interest in terms of Basel II, since they already include significant elements of the future Supervisory Review Process (SRP) as regards the issue of market price risk.

By the end of last year the market risk models of 14 banks had been approved.

Last year one domestic bank's risk model was approved for supervisory purposes, increasing the total number of banks whose models have been approved to 14. At the end of 2002 another institution submitted its model to BaFin for approval. In conjunction with the German Bundesbank, BaFin performed on-site audits of two banks which had either extended their models or changed or adjusted their model methodology or modelling environment. Several risk model audits are planned for 2003, the majority of them dealing with the comparatively difficult subject of specific risk (risk from market-atypical price changes).

Personnel cuts must not be to the detriment of risk controlling processes.

Faced with poor profitability, many German banks have been forced to downsize their staff structures. However, much as BaFin appreciates the need for such measures, will ensure that the minimum standards required in the field of risk controlling are maintained.

The year 2002 was also marked by major market movements, albeit not as extreme as the movements in the wake of the terrorist attacks of 11 September 2001. During these turbulent times, the risk models have not merely proved themselves but have been impressive in their robust predictive quality.

The market fluctuations not factored into the models receded in 2002.

The adjustment of "add-on" factors has reduced the range of variation between different banks from 1.5 in 2001 to 1.0 in 2002 (cf. Table 6). This reduced the median<sup>19</sup> from 0.30 in 2001 to 0.25 in 2002. This means that for half of the credit institutions audited BaFin fixed the "add-on" factor at 0.25 or less; the market fluctuations not factored into the model had reduced.

Table 6

#### Risk models and factor ranges

Year	New applications	Withdrawn applications	Refusals	Number of banks operating own models	Minimum add-on factor	Maximum add-on factor	Median
1997	5	0	2	3	-	-	-
1998	15	2	4	9	0.1	2.0	1.45
1999	5	0	0	8	0.1	1.6	0.85
2000	2	0	0	10	0.0	1.6	0.30
2001	2	0	0	13	0.0	1.5	0.30
2002	1	0	0	14	0.0	1.0	0.25

In BaFin's opinion, there are still only four banks which have completed the development of a market risk model which includes all significant market risk factors (so-called "full use"), and even in these cases a number of minor corrections will be required. The other banks, where the risk models are only in partial use, have been urged by BaFin to implement full use as soon as possible. If BaFin has a well-founded suspicion that certain credit institutions are using partial models in the long term purely in order to gain advantages within the area of equity, the transition to full use may have to be implemented via supervisory action.

<sup>19</sup> The median is the 50% quantile of a distribution, i.e. 50% of the distribution is below the median and 50% above the median.

To date, the risk model audits have been performed by teams of the German Bundesbank, under BaFin's leadership. In accordance with the 2002 reforms of financial market supervision, BaFin will order the audits while the Bundesbank will as a rule both execute and head the audits. BaFin's own specialists will be involved in the audits, and in some individual cases will carry out the audits themselves. BaFin will back up the audits with regular visits to banks operating their own risk models in order to keep in close touch with the practical application of the models. BaFin is responsible for the final evaluation of the audit findings and for confirming the suitability of the risk model and setting the add-on factor.

## 2 Market supervision

### 2.1 Basis of supervision

The year 2002 saw a continuation of the adverse market trends of the previous year. Stock market slumps, corporate bankruptcies, and press reports of dubious practices by issuers all conspired to rock investor confidence. Accordingly, the supervisory authority must redouble its efforts to promote investors' trust in the market through effective consumer protection.

The cornerstones of the rules of conduct are the duties of disclosure and organisational duties.

Investor protection is based on the rules of conduct for investment services enterprises enshrined in the Securities Trading Act (Wertpapierhandelsgesetz – WpHG). The cornerstones of the rules of conduct are the duties of disclosure and organisational duties required of financial institutions. As far as disclosure is concerned, investors can only make independent, responsible investment decisions if they are given comprehensive information about the nature, risks, costs, and opportunities of an investment. On the organisational front, every institution must be well equipped in business terms for the proper and efficient provision of the services on offer. Furthermore, the issue of potential conflicts of interest must be properly addressed and regulated in order to ensure that contradictory goals within investment services enterprises are not resolved to the investor's disadvantage.

The WpHG's rules of conduct set minimum standards. BaFin's job is to monitor credit and financial service institutions' compliance with these standards.

#### 2.1.1 Amendments to the Securities Trading Act

##### New rules for the analysis of securities

The 4th FMFG added to the WpHG rules governing the analysis of securities. According to the new provisions, an investment services enterprise which makes available or publishes an analysis of securities must be underpinned by research carried out with the necessary professional expertise and conscientiousness. Conflicts of interest must be disclosed (Section 34b WpHG).

Shortly after the law came into force, discussions were held with banks and associations to clarify the terminology used in Section 34b WpHG.

After consultation with financial industry associations, BaFin prepared an Announcement, published in March 2003, on the central issues regarding the application of the provisions.

The means whereby analyses of securities are made public is irrelevant.

Securities analysis is an investigation of a security or its issuer which culminates in a recommended action, for instance "buy" or "hold". The means whereby the analysis is made public is irrelevant. Accordingly, such analyses include not only ones published in print or electronically but also public appearances in which securities are discussed, for example TV interviews with analysts. After all, private investors in particular attach considerable weight to such TV appearances. Moreover, an analysis of a security is also deemed to have been made if an institution includes third-party analyses in its research (secondary analysis) or if it adopts this analysis altogether without stating its source. However, neither recommendations of a security without any further comment, i.e. simply to "buy share X", nor recommendations relating to a particular regional or sectoral portfolio which do not name individual securities constitute securities analysis.

Examples of when the regulations require the disclosure of conflicts of interest.

The Announcement also answers questions in relation to the disclosure of conflicts of interest. The Act sets out a number of examples of when disclosure is required. Specifically, an investment services enterprise must disclose that

- it has an interest of one per cent or more in the share capital of the company whose securities are the subject of the analysis;
- it was a member of a syndicate underwriting the most recent issue of the company's securities which are the subject of the analysis;
- it has a contract with the issuer to manage their securities within the capital market.

There is also a duty of disclosure if a bank or financial service provider holds in its trading portfolio net short positions totalling one per cent or more of the share capital of the company or share being analysed. The investment services enterprise must further note other conflicts of interest, especially if it cannot guarantee the necessary confidentiality with respect to other parts of the company – for instance the credit, trading, or M&A departments – via organisational measures within the meaning of Section 33 (1) WpHG, e.g. in the form of so-called Chinese Walls.

### **Duties of disclosure in relation to financial futures transactions**

Consumers must be informed of the special risks of financial futures transactions.

The duty to provide information about financial futures transactions, hitherto regulated by the Stock Exchange Act, has now been redrafted and incorporated into the WpHG (Sections 37d to 37g). The content in terms of specific requirements to be observed is essentially the same: banks or financial services providers which conclude or arrange financial futures transactions must inform the consumer of the special risks associated with financial futures transactions, for instance that a loss may exceed the margin. However, in the case of commodity futures transactions there is no longer any such special requirement. The letter of notification may only contain information in relation to financial futures transactions and must be signed by the consumer. Said notification must be renewed after two years.

A new feature is the right to damages in case of violation of this duty to provide information.

The criterion of legal capacity to enter into a securities futures transaction now no longer applies. Previously, failure to meet this criterion rendered a transaction non-binding, but now the amended rules provide for a right to claim damages in case of breach of the duty to provide information. The investment services enterprise has the burden of proof for demonstrating whether a violation has occurred and also regarding the question of fault.

BaFin monitors compliance with the duty to provide information. The annual audit of compliance with the rules of conduct now includes the area of "provision of information" in relation to financial futures transactions.

### Rules of conduct

The duties to provide information and to provide adequate documentation have been broadened.

With a view to strengthening investor protection, the 4th FMFG of 1 July 2002 has in some respects broadened the rules of conduct. For instance, the number of persons and bodies required to provide BaFin with information has been increased in order to improve the information available for supervisory purposes. Previously, only investment services institutions and affiliated enterprises, plus their owners, directors and employees, were required to disclose information to BaFin. Now, however, all third parties called in to assist in the provision of services, for instance custodian banks, must provide information (Section 35 (1) sentence 1 WpHG). Moreover, the requirements regarding asset manager documentation have been extended. Since mid-2002, all orders placed with third parties must be recorded, including orders placed with investment fund companies – a group previously not included (Section 34 (1) no. 4 WpHG). This approach will facilitate the seamless assessment of order flows.

### New circumstances warranting administrative fines

Additions have been made to the schedule of fines.

The additions to the schedule of fines set out in Section 39 WpHG have enabled BaFin to more effectively implement its supervisory instruments. If an investment services enterprise violates the prohibition on making recommendations that are not in the client's interest, BaFin can impose a fine of up to €200,000. This applies, for instance, if the institution makes transactions on its own account on the basis of its knowledge of client orders which have not yet been executed in order to profit from price changes triggered by said client orders.

Breach of the duty to inform BaFin of the identity of auditors of annual financial statements before appointing them will now also be subject to a fine. Previously, BaFin could only exact a fine if institutions failed to meet their duty to appoint an auditor at all. Finally, since July 2002 violations of the duties of disclosure in respect of analyses of securities are subject to fines of up to €200,000.

### Exemption from the annual audit

BaFin may exempt institutions from the annual audit obligation if the nature and extent of their business activities permit it.

The 4th FMFG has put in place the possibility of exempting investment services enterprises from the annual audit of compliance with the rules of conduct and reporting requirements. On application, BaFin may refrain from carrying out the audit if it appears unnecessary in light of the nature and extent of the investment services enterprise's business activities (Section 36 (1) sentence 2 WpHG).

### 2.1.2 Internalisation

An issue that was debated in 2002 not only by the supervisory authorities and market participants but also in the media was the in-house execution of client orders by credit institutions.

Xetra BEST is a form of market trading.

The Xetra BEST (Xetra Best Execution) function of Frankfurt Stock Exchange's Xetra trading system is designed for transactions between the investor and the best executor, i.e. the bank participating in Xetra BEST. The aim is to give investors access to a better price than would be on offer at the same time via the open Xetra order book. The prices achieved are not actually stock exchange prices, but the Land of Hesse's Exchange Supervisory Authority has determined that Xetra BEST can nevertheless be deemed a form of market trading. Trading on Xetra and Xetra BEST is monitored by Frankfurt Stock Exchange's Trading Surveillance Office (Handelsüberwachungsstelle). A similar execution of orders takes place via the NASDAQ Deutschland exchange.

Trading over banks' in-house trading systems is supervised as an investment service.

The situation is different when banks set up their own in-house systems to facilitate the bank-internal execution of securities orders. An example is Deutsche Bank AG's db PIP-Service (Price Improvement Service), whereby the bank buys or sells the ordered securities outside any stock exchange trading system. When placing an order, the client specifies a reference stock exchange as a benchmark to which the bank gears itself during execution – the execution price must be at least as good as the reference price.

These systems are not supervised by the Trading Surveillance Office. However, the transaction does represent an investment service which must comply with the provisions of the WpHG. These provisions outline specific requirements regarding the information to be given to the client and also relating to the organisation of trading. Accordingly, this kind of trading system is subject to BaFin supervision in order to ensure compliance with the provisions of the WpHG.

The debate over internal order execution has now moved to the European level: draft versions of the new Investment Services Directive provide that the bid and offer prices in relation to banks' in-house execution of orders must be disclosed if the shares ordered are admitted to trading on a regulated market and there is a liquid market for them.

## 2.2 Ongoing market supervision

At the end of 2002, BaFin was responsible for the supervision of 200 private credit institutions including foreign banks, 520 savings banks, and 1,480 cooperative banks. As part of its supervisory duties, BaFin also audited the credit institutions' compliance with the WpHG's conduct-of-business rules.

During the year under review, BaFin received 26 applications from credit institutions for exemption from the annual audit. BaFin granted exemption in four cases, refused it in four other cases, and at the end of the year the other 18 cases were still pending.

### 2.2.1 Annual audits

Marginalie: BaFin's main focus was the auditing of staff transactions. BaFin's general focus in the audits of savings banks and cooperative banks was on the ongoing control of staff transactions by a body independent of the sales, trading, and settlement departments. For ten selected credit institutions a further focal point was set, targeted at the organisational structures pertaining to the analysts employed by the bank, with special reference to their independence and to the handling of potential conflicts of interest. Additionally, BaFin selectively audited asset management and the placement of orders via the Internet.

In the case of private and foreign banks there was no central theme to the 2002 audits. Depending on specific supervisory needs, the following areas were investigated:

- provision of information to clients involved in day trading business;
- the organisational integration of analysts with special reference to their independence and the avoidance of conflicts of interest;
- compliance with requirements to keep and retain records;
- the prompt passing on and execution of client orders;
- compliance with the ban on cold calling, i.e. telesales activities without prior authorisation by the potential client; as well as
- asset management's compliance with investment guidelines.

In 2002, the directorate responsible for securities supervision evaluated 158 reports from the private and foreign banks sector, and took supervisory action in 92 cases. Appraisals of a total of 316 savings bank and cooperative bank audit reports led to supervisory action in 107 cases. Within this context, BaFin asked the institutions in question to respond accordingly and instructed them to report on when and how they would remedy the deficiency. At the next annual audit BaFin will then assess the level of implementation of the proposed steps. In 96 cases BaFin staff assisted in the audits. In 2002, BaFin also carried out three special audits.

Shortcomings were found in compliance with the rules of conduct and organisational duties.

The findings in the audit reports largely focused on compliance with the general and specific rules of conduct and organisational duties. The main shortcomings identified were a lack of documentation of client details, failure to explain risks, and failure to comply with the rules of conduct governing staff transactions.

Some banks argued that it is unnecessary to obtain all client details where "low-risk" products are involved. However, the provisions governing the rules of conduct state that banks must obtain details of financial circumstances except in the case of investments in negotiable securities where the issuer has an extremely sound credit status, for instance federal or Land securities or comparable securities issued by EEA states. There are no other exceptions. Verification pursuant to Section 31 WpHG is impeded by banks which obtain client details but fail to do so in a clear and comprehensible manner. BaFin noted several such cases.

During the year under review, shortcomings were also noted in the provision of pertinent advice and information relating to investments or the suitability of specific products for potential investors. In some cases, credit institutions recommended products which were unsuitable for clients' investment objectives, and occasionally

employees without the necessary expertise had recommended specific securities. In serious cases BaFin defined specific key points which will form the focus of the next audit.

As regards organisational duties, shortcomings were identified in the field of ongoing monitoring, and assessments of potential conflicts of interest within institutions were often neglected. In a few cases the compliance department did not report directly to the Management Board but rather to lower-level management. Credit institutions were instructed to remedy these shortcomings.

One problem at smaller savings banks and cooperative banks was that Eurex futures transactions were often not handled properly. In some cases, clients were not required to put up margins where the nature of the transaction necessitated it, and this led to the positions having to be closed. In other cases, client advisers failed to monitor the clients' positions although this had been promised beforehand.

The annual audit reports revealed a number of violations of the requirement to keep records in accordance with Section 34 WpHG. In six cases, BaFin imposed fines and two cases were dropped.

### **2.2.2 Evaluation of the current situation in the field of compliance**

At the end of 2001, the former Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel – BAWe) carried out a general evaluation of compliance by savings banks and cooperative banks with the organisational duties required under Section 33 WpHG. This was analysed during the first quarter of 2002.

The investigation, which took the form of a series of interviews, was carried out at 50 credit institutions selected by BaFin. In addition to all the Land banks and the two central cooperative bank institutions, the bulk of these were major credit institutions involved in large volumes of securities transactions, with corresponding potential for conflicts of interest.

Firstly, Compliance Units' organisational links were examined, a process which revealed a highly heterogeneous picture. Generally, the Compliance Units were structured around legal departments, administration, controlling units, or the Management Board secretary's office; in some cases Compliance was an independent unit. In almost all cases legal requirements, particularly those requiring direct subordination to the Management Board, were fulfilled. The bulk of compliance personnel are at the second or third management level, thus demonstrating the importance of compliance for the majority of institutions in formal hierarchical terms.

Staff qualifications and numbers were also investigated in depth. As a rule, compliance personnel contribute extensive experience from other fields of investment business, often having been previously employed in internal auditing, controlling, administration, and less often in sales. Advanced training is mostly carried out by the professional associations or private firms.

The general evaluation of compliance revealed a highly heterogeneous picture.

At all the institutions investigated monitoring staff transactions was one of the key tasks for compliance.

The Compliance Officer may also be responsible for anti-money laundering issues.

Staffing levels at banks varied according to the number of tasks assigned to the Compliance Units. This is an area where the law leaves considerable room for manoeuvre. Thus, for instance, tasks assigned to Compliance at some banks were performed by internal auditing at others. At all the savings banks and cooperative banks investigated monitoring staff transactions was one of the key tasks for Compliance. Further tasks include employee training, drawing up and implementing new instructions, and also monitoring the collection of client data and the provision of information to clients by the investment advisers. In most cases compliance personnel also act as in-house contacts for questions relating to the Securities Trading Act as well as for dealings with the supervisory authority.

Compliance Officers are also often responsible for dealing with anti-money laundering issues. This kind of multiple tasking is permissible, provided Compliance Units do not come to be viewed as a form of "human resources pool". In individual cases this did appear to be the case as money laundering investigations proliferated in the wake of 9/11.

To sum up, the investigations found that, despite shortages of qualified staff in some individual cases, compliance is now an integral and automatic component of savings banks' and cooperative banks' investment business.

### 3 Currency changeover of 1 July 1990 and allocation of equalisation claims

Under the German Treaty on Monetary, Economic and Social Union of 18 May 1990 (Staatsvertrag über die deutsch-deutsche Währungs-, Wirtschafts- and Sozialunion), the former BAKred allocated equalisation claims and equalisation liabilities to the various credit institutions and former foreign trade enterprises in the territory of the former German Democratic Republic<sup>20</sup>. Since 2001, the allocations have come to an end, with a single exception based on a special legal state of affairs. The extent of the equalisation claim is still a matter of dispute in two cases relating to major banks on which administrative court rulings are pending.

At the end of 2002, net liabilities of the "Ausgleichsfonds Währungsumstellung" totalled around €3.4 billion.

The credit institutions and former foreign trade enterprises were allocated equalisation claims totalling €45.6 billion and equalisation liabilities totalling €1.9 billion. The balance of these two items is thus €43.7 billion. Taking into account payments made as at 31 December 2002, net liabilities of the "Ausgleichsfonds Währungsumstellung" remaining were €3.4 billion.

If their business affairs develop more favourably than estimated in the DM Opening Balance (DM-Eröffnungsbilanz) of 1 July 1990, these

<sup>20</sup> cf. BAKred, 2000 Annual Report (Jahresbericht 2000), Chapter VII, for a detailed exposition of the economic and legal basis for the allocation of claims and payment obligations.

credit institutions and former foreign trade enterprises may under certain circumstances (cf. Sections 36 (4) and 43a et seq. D-Mark Accounting Act – D-Mark-Bilanzgesetz – DMBilG) have to make payments to the “Ausgleichsfonds Währungsumstellung”. BaFin supervises compliance with these obligations via the year-end audits, if necessary backed up by special audits pursuant to Section 44 KWG.

Table 7

**Investigations and payment obligations**

Audit report summaries received during the year under review	414
• of which including reservations by the auditor	18
• of which taken up with the credit institutions	11
Audits pursuant to Section 44 KWG	4
Amounts paid to the “Ausgleichsfonds Währungsumstellung” by credit institutions and former foreign trade enterprises	
• in 2002	€0.618 billion
• since the payment obligation came into being until 31 December 2002	€5.158 billion

In 2002, payment obligations pursuant to the DMBilG were considered to be the most important issue to be addressed. Discussions centred particularly on the organisational requirements for compliance with duties, calculation of the capital sums and interest due for payment, as well as the preconditions for the existence of such payment obligations. BaFin also looked at the issue of the possible settlement of payment obligations in relation to written-down old loans via one-off equal-value payments by the credit institutions. Another subject for discussion was the granting of loans before 1990 to agricultural enterprises in relation to which the credit institutions had made debt subordination arrangements.

# IV Supervision of financial services institutions and securities trading banks

- 1 Solvency supervision
- 2 Market supervision

## 1 Solvency supervision

The number of financial services institutions fell by 71 – from 828 in 2001 to 757 in 2002.

At the end of 2002, 757 financial services institutions held licenses to provide financial services (2001: 828), as did 42 securities trading banks. The year-on-year decline in the number of companies operating within this area is mainly due to difficult market conditions, highlighted by client demand falling for the third year in a row. Faced with falling commission income and fragile equity positions, many service providers were forced to cease trading, while many other enterprises only continued operations thanks to revenue generated in other lines of business such as insurance mediation.

The total number of licence applications has fallen significantly.

If exclude licence applications to operate businesses providing money transmission and foreign currency dealing services, i.e. operations which are only subject to supervision in relation to money laundering issues, this downward trend was also reflected in the number of licence applications made in 2002. With the exception of the two above-mentioned lines of business, just 67 enterprises applied for licences, as opposed to 102 in 2001 and no less than 190 in 2000. Of the 67 applications submitted in 2002, 57 were new applications, compared with 85 in 2001; ten were applications for licences to extend operations (2001: 17). A number of new applications were submitted by the former employees of various credit institutions, reflecting the staff cuts in the banking industry. BaFin granted 26 enterprises a licence to provide investment and financial services. In six cases BaFin heard appeals from applicants against rejected licence applications, and in four cases BaFin upheld its rejection on appeal. At the end of the year, 31 applications were still pending. This was partly due to the fact that many applicants were dilatory in pursuing their applications due to adverse business prospects.

In the field of money transmission and foreign currency dealing services BaFin received 77 licence applications during the year under review. Four applications were successful, and one was rejected by BaFin. As three licences were returned, at the end of 2002 BaFin had under its supervision 64 enterprises operating money transmission and/or foreign currency dealing businesses.

Assessing licence applications is often very labour-intensive.

As part of the very thorough and labour-intensive licensing procedure BaFin must among other things verify that future senior managers possess suitable professional expertise and are of good repute. Furthermore, the enterprises must present a business plan and furnish proof that they have sound organisational structures and the funds necessary for the intended line of business. The applications submitted are often incomplete, and many applicants find it difficult or impossible to demonstrate that they possess the practical experience necessary to

provide the proposed financial services. In some cases the applicants were unable to furnish proof that they possessed the necessary minimum capital, while others failed to present viable business plans, which must include projected balance sheets for the next three financial years.

+BaFin's supervision of financial services providers included extensive advisory duties.

BaFin expends considerable effort on advisory aspects of its supervisory role, particularly when it comes to financial services providers. Some financial services providers have difficulty in meeting their reporting duties and requirements to present documentation. In some cases the required quarterly submissions of monthly statements and also the annual financial statements and audit reports are submitted months late or even not until the following year. Furthermore, many of these institutions' auditors are not sufficiently familiar with the special legal requirements applying to bank supervision.

The warnings that BaFin has had to issue to some senior managers frequently result from inadequacies in the enterprise's organisational structures, leading to repeated violations of their supervisory duties. The reason for BaFin's decisions to revoke eight licences was often to be found in the enterprises' chronic shortage of funds.

### **Supervisory measures**

The generally poor level of profitability within this segment called for especially thorough supervisory activities to ensure problems were identified early – with the express purpose of taking preventive action to avert investor losses. In 2002, BaFin increased its checks on institutions' business dealings and investigated shortcomings in their organisational structures.

BaFin had to issue six warnings to managers and revoke eight licences.

### **Round-table discussions with finance industry associations**

In 2002, the first round-table discussions took place between financial services provider associations and BaFin representatives. The discussions covered the problems faced by financial services providers and their suggestions for dealing with them. However, the financial services institutions associations lack an umbrella organisation to represent their collective interests. A second round-table discussion took place in early 2003.

### **Stockbrokers and securities trading banks**

Some stockbrokers and securities trading banks have ceased trading.

The continuing stock market slump, the amendment of the Stock Exchange Act and technological changes in the way stock exchanges do business have forced stockbrokers and securities trading banks to make radical adjustments. Some institutions proved unable to cope with these structural changes: in 2002 eight securities trading banks discontinued operations, while four banks were subject to insolvency proceedings. Compensation cases were established in relation to two of the above-mentioned securities trading banks, and there was one other compensation case relating to an institution which closed in 1999<sup>21</sup>.

<sup>21</sup> cf. BAKred, 2000 Annual Report (Jahresbericht 2000), Chapters II 3 and III 2, on compensation cases, the Compensation Scheme, and deposit guarantees in general.

A further 13 stockbrokers or stockbroking firms have ceased trading with clients; one institution is insolvent. For the purpose of streamlining operations, two subsidiaries of British institutions transferred their business operations to their parent companies' German branches. Four former stockbrokers are continuing to trade as financial enterprises not requiring licences, and in four further cases the institutions were absorbed into newly-established incorporated companies.

A quarter of all securities trading banks and brokers suffered losses.

Despite downsizing and cost-reduction measures, a quarter of all securities trading banks and stockbrokers suffered losses, and further closures can be expected. The prevailing economic climate means it will also become increasingly difficult for institutions to find enough solid, reputable investors.

As institutions increase in size the demands on directors are also becoming greater. Accordingly, last year BaFin once again had to take more vigorous supervisory action to ensure that it maintained an accurate overview of these developments. To this end, BaFin carried out nine special audits of compliance with statutory risk management and controlling requirements. A further aim of these audits was to ensure that efficacy of business activities in these fields is not compromised by cost-cutting measures.

### **Credit card and traveller's cheque enterprises**

In July 2002, credit card issuers became subject to official authorisation.

In line with the 4th FMFG, since 1 July 2002 the catalogue of financial services listed in the German Banking Act (Kreditwesengesetz – KWG) has been extended, placing enterprises issuing or managing credit cards or traveller's cheques under BaFin's regular supervision (cf. Section 1 (1a) no. 8 KWG). The only exception to this is credit card business where the card issuer is also the provider of the underlying service; for instance, this is the case with department store customer cards which may only be used for payment in that store (so-called bilateral systems).

BaFin has notified credit card issuers that they now require a licence. Institutions previously permitted to operate without licences were instructed by BaFin to report their activities to BaFin by 1 November 2002. Provided they submit their reports on time, the licence is deemed to have been granted in relation to the activities cited in the report. BaFin received 24 such reports, of which 20 were from enterprises not involved in credit card business. Accordingly, as BaFin did not receive any applications for new licences in 2002, at the end of 2002 just four credit card companies had come under its supervision.

### **European "single passport"**

At the end of the year, 1,176 investment firms within the meaning of the Investment Services Directive, i.e. both credit and financial services institutions, were active in Germany either via a branch office or a cross-border enterprise with its registered office in another European Economic Area (EEA) country. These 1,176 enterprises are only subject to limited supervision by BaFin in accordance with Section 53b (3) and (4) KWG; primary supervision falls within the remit of the competent home-country authorities. The institutions were from 16

European countries, but more than two thirds of them originated in the United Kingdom.

Up to 31 December 2002, German financial services institutions submitted a total of 170 reports relating to cross-border service provision or branches in the EEA.

## 2 Market supervision

At the end of 2002, 3,897 enterprises were registered with BaFin as tied agents.

At the end of 2002, BaFin was responsible for the supervision of 757 financial services institutions, and an additional 3,897 enterprises were registered with BaFin as so-called tied agents. These enterprises are not deemed investment services enterprises. They work as agents exclusively on behalf and under the liability of other licensed institutions and are not themselves licensed to provide investment services. Because the licensing duty entails certain legal requirements and considerable costs, many brokers prefer to work for other investment services enterprises, under their liability and subject to their internal control. However, their activities are indirectly subject to BaFin supervision because, as in the case of outsourcing, they are ascribed to the enterprise assuming liability, and the outsourced areas are included in the annual audit.

### Exemption from audits

In the past the complaint has often been voiced that the annual audit imposes disproportionately high costs on smaller institutions. Accordingly, the 4th FMFG creates the possibility of exempting investment services enterprises from the annual audit of compliance with the rules of conduct and disclosure duties. On application, BaFin may refrain from carrying out this annual audit if the nature and extent of the investment services enterprise's business activities are such that it is deemed unnecessary (Section 36 (1) sentence 2 WpHG).

There is no automatic right to exemption from the annual audit.

The provision does not grant institutions any automatic right of exemption. Rather, there is a right to expect a decision based on the correct exercise of BaFin's discretionary powers. The "nature of business" criterion cited in the Act for the exercise of said discretionary powers includes the client structure, for instance professional clients only, and the degree of risk inherent in the products offered. The "extent of business activities" (i.e. scale of business) criterion is determined among other things by the number of clients and employees or the volume of assets managed. An overall assessment of the above factors determines whether or not the enterprise may be exempted from the audit.

Exemption may only be considered if this does not put investor protection at risk.

Naturally exemption from the audit can only be granted if it can be assumed that this will not compromise investor protection. Accordingly, exemption may only be considered if previous audits have not uncovered any shortcomings, and neither the nature of the enterprise's business nor its organisational structures have changed significantly since. In the year under review, BaFin only granted exemptions for a one-year period. In July 2002 BaFin circulated a letter about the above-mentioned new rules to financial industry associations. The letter set out the criteria governing BaFin's decisions regarding applications for exemption from the annual audit.

Since the provision came into force on 1 July 2002, BaFin has received 54 applications from financial services enterprises. In 23 cases BaFin duly refrained from carrying out the audit and in 13 cases the application was refused, with the other cases still pending at the end of the year.

### **Audits of financial services providers**

The audits found that the most frequent source of shortcomings was compliance with organisational duties.

In 2002, BaFin evaluated 873 reports of the auditing of financial services enterprises. The reports showed that the most frequent source of shortcomings was the field of organisational duties. Since 2000, the employee guidelines have also applied to financial services institutions, but the audits revealed that these had often not been correctly implemented, in some cases as a result of misunderstandings which have since been addressed. A further weak point related to the internal corporate controls aimed at ensuring proper business processes. In many cases the controls were not adequately documented, and the duty to provide information with regard to so-called kickback payments was not always complied with.

The audit reports prompted BaFin to take supervisory action in 160 cases, most often in the form of instructions to remedy the shortcomings in question.

### **Administrative fines and legal proceedings**

BaFin imposed four fines and dropped two court cases in relation to violations of the requirement to keep records pursuant to Section 34 WpHG. One of the court cases was initiated due to suspicion of a violation of the prohibition on cold calling, but was subsequently dropped (Section 46 Administrative Offences Act -Gesetz über Ordnungswidrigkeiten – OWiG) because of lack of adequate evidence of a criminal offence. Of the cases still pending from 2001, two ended with the imposition of fines and six cases were dropped.

The Federal Administrative Court (Bundesverwaltungsgericht) confirmed the ban on omnibus accounts.

In 2002, the Federal Administrative Court<sup>22</sup> upheld the ban imposed by BaFin on the maintenance by an investment services enterprise of so-called omnibus accounts. The basis for this was a ban imposed by BaFin because an investment services enterprise did not immediately deposit funds received from its client dealings in a deposit-taking credit institution, nor did it ensure that such funds were deposited separately from the enterprise's own money and from other client funds. In accordance with Section 34a (1) WpHG, the obligation to deposit client money separately applies to all investment services enterprises which use client money in their own name and on third-party account and which are not deposit-taking credit institutions. The legality of BaFin's decision was initially upheld by Frankfurt am Main Administrative Court, and subsequently, on direct appeal to the Federal Court, by the Federal Administrative Court, which ruled that the provisions of Section 34a (1) WpHG were not contrary to the provisions of European law.

<sup>22</sup> BVerwG 6 C 2.02, 24 April 2002.

# V Supervision of investment fund business

- 1 Solvency supervision and market supervision of investment companies
  - 1.1 Basis of supervision
  - 1.2 Financial situation
- 2 Licensing foreign investment funds

## 1 Solvency supervision and market supervision of investment companies

### 1.1 Basis of supervision

Significant changes to the Investment Companies Act (Gesetz über Kapitalanlagegesellschaften – KAGG).

The 4th FMFG has significantly changed the legal framework within which the German investment industry operates. The Investment Companies Act (Gesetz über Kapitalanlagegesellschaften – KAGG) has abolished redundant restrictions on investment and significantly broadened investment opportunities, particularly in relation to real estate funds. The aim is to make Germany a more attractive investment environment. At the same time the Act has strengthened investor protection and the “consumer friendliness” of investment products.

The most important amendments to the KAGG are:

- Extending the range of permissible ancillary services  
In future, investment companies may also sell non-group fund units and provide investment advice, allowing investors to acquire different providers' units from a single source.
- The introduction of units with varying rights  
The amendments allow investment companies to set up different classes of unit within a fund. Previously accumulation and distribution funds, for instance, had to be established separately.
- The expansion of investment opportunities for securities-based funds  
Over and above the previously authorised share indices, index funds may now also track the securities indices recognised by BaFin. To this end, they may exceed the investment limits.
- Extended opportunities to invest in open-ended real estate funds  
The assets of open-ended real estate funds may now be freely invested in real estate outside the European Economic Area (EEA). The same applies to the acquisition of property leasehold rights, which are thus considered to be equivalent to the acquisition of full ownership. Furthermore, the right to purchase residential property and to acquire part ownership, as well as the right to acquire residential leasehold and partial leasehold rights within the EEA has been broadened; this now also applies to countries outside the EEA. However, investments which involve currency risk may not exceed 30% of the fund assets. Alongside these extended investment options, investor protection has also been improved. The unit price

must now be calculated on every stock exchange trading day rather than once a year, and membership of Expert Committees must now be for limited periods in order to prevent experts' independence becoming compromised.

Since 2003, new standard contract conditions apply; they have been coordinated with BaFin.

In response to the wide-ranging amendments to the KAGG, BaFin set out to adjust the standard contract conditions in coordination with the Federal Investment and Asset Management Association (Bundesverband Investment und Asset Management e.V. – BVI), and duly adjusted standard contract conditions for all fund types have been available since the beginning of 2003.

In the year under review, BaFin completed its work on the Circular concerning the outsourcing of business by investment companies. The draft Circular incorporates the provisions of the Directive on investment funds in relation to the outsourcing of investment fund business. These provisions must be implemented by August 2003. To avoid anticipating the statutory provisions, with the associated risk of introducing contradictory regulations, BaFin has postponed publication of the Circular until the text of the Act has been finalised.

### **Cost transparency and conduct-of-business rules for investment companies**

The final version of the 4th FMFG does not contain any rules designed to improve cost transparency. Accordingly, the BVI has taken the initiative in this respect: as part of a system of self-regulation, it has proposed both a cost transparency concept and also a system of conduct-of-business rules for investment companies. In October 2002 the Association adopted the "BVI Conduct-of-Business Rules", as recommended best practice for investment companies. The aim of the code of conduct is to ensure that investment companies manage their special assets with the due diligence of a prudent businessman and in the exclusive interests of the unit holder. The BVI Conduct-Of-Business Rules have been in place since January 2003.

BaFin welcomes the BVI system of self-regulation as an important milestone.

The BVI's proposals contain recommendations for the improvement of cost transparency, for the handling of conflicts of interest, and for the execution of securities transactions in the investor's interests. During the preparation of the BVI Conduct-Of-Business Rules, BaFin was given the opportunity to offer additional ideas and suggestions, which have found their way into the proposals. BaFin welcomes the BVI Conduct-Of-Business Rules as a step in the right direction, but regards a number of further improvements as desirable, for instance the disclosure of fees for keeping securities on a client's behalf, of kick back agreements, and of group revenues.

BaFin will take the BVI's recommendations into account when carrying out audits. A new supervisory unit has been established in Frankfurt am Main to reinforce the monitoring of the market conduct of German investment companies and thus of the conformity of their fund management activities with the conduct-of-business rules. If necessary, BaFin will issue its own, more far-reaching conduct-of-business rules at a later date, though this will not be possible until the corresponding legal foundations are in place. The deadline imposed on German legislators in this respect by the Directive on investment funds is 13 February 2004.

## 1.2 Financial situation

Unlike share-based funds, Eurobond funds and real estate funds benefited from stock market conditions in 2002.

Securities markets, particularly the stock sector, went into a tailspin in the year under review. Since unit trusts/common funds (also referred to as "investment funds") chiefly invest in transferable securities, the adverse trading conditions on the world's stock exchanges directly affected fund growth. Naturally, share-based funds were particularly severely affected. In contrast, unit trusts/common funds investing in bonds denominated in euros were able to achieve positive growth thanks to falling interest rates. Meanwhile, international bond-based funds suffered due to the weakness of the dollar. Like money market funds they only achieved minimal growth. However, real estate funds experienced stable growth.

Companies have been closing low-volume funds.

Falling prices of the securities forming part of the fund assets have a negative impact on unit price development because the redemption value is calculated from the fund assets and the number of units issued. In view of drastic reductions in fund volumes, managers of share-based funds were confronted with the question of whether it made economic sense to continue managing them at all. In response, many of the investment companies involved chose to close low-volume funds, since the poor outlook on the stock markets during the year had prevented the influx of the financial resources necessary to curb the reductions in fund volumes.

As well as leading to a reduction in the overall number of investment funds, the prevailing economic malaise also heralded a certain realignment in the investment company industry. Thus, during the past year the only new investment company to be launched was a real estate fund investment enterprise. Meanwhile, although no securities investment companies have actually had to close, mergers have resulted in a market shake-up.

### Supervision of real estate funds

The trend towards open-ended real estate funds continued unabated.

The trend – first observed two years ago – towards investment in open-ended real estate funds continued unabated. Almost all real estate funds once again registered a healthy influx of funds. In view of continuing uncertainty on the stock markets and the improved legislative framework put in place by the 4th FMFG, all the signs are that open-ended real estate funds will continue to thrive. Most importantly, the lifting of investment restrictions has enabled companies to intensify their search for profitable investment opportunities abroad. During 2002 the number of open-ended real estate funds increased from 22 to 24. Between them they manage total assets of 75 billion euros.

The market in special real estate funds also experienced a significant upward trend, with the establishment of ten new investment companies, raising their total number during the year under review from 47 to 57.

### Annual statistics on investment supervision

During 2002 BaFin granted one domestic German investment company a licence to operate an investment business, while mergers or

acquisitions led to the winding up of four companies. At the end of 2002, some 81 investment companies held licences, down from 84 in 2001.

BaFin approved new contractual terms and conditions for 125 funds (previous year: 205) and in 235 cases approved changes in contractual terms and conditions (previous year: 217). In total, 34 funds were closed. At the end of 2002, the overall number of funds open to the general public that were managed by German companies stood at 1,380 (previous year: 1,281). These break down as follows:

- 43 money market funds (previous year: 46)
- 187 funds of funds (previous year: 162)
- 4 mixed securities and real estate funds (previous year: 3)
- 53 "AS-Fonds" (previous year: 47)
- 24 open-ended real estate funds (previous year: 22)
- 1,069 variously structured securities funds

In addition, investment companies managed 5,814 special funds (previous year: 5,817).

## 2 Licensing foreign investment funds

The reporting procedure for the marketing of foreign investment units has been modified.

The 4th FMFG has also amended the Foreign Investment Act (Auslandinvestment-Gesetz – AuslInvestmG) which regulates the marketing of foreign investment units in Germany. The changes chiefly affect the reporting procedures preceding the start of sales operations. Foreign investment funds (also referred to as "unit trusts/common funds") are required initially to undergo this procedure with BaFin. From now on, in the case of funds conforming to the EU Directive, i.e. ones corresponding to the UCITS Directive, and also in the case of all other foreign unit trusts/common funds, incomplete sales reports must be supplemented within six months. Furthermore, provisions governing the submission of promotional literature in the case of other investment funds has been repealed, in conformity with the situation applying to funds conforming to the EU Directive. For the information of foreign investment companies BaFin has now published an amended fact sheet for reports complying with the Foreign Investment Act.

In parallel BaFin has been taking a critical look at the marketing activities of some foreign investment funds, in one case withdrawing permission to continue sales activities due to unauthorised advertising measures. Additionally, BaFin has had to clarify numerous issues in relation to the legitimacy of the sales activities of some foreign investment funds. These mostly related to private equity funds or hedge funds whose classification in line with the Foreign Investment Act depends on the individual fund design in each specific case<sup>23</sup>.

### Number of reports

The number of sales reports was somewhat lower than in the previous year.

In 2002, the number of newly submitted sales reports (Vertriebsanzeigen) was 927, thus falling some way short of the peak figure of

<sup>23</sup> cf. BAKred's 2001 Annual Report, p. 52 et seq. for details regarding the supervisory classification of private equity funds and hedge funds.

1,143 reports registered in 2001. Nevertheless, this figure was still the third highest since the Foreign Investment Act was enacted in 1970. Processing these reports on time was given top priority by BaFin.

The majority of the reports submitted (856 in 2002, compared with 1,030 in 2001) related to funds conforming to the EU Directive, thus being able to make use of the simplified reporting procedure pursuant to Section 15c AuslInvestmG. A further 71 reports in accordance with Section 7 AuslInvestmG (previous year: 113) were furnished in relation to other investment funds not conforming to the Directive, most of them funds of funds.

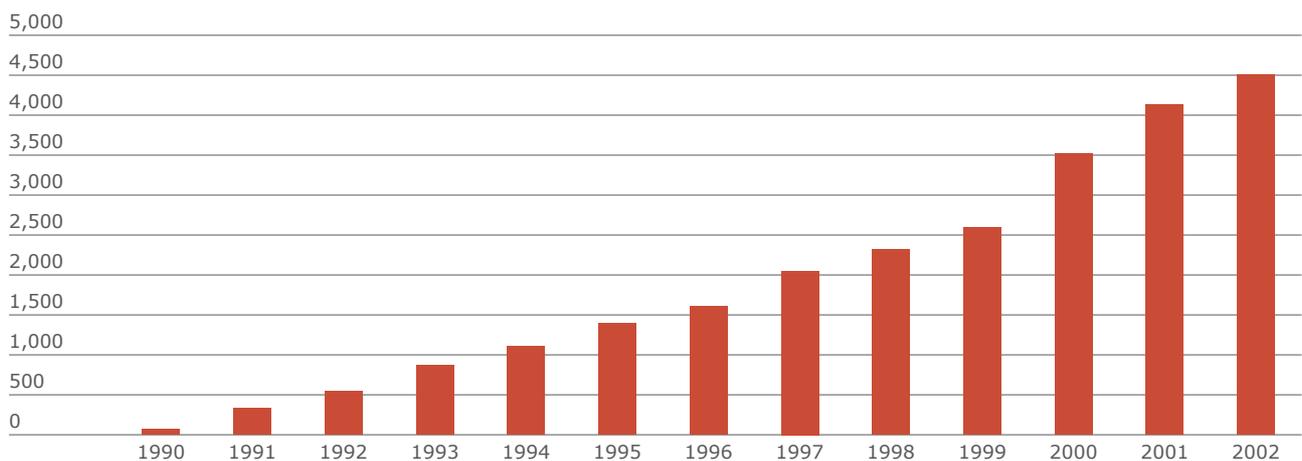
Most foreign funds are based in Luxembourg.

At the end of 2002, 1,350 foreign investment funds with 4,929 individual funds<sup>24</sup> (previous year: 4,488) were entitled to openly market their units in Germany. In total, 202 of the individual funds were funds of funds. As in previous years the overwhelming majority of the funds were based in Luxembourg, with the second commonest home country being Ireland. The total number of duly licensed foreign investment funds rose by almost ten per cent in 2002.

The following graphs depict the growth in numbers of licensed individual investment funds, subdivided into EU Directive-compliant funds (Section 15c AuslInvestmG) and other funds (Section 7 AuslInvestmG).

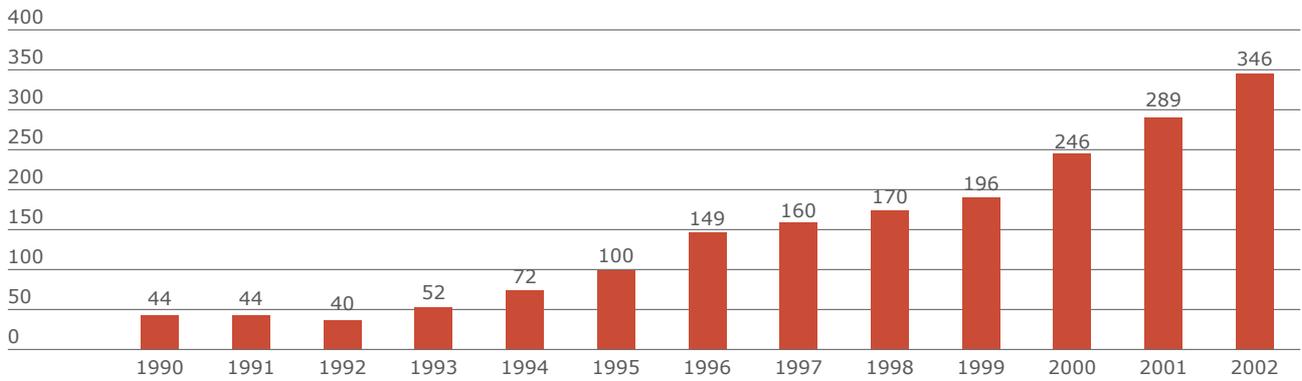
Fig. 7

#### Individual investment funds in accordance with Section 15c AuslInvestmG



<sup>29</sup> Figure includes subfunds of umbrella funds.

Fig. 8

**Individual investment funds in accordance with Section 7 AusInvestmG**

# VI Supervision of insurance undertakings

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# 1 Basis of supervision

## 1.1 Occupational pension provision

Incentives for occupational pension provision take force as from 2002.

The Act to Promote Old-Age Provision (Altersvermögensgesetz – AVmG) offers grants and tax incentives to encourage individuals to make private or company insurance provision for their retirement pensions. This law entered into force on 1 January 2002, and introduced the following key changes:

- Employees have a legal right to convert earnings into occupational pension contributions, i.e. to opt for a direct insurance plan (Entgeltumwandlung).
- Employers are legally obliged to ensure that pension provision commitments can be met.
- Employee contributions from earnings attract new tax incentives.
- Vesting periods have been shortened.
- Portability has been improved in the event of a change of employer.
- New pension funds make for greater flexibility in arranging the funding of pension commitments.
- New defined contribution plans with guaranteed minimum benefits permit greater transparency in calculating pension commitments.

Pension funds are now also permitted to provide payout schemes.

Some regulations, in particular those governing pension funds, were changed once again by the Steelworkers' Supplementary Insurance (Reform) Act (Hüttenknappschaftliche Zusatzversicherungs-Neuregelungs-Gesetz – HZvNG) of 21 June 2002. The main impact of the changes is to bring the range of benefits provided by pension funds into line with tax-incentivised private pension provision by permitting pension funds to offer payout schemes of the same kind. The legislator also took the decision to bring about greater harmonisation with the provisions of the Law on the Improvement of Company Pension Schemes (Gesetz zur Verbesserung der betrieblichen Altersversorgung – BetrAVG).

The Federal Insurance Supervisory Office was heavily involved in preparatory work for the ministerial bill. In parallel, the supervisory office prepared additional regulations for the implementation of Sections 112 et seq. of the Insurance Supervision Law (Versicherungsaufsichtsgesetz – VAG). BaFin forwarded the draft for a regulation on pension fund accounting to the responsible ministry, the Federal Ministry of Justice, in summer 2002. As planned, Circulars of

implementation<sup>25</sup> on risk-sensitive pension fund investment were prepared by BaFin, but these have not yet been officially passed. BaFin also discussed issues surrounding the interpretation of the new statutory regulations with working groups from the German Institute of Consulting Actuaries (Institut der versicherungsmathematischen Sachverständigen für Altersversorgung e.V. – IVS). Consensus was reached in the majority of areas. The results were published by the German Actuarial Society (Deutsche Aktuarvereinigung – DAV).

New defined contribution plans with guaranteed minimum benefits were incorporated into occupational pensions law.

Defined contribution plans with guaranteed minimum benefits have been newly introduced under occupational pension law. Under this regime, retirement benefits are determined according to the contributions paid in and the yields these produce. Nonetheless the amount available at the beginning of the payout phase must be no less than the sum of contributions paid in, with the exception of deductions made to cover any biometric risk. Schemes with contribution-based benefits can be provided by either "Pensionskassen" or pension funds.

## 1.2 Amendments to the Insurance Supervision Law

### Supervision of reinsurers

Insurance supervision of reinsurers has been expanded. This move is in keeping with international standards.

Developments in the international markets gave rise to a debate at national and international level as to whether reinsurers should be brought under the supervisory regime, and if so, which standards should apply. The German legislator decided to expand supervision of reinsurance undertakings in the Fourth Financial Market Promotion Act (Viertes Finanzmarktförderungsgesetz – 4th FMFG).

From 2005, special supervisory regulations will apply to reinsurers.

Prior to the reform, BaFin only had the right to request certain information in order to assess the undertakings' financial positions. The provisions which have applied since 1 July 2002 are now considerably wider in scope. In the statute, the legislator laid down both the legal form and the domicile of the main administration. Furthermore, it instituted regulations on the qualification of board members, whose personal reliability and professional competence must now be verified by BaFin, as is already the case with primary insurers. The provisions on investment assets were framed with the global activities of reinsurers in mind. To ensure that undertakings retain the necessary flexibility in this regard, only the general principles of security, profitability, and liquidity are applied. The mix and spread of investments must be assessed in the light of the undertaking's particular risk structure. BaFin's rights of intervention are restricted to measures which ensure compliance with relevant laws and regulatory requirements, and which safeguard business solvency at all times. To give undertakings sufficient time to make the necessary adaptations, the provisions on legal form and on investment only become applicable from 1 January 2005.

<sup>25</sup> cf. Section 1 (2) of the Regulation on Investment of the Restricted Assets of Pension Funds (Verordnung über die Anlage des gebundenen Vermögens von Pensionsfonds - PFKapAV) of 21 December 2001, Federal Law Gazette (Bundesgesetzblatt - BGBl.) I p. 4185.

### Other changes to the Insurance Supervision Law

As well as extending the supervisory regime to reinsurance undertakings, Article 16 of the Fourth Financial Market Promotion Act substantially increases supervision of the owners of qualified participating interests. The main purpose of this was to combat money laundering, and it led to concomitant harmonisation of the relevant provisions of the German Banking Act (Gesetz über das Kreditwesen – KWG).

In Section 7a (2) of the Insurance Supervision Law (Versicherungsaufsichtsgesetz – VAG) the legislator revised the previous definition of a qualified participating interest. The essential changes are: the stipulation that for insurance undertakings in the legal form of an Aktiengesellschaft (i.e. a public limited company/stock corporation – AG) the amount of the participation as a proportion of capital (rather than nominal capital) is the determining factor; the reference to Section 22 of the Securities Trading Act is clarified; the definition of subsidiary and parent undertakings is extended.

In Section 8 (1) VAG the grounds for outright refusal of authorisation to an insurance undertaking due to supervisory breaches by the owners of qualified participating interests have been reviewed (sentence 1 no. 2). The new provisions stipulate that in case of doubt, the conditions of Section 7a (2) sentence 1 and 2 VAG are fulfilled if facts warrant the assumption that the owner of a qualified participating interest obtained the funds used to acquire it by means of any action which objectively constitutes an illegal act. In Section 8 (1) sentence 4 VAG the legislator also defined the nature of a “close link” between a direct insurance undertaking and another natural person or company.

Section 104 of the Insurance Supervision Law (VAG) was reworded. Besides consequential amendments, it was made clear that the supervisory authority still has rights to request information and the submission of documents (paragraph 1 sentences 2 to 4) even after the three-month period has elapsed within which it can prohibit an acquisition (Section 104 (1b) VAG). Furthermore, the rights of intervention were extended in cases where the owner of a qualified participating interest gives up or reduces the participating interest (Section 104 (3) sentence 3 VAG).

## 1.3 New provisions in the Compulsory Insurance Act

On 1 January 2003, the Act Amending the Compulsory Insurance Act (Gesetz zur Änderung des Pflichtversicherungsgesetzes) and other regulations, passed on 10 July 2002, entered into force. Its particular function is to translate the Fourth EU Motor Insurance Directive of 16 May 2002 into German law. The purpose of this law is to facilitate easier settlement of claims for accidents which occur abroad. Motor liability insurers are now obliged to appoint a claims representative in each Member State of the EU. The legislator has laid down detailed regulations on these claims representatives and their responsibilities. Likewise there is a new requirement to set up a compensation body and an information centre.<sup>26</sup> GDV Dienstleistungs-GmbH & Co. KG, which operates “Zentralruf” ([www.zentralruf.de](http://www.zentralruf.de)), the German motor

Motor liability insurers are now obliged to nominate a claims representative in each EU Member State.

<sup>26</sup> cf. detailed explanation in BAV Annual Report 2001 Part A, p.11 et seq.

insurers' international claims hotline, has agreed to take on the information centre functions, while the organisation set up to compensate victims of uninsured traffic accidents, "Verkehrsofferhilfe e.V." ([www.verkehrsofferhilfe.de](http://www.verkehrsofferhilfe.de)), will assume the functions and rights of the compensation body. The insurers are required to notify BaFin and the information centres of their nominated claims representatives.

#### 1.4 Reform of the Insurance Contract Act – interim report

Interim report submitted by the Commission for Reform of the VVG.

Appointed in the year 2000, the Commission for the Reform of the Insurance Contract Act (Versicherungsvertragsgesetz – VVG) published an interim report in October 2002 on its work thus far. Its proposals include the integration of established legal precedents into the VVG. The Commission also points out the need for some long overdue changes concerning the "all or nothing" principle and the indivisibility of premiums. The Commission expressly left some problems unresolved, partly because the EU Directives on distance marketing of financial services and on insurance mediation were not adopted until after the interim report had been completed.

#### Health insurance

The interim report also contains specific proposals for the reform of health insurance.

- When changing insurance providers, the funds accumulated as a result of statutory premium loading under Section 12 (4a) VAG should be transferable.
- Benefits in kind and direct settlement of charges between the insurer and benefit provider (so-called Managed Care elements) should be possible.
- Upon merger or portfolio transfer, there should be a five-year suspension of the right to change tariffs (Section 178 et seq. VVG) – tariffs are also referred to as scales of premiums – where switches are only between the merged or transferred health insurance portfolios.

The expert commission also took a stance on the question of whether the use of genetic testing should be legally regulated. It takes the view that because a voluntary commitment has been given by corporate members of the German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft e.V.) there is currently no need to enact specific legislation on the matter.

BaFin puts the case for a statutory ban on making insurance cover conditional upon genetic testing.

In the view of BaFin there should be a statutory prohibition on making submission to a genetic test a condition of obtaining insurance cover. Every insurance customer has a "right not to know" deriving from the basic right to self-determination in respect of personal information. In the absence of statutory regulation, there would be insufficient protection for the interests of those not wishing to find out about certain genetic characteristics. The commitment given by the insurance industry associations – not least because it is voluntary and not indefinite – is no substitute for statutory regulation.

In late 2002 and early 2003, BaFin met with representatives of regional ministries of justice and of industry associations to discuss the Commission's interim report. The Commission intends to put forward a fully drafted bill by the end of this year.

## 1.5 Circulars

### Circular on investment

In Circular 29/2002 (VA) of 12 December 2002, BaFin explained the general principles of investment set out in Section 54 (1) VAG and gave detailed information on the new investment provisions set out in the Investment Ordinance (Anlageverordnung – AnlV). The new Circular replaces Circular 4/95.

Restricted assets may not be invested in exchange-listed bearer bonds except under certain conditions.

In order to assess an investment's security, insurers need to take into consideration the ratings it has received from recognised rating agencies. Where the rating of investments such as bearer bonds is normal market practice, these must have an Investment Grade Rating<sup>27</sup>. Otherwise they can only be included in the restricted assets if the insurance undertaking has verifiably carried out a positive assessment of their level of security, which entails having the necessary resources in terms of personnel and expertise to do so. Investments of this kind can only be included in the portfolio to a limited extent and with due consideration of overall risk capacity. They must be monitored with particular care throughout the investment term.

Stress tests are essential for risk management.

Moreover, Section 6 of the Investment Ordinance (Anlageverordnung – AnlV) sets out further details on investment management and internal auditing procedures. Following the IAIS Standard on Asset Management, the Regulation imposes qualitative targets for investment management and risk management. Accordingly, stress tests are imposed as a risk management tool. Furthermore, a thorough reporting regime is introduced which obliges insurance undertakings to disclose their internal investment guidelines, describe their asset-liability management, and provide other detailed information on their investment policy and monitoring and control procedures.

### Circular on reporting, notification, and disclosure requirements

BaFin brought Circular 5/97 on reporting, notification, and disclosure requirements into line with the new investment rules introduced by the Investment Regulation.

The new Circular 30/2002 (VA) of 12 December 2002 specifies the obligation of insurance undertakings to disclose the acquisition of investments listed in Section 54 (4) VAG, to issue reports on all their investments (Section 54d VAG), and to disclose the valuations used for land and titles to land (Section 66 (3a) VAG). The supervisory authority has integrated the reporting obligations set out in Circulars 3/99 and 1/2002 concerning structured products, asset-backed securities, and credit-linked notes into the new Circular.

Insurers must state their strategy when investing in funds.

For the first time, details must be provided of the strategic thrust and key components of funds along with other important information relevant to supervision, such as the nature and rating of annuity

<sup>27</sup> Long-term ratings: BBB- (Standard & Poor's, Fitch), Baa3 (Moody's); short-term ratings: A-3 (Standard & Poor's), F 3 (Fitch), or Prime 3 (Moody's).

instruments and the proportion of each type of investment held. Furthermore, the Circular gives insurers the option under Section 2 (3) AnIV of calculating the attributable share of equities, profit participation rights, claims from subordinated liabilities, and participating interests when determining the risk capital allocation for special securities funds – provided that the fund is suitably transparent – rather than basing the allocation on all the fund's assets.

The new "Nachweisung" 670 and 671 evidence sheets facilitate a quarterly review of investments held and the book and current values of assets.

Given the increasing volatility of financial markets and growing complexity of investment strategies used by insurers, the supervisory authority requires more thorough information and greater transparency regarding insurers' assets in order to be able to assess the soundness of investments. The new "Nachweisung 670" evidence sheet provides a quarterly overview of the investments held, organised according to the categories of investment in the Investment Regulation. Details of the book values and current market values of assets are to be submitted on the new "Nachweisung 671" evidence sheet, also on a quarterly basis. "Nachweisung 671" reveals details of hidden reserves and hidden charges on the relevant assets and states how technical liabilities were covered over the year.

The stress tests to be carried out as a qualitative tool have been incorporated into the reporting obligations. The new Circular contains instructions on the parameters and stress testing model. Depending on the results of the stress tests and the scale of any shortfall in cover, the undertakings must comply with additional verification or notification requirements.

### **Circular on asset-backed securities and credit-linked notes**

On 12 April 2002 the Federal Insurance Supervisory Office issued Circular 1/2002 on asset-backed securities and credit-linked notes.

This concerns structured financial instruments backed by underlying assets, with interest and redemption payments met out of cash flow from the underlying asset. Due to the complexity of these instruments and the structural and material risks involved – creditors bear not only a market risk but also a credit risk with the potential for total loss -, the supervisory authority felt compelled to take a stance on the issues raised.

The scope of application of Circular 1/2002 covers all financial products created by repackaging debts or transferring credit risks.

New financial instruments such as ABS and CLN must comply with the key statutory requirements of security, profitability, and liquidity.

Asset-backed securities and credit-linked notes must satisfy the general requirements of Section 54 (1) VAG for investment security, profitability, and liquidity. The principle of investment security must be given the highest priority. In assessing security, the standards applied must be more stringent than usual in view of the complexity of the structures. The principle of investment security demands that a financial instrument acquired by an insurance undertaking must have, as a minimum, an external investment grade rating from a recognised rating agency. It is not sufficient for such a rating to have been attached to the issuer or the underlying asset.

The only means of investing restricted assets in financial products which do not meet these requirements is to invoke the saving clause

(also referred to as “escape clause” (Section 1 (2) AnIV) and even then, only if the products have received a verifiable positive rating for investment security. The positive assessment should be based on as many factors as possible, such as the average rating of the underlying asset, the nature and term of the underlying receivables, known defaults, securitisation mechanisms, and the overall structural profile.

### **Circular on the “Deckungsstock” (coverage fund)**

BaFin published guidance on the “Deckungsstock” (i.e. coverage fund, also referred to as the premium reserve fund) in Circular 31/2002 (VA) of 12 December 2002. It contains particular specifications for establishing and managing the “Deckungsstock” list, the assets to be entered therein and the safekeeping of the “Deckungsstock” assets. A new version of Circular 3/96 had become necessary as a result of the changes to the investment rules, particularly the entry into force of the Investment Ordinance on 1 January 2002. Despite the broadening of possible types of investment by the Investment Regulation, the number of forms relating to the “Deckungsstock” list has successfully been reduced in the new Circular.

### **Circular on trustees**

Finally, BaFin published Circular 32/2002 (VA) of 12 December 2002 on the subject of “Deckungsstock” trustees.

Recent changes to the investment regulations had meant that revisions were necessary to the rules set out in Circular 4/96 on the appointment, role, and powers of the “Deckungsstock” trustee and the safekeeping of investments.

According to Section 72 (3) VAG, trustees may only approve certain transactions in writing. The trustee can now also approve such a transaction with a digital signature, which must be verified by means of a public key issued by a certified authority within the terms of the Digital Signature Act. The trustee must have previously obtained written assurance from the recipient of the signature that all documents bearing a digital signature will be verified. The trustee is required to store the signature card and the PIN separately and secure them against unauthorised access.

The trustee can now approve transactions by means of a verified electronic signature.

## **1.6 New standard contract terms for special securities funds**

In 2002, BaFin and the German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft e.V. – GDV) reached agreement on new standard contract terms for mixed special securities funds. These served to implement amendments to the Investment Companies Act introduced by the Fourth Financial Market Promotion Act and the extension of investment possibilities by the Investment Regulation. Shares in special securities funds which comply with the new regulatory standard now qualify to be held in the restricted assets under Section 1 (1) no. 15 AnIV. Where insurance

BaFin and the GDV agreed new standard contract terms for mixed special securities funds.

undertakings adjust their existing funds to the new standard contract terms, BaFin is to be informed and the General and Specific Contractual Terms and the Guidelines for the Investment Committee are to be submitted at that time.

In future there will no longer be a requirement – even for securities funds open to the general public – to supply an up-to-date assets statement since the supervisory authority now receives the necessary information through the reporting regime (Annex 4 to Circular 30/2002 (VA)). To expedite the inspections, the supervisory authority asks undertakings to confirm that the contractual terms comply with the new standard contractual terms. Where this is not the case, companies must indicate areas of non-compliance.

## 1.7 Management Board members at Supervisory Board meetings

It is inadmissible for Management Board members to have an unrestricted right to attend Supervisory Board meetings.

At the beginning of 2002, the insurance supervisory authority imposed conditions on provisions in Articles of Association (also referred to as “Bylaws”) concerning regular attendance by Management Board members at Supervisory Board meetings (Official Bulletin of the BAV – VerBAV 2002, 67). The supervisory authority had no objection to rules of the kind which allow Management Board members to participate in a Supervisory Board meeting to speak on individual agenda items. The same view is taken where Management Board members are available for questions and answers on the situation of the insurance undertaking at the beginning of every Supervisory Board meeting.

Following the establishment of integrated financial services supervision, BaFin revised the regulations with a view to bringing them into line with practice in comparable financial services sectors (VerBaFin 2002, 248). Allowing Management Board members an unrestricted right to attend Supervisory Board meetings continues to be inadmissible. In addition, the Supervisory Board retains the right to exclude certain individual members or the entire Management Board from attending a Supervisory Board meeting where, for instance, personal matters relating to a Management Board member or claims for damages against the Management Board are to be discussed.

## 1.8 Insurance selling

In the reporting period BaFin concluded three prosecutions for administrative offences which it had initiated in accordance with Section 36 of the Administrative Offences Act (OWiG) in combination with Section 145a VAG against insurance intermediaries for breaching the ban on refunding commission payments.<sup>28</sup>

<sup>28</sup> cf. Section 144a (1) no. 3, Section 81(2) sentence 4 VAG in conjunction with the Decree of the Private Insurance Supervision Office of the German Reich (Reichsaufsichtsamt für Privatversicherungen) of 8 March 1934 concerning life insurance - No. 58 as published in the Deutscher Reichsanzeiger and the Preußischer Staatsanzeiger dated 9 March 1934.

In the first case, for taking out an pension insurance policy, an insurance intermediary paid the client's first three premiums on the policy, a total sum of €241.94.

The second case concerned an insurance intermediary who paid a client a total of €1,022.58 for taking out two life insurance policies.

In the third case an insurance intermediary paid a client as much as €2,242.01 for taking out two life insurance policies.

All three intermediaries paid the fines imposed.

## 2 Statistical data

### 2.1 Number of undertakings

In the year 2002, 13 additional undertakings came under Federal supervision, bringing the total to 691. Twelve further public law insurance undertakings are under Land supervision, and their data are included in the summary of business trends for 2002. The German insurance industry breaks down into the following categories.

Table 8

**Number of insurance undertakings under supervision**

	Active insurance undertakings (IU)			Inactive IU
	Federal supervision	Land supervision	Total	
Life insurers	110	4	114	18
"Pensionskassen"	154		154	4
Death benefit funds	45		45	4
Health insurers	55		55	
Property and casualty IU	238	8	246	15
Reinsurers	43		43	5
<b>Total</b>	<b>645</b>	<b>12</b>	<b>657</b>	<b>46</b>

### 2.2 Commencement of insurance business

#### Life insurers

In the year under review, BaFin authorised two public limited companies (Aktiengesellschaft – AG), also referred to as stock corporations, to commence life insurance operations. One of these companies was Protektor Lebensversicherung AG. The other authorisation was connected to a restructuring programme.

In addition, the year 2002 saw the establishment of new German branches by three life insurers from other countries in the European Economic Area (EEA). Two of the undertakings in question were Irish and one was British.

In the year 2002, 18 life insurers from other EEA countries registered to provide services in Germany in accordance with the EU Third Life Assurance Directive (92/96/EEC). The following table gives a breakdown of the 18 insurers by country of domicile:

Table 9

**Life insurers from the EEA**

Belgium	1
Ireland	5
Liechtenstein	4
Luxembourg	1
Netherlands	1
Spain	3
United Kingdom	3

**Property and casualty insurers**

In the year 2002, BaFin issued two German public limited companies with authorisation to commence property and casualty insurance operations. Along with a small number of enquiries which did not culminate in authorisation proceedings, five authorisation proceedings were still pending at the end of 2002.

Whereas the year 2001 saw branches established in Germany by no fewer than five companies from elsewhere in the EU/EEA, in 2002 no such branches were established in this sector.

In the year under review, 29 insurance companies (compared with 17 in the previous year) underwent first-time registration to commence service provision in Germany. The domiciles of these companies are as follows:

Table 10

**Property insurers from the EEA**

Austria	1
Denmark	1
France	2
Greece	1
Ireland	11
Luxembourg	1
Netherlands	3
Norway	1
Spain	1
Sweden	2
United Kingdom	5

In addition some insurance undertakings already registered as service providers applied to extend their business operations. Their provision of compulsory insurance policies continues to be somewhat limited. In the year 2002 a number of insurers also wound up their service provision activities in the Federal Republic of Germany.

As in the previous year, no branches were established in 2002 by third-country insurance undertakings pursuant to Sections 105 et seq. VAG.

### Reinsurers

The number of specialist reinsurers rose slightly in the year under review from 40 to 43; three additional undertakings commenced reinsurance operations.

### “Pensionkassen” and pension funds

In the year under review, BaFin authorised 22 “Pensionskassen” and 18 pension funds to conduct business in Germany. As regards the legal form of the “Pensionskassen”, 21 were public limited companies (Aktiengesellschaft – AG) and only one was a mutual insurance company (Versicherungsverein auf Gegenseitigkeit). Four application proceedings remained open by the year's end. BaFin authorised 17 public limited companies and one mutual association to operate as pension funds. In this sector, ten proceedings remained open by the year's end.

## 2.3 Reporting during the course of the year

Since the 1995 financial year, insurance undertakings have reported a selection of current accounting and portfolio data on a quarterly basis to BaFin or its predecessor, the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV).

Based on the financial years 1995 to 2001, experience shows that the provisional figures can deviate from the final figures, partly for reasons of classification. Thus, the provisional figures for 2002 are compared with the provisional figures for 2001. In the property and casualty insurance sector, the attempt is also made to project final figures for 2002, based on a ratio of the provisional to the final figures in the years 1998 to 2001.

### 2.3.1 Business trend

#### Life insurers

In the private life insurance segment, new business (i.e. policies with the first premium paid) rose substantially from 8.3 million to 9.8 million new policies (+17.8%). The 43.6% growth in new business in the pension and other life insurance segments is responsible for this increase. At the same time, the underwritten amount of new insurance policies remained almost constant at €225.1 billion (previous year €224.8 billion).

As a share of all new life policies, the percentage of “classic” endowment policies declined from 23.6% to 20.3%. Term assurance policies accounted for 27.9% as compared with 34.0% in the previous

The increase in new life insurance business came largely from growth in sales of pension insurance.

In contrast, the proportion of endowment policies fell.

year. The share of pension and other life insurance policies continued to grow, from 42.5% to 51.8%. Endowment policies rose slightly as a share of new business, from 19.5% to 20.6% of the total amount underwritten. Term assurance policies, as in the previous year, accounted for a 30.7% share; the proportion of pension and other life insurance policies fell from 49.8% to 48.6%.

**Marginalie:** Early withdrawal from policies remained stable. The number of early withdrawals (surrendering of policies, conversion into paid-up policies, or other forms of premature termination) remained unchanged at 3.1 million policies. The underwritten amount of the prematurely terminated policies rose by 7.3% to €91.0 billion. The rise in early withdrawals is higher than average in the pension and other life insurance segments, amounting to 17.9% in terms of the number of policies and 33.1% of the underwritten amount.

The life insurance portfolio reached 91 million policies with an underwritten amount of around €2,050 billion at the end of 2002.

At the end of 2002, the total portfolio of private life insurance policies amounted to 90.6 million policies (+ 2.1%) with an underwritten amount of €2,048.5 billion (+ 4.0%). The proportion of endowment policies declined from 65.7% to 61.5% of policies, and from 56.6% to 53.3% of the underwritten amount. The proportion of term assurance policies, accounting for 16.4% of policies and 19.2% of the amount underwritten, remained virtually constant. Pension plans and other life insurance accounted for 22.2% of policies compared with 17.8% in the previous year, and 27.5% (up from 24.5%) of the underwritten amount.

The gross premiums written for private insurance business rose by 2.8% to €64.7 billion.

The major changes in the pension plan and other life insurance segments are a consequence of the structural reform of pensions. German citizens are manifestly beginning to adopt a new approach to their private pension provision for retirement.

### Health insurers

A comparison of the provisional figures for health insurance in 2002 and 2001 shows 6% growth in 2002, roughly on a par with the previous year.

In the year 2002, private health insurance posted growth of 6.0% to €23.1 billion, on a par with the previous year's 5.8% growth in gross premiums written.

Benefits paid to claimants during the financial year rose by 6.9% (compared with + 5.2% the previous year) to €14.5 billion. The rate of increase in overall payments of claims was thus higher than the rate of growth in premiums in the year 2002.

Despite advice issued by the former Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV) in its Official Bulletin<sup>29</sup> on standardisation of practices for recording and reporting statistical information on policies held by natural persons, the figures reported in different sources still show significant divergence. It therefore serves no purpose to evaluate the statistical data produced over the course of the year.

<sup>29</sup>Official Bulletin of the BAV (Veröffentlichungen des Bundesaufsichtsamtes für das Versicherungswesen - VerBAV) 1998, p. 192.

### Property and casualty insurers

In the year 2002, private property and casualty insurers generated a rise of 3.6% in gross premiums written, to €56.4 billion.

Payouts on insurance claims increased substantially compared with the previous year.

Gross payments to meet insurance claims from the financial year rose by 14.0% (compared with the previous year's – 1.1%) to €22.4 billion, and gross payments to meet insurance claims from past years rose by 7.3% (previous year: – 7.3%) to €14.0 billion. Gross provisions of €15.9 billion for private insurance claims from the financial year were 1.0% lower than in the previous year (previous year: + 10.4%), while gross provisions of €39.6 billion for private insurance claims from past years were 3.9% higher than in 2001 (previous year: + 3.8%).

The largest segment by far is motor vehicle insurance (also referred to as "motor insurance") with a volume of €21.8 billion in gross premiums written. This represents a 2.8% rise, following 5.1% growth in 2001. Gross payments to meet insurance claims in this financial year were up 3.4%, and 9.6% more was paid out on insurance claims from past years. Gross provisions recognised for private insurance claims in this financial year fell by 1.7% after a + 3.6% rise in the previous year; gross provisions recognised to meet outstanding private insurance claims from past years were up 1.3% compared with a 2.5% increase in the previous year.

General liability insurance generated €6.9 billion in premium income, representing an increase of 1.4%. Payouts on claims from the financial year were 0.7% higher, while payouts on claims from past years were up by 14.2%. Gross provisions for private insurance claims are of special importance in this insurance class, and fell by 20.0% for outstanding insurance claims from the financial year, after a jump of +26.8% in the previous year. The increase in provisions allocated for outstanding insurance claims from past years was 8.1%, as compared with 7.9% in the previous year.

The fire insurance segment posted gross premiums written of €1.9 billion (+ 1.7%; previous year – 0.5%). This marks the first reversal of the decline in premium income which has persisted since 1995. However, the trend is still noticeable in the continuing significant decline in the number of policies, this year by – 3.6% and last year by – 2.5%. Gross payments for claims during this financial year fell by 8.1%, and gross provisions allocated for private insurance claims in the financial year were as much as 14.6% lower. Payouts on claims from past years were down 3.0%, and provisions were reduced by 3.5%.

Comprehensive insurance on residential buildings and comprehensive home contents insurance combined to generate premium income of approx. €6.1 billion (+1.6%). Gross payments to meet insurance claims from this financial year rose by 56.8% (having fallen by 6.1% the previous year), while payouts on insurance claims from past years were 0.8% higher than in 2001 (previous year: – 31.1%). Provisions allocated for claims during the financial year were 41.6% higher (previous year: + 13.0%), and provisions allocated for claims from past years were on a similar level to the previous year (+ 0.1%; previous year: – 6.9%).

The general casualty insurance segment generated €5.7 billion in gross premiums written, a 3.4% increase on the previous year's income.

Gross provisions allocated for outstanding private insurance claims in this financial year fell by 2.6% while those for claims from past years rose by 0.5%.

Projection for the 2002 financial year.

As in previous years, BaFin has attempted to project final figures for the year 2002 in the property and casualty insurance segment based on data from reporting during the course of the year. Although in previous years the definitive figures have sometimes diverged considerably from these estimates, primarily because of changes in the allocation of provisions, it has still been possible to identify clear trends.

Method for the projection.

To determine the projected results, a factor is computed based on the ratio of fourth-quarter figures to definitive figures in the preceding years 1998 to 2001, and this factor is applied to the quarterly figures for the year 2002. This simple methodology does not provide projections of the same quality as, for instance, election forecasts, but does give pointers which are confirmed in the first publications by individual undertakings and by the GDV on the course of business in 2002. For reasons associated with the type of data reported during the course of the year, the projection is restricted to the gross profit before premium refunds and changes in the equalisation provision.

Gross premium income for the insurance industry as a whole is projected at €56.5 billion – approx. two per cent above the previous year's level.

From private insurance overall, gross premium income in 2002 can be expected to reach levels of €56.5 billion, as compared with €54.2 billion in 2001. Expenditure on claims from this financial year will be in the region of €48.4 billion (compared with €44.1 billion in 2001) and the settlement result is projected at €5.0 billion (€4.7 billion in 2001). Thus, the total claims expenditure looks set to increase from €39.4 billion to €43.3 billion; the claims ratio rises from 72.7% to 76.7%. The expense ratio will fall slightly from 27.1% to 26.6%. Taking account of other technical items, the gross underwriting loss is expected to deteriorate from €0.7 billion to €2.5 billion in the year 2002.

Projection indicates an expected loss of approx. €200 million for motor vehicle insurance.

For the largest insurance class, motor vehicle insurance, BaFin expects a decline in the gross underwriting loss from €0.5 billion to €0.2 billion (- 1.0% following last year's - 2.5%). Expenditure on claims from this financial year will increase marginally from €20.2 billion to €20.5 billion. Premium income will rise from €21.4 billion to €22.1 billion, an indication of the premium increases which have taken place. Accordingly, the claims ratio after settlement will decrease from 84.4% to 83.0%.

Projection: personal liability insurance premiums have risen slightly. The underwriting result – as last year – will be a loss in the region of €400 million.

Premium income for general liability insurance will reach €6.9 billion, slightly higher than the previous year's level. Expenditure on claims from this financial year will fall from €5.7 billion to €5.4 billion and the settlement result will decline from €0.9 billion to €0.4 billion. Estimated gross claims expenditure amounts to €5.0 billion at the end of 2002, as compared with €4.9 billion the previous year. The claims ratio will remain unchanged at 72.0%, and the gross underwriting result will be a loss of €0.4 billion.

In the fire insurance class the projection indicates a significant fall in the claims ratio.

Premium income from fire insurance is expected to be almost unchanged, at €1.9 billion. The claims ratio will fall from 78.6% to 64.7%. The gross underwriting result is estimated to be a profit in the region of €42 million (2.2%).

Table 11

**Projection for the 2002 financial year**

€ billion	Total privat insurance business		Casualty insurance		General liability insurance		Montor insurance		Fire insurance		Verbundene Hausrat- und Wohngebäude-	
	2002 estimate	2001	2002 estimate	2001	2002 estimate	2001	2002 estimate	2001	2002 estimate	2001	2002 estimate	2001 (geschätzt)
<b>Grosspremium income</b>	56.5	54.2	5.7	5.5	6.9	6.8	22.1	21.4	1.9	1.8	6.0	5.9
<b>Expense for current year claims</b>	48.4	44.1	2.4	2.4	5.4	5.7	20.5	20.2	1.5	1.6	5.9	3.7
<b>Settlement result</b>	-5.0	-4.7	-0.7	-0.6	-0.4	-0.9	-2.2	-2.1	-0.2	-0.2	-0.2	-0.2
<b>Gross claims expense</b>	43.3	39.4	1.7	1.8	5.0	4.9	18.3	18.0	1.2	1.4	5.7	3.5
<b>Gross underwriting expense</b>	15.0	14.7	2.0	2.0	2.4	2.3	4.0	3.9	0.5	0.6	2.0	2.0
<b>Gross balance from other technical items</b>	0.7	0.8	0.5	0.6	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
<b>Gross underwriting result (before premium refunds)</b>	-2.5	-0.7	1.4	1.1	-0.4	-0.4	-0.2	-0.5	0.0	-0.3	-1.8	0.4
<b>Claims ratio</b>	76.7%	72.7%	30.3%	33.5%	72.0%	72.0%	83.0%	84.4%	64.7%	78.6%	93.8%	58.3%
<b>Expense ratio</b>	26.6%	27.1%	35.7%	36.8%	34.3%	33.8%	18.2%	18.1%	26.0%	30.4%	33.6%	33.3%
<b>Gross profit ratio</b>	-4.5%	-1.3%	25.1%	19.4%	-6.2%	-5.7%	-1.0%	-2.5%	2.2%	-15.6%	-29.2%	6.6%

According to the projection, comprehensive home contents insurance and comprehensive insurance on residential buildings are likely to end the year on a loss of €1.8 billion as a result of significantly higher claim levels during the year.

Premium income for comprehensive home contents insurance and comprehensive insurance on residential buildings will remain almost unchanged at €6.0 billion. Following the previous year's profit of €0.4 billion, the gross underwriting result in the year 2002 is likely to register as a loss of €1.8 billion. Expenditure on claims from this financial year will increase substantially from €3.7 billion to €5.9 billion. Accordingly there will be a considerable increase in the claims ratio from last year's 58.3%, to 93.8%.

The result for casualty insurance will be €1.4 billion following on from €1.1 billion in the year 2001.

For further details, please consult table 11 .

### 2.3.2 Investments

Total investments of all insurers increased by 6.5% to over €1,000 billion.

The total of investments held by insurance undertakings increased by 6.5% in 2002 (previous year's increase: + 8.3%) to €1,006.3 billion (previous year's figure: €943.8 billion). For details, please see Table 12. The following section takes a closer look at a few selected points.

Since land investments represented only a 0.8% share of total new investments and declined in book value, the proportion of land investments held decreased by a further 1.6% from 2.8% to 2.6%.

According to the projection, the book value of equity holdings fell by 41% as a result of the bear market.

In spite of rising book values, bonds fell slightly as a proportion of investments. In contrast, the proportion of registered bonds, which are always recognised at par value, continued to rise.

The book value of interests in affiliated companies rose by 31.8%. This effectively increased such holdings from 9.1% to 11.2% as a share of total investments.

Book values of direct shareholdings dwindled by 41.0% due to continuing stock market weakness. Slight growth of 1.8% had been registered in the previous year despite evident signs of the looming crisis. The small proportion of investments held directly in stocks dropped again from 3.6% in 2001 to 2.0%, falling below the 3% mark for the first time since the year 1996.

While holdings of investment certificates increased by 6.2% (previous year: +11.0%), as a proportion of total investments they declined slightly from 22.9% to 22.8%.

Although the book value of bearer bonds rose by 5.4%, as a proportion of total investments they fell from 8.5% to 8.4%. In view of the current phase of low interest rates, insurers are obviously afraid of having to write down assets should the money capital rate rise. Investments in certificates of debt, popular for their "depreciation-proof" characteristics, rose by 10.1% (previous year + 9.6%). This accounted

Table 12  
Investments in 2002

Investments of all insurance undertakings (IU)	Balance as at 1. 1. 2002		Additions in 2002		Balance as at 31.12. 2002		Change in 2002	
	in €m	in %	in €m	in %	in €m	in %	in €m	in %
Land, leasehold rights, and buildings	26,392	2.8%	3,493	0.8%	25,973	2.6%	-419	-1.6%
Interests in affiliated enterprises	85,766	9.1%	68,563	15.9%	113,032	11.2%	+27,266	+31.8%
Loans to affiliated enterprises	20,587	2.2%	16,021	3.7%	20,376	2.0%	- 211	- 1.0%
Participating interests	14,900	1.6%	9,458	2.2%	21,121	2.1%	+ 6,221	+ 41.8%
Loans to undertakings linked by virtue of Participation	2,360	0.2%	2,606	0.6%	4,766	0.5%	+ 2,406	+ 101.9%
Equities	33,820	3.6%	28,589	6.6%	19,959	2.0%	- 13,861	- 41.0%
Investment certificates	216,290	22.9%	63,679	14.8%	229,621	22.8%	+ 13,331	+ 6.2%
Other, variable-yield Securities	5,404	0.6%	1,192	0.3%	5,038	0.5%	- 366	- 6.8%
Bearer bonds and other fixed-interest securities	80,097	8.5%	91,339	21.2%	84,432	8.4%	+ 4,335	+ 5.4%
Loans secured by mortgages, land charges, and capital annuity charges	68,951	7.3%	7,667	1.8%	71,142	7.1%	+ 2,191	+ 3.2%
Registered bonds	211,000	22.3%	46,131	10.7%	211,235	21.0%	+ 235	+ 0.1%
Certificates of debt and Loans	147,264	15.6%	48,218	11.2%	162,144	16.1%	+ 14,880	+ 10.1%
Loans and prepayments on insurance certificates	5,344	0.6%	1,859	0.4%	5,465	0.5%	+ 121	+ 2.3%
Other loans	7,319	0.8%	2,048	0.5%	8,063	0.8%	+ 744	+ 10.2%
Deposits with credit institutions	15,155	1.6%	38,088	8.8%	19,618	1.9%	+ 4,463	+ 29.4%
Other investments	3,869	0.4%	1,644	0.4%	4,280	0.4%	+ 411	+ 10.6%
<b>Total investments</b>	<b>944,518</b>	<b>100.0%</b>	<b>430,595</b>	<b>100.0%</b>	<b>1,006,265</b>	<b>100.0%</b>	<b>+ 61,747</b>	<b>+ 6.5%</b>
Life insurers	570,646	60.4%	207,491	48.2%	593,082	58.9%	+ 22,436	+ 3.9%
"Pensionskassen"	70,731	7.5%	21,308	4.9%	72,293	7.2%	+ 1,562	+ 2.2%
Death benefit funds	1,379	0.1%	466	0.1%	1,409	0.1%	+ 30	+ 2.2%
Health insurers	80,978	8.6%	33,620	7.8%	88,741	8.8%	+ 7,763	+ 9.6%
Property and casualty insurers	100,673	10.7%	57,928	13.5%	104,299	10.4%	+ 3,626	+ 3.6%
Reinsurers	120,111	12.7%	109,782	25.5%	146,441	14.6%	+ 26,330	+ 21.9%
<b>All IU</b>	<b>944,518</b>	<b>100.0%</b>	<b>430,595</b>	<b>100.0%</b>	<b>1,006,265</b>	<b>100.0%</b>	<b>+ 61,747</b>	<b>+ 6.5%</b>

Above-average growth in investments, according to projection, for health insurers and reinsurers.

for their proportionate increase in relation to overall investments, rising from 15.6% to 16.1%.

As in the previous year, total investment growth posted by health insurers with 9.6% and reinsurance undertakings with 21.9% was significantly higher than the average (6.5%). In contrast, the 3.9% achieved by life insurers, 3.6% by property and casualty insurers and 2.2% by "Pensionskassen" and death benefit funds represent significantly lower than average growth. The sharp rise for health insurers results from the statutory increase in provisions recognised (allocated from surpluses) to reduce premium increases in old age. Reinsurers achieve their growth essentially by raising premiums and increasing their share capital. For property and casualty insurance undertakings the main influence has been the fall in surplus funds as a result of stagnating premium income and rising claims expenditure.

## 2.4 Solvency 2001

### 2.4.1 Life insurers

Evaluation of the solvency sheets submitted by 117 life insurance undertakings for the 2001 financial year established that the solvency margin to be covered amounted to €22.2 billion. Their returns indicated that the categories of mathematical provisions and risk capital accounted for by far the most sizeable elements of the required amount, whereas supplementary and unit-linked life insurances were of lesser importance. Five of the 117 undertakings only had to cover the minimum guarantee fund due to their low volume of business.

The eligible own funds in terms of the solvency regulations for the insurance undertakings in aggregate amounted to €44.2 billion. This puts coverage of the solvency margin at 199%.

The composition of own funds was:

Own Funds A	EUR	6.371	billion	(14.4%)
Own Funds B	EUR	37.354	billion	(84.5%)
Own Funds C	EUR	0.488	billion	(1.1%)

In the 2001 financial year, BaFin authorised eleven life insurers to treat Own Funds C as eligible own funds.

Own Funds A consisted principally of the paid-in share capital, half of the unpaid share capital, and the reserves. Own Funds B consisted of the part of the provisions for premium refunds not yet allocated for profit participation, which can be used to cover an extraordinary loss (Section 56a (5) VAG). Own Funds C represent the value of future surpluses which can be deemed eligible with BaFin's approval. The approval of future surpluses as own funds only extends up to the amount needed to cover the solvency margin when Own Funds A and B leave a shortfall in coverage. In the 2001 financial year, eleven life insurers were permitted to use Own Funds C as eligible funds.

A large number of life insurers had up to 100% surplus coverage of the solvency margin.

For 9% of undertakings, the amount of own funds was equal to the solvency margin, these being the undertakings which were permitted to use Own Funds C to achieve the necessary coverage. 52% of undertakings had surplus coverage of the solvency margin of up to 100%; around one-fifth of undertakings (22%) had surplus coverage of between 100% and 200%; for 8.5% the surplus was between 200% and 300%, and 8.5% had in excess of 300% surplus coverage.

According to the solvency regulations at least half of the guarantee fund must be covered by Own Funds A and B. All undertakings fulfilled this requirement.

Six undertakings allocated participation rights as own funds in the 2001 financial year.

Pursuant to Section 53c (3) sentence 1 no. 3a VAG, insurers may also include a limited amount of capital represented by participation rights in the own funds allocated for coverage of the solvency margin. In the 2001 financial year, six undertakings included total capital represented by participation rights of €46.3 million as eligible own funds. This was equal to 23.8% of these undertakings' paid-in capital. None of the undertakings exceeded the permissible upper limit of 25% (Section 53c (3c) VAG).

#### 2.4.2 Death benefit funds

In 2002, BaFin evaluated the solvency sheets submitted by death benefit funds for the 2001 financial year. With the exception of one public limited company (AG), all 45 of the death benefit funds under Federal supervision were constituted in the legal form of "kleinere Vereine" (smaller mutual societies). Those 27 funds which had undertaken a recalculation of the mathematical provisions on the balance sheet date had to provide evidence of adequate solvency in the form of a solvency sheet. All death benefit funds provided evidence of adequate solvency.

Most death benefit funds demonstrated surplus coverage of the solvency margin of up to 100%.

The solvency margins which these 27 death benefit funds had to cover amounted to €43.7 million. Own funds of €52.1 million were available to cover this amount. This corresponds to a coverage ratio of 119.3%. All together, 21 undertakings achieved surplus coverage of up to 100%, four had surplus coverage of 100% – 200%; one death benefit fund came within the bracket of 200% – 300%, while one was categorised as having an excess coverage of over 300%.

Six death benefit funds obtained BaFin's permission to treat future surpluses as eligible for coverage of the solvency margin.

74.9% of the own funds consisted of the loss reserve or, in the case of the one public limited company mentioned, subscribed capital and capital reserves. None of the undertakings included capital represented by participation rights or subordinated liabilities in own funds. As a share of total own funds, unused provisions for premium refunds constituted 13.5%. The category known as "explicit own funds" thus accounted for 88.4%. Six death benefit funds obtained BaFin's permission to treat future surpluses as eligible for coverage of the solvency margin. Future surpluses made up 11.6% of total own funds.

All death benefit funds had dedicated "explicit" own funds of three times the minimum solvency limit. The minimum solvency limit is one-sixth of the solvency margin. Death benefit funds are not required to maintain a minimum guarantee fund. Seven insurers applied halved rates to calculate the solvency margin (2% instead of 4% of mathematical provisions and 0.15% instead of 0.3% of capital at risk) because their premiums in the past three financial years had not exceeded €500,000.

### 2.4.3 Private health insurers

Of the 55 health insurers under Federal supervision in 2001, three undertakings in the legal form of "kleinere Versicherungsvereine" (mutual societies with limited activity) were exempted from the solvency regulations of Section 53c VAG, since their volume of premiums did not exceed €1.87 million and their Articles of Association made provision for obligatory top-ups by members.

The solvency margin to be covered has risen by a good seven per cent year on year.

Evaluation of the solvency sheets submitted by 52 health insurers established that the solvency margin to be covered was €1,220 billion. This represents a rise of 7.2% on the previous year. In total, 33 undertakings used the premium index to determine the amount of the solvency margin, and five undertakings used the claims index. Fourteen of the companies only had to cover the minimum guarantee fund due to their low volume of business.

More than half of health insurers covered the solvency margin by more than 100%.

The required solvency margin was covered by own funds amounting to €2.7 billion in the case of the 52 undertakings. This equated to 2.7% growth compared to the previous year. Since the growth in the solvency margin had exceeded the growth in own funds, the coverage rate dropped from 232.7% to 223%. Ten undertakings achieved surplus coverage of the solvency margin of up to 50% and ten achieved surplus coverage of between 50% and 100%; for 19 undertakings the surplus coverage was between 100% and 200%, and for 16 it was in excess of 200%.

One insurer used supplementary contributions as own funds and two used surrogate forms of capital.

One health insurer with the legal form of a mutual society (Versicherungsverein auf Gegenseitigkeit – VVaG) availed itself of the possibility of using supplementary contributions, which were eligible under its Articles of Association, as own funds (§ 53c (3) sentence 1 no. 5 VAG). A total of two undertakings used so-called surrogate forms of capital, such as subordinated liabilities and capital represented by participation rights, amounting to €46.5 million, as own funds.

### 2.4.4 Property and casualty insurers

228 property and casualty insurers had own funds of €24.4 billion in total.

BaFin evaluated the information on solvency supplied by property and casualty insurers for the 2001 financial year. The evaluation was based on the solvency sheets submitted by 228 property and casualty insurers. The amount of the solvency margins to be covered by them collectively was €7.1 billion. The 228 undertakings had own funds of €24.4 billion in total. This corresponds to a coverage rate of 343%. 222 undertakings achieved surplus coverage of the required amount with their available own funds. Six companies were found to have deficiencies in coverage of €4.3 million in total, which gave rise to objections by the supervisory authority. The detailed situation was as follows:

Table 13

**Solvency of property and casualty insurers**

Provision for solvency margins				
	2001		2000	
	€m	No. of IU	€m	o. of IU
Minimum guarantee fund	22,6	35	20,9	32
Premium index	3.377,7	117	3.936,0	126
Claims index	3.712,6	76	3.523,7	76
<b>Total</b>	<b>7.112,9</b>	<b>228</b>	<b>7.480,6</b>	<b>234</b>
Own funds				
	2001		2000	
	€m	No. of IU	€m	o. of IU
<b>Collective amount</b>	<b>24.373,3</b>	<b>228</b>	<b>20.730,6</b>	<b>234</b>
of which:				
Capital represented by participation rights	253,5	6	232,9	6
Subordinated liabilities	180,7	5	15,2	2
Suppl. contributions (mutuals - VVaG)	1.323,5	25	1.172,1	23
Coverage				
	2001		2000	
	%	No. of IU	%	No. of IU
Collective coverage rate	343%		277%	
Shortfalls in coverage	€4.3m	6	€23.9m	9
Surplus coverage up to 100%	39%	88	39%	91
Surplus coverage 100% to 200%	22%	50	23%	54
Surplus coverage 200% to 300%	14%	32	12%	27
Surplus coverage of 300%+	23%	52	23%	53
<b>Total</b>	<b>100%</b>	<b>228</b>	<b>100%</b>	<b>234</b>

**2.4.5 "Pensionskassen"**

Of the 136 "Pensionskassen" under Federal supervision in the 2001 financial year, 101 undertakings had to return a solvency sheet. In accordance with Circular 3/97, "Pensionskassen" in the legal form of "kleinere Versicherungsvereine" (mutual societies with limited activity) are required to submit solvency sheets only as at those dates on which their mathematical provisions are recalculated.

The solvency margin for the 101 undertakings collectively was €3.0 billion. With own funds amounting to €3.7 billion in total, the resulting coverage rate is 123.1% (previous year 131.2%). There are fundamental problems in comparing the year 2001 data with that of the previous year because of the differing composition of the group of undertakings required to submit solvency sheets. Even so, the decline is an early reflection of the weaker results caused by the downturn in markets in 2001.

MTwo "Pensionskassen" with shortfalls in coverage have since rectified them. Most had surplus coverage of up to 100 %.

Two "Pensionskassen" did not have sufficient own funds to cover either the solvency margin or half of the guarantee fund; both have since rectified the shortfall in coverage. The majority of the other "Pensionskassen", 77 in all, showed surplus coverage of up to 100%. A total of 15 undertakings had surplus provisions of between 100% and 200%, four had surplus provisions of between 200% and 300% and three had surplus provisions of more than 300%.

49 "Pensionkassen" counted future surpluses and hidden reserves towards own funds.

The undertakings' own funds can be broken down into 30.7% Own Funds A (members' funds and loss reserve), 30.3% Own Funds B (unused parts of the provision for premium refunds), and 39.1% Own

Funds C (future surpluses and hidden reserves associated with investments). In total, 48 "Pensionskassen" included future surpluses from Own Funds C to cover the solvency margin. Furthermore, BaFin authorised one "Pensionskasse" to use Own Funds C in the form of hidden reserves on assets. No undertaking counted so-called surrogate forms of capital towards own funds.

For calculation of the solvency margin, 22 undertakings applied halved rates (2% instead of 4% of mathematical provisions, and 0.15% instead of 0.3% of capital at risk) because none of them had taken more than €500,000 in premiums in the past three financial years.

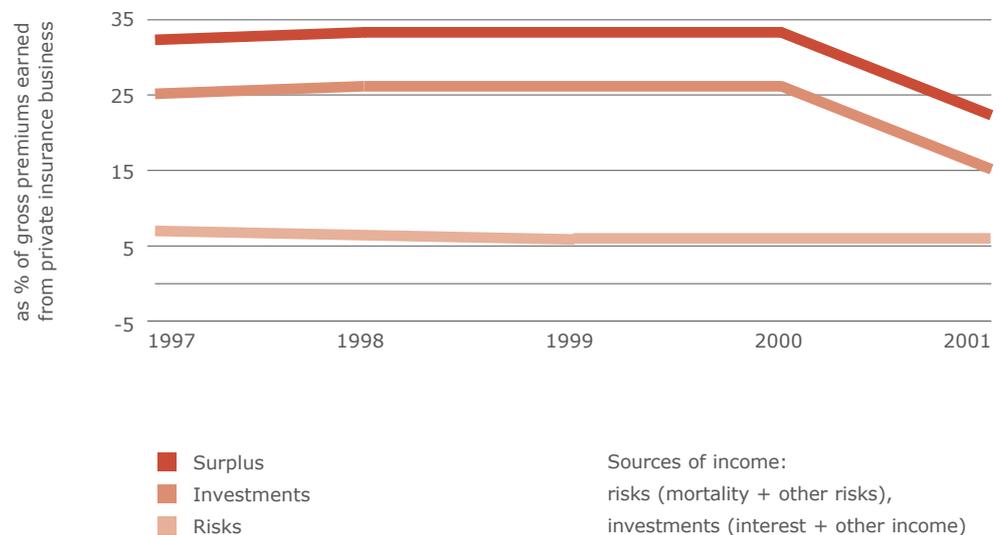
## 2.5 Overview of life insurance surpluses in 2001

Precise figures for the total business volume of all life insurance undertakings, in the form of a breakdown of the surplus by sources of income for the last three business years, can be found in Table 141 (Appendix). The surplus is stated as the total of the individual sources of income after the whole of the direct credit to policyholders has been deducted. Here it should be borne in mind that the whole of the direct credit has been deducted from the net interest income, as in past years, because the direct credit is largely attributable to this source of income. However, since a part of the direct credit originates from other sources of income (in particular, from the risk result), the deduction from the net interest income is rather high. Hence the income figure is somewhat understated. Likewise, the percentages stated in Table 141 represent the relationship of income from the individual sources of income to the gross premiums earned (except premiums from the provision for premium refunds) from private insurance in aggregate.

Fig. 9

### Life insurance - surplus

(total) from private insurance business



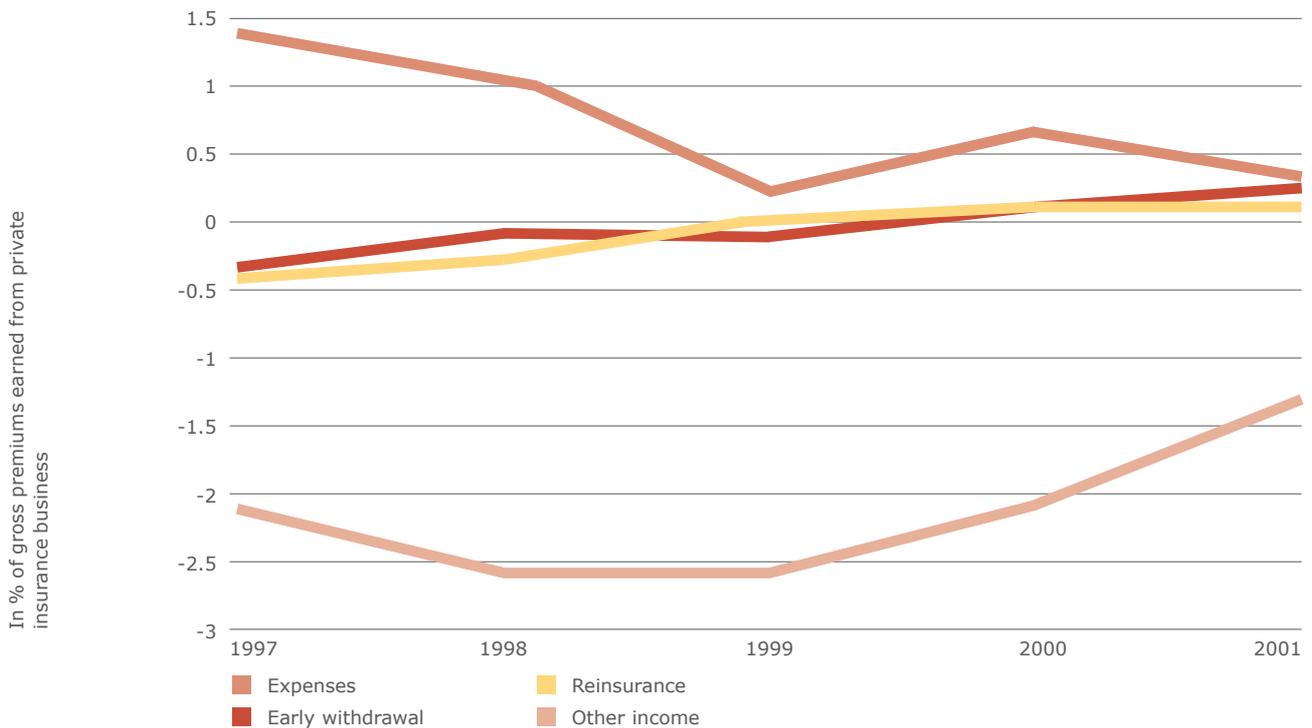
The total surplus from private insurance fell by around €6.7 billion in comparison to the year 2000, to €13.5 billion in the 2001 financial year. As a percentage of gross premiums earned, this brought the total surplus down from 33.2% in the previous year to 22.1%. This decline is attributable to the drastic fall in investment yields. This affects both the net interest income and the remaining income. The return from other risks was also reduced slightly. Higher losses occurred in the area of acquisition costs – which comprise direct and indirect costs of obtaining and processing new business – and from the difference between the tariff premium and the standard premium (a tariff is also referred to as a scale of premiums). Counter to this trend, the yield from early withdrawals increased slightly and the loss from other income was reduced. The income percentages from mortality, administrative costs, and reinsurance remained unchanged. Investments and risks continued to be the most important sources of income. As in previous years, the level of surplus was somewhat lower than the total of these two sources of income, because the balance from other sources of income was negative.

The mortality surplus amounted to 5.3% as in the previous year and the balance of surpluses from other risks was 1.5% (previous year: 1.6%) of gross premiums earned. Earnings from early withdrawals (i.e. cancellations) amounted to 0.2% (previous year: 0.1%). Thus, the total net income from risks was unchanged in percentage terms from the previous year. The most important other risks include accidental death, occupational disability, and endowment. While income from accidental death and occupational disability risks continued to be positive, income from endowment insurance was once again negative in 2001 due to increasing life expectancy.

Grafik 10

**Life insurance - sources of income:**

early withdrawal, costs (acquisition and administrative costs),  
 reinsurance (mortality + other risks + other income), other income



The total result from investments decreased by approx. 42% to €9.8 billion (previous year: €16.9 billion). This was caused by the lower gains in comparison to previous years. The fact that the net interest income was so severely affected is explained by the fact that gains within unit trusts/cover funds (also referred to as "investment funds"), unlike directly held equities, are computed as running gains and are thus recorded as "net interest income" and not as "other income". The remaining investment income for 2001, which primarily represents the balance of the realisation of hidden reserves on the one hand and write-downs of investments and realised losses on the other hand, amounted to approx. €2.4 billion (previous year: €4.7 billion) or 3.9% (previous year: 7.6%) of gross premiums earned.

As in the past year, once again early withdrawals, i.e. all forms of cancellation, from life insurance policies yielded a small return of 0.2% (previous year: 0.1%) of gross premiums earned.

The loss from acquisition costs was 3.3% of gross premiums earned, a significant increase on the previous year's figure of 2.9%. However, this figure must be qualified, i.e. put into perspective, because as a result of the taxation debate which began in mid-1999, many new policies which were scheduled to commence in 2000 were brought forward to the end of 1999. In 2000, this caused the volume of business throughout the insurance sector to fall by 30.2% (as a proportion of the underwritten amount) or by 28.8% (in relation to the number of policies). Accordingly, the figure for losses from acquisition costs (costs of obtaining and processing new business) in 2000 was unusually low. Other factors to take into account are that the first private old-age provision products (Riester pension reform) went on sale at the end of 2001, and increasing stock market volatility boosted interest in insurance products.

Taking account of administrative costs, the positive result was similar to the previous year's 3.6% of gross premiums earned. As in past years, this produced a sufficient surplus from the administration costs contained in the so-called tariff premiums to cover the loss from acquisition costs. Thus the acquisition and administrative cost elements of premiums have more than covered their own costs for a number of years. The overall expense-related result (insurers make assumptions about future costs; if they operate more cost-effectively than anticipated, they generate a surplus) amounted to 0.3% of gross premiums earned (previous year: 0.7%).

The difference between tariff premiums and standard premiums referenced in the breakdown of surpluses is caused by the different bases used to calculate the tariff premium and the mathematical provision for some new tariffs. The premium which would have resulted according to the calculation base for the mathematical provisions is known as the standard premium ("Normbeitrag"). Where a negative result is shown, this means that the calculation of premiums for certain tariffs took place under more optimistic assumptions (e.g. with a higher technical interest rate) than the calculation of the mathematical provisions (maximum technical interest rate 3.25% for tariffs as from July 2000). In these cases, the undertakings must put up the present value of premium differences as additional coverage capital, entailing an additional expense in the first instance. The loss posted for 2001 from this source of income amounted to approx. €38 million (0.1% of

gross premiums earned) and therefore had a minimal impact on the total result.

The total result from reinsurance business (passive reinsurance) was unchanged in percentage terms on the previous year and amounted to 0.1% of gross premiums earned.

## 2.6 Current values of investments 2001

For investments stated on the balance sheet at historical cost, according to Section 54 of the Ordinance on Insurance Accounting (Verordnung über die Rechnungslegung von Versicherungsunternehmen – RechVersV), the total current value must be calculated and stated in the Notes to the annual report when it is published. Exceptions to the requirement to state current values are registered bonds, mortgages, and other claims which must be recognised at their nominal amounts according to the German Commercial Code (Handelsgesetzbuch – HGB) Section 341c (1).

In their reports to BaFin, insurers have to state the current values separately for each type of investment. The current values of investments held by primary insurers were discussed in Part B of BaFin's Annual Report for the year 2001. Now figures for the reinsurers can be provided. Here the following picture emerges for primary insurers and reinsurers (with the exception of "Pensionskassen" and death benefit funds), although there is limited scope for drawing meaningful conclusions from the data presented at this juncture in the light of the current situation in the capital markets.

Table 14

### Current values of investments of all insurances

All insurance undertakings (except "Pensionskassen" and death benefit funds)	Book values		Current values		Hidden reserve % of book value		
	€m	% share	€m	% share	€m	%	%
Land, leasehold rights, and buildings	22,726	2.4	37,918	3.5	15,192	66.9	9.7
Investments in affiliated enterprises and participating interests	123,261	13.3	233,033	21.4	109,772	89.1	69.9
Equities	33,528	3.6	54,118	5.0	20,589	61.4	13.1
Investment certificates	187,899	20.2	194,915	17.9	7,016	3.7	4.5
Bearer bonds and other fixed- interest securities	69,432	7.5	71,727	6.6	2,295	3.3	1.5
Other investments	492,725	53.0	494,863	45.5	2,138	0.4	1.4
<b>Total investments</b>	<b>929,571</b>	<b>100.0</b>	<b>1,086,572</b>	<b>100.0</b>	<b>157,001</b>	<b>16.9</b>	<b>100.0</b>
of which:							
Life insurers	582,954	62.7	614,282	56.5	31,328	5.4	20.0
Health insurers	81,006	8.7	85,770	7.9	4,764	5.9	3.0
Property and casualty insurers	101,022	10.9	132,731	12.2	31,709	31.4	20.2
Reinsurers	164,589	17.7	253,789	23.4	89,200	54.2	56.8

Table 15

**Current values of investments of all reinsurers**

Reinsurers	Book values		Current values		Hidden reserve		
	in € millions	% share	in € millions	% share	in € millions	in % des book value	% share
<b>Land, leasehold rights, and buildings</b>	1,637	1.0	4,507	1.8	2,870	175.3	3.2
<b>Investments in affiliated enterprises and participating interests</b>	69,709	42.4	151,067	59.5	81,358	116.7	91.2
<b>Equities</b>	6,364	3.9	11,393	4.5	5,029	79.0	5.6
<b>Investment certificates</b>	17,167	10.4%	17,691	7.0%	525	3.1	0.6
<b>Bearer bonds and other fixed- interest securities</b>	16,146	9.8	16,450	6.5	303	1.9	0.3
<b>Other investments</b>	53,566	32.5	52,680	20.8	-885	-1.7	-1.0
<b>Total investments</b>	164,589	100.0	253,789	100.0	89,200	54.2	100.0

At the end of 2001, land and investments in affiliated enterprises and participating interests accounted for 80% of the valuation reserves.

Of the valuation reserves reported to BaFin as at 31 December 2001, amounting to €157.0 billion (previous year's figure: €212.2 billion), around 80% (previous year: 68%) fall into the categories of land and investments in affiliated enterprises and participating interests. Overall, these investments have very limited if any marketability, since for the most part they consist of business premises in use by the company itself, or of participating interests within a corporate group. The hidden reserves on equities and investment certificates (18%; previous year 30%) are heavily dependent on capital market trends.

After showing initial signs of recovery, prices on national and international stock exchanges went on to continue their decline over the course of the year 2002. Because insurance companies are vulnerable to unpredictable (extreme) developments on the capital markets – in particular, persistent falling prices for equities and investment certificates in tandem with low interest rates – BaFin pays especially close attention to changes in hidden reserves and associated effects on the insurers' income and on their general financial position.

## 3 Supervision of individual areas of the insurance industry

### 3.1. Life insurers

Developments in the capital markets in 2002 posed life insurance undertakings with a challenge on a hitherto unknown scale. On top of the continuing fall in interest rates within the bond markets, the situation was exacerbated by falling share prices. By adjusting their profit participation for the year 2003 to the new economic climate and establishing "Protector" as a company to rescue the portfolios of ailing life insurers, the life insurance undertakings began to show signs of making headway.

### 3.1.1. Financial position

Trends within the capital markets in 2002 resulted in an extraordinarily difficult situation for a number of life insurance undertakings. In addition to declining interest rates within the bond markets, the tumble taken by share prices in 2002 was on an unprecedented scale. It was only fairly recently that many life insurers had significantly increased their equity investment holdings, both in terms of direct ownership and indirectly by way of unit trusts/cover funds (also referred to as "investment funds"). These undertakings in particular were the hardest hit by the decline in prices.

Last year BaFin conducted two surveys on the prospects of business success and the impacts of falling share prices on capital markets.

In July and October of 2002, BaFin called upon all life insurers to submit forecast profit calculations for the 2002 financial year. In both questionnaires the supervisory authority set out two negative scenarios in respect of share prices at the end of 2002, in each case oriented to the stock market situation at the time. The objective was to make an early assessment of the impact a further price decline would have on the economic success of life insurers, and the extent to which undertakings needed to implement risk-limitation measures.

Furthermore, the supervisory authority questioned undertakings about their coverage of underwriting obligations with the right quality of investments.

In addition, the supervisory authority questioned undertakings about their coverage of underwriting obligations with the appropriate investments, requesting both book values and current values. Analysis in terms of current values was rendered necessary for the first time in the year 2002 following the amendment of Section 341b (2) in order to assess coverage of the "Deckungsstock" with sound investments (and also in view of the newly introduced Section 66 (3) sentence 2 VAG); in addition, where hidden charges exist, the aim is to predict the possible development of coverage in terms of book values.

This is because according to Section 341b (2) sentence 1 HGB, insurance companies holding securities which are recognised at historical cost and intended to continuously serve the business operations have the option of categorising them as non-current assets and accounting for them accordingly. Such assets need not be written down in response to short-term price fluctuations but only if their value appears likely to be permanently impaired. Refraining from write-downs can result in hidden charges in such instances. Without additional information on depreciation practices, it is no longer a straightforward matter for BaFin to assess the extent to which declining share prices will push down the gross surplus in the current financial year.

The second survey was also concerned with the determination of profit participation.

Moreover, in the second questionnaire the insurers were asked to make a declaration on profit participation for 2003. In this way BaFin gained an overview of whether the Management Board's resolution on profit participation was in line with the proposal of the Responsible Actuary, and took appropriate account of the individual company's financial position.

BaFin conducted these survey programmes in order to carry out a predictive form of supervision assisted by forecast data and scenario-based calculations, in the context of a difficult situation in the capital market. In this way BaFin was well informed about the situation of life insurers and was able, if necessary, to intervene correctively at an early juncture in individual cases.

### 3.1.2 Permitted accounting instruments for life insurers

Based on the growing volatility in the capital markets, BaFin has been looking into additional possibilities for insurers to respond to the current market conditions.

Financing the direct credit to policyholders out of the provision for premium refunds is permitted as an exception. The amount deducted has to be entered in the income statement under "other technical income".

BaFin sees no cause for concern if life insurers – in the case of the existing portfolio, following a change to their overall business plan for profit participation – wish to lower the direct credit as from the 2002 financial year.

Furthermore, the possibility exists of financing the direct credit for this portfolio, in justified extraordinary situations, by means of withdrawal from the provision for premium refunds. This might be conceivable if the life insurer's profit situation had substantially worsened since the direct credit was determined. Once again, this requires appropriate prior documentation in the business plan. Authorisation in accordance with Section 56a VAG is not required since the withdrawal is used to increase insurance benefits to policyholders or to make rebates to policyholders. The withdrawn amount must be entered in the income statements under the heading "other technical income" and may not be netted with any amount allocated to the provision for premium refunds. The withdrawal must also be stated in the annual report in the notes to the provision for premium refunds. For new contracts, the financing of the direct credit from the provision for premium refunds is possible within the bounds of contract law.

In the year under review, several life insurers made changes to their overall business plan for profit participation. A few of them wished to make immediate use of the newly authorised ruling in the 2002 financial year.

In principle, it is possible to reduce the terminal bonus reserve fund for new policies.

For new policies, it is possible to reduce the terminal bonus reserve fund in line with the declaration (Section 28 (6) RechVersV) where this is not in breach of any contractual agreements with the customer. The released funds are to be transferred to the unused provision for premium refunds.

For existing policies, due consideration must be given both to the provisions of the Ordinance on Insurance Accounting and to the terms of the overall business plan for profit participation in establishing the terminal bonus. As a matter of principle, where any change is made to the terminal bonus rates, the funds committed to the terminal bonus reserve fund must be preserved for the portfolio of policies for which they were established<sup>30</sup>. Hence bonuses should only be declared if they can be maintained permanently. To safeguard the interests of policyholders, guidelines on the financing of declared terminal bonuses have therefore been passed. With adequate financing, then, the terminal bonus reserve fund will essentially contain sufficient funds to cover the full rate. Should the profit situation change, drastic cuts in the terminal bonus rate are rendered unnecessary and the reduction should be confined to what is essential. The necessary allocation to the terminal bonus reserve fund in the financial year of the reduction can be reduced to zero if the reduced rate set is such that the fund already contains sufficient provisions to finance it. Amendments to the overall

<sup>30</sup> cf. Section 4 of the specimen business plan; VerBAV 1994 p. 5.

business plan for profit participation for the purpose of reducing or reversing the terminal bonus reserve fund for existing policies were therefore ineligible for authorisation. In particular, BaFin had to turn down applications to transfer funds from the terminal bonus reserve fund into the unused provision for premium refunds in order to achieve a blanket increase in the bonus rate related to the interest surplus. Authorised use of the terminal bonus reserve fund to cover losses in accordance with Section 56a VAG remains unaffected.

### **3.1.3. Establishment of Protektor Lebensversicherungs-AG**

All life insurers affiliated with the GDV are shareholders in the rescue company Protektor.

On 9 December 2002 BaFin authorised Protektor Lebensversicherungs-AG, Berlin, to commence business. All life insurers affiliated with the German Insurance Association (Gesamtverband der deutschen Versicherungswirtschaft – GDV) have become shareholders of Protektor, each in proportion with their market share. Protektor was established with share capital of €3.2 million; if required, the share capital will be increased up to a limit of 1% of the shareholders' investment assets (currently approx. €5.5 billion). Protektor functions as a rescue company for life insurers under serious onslaught. Should a life insurer find itself in financial difficulties which can no longer be solved by the undertaking itself, or by its owners, Protektor AG will assume responsibility for rescuing the jeopardised insurance policies in the interests of policyholders. Besides the protection afforded by regulations on the "Deckungsstock" and on investments, the existence of Protektor now constitutes a further instrument ensuring the stability of German life insurers.

### **3.1.4 Appointment of a special commissioner**

In July 2002 BaFin appointed a special commissioner to sit on the Management Board of a life insurer after becoming aware of facts which gave grounds for concluding that the interests of policyholders were at risk. The special commissioner found an acceptable solution for this undertaking: the insurance portfolio was taken over by another insurance undertaking. The policies will remain in force and unchanged, without detriment to policyholders.

### **3.1.5 Report of the Responsible Actuary**

As in past years, in filing their reports in accordance with Section 11a (3) VAG some Responsible Actuaries have not taken the special characteristics of the particular life insurer sufficiently into consideration. In particular, once again the safety margins built in to the calculation bases were not adequately represented.

The supervisory authority issued a reprimand for the flawed reporting and demanded correction of the following points in the reports:

- The assessment of the safety margin built into the "technical interest" calculation base relied on yields which were not appropriate for the purpose. In some cases the comparative yields were not determined with reference to the undertaking's investments but based on the ten-year average of yields on government bonds. In other cases the company-specific

benchmark yields were inappropriately raised by calculating an average which incorporated the company's figures from past years. There were even instances where the existence of a safety margin was merely mentioned but not quantified, and no indication was given of the underlying benchmark interest rate.

- When setting out the safety margins built in to the biometric calculation bases, actuaries' reports should take account of losses for portfolio components representing separate sources of income, data which is available from the reports compiled for BaFin.
- If peculiarities in the result from costs emerge in certain accounting categories or portfolio groups, they should be scrutinised separately.
- The results of the scenario calculations on safeguards and liquidity should be discussed in detail.

The life insurance undertakings concerned agreed to pay greater attention to the representation of company-specific peculiarities in future actuaries' reports.

### 3.1.6 Advertising relating to profit participation

In numerous on-site inspections BaFin has had to reprimand advertising which refers to future profit participation.

In the period covered by the report, BaFin stepped up its attention to the advertisement of future profit participation. In this respect, the supervisory authority does not see the representation of benefits as an irregularity in the terms of Section 81 (2) VAG if life insurers comply, as a minimum, with the recommendation in Circular 2/2000 of 23 October 2000. Virtually all on-site inspections and numerous instances in the course of supervisory work gave rise to objections on this issue. The key points drawing criticism concerned insufficient emphasis of guaranteed benefits as opposed to profit participation, and the frequent lack of any reference to the guaranteed tariff premium for term assurance policies. In the light of the downward trend in capital markets, both the size of the bonus rates quoted and the level of interest rate used internally by the company to establish that the bonus could be financed were criticised in individual cases. BaFin called upon the life insurance undertakings to take the necessary corrective steps without delay.

BaFin criticised certain insurers' representation of aggregate rates of return.

Some life insurers, in presenting their bonus declaration for the 2003 financial year made press statements quoting their aggregate yield, which is commonly defined as the technical interest plus an interest surplus bonus, as a single rate of return inclusive of terminal bonuses. BaFin expressly makes the point that statements of that kind are very likely to mislead insurance customers. It called upon the undertakings concerned to desist from making representations of this kind.

### 3.1.7 Advertising and sales methods

BaFin conducted on-site inspections of a number of life insurers for unfair advertising and sales practices.

Telephone marketing calls to private individuals without their prior consent is prohibited.

In all cases, life insurance products were being sold by call centres whose staff contacted both existing and prospective customers. Despite the precedent long upheld by the German Federal Court of Justice (Bundesgerichtshof – BGH) that it is illegal to contact

customers by telephone for the purpose of advertising without their prior consent, no such consent had been obtained by the insurers concerned.<sup>31</sup> BaFin expressly points out that even when there have been prior business contacts, the customer's specific consent must be obtained for telephone advertising. The insurer may not intrude on the customer's privacy on the assumption that the customer would not be likely to object.

A further problem with telephone advertising campaigns is the completion of contractual formalities. In almost all cases the content of the agreed contract was not clear since there was no written application form and the telephone records were incomplete or faulty. Furthermore, customers were given insufficient information, if any, about their right to withdraw, i.e. cancel, within a cooling-off period (Section 5a VVG), and the duty of identification specified in the Money Laundering Act was not always observed.

Upon request, the life insurers concerned immediately put a stop to the advertising measures which had given rise to the objections. The policies of customers concluded in this way were suspended on request.

### 3.1.8 Contribution deposits

In one local inspection BaFin noted that a life insurer was applying an interest rate to many longer-term contribution deposits (Beitragsdepot) which was significantly higher than the current capital market rate and also higher than the company's most recent surplus declaration. This practice is inadmissible because it disproportionately benefits the owners of these contribution deposits in relation to the other policyholders. BaFin took issue with this practice, insisted on adjustment of the rates of interest to a rate no higher than the current aggregate yield, and allowed a transition period for the adjustment to be made. The company undertook to make the required adjustments.

## 3.2 Death benefit funds

Death benefit funds are found to be economically secure.

BaFin conducted surveys among death benefit funds in August and October 2002 on the impact of trends in stock market prices and on their profit forecasts for 2002. Evaluation of the information provided revealed the economic position of the death benefit funds overall to be secure. All death benefit funds anticipate being able to cover the required "Deckungsstock" (coverage fund) at both book and current values. The undertakings surveyed overwhelmingly forecast that net interest income and consolidated results would continue to be sufficient to guarantee compliance with the solvency regulations.

<sup>31</sup> cf. Judgement of the German Federal Court of Justice (Bundesgerichtshof - BGH), 8 December 1994, in VerBAV 1995, p.17.

### 3.3 Private health insurers

The year 2002 proved that private health insurance undertakings were calculating premiums on a sound basis. Due to the difficulties in the capital market, some undertakings could no longer generate their technical interest. The safety measures built into the remaining calculation bases, in particular the safety loading of premiums, prevented any private health insurance undertaking from falling into serious economic difficulties.

#### 3.3.1 Financial position

As of 31 December 2001, it also became possible for health insurers to apply the so-called "gemildertes Niederstwertprinzip" (modified or diluted lower-of-cost-or-market principle) for the first time in their valuation of securities (Section 341 b (2) sentence 1 in conjunction with Section 253 (2) sentence 3 HGB). About half of the 55 health insurers under Federal supervision chose to exercise this right in the 2001 financial year.

The stock market slump will have a negative impact on net yields.

The ongoing stock market slump will have a negative impact on income from investments, and hence on net yields, because substantial write-downs are inevitable. This may well also push down the gross surplus despite an expected rise in gross premiums written, from €21.7 billion in the year 2001 to around €23 billion in the year 2002. The investment portfolio in this segment will be somewhere in the region of €90 billion.

The supervisory authority thoroughly investigated whether undertakings had sufficient investments to cover their obligations, measured in terms of book and market values.

In the year under review BaFin questioned most health insurers more than once about their financial situation. Some undertakings, for example those who held no equities or variable interest securities in their portfolios, were not included in the study. The supervisory authority focused on the question of whether undertakings had sufficient investments of acceptable quality to cover their obligations to policyholders, measured in terms of book and current values. Furthermore, the supervisory authority checked whether insurers were generating the guaranteed 3.5% minimum rate of return on mathematical provisions from investment income, and examined the situation with regard to surpluses. In view of the volatility of the capital markets, BaFin required undertakings to respond to various scenarios depending on the level of the DAX index as at 31 December 2002.

The health insurers concerned have since redressed the shortfalls in coverage or the deficiencies.

In terms of book values, one health insurer reported a shortfall in coverage of its "Deckungsstock" requirement (mathematical provisions). Two further health insurers were found to have deficiencies in their required "Deckungsstock"; consequently both undertakings were unable to cover the mathematical provisions with the current value of their investments. At the instigation of BaFin, the health insurers concerned have since redressed these shortfalls in coverage or deficiencies. All three undertakings are required to keep the supervisory authority informed regularly of their coverage situation.

Alongside income from investments, health insurers may also utilise other potential sources of surpluses, e.g. the built-in safety loading of premiums.

Approximately, one-third of health insurers are unlikely to be able to generate the guaranteed 3.5% minimum rate of return on mathematical provisions from investment income. However, the different calculation principle which operates in health insurance means

that there are other potential sources of surpluses, in particular a built-in safety loading of at least 5% of the gross premium. This serves to equalise losses if there is a temporary slide in the accuracy of any or all calculation bases in relation to the actual course of business, or if chance fluctuations render them inadequate. Thus the majority of these undertakings can finance the technical interest rate out of the safety loading, leaving a positive gross surplus after taxes.

A small number of health insurers will produce a below-par gross surplus. Nevertheless, according to current figures, these undertakings have sufficient own funds available in the 2002 financial year to equalise the loss. They will thus comply with the solvency regulations.

Currently no health insurer appears to be at any risk of failing.

At present the supervisory authority does not expect any health insurer to experience serious problems, particularly as the undertakings must check every tariff on an annual basis and compare the required insurance benefits with the calculated insurance benefits, which can be used to justify a premium increase. If so, the undertaking must review all of its calculation bases and adjust them accordingly. If premiums are adjusted, the undertaking can also lower the technical interest rate.

However, a further decline in net yields is likely.

Still, the weakness of the capital markets will not leave the health insurers balance sheets unscathed. A further reduction in net yield is to be expected. Payments of claims will continue to rise because of the increasing costs of medical treatment, reaching a level of approx. €15 billion. The poor results from investments and rising expenditure on claims will also have a detrimental effect on the health insurers' gross surpluses. Hence direct credits from the interest surplus bonus according to Section 12a VAG and allocations to the provisions for profit-related premium refunds will be lower. The companies have fewer resources at their disposal to mitigate future premium increases.

### **3.3.2 Raised ceiling for compulsory statutory health insurance**

The legislator raised the ceiling for compulsory membership of the statutory health insurance scheme to annual earnings of €45,900

In the new Act on Stabilisation of Contribution Rates [to Statutory Health Insurance and Social Security Pension Insurance] (Beitragssatzsicherungsgesetz – BSSichG) the legislator raised the annual earnings ceiling for the year 2003, this being the ceiling for compulsory contributions to the statutory health insurance scheme. The jump from €40,500 to €45,900 went beyond the normal annual raising of the threshold. However, for wage and salary earners who had exceeded the previous annual pay ceiling and moved out of the statutory system into a substitutive health insurance scheme as at 31 December 2002, the ceiling for compulsory statutory health insurance in the year 2003 is €41,400.

### **3.3.3 Mail order pharmacies**

BaFin received numerous submissions on the refund of costs for medicines from mail order pharmacies and on the prohibition of advertising medicines for sale by mail order.

The German courts issued an interim injunction preventing a Dutch mail order pharmacy from marketing medicines to the Federal Republic of Germany over the Internet.<sup>32</sup> The Federal Insurance Office (Bundesversicherungsamt – BVA) prohibited statutory insurance schemes from refunding the costs of prescription drugs obtained from mail order suppliers. The German Medicines Act (Arzneimittelgesetz – AMG) expressly forbids the sale of prescription drugs by mail order (Section 43 (1) AMG). Likewise under the Act on Advertising in the Health Sector (Heilmittelwerbeengesetz – HWG) it is illegal to advertise the sale of such drugs by mail order (Section 8 (1) HWG). On the other hand, individuals are permitted to purchase them without the involvement of a commercial or professional intermediary (Section 73 (2) no. 6a AMG).

Health insurers should be able to reimburse the costs of medicines from mail order pharmacies.

BaFin takes the view that private health insurers are not contravening the law if they reimburse the costs of medicines purchased from mail order pharmacies. In the cases in question, the insureds purchased the medicines from authorised (Dutch) pharmacies. Reimbursement of costs for medicines purchased from pharmacies is one of the benefits which health insurers are contractually obliged to provide, since the General Conditions of Insurance include clear provisions for compulsory reimbursement. Neither does BaFin view such reimbursement of costs as “promoting illegal purchase”. Although two courts decided during the interim injunction proceedings that the conduct of the Dutch pharmacy contravened German law, neither of the two judgements were confirmed on the main issue:

- The judgement of the Berlin regional court<sup>33</sup> stated that the Dutch pharmacy was not in contravention of the prohibition on mail order trading (Section 43 (1) AMG) but was covered by Section 73 (3) sentence 6a AMG.
- The Frankfurt regional court<sup>34</sup> suspended the proceedings and referred the question of the permissibility of the prohibition on mail order trading to the European Court of Justice for a preliminary ruling.

Some insurers addressed the issue of “mail order pharmacies” in customer magazines or mailings. They named sources of supply, described how to place orders, showed how costs could be saved by ordering medicines from mail order pharmacies and clarified that they would definitely reimburse the costs of purchase.

Factual information on the purchase of medicines from mail order pharmacies is not prohibited advertising.

BaFin did not regard this conduct as prohibited advertising for the purchase of medicines by mail order according to Section 8 (1) HWG. Reasonably priced methods of obtaining medicines are of particular public interest. Such publications thus fall into the sphere of freedom of information protected by Article 5 (1) of the Basic Law (Grundgesetz – GG).<sup>35</sup> The supervisory authority takes the view that the factual information provided to health insurance customers on the scope of their benefit entitlements should not be seen as advertising content. However, no recommendation may be issued to purchase medicines by

<sup>32</sup> Berlin Court of Appeal, ruling of 29 May 2001 - 5 U 10150/00; ruling of the Frankfurt a.M. Higher Regional Court of 31 May 2001 - 6 U 240/00.

<sup>33</sup> Ruling of 30 October 2001, case no. 103 O 109/01.

<sup>34</sup> Ruling of 10 August 2001, case no. 3/11 O 64/01.

<sup>35</sup> cf. Hamburg Regional Court, judgement of 14 October 1997, case no. - 312 O 243/97.

mail order. It must also be made clear that the insured alone have the right to decide where they buy their medicines, and that no distinction is made as to the source of supply when determining whether drug costs are eligible for reimbursement.

### 3.3.4 Managers of insurance undertakings

BaFin's position is that there are certain circumstances where it is not possible to make separate assessments of a manager's professional qualification for different insurance undertakings. Accordingly, a manager cannot have the requisite professional qualification for company A if it has been found wanting at company B.

In the year 2002 this question arose in a particular set of circumstances. The Supervisory Boards of a health and a property insurance company retained a manager in post although his professional deficiencies as a Management Board member had been largely to blame for a state of financial disorder in one of the corporate group's life insurance undertakings which threatened to bring down the company. BaFin appointed a special commissioner to the life insurer to safeguard the interests of policyholders. At the time, neither the health insurance nor the property insurance undertaking was in a critical financial situation.

### 3.3.5 Telephone advertising

BaFin objected to the conduct of a health insurer which circulated publicity vouchers to private individuals via a bank, containing the message: "Please send a free, no-obligation proposal to the address below" but then proceeded to contact the individuals by telephone. According to the precedent upheld by the Federal Supreme Court of Justice, telephone calls for the purposes of advertising are only permissible when the recipients of such calls have previously given their direct or tacit consent, which was not the case in this instance. The health insurer will redesign the voucher form accordingly.

### 3.3.6 Submission of technical calculation bases

There appears to be confusion among some health insurers as to precisely when changes in the technical calculation bases for substitutive health insurance must be notified to BaFin. Some undertakings submitted the changes only a few days before the premium changes took effect, and one undertaking even did so retrospectively.

No later than approval is given by the trustee, health insurers in substitutive health insurance must notify the supervisory authority of changes to technical calculation bases.

Insurance undertakings have to notify the supervisory authority of their "intention to use" new or adjusted technical calculation bases (Section 5 (5) no. 1a VAG) and submit all the indicated documentation "without delay", where the tariffs concerned apply to substitutive health insurance (Section 13d no. 8 VAG). The intention first becomes evident well in advance of the premium change taking force. It becomes evident no later than when the independent trustee agrees to the premium adjustment. BaFin will monitor compliance with the statutory notification deadline more closely in future.

### 3.3.7 Premium adjustment clauses

Premium adjustments for health insurance written on a similar basis to life insurance are restricted by various regulations. They may only be effected once the approval of the trustee has been obtained, certain material conditions have been met, and certain procedural regulations observed.

After a premium adjustment in substitutive health insurance, the calculation bases should only be changed for a serious reason. The new method must be equivalent to the standard method.

In the year under review, one health insurance company had submitted a different method for calculating the daily hospitalisation benefit tariff, as a follow-up to a premium adjustment. According to Section 12 (2) sentence 4 of the Calculation Ordinance (Kalkulationsverordnung – KalV) this is basically permissible – but only on condition that a serious reason exists for the change, and that the new method in turn is equivalent to the standard method. In BaFin's view the requirement for equivalence was not fulfilled since the new method did not make any provision for extrapolation. If a change in the extrapolation period is sufficient to disqualify a method on the grounds of non-equivalence, then a method where extrapolation is completely omitted cannot possibly be viewed as equivalent. The health insurer was of the opinion that no extrapolation was necessary for daily hospitalisation benefit because daily benefit tariffs – unlike cost tariffs – are not subject to increased benefits due to cost increases in the health sector and therefore there was no trend to take into consideration. BaFin did not accept this argument because even in the case of daily benefit tariffs, changes in the level of benefits were commonly seen which were not based on chance fluctuations. For example, the average duration of a hospital stay has continuously decreased over past years, which has an impact on the level of benefits for daily hospitalisation benefit insurance.

Furthermore, there was no serious reason to change the method for comparing the claimed and the projected insurance benefits. The health insurance undertaking refrained from applying the new method.

### 3.3.8 Probability tables

Germany has made use of the provision under the Non-life Insurance Directive of the European Union, and obliged health insurers which are qualified to provide a complete or partial alternative to the statutory health insurance system (known as "substitutive" health insurance) to calculate premiums on a similar basis to life insurance only. This means that in accordance with Section 12 (1) no. 2 VAG, insurers must base their premium calculations on probability tables which contain standard assumptions about the risk of invalidity and sickness, mortality, probability of risks by age and gender, and the probability of cancellation.

In order to facilitate the access of foreign undertakings to the German market, BaFin passes on probability tables to the supervisory authorities in other home Member States.

A calculation on a similar basis to life insurance presupposes the availability of statistical data on which to base this calculation. Insurance undertakings with a history of operating in a particular market generally use data built up by their own companies for this purpose. New undertakings however, particularly those from abroad, often find it difficult to obtain sufficient data. In order to facilitate the access of foreign undertakings to the German market, the Federal Republic of Germany has undertaken to pass on probability tables to

the supervisory authorities in other home Member States. To this end, health insurers based in Germany have to provide data annually, on the basis of which the supervisory authority compiles probability tables.

The most important tables needed for calculation are those on mortality, probability of cancellation, and age-dependent figures for expected claims.

The data required for the calculation and published in the form of probability tables consists primarily of suitable mortality tables, probabilities of cancellation, and tables with age-dependent figures for expected claims (per capita claims) for a diverse range of benefits offered. These three tables must be updated regularly for various reasons. Mortality and cancellation rates are variable; new products are of major importance to the health insurance market, and the healthcare system is characterised by substantial cost increases.

A range of tables required revision during the past year.

Once again in 2002 BaFin evaluated the data provided by those health insurance undertakings obliged to do so. Numerous tables on per capita claims had to be published for the first time, these being the tables for out-patient, in-patient and dental tariffs (also referred to as scales of premiums). The last published versions of the cancellation tables had also been superseded. One reason for this was that the observed figures for frequency of cancellation were lower. In addition the procedure established for some time for the evaluation of per capita claims data, whereby policies beginning in the year of evaluation and the two previous years are not included in the evaluation, was also applied to the cancellation analysis for the first time.

### 3.3.9 On-site inspections

#### KonTraG – Management and monitoring systems

In the course of many on-site inspections during the year 2002, BaFin once again dealt with the requirements of the Law Concerning the Control and Transparency of Corporations (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich – KonTraG).

The requirements of KonTraG were nothing new, thanks to the reporting regime imposed by the supervisory authority.

The Law Concerning the Control and Transparency of Corporations (KonTraG), which entered into force in May 1998, obliges Management Boards to take appropriate measures, particularly by establishing a monitoring system, in order to identify at an early stage potential risks which threaten the continued existence of the company as a going concern. As a result of the system for notification and reporting to BaFin as well as industry-specific safety measures, these requirements were nothing new for insurance undertakings; their present controlling and internal auditing practices already fulfil the function of management and monitoring systems.

Risk management systems are similar in process but differ, for instance, in the classification of risks.

BaFin established in the course of on-site inspections that the requirements of the Stock Corporation Act (Aktiengesetz – AktG) have been implemented properly by undertakings (Section 91 (2) AktG). The risk management systems are designed to follow a similar process. The classification of risks differs from one undertaking to another. For risk management purposes, risks are subjected to qualitative rather than quantitative assessment. Many companies carried out a risk audit in preparation for setting up the risk management system.

Some insurers backed their risk assessments with evidence about probability of occurrence.

From the aggregate of risks, those which could have a critical or long-term impact on corporate assets, finances or profits were isolated. To this end, the companies had to carry out a risk assessment. Some insurers backed their risk assessments with evidence about probability of occurrence. Then the level of claims or losses was determined. Some insurers made reference to a points system. Since in many cases the risks could only be quantified imprecisely or with difficulty, for the most part risks were classified on the basis of experience. This resulted in the grouping of risks according to high, moderate and low impact, or into the categories "critical" and "other" risks. Some examples of risks considered to be critical or existence-threatening are a lack of new business, stock market losses or high depreciation requirements, insufficient solvency, and total failure of IT systems. Other risks are, for example, shifts in demand, and investment risks from losses or forward exposures.

The management system is updated by means of regular risk assessments.

The organisation of risk management in the undertakings includes both centralised and decentralised features. As a rule, regular reporting takes place on identified risks, with assessment of the critical risks on a quarterly basis, and other risks six-monthly or annually. Where necessary, reports are made immediately. Some undertakings make use of predefined warning indicators, triggered if claims or cancellations cross or deviate from certain threshold values. For risk management, appropriate remedial or monitoring measures are taken in order to mitigate or prevent the risk. Regular risk assessments are conducted to keep the management system up to date, i.e. risks are reclassified or deleted and new risks are entered as necessary.

### **Retroactive approval from legal and actuarial trustees**

The approval of trustees may not be issued retroactively.

In an on-site inspection BaFin reprimanded a health insurer for having obtained the approval from trustees for premium adjustments and changes to the General Conditions of Insurance following actual implementation, i.e. retroactively. The approval of trustees must be obtained before the changes take effect. The statutory provisions clearly state that premium adjustments (Section 178g (2) VVG) and changes in terms and conditions (Section 178g (3) VVG) become effective from the beginning of the second month following the notification of policyholders (Section 178g (4) VVG).

Policyholders must be informed before changes take effect.

Nevertheless, an undertaking can specify that changes will take effect at an earlier or later date. This follows from the wording "where nothing else has been agreed". However, the law only allows for the possibility of setting a different date after the change notified to the policyholder has taken effect. The provision does not release insurers from informing policyholders about changes before they take effect. However, since policyholders can only be informed of changes to premiums or General Conditions of Insurance once they have been approved by the trustee, the trustee's approval must be obtained before the changes take effect. This interpretation follows incontestably, not only from the history behind the development of this standard but also from the systematic interpretation of a policyholder's extraordinary termination right according to Section 178h (1) VVG.

BaFin took issue with unduly long intervals between internal audits in some undertakings.

### 3.3.10 Internal auditing

In the course of on-site inspections the insurance supervisory authority once again had to take issue with inadequate internal auditing practices in some undertakings. It was not unusual to find that intervals between inspections were unduly long, or important elements of companies were excluded from an audit. Thus, for example, in decentrally organised undertakings where the processing of benefits also takes place in branch or regional headquarters, it is especially important that frequent audits take place to ensure that uniform and accurate information is gathered on the benefits to be paid out under each tariff.

## 3.4 Property and casualty insurers

Large underwriting losses and the disappointing development of capital markets called for a high degree of vigilance from BaFin with regard to property and casualty insurers in 2002, and resulted in several supervisory measures. The supervisory authority called upon the undertakings concerned to submit interim financial statements, mid-year solvency sheets, and calculations of coverage, and to report on introduced or planned rescue measures. The call to allocate additional capital was just as necessary as the submission of solvency plans.

### On-site inspections

Once again in 2002 BaFin conducted on-site inspections of a number of property and casualty insurers. These inspections focused on underwriting results and the total result, technical provisions, investments, adequacy of own funds, accounting, and distribution of costs.

As regards underwriting results, the continued substantial gross and net losses in motor vehicle insurance were analysed particularly critically. In this area BaFin called upon the individual undertakings concerned to take suitable measures to improve their results, and to include these in their reporting.

The costs of the employed external workforce may only be deducted in part.

In one case BaFin had to point out, in the context of calculating premium transfers, that there are limitations on including the costs of the employed external workforce as part of the deductible costs. Costs in this category are only included in the costs deducted if the external workforce is employed in place of representatives working on a commission basis in the areas of acquisition, collection and customer care. Costs incurred for supporting the external workforce and other tasks must be excluded.

Since valuation of the provision for claims is on an itemised basis, blanket supplements or deductions are not permissible.

With regard to the provisions for claims outstanding, BaFin noticed in various instances that insurers had applied blanket supplements or deductions to provisions for claims established on an itemised basis. The supplements were primarily added for major claim risks and revived claims, whereas blanket fixed deductions were to reflect the probability of lower average claims. In the latter case, the following year an insurer reduced the provision for old claims by revaluing it by

the amount of the blanket deductions, so that the blanket deductions were not reflected in the settlement result. Blanket supplements to or deductions from provisions for claims are incompatible with the itemised basis of valuation and thus not admissible.

Claims in the period from closure of the claims register to the balance-sheet date may be estimated, but must be included in the claims figure for the financial year.

The "fast close" practice resulting in increasingly early preparation of annual financial statements also means that the claims register is closed before the end of the financial year. BaFin made it clear in this respect that although claims recorded between the closure of the claims register and the balance-sheet date must be entered as estimates in the annual accounts, nevertheless they must definitely be recorded under the part of the claims provision which applies to (known) insurance claims during the financial year, and not attributed to the part of the provision earmarked for later claims.

In the establishment of provisions for partial losses, the criteria for the method of estimation were not always specified sufficiently.

On occasion it was necessary for BaFin to take issue with the establishment of provisions for partial losses. The criteria underlying the method of estimation were not always adequately specified or documented. The same applies to blanket supplements which are mathematically vague and difficult to verify. Furthermore, when determining the size of the late claims provision, BaFin demanded that insurers should include the number and cost of expected late claims for all subsequent years.

In one case BaFin became aware that an insurer had failed to establish a provision for internal claims settlement expenses. One undertaking had calculated the provision for external claims settlement expenses separately, by adding a supplement to the reserve for single claims. The following deficiencies are associated with this method:

- The insurer must work on the assumption that the claims settlement expenses amount will develop in proportion with the size of the provisions for claims. However, this will not necessarily be the case.
- Claims which have already been settled in part or in full are not taken into consideration.
- The application of the supplement factor to the reserve for single claims resulted in substantial settlement gains.

Settlement results from claims have worsened significantly.

BaFin also checked whether the provisions for claims outstanding were commensurate. Settlement results have worsened significantly and occasional settlement losses occurred. However, the individual partial provisions must be allocated such that, at the least, as the provisions for claims are released no losses are incurred overall.

Typical errors in the equalisation provision.

In one case the calculation of the equalisation provision was based on an incorrect period of observation. Furthermore, BaFin complained that there was no documented examination of whether the conditions for establishment of the equalisation provision had been met. One undertaking had wrongly calculated the additional contribution rates to determine the premiums earned. In one case different data had been included in the calculation, on the basis of tax law, than was reported in the annual financial statements, governed by commercial law. The equalisation provision is established in accordance with Section 341h HGB in conjunction with Section 29 RechVersV, in other words it is governed by commercial law, and criteria relating to taxation are not relevant.

Marginalie: When segments of the insurance industry are in deficit, the need to establish provisions for impending losses must be examined.

BaFin also made it plain that insurers must examine the extent to which provisions need to be recognised for impending losses for classes of insurance operating at a deficit. The reference interest rate on which this decision should be based is the current net yield. There is no justification for failing to record specific items due to a lack of tax allowances.

Turning to investments, BaFin noted breaches of the reporting, notification, and disclosure requirements set down in Circulars 5/97, 3/99, and 3/00. Isolated cases of non-compliance with the regulations on mix and diversification of investments were also found. In connection with the use of the cash-pool method, BaFin particularly drew attention to the supervisory standards concerning the duration of external borrowings granted within this framework, and eligibility for the restricted assets.

Marginalie: The auditor responsible for the annual financial statements must not be involved in the bookkeeping.

In the accounting sphere, an objection was raised in one case for insufficiently diversified figures in the Management Report. More than once the forms and evidence sheets under the Ordinance Concerning the Reporting by Insurance Undertakings to the Federal Insurance Supervisory Office (Verordnung über die Berichterstattung von Versicherungsunternehmen gegenüber dem Bundesaufsichtsamt für Versicherungswesen – BerVersV) were found to be incorrectly completed. In addition, the insurance supervisory authority reprimanded the auditor of an insurance company for having completed both the internal and the external financial statements. According to Section 319 (2) sentence 5 HGB, however, anyone who has worked on the bookkeeping or preparation of the annual accounts is disqualified from being the auditor responsible for the annual financial statements.

The distribution of costs also gave rise to formal complaints. For example, sometimes no allocation formula was used, or the formula in use was outdated or did not reflect the real reasons for the costs (lack of causality). For allocating claims settlement expenses, an appropriate formula is deemed to be one-third payments of claims and two-thirds number of claims processed.

### 3.4.1 Motor vehicle insurance

#### Discrimination against foreigners

In the year 2002 BaFin once again had to examine new or amended General Conditions of Insurance and internal underwriting rules in which some insurers imposed special conditions for certain groups of foreigners. In this context the supervisory authority had to assess whether the tariff provisions and premium calculations represented an irregularity under the terms of Sections 81 (2) and 81e VAG.

An irregularity exists if the premium calculation relates solely to the nationality of the policyholder.

If the provisions or the premium calculation are based solely on the policyholder's or insured's nationality or ethnic origin, the answer is in the affirmative.<sup>36</sup> Tariff conditions or clauses of this kind often contain

<sup>36</sup> cf. also Circular 6/95, VerBAV 1995, p. 372.

highly specific wording. For example there are General Conditions of Insurance which make provision for policyholders with an EEA driving licence to be placed on a different tariff from drivers who obtain their licence in Germany. Different clauses are also used to bar foreigners from a better no-claims class, to reduce the intermediary's incentive to sell the policy by reducing the commission, or to deny foreigners special deals on the basis of so-called "soft" tariff features, such as the low-mileage discount otherwise widely offered by insurers. Some clauses make provision for the possibility of demanding surcharges on top of the tariff premium. In some variants of these clauses only the maximum rate is defined and the size of the individual surcharge depends on non-tariff criteria.

Some insurers have already dropped certain distinctions.

In response to a query from BaFin, various insurers objected that the groups concerned represented a worse subjective risk, and that their practice was necessary to make premiums viable. Companies which use variations on the "country where driving licence was obtained" clause argued that the quality of driving tests and the practical living environment were different in the country where the driving licence was acquired. Some insurers provided statistical material to support their arguments. Others simply pointed out that their clauses or similar ones were also used by competitors. In response to BaFin's request, some insurers have already dispensed with certain distinctions.

Should BaFin come to the conclusion after assessing all the arguments put forward that certain clauses and tariff provisions constitute an irregularity as defined in Section 81 (2) VAG, the supervisory authority will emphatically demand and enforce changes to these rules.

Insurers must respect the prohibition on preferential contracts contained in Section 81 (1) sentence 4 VAG.

In 2002, BaFin once again had to take action against insurers who offered a so-called "loyalty bonus", the size of which was set at the intermediary's discretion. Motor vehicle insurance policies may not be sold at a cheaper premium than the general tariff of the undertaking. The obligation to treat all members equitably is not incumbent solely on mutual insurers (VVaG) (Section 21 (1) VAG); in fact all insurers must respect the prohibition on beneficiary contracts as per Section 81 (1) sentence 4 VAG<sup>37</sup>. Any preferential treatment of this sort is open to objections because Section 5 of the Compulsory Insurance Act (Pflichtversicherungsgesetz – PflVG) provides for compulsory acceptance at the "company's general tariff". However, this presupposes that a generally binding tariff with defined premiums exists in reality and not just on paper. In addition, preferential contracts can contribute to below-par results if risk-sensitive premiums are no longer charged.

### 3.4.2 Financial losses liability insurance

BaFin received information from a judicial department of one of the Länder that insurers had often failed to send notification that professional indemnity insurance for attorneys was non-existent or had

<sup>37</sup>In conjunction with the Regulation on the Prohibition of Special Bonuses and Beneficiary Contracts in Property Insurance (Verordnung über das Verbot von Sondervergütungen und Begünstigungsverträgen in der Schadenversicherung) of 17 August 1982.

been terminated. All liability insurance providers are obliged to issue such notifications in accordance with Section 158c (2) VVG. The insurers' obligations to meet any third-party claims do not cease until one month after notification of the competent body. Hence insurers must do everything possible from an organisational point of view to ensure immediate notification in order to avoid legal ambiguities and prolongation of the liability risk.

### **3.4.3. Casualty insurance**

#### **Casualty insurance with premium refund**

At the end of 2002 BaFin was supervising a total of 26 insurers offering casualty insurance with a premium refund (previous year: 25 undertakings). Two insurers had entered this business in 2002 and the portfolio of one undertaking expired in 2001.

#### **Business plans for the portfolio of existing contracts**

In the past year BaFin found that two insurance undertakings had not adhered to their business plans on profit participation. However, casualty insurers are obliged to run their insurance business for existing contracts according to the approved business plans, and changes to the business plans may only be made after obtaining the supervisory authority's consent. Any possibility of obtaining retroactive authorisation is expressly ruled out.

#### **Profit participation**

BaFin discussed issues concerning profit participation with some insurers. These concerned cross-subsidisation of the new portfolio by the old portfolio, the participation of policyholders in profits from all sources, and the appropriate allocation of operating costs between casualty insurance with and without the premium refund.

#### **"HUK" pensions**

On 1 July 2000 the maximum interest rate was lowered from 4% to 3.25%.<sup>38</sup> About half of Responsible Actuaries responded by lowering the technical interest rate for the pensions portfolio of third-party, accident, and motor vehicle insurance (Haftpflicht-Unfall-Kraftfahrtversicherung – HUK) to 3.25%. The remainder of Responsible Actuaries followed the recommendation of the DAV to apply the previous technical interest rate of 3.5% or 4% to old claims, but to use a rate of 3.25% for new claims.

In making its recommendation, the DAV applied the fixed interest rate principle set out in Section 2 (2) of the Mathematical Provisions Ordinance (Deckungsrückstellungsverordnung – DeckRV) by analogy. BaFin does not deem this principle applicable to the mathematical

BaFin rejects the analogous practice of using a fixed interest rate to calculate the mathematical provisions of "HUK" pensions.

<sup>38</sup> First Regulation amending the Regulation on Mathematical Provisions (Erste Verordnung zur Änderung der DeckRV) (VerBAV 2002, p. 176).

provisions of HUK pensions, because to ensure that the liabilities under the insurance contract can be met at all times, the size of the individual mathematical provision, and hence the technical interest rate used, is critically important. The maximum interest rate laid down in the DeckRV should thus only be exceeded for a serious reason. In life insurance, where the fixed interest rate principle is directly applicable, it is intended to prevent unduly severe fluctuations as regards liabilities within the balance sheet. This justification does not apply to a property and casualty insurer, however, because here the mathematical provisions for "HUK" pensions only make up a small share of the technical provisions. Negotiations with the DAV have not yet been concluded.

Some insurers applying the above-mentioned principle use the date of the claim or the policy start date as the criteria for distinguishing between old and new claims. BaFin pointed out that regardless of the applicability of the fixed interest rate principle, these are not the correct criteria to use for making that distinction because long periods of time may have elapsed from those dates until the mathematical provisions were first recognised.

### 3.5 Reinsurers

In its report on the 2001 financial year, or the year 2001/2002, BaFin was able to include the annual financial statements of 35 (as compared with the previous year's 34) reinsurance undertakings, consisting of 30 public limited companies (AG), one mutual insurance company (VVG), one public law insurance undertaking and three private limited companies (GmbH). Five undertakings submitted statistics which contained errors.

#### 3.5.1 Financial position

For the professional reinsurers, the year 2001 covered by this report will be remembered for the highest insured loss ever faced by the insurance industry: the terrorist attacks of 11 September 2001 on the World Trade Center. Other large-scale claims were also detrimental to the reinsurers' underwriting result, for instance the impact of the Enron case within the area of credit insurance, the Toulouse chemical factory explosion in the transport segment, and several plane crashes within the area of aviation insurance. More sizeable claims in the pharmaceutical industry sector – for instance, the Lipobay case – accentuated the strain on the reinsurance market.

The insurance sector was severely impacted by 9/11, and these events resulted in a substantial rise in prices. However, the premium increases will only take effect at a later date.

#### Gross claims ratio

The gross claims ratio before settlement rose substantially, from 66.3% to 81.6% of gross premiums earned. The high claims ratio was further aggravated by the poorer settlement result. This took the total burden relating to the area of claims up to 92.2% of

In the year 2001, the insurance industry had to contend with the highest insured loss on record.

The total burden relating to the area of claims increased to 92% of premiums as compared with 72% in the previous year.

premiums as compared with 72.1% in the previous year. Although a substantial share was covered by retrocessionnaires, a colossal increase in the net loss remained, which could not be mitigated. Even withdrawals from the equalisation provision did nothing to ease the situation.

Reinsurers' costs were slightly less strained than in the previous year. The gross expense ratio fell on aggregate from 30.8% to 30.2%. Having said that, this does not yet represent a return to the lower levels of past years.

The reinsurers' combined ratio leapt due to the increase in losses, to 122.4% (from the previous year's 102.9%).

### 3.5.2 Premiums situation

Reinsurance cover is offered not just by reinsurers but also by primary insurers.

The gross premiums written for ceded risks (i.e. in reinsurance) were distributed as follows between reinsurers and primary insurers.

Table 16

#### Gross premiums in the reinsurance business

Gross premiums written	Reinsurers	Primary insurers (reinsurance contracts accepted)	Total
Year	€m	€m	€m
2001	45,459.9	3,382.3	48,842.2
2000	40,011.9	3,175.5	43,187.4
1999	35,595.7	2,637.7	38,233.4
1998	32,113.1	2,486.6	34,599.7
1997	31,710.0	2,600.3	34,310.2

Reinsurers continued to expand their share of total reinsurance business in the year under review.

The premium increases of 13.6% on the part of the 35 reinsurers, on a higher scale than the 6.5% increase imposed by primary insurers, meant that the reinsurers' share of the total volume of insurance business accepted rose from 92.6% to 93.1%. The number of primary insurers carrying on inward reinsurance fell during the year from 184 to 183 insurance undertakings; as in the previous year, 39 of these were life insurers and 15 were health insurers.

In net terms, the reinsurance business makes a positive contribution to Germany's invisible trade balance.

For reinsurers the premium income for reinsurance business accepted from domestic ceding insurers only showed a moderate rise of 3.3% (previous year: 3.7%), whereas once again there was a jump in foreign business by 23.5% (previous year: 22.3%). The share of risks accepted from foreign ceding insurers thus increased further, to a new level of 55.5% (previous year: 51.1%); clearly the potential for premium growth could still be found abroad.

Calculated in relation to gross premiums earned, business accepted by all domestic insurance undertakings from abroad was substantially higher, at €26.3 billion, than the insurance business ceded abroad, at €9.4 billion. Thus, domestic insurance undertakings provided the

international reinsurance market with more capacity than it utilised itself, contributing in net terms to Germany's invisible trade balance (i.e. relating to services) in the process.

Proportional reinsurance in the form of quota share and surplus reinsurance contracts accounted for 79.3% of the gross premiums written by reinsurers. The remainder was made up almost entirely of non-proportional excess of loss reinsurance business.

The composition of the portfolio from gross premiums written by professional reinsurers, in terms of the individual insurance classes, is as follows:

Table 17

**Gross premiums of reinsurers by insurance class**

Insurance classes	2001	2001	2000	1999	1998
	Gross premiums written €m	as % of aggregate gross premiums written			
Casualty insurance	1,510.7	3.3	3.9	4.0	4.3
Liability insurance	4,219.5	9.3	8.5	9.1	9.1
Motor vehicle insurance	7,954.0	17.5	19.3	19.0	19.6
Aviation insurance	1,242.6	2.7	2.4	2.4	2.6
Legal expenses insurance	363.2	0.8	1.0	1.0	1.1
Fire insurance	7,210.6	15.9	14.8	14.7	15.2
Burglary / theft insurance	238.7	0.5	0.6	0.7	0.8
Water damage insurance	60.8	0.1	0.1	0.2	0.2
Plate glass insurance	62.2	0.1	0.1	0.2	0.2
Storm insurance	636.3	1.4	1.2	1.2	1.1
Comprehensive home contents cover	464.9	1.0	1.1	1.3	1.5
Comprehensive residential buildings cover	924.3	2.0	2.2	2.4	2.6
Hail insurance	437.8	1.0	1.1	1.2	0.9
Livestock insurance	68.4	0.2	0.1	0.1	0.1
Engineering insurance	2,112.5	4.6	4.1	3.9	4.8
Multiple peril insurance	1.6	0.0	0.0	0.0	0.0
Transport insurance	2,076.6	4.6	4.4	4.4	4.0
Credit insurance	1,478.0	3.3	3.2	3.4	3.7
Extended coverage	438.0	1.0	1.0	1.2	0.9
Business interruption insurance	425.8	0.9	1.0	1.1	1.3
Assistance benefits	9.8	0.0	0.0	0.0	0.0
Aviation liability insurance	569.1	1.3	0.5	0.5	0.5
Other insurance	992.7	2.2	2.2	2.1	2.1
<b>Property/casualty insurance business</b>	<b>33,498.4</b>	<b>73.7</b>	<b>72.8</b>	<b>74.2</b>	<b>76.6</b>
Life insurance	10,338.4	22.7	22.7	21.5	20.3
Health insurance	1,623.1	3.6	4.5	4.4	3.1
<b>Total volume of insurance business</b>	<b>45,459.9</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Shifts in the balance of premiums within the sector as a whole arose predominantly in health insurance (- 0.9%) and in motor vehicle insurance (- 1.8%). The 0.9% increase in property and casualty insurance as a percentage of total business derived largely from premium increases for fire insurance (1.8%) and for general personal liability insurance (0.8%). The growth in premiums in the fire

insurance segment, as in several other insurance classes with a predominantly industrial component, may result from premium increases in this business segment.

Once again the reinsurers' retrocession ratio was up slightly on the previous year. Of the €45.45 billion gross premiums written, the undertakings ceded €12.2 billion to retrocessionnaires. The retrocession ratio thus amounted to 26.8% (previous year 26.3%). A breakdown of the reinsurers' gross and net premiums by insurance segment for the reporting year 2001 can be found in the Appendix (Table 641).

### 3.5.3 Technical provisions in the individual classes of insurance

Gross technical provisions increased by €17.8 million (17.0%) to €122.3 billion. Measured in relation to gross premiums earned, the provisions ratio for total business rose to 278.6% (previous year: 265.9%). While provisions for unearned premiums grew by €1.6 billion (25.4%), the mathematical provisions rose by €1.9 billion (5.1%) and the provision for outstanding insurance claims rose by €14.3 billion (27.2%).

The amount of provisions was influenced by the equalisation provision.

As in past years, in the year under review the amount of provisions was noticeably influenced by the equalisation provision (inclusive of similar provisions), which is calculated with reference to the level of retention but included in the gross premiums. At the end of the year under review this amounted to €6.5 billion (previous year: €6.7 billion). This is equivalent to 20.4% of net premiums earned.

The largest share of the total technical provisions was allocated to life insurance, as last year. In this insurance class the provisions amounted to €40.4 billion (33.0% of total provisions); of these, €36.2 billion were mathematical provisions. Technical provisions for general personal liability insurance and motor vehicle insurance were on a comparable scale, at €21.0 billion (17.2% of provisions) and €17.5 billion (14.3%) respectively. In fire insurance the technical provisions rose by 65.9% to €14.6 billion (11.9%). The substantial increase was attributable to the September 11, 2001, attack on the World Trade Center. This was also the cause of significant increases in provisions in the aviation insurance segment. In aerospace insurance the level of provisions doubled, and in aerospace liability insurance provisions rose by 186%.

Further details can be found in Tables 630 and 631 in the Tables section of the Appendix.

### 3.5.4 Aggregate underwriting result

The underwriting result for professional reinsurers is outlined in the following table.

Table 18

#### Underwriting result for the individual insurance classes

Insurance segments	2001	2001	2000	1999	1998
	€millions	as % of gross premiums earned			
Casualty insurance	+ 61.4	+ 4.1	+ 3.9	+ 0.5	+ 5.4
Liability insurance	- 1,538.4	- 38.2	- 10.3	- 2.2	- 7.8
Motor vehicle insurance	- 188.7	- 2.4	- 11.9	- 12.7	- 9.9
Aviation insurance	- 1,433.3	-125.8	-1.0	- 28.8	- 35.3
Legal expenses insurance	+ 16.0	+ 4.4	+ 7.1	+ 5.0	+ 7.1
Fire insurance	- 5,202.4	- 75.1	- 18.3	- 43.3	- 7.5
Burglary / theft insurance	+ 1.6	+ 0.7	+ 3.8	+ 3.3	+ 16.6
Water damage insurance	- 1.5	- 2.6	- 4.5	+ 8.8	+ 9.9
Plate glass insurance	+ 4.0	+ 6.5	+ 20.2	+ 18.8	+ 16.4
Storm insurance	+ 12.1	+ 2.0	- 9.1	- 142.3	+ 2.3
Comprehensive home contents cover	+ 20.3	+ 4.3	+ 13.0	+ 2.8	+ 17.4
Comprehensive residential buildings cover	+ 50.9	+ 5.6	+ 1.7	- 40.5	+ 7.6
Hail insurance	- 10.4	- 2.4	- 10.7	- 17.1	- 16.3
Livestock insurance	+ 7.1	+ 10.5	+ 8.6	+ 15.2	- 18.7
Engineering insurance	- 428.1	- 21.9	- 17.9	- 14.8	- 5.0
Multiple peril insurance	+ 0.5	+ 32.1	+ 28.4	- 18.2	+ 30.3
Transport insurance	- 996.7	- 48.6	- 24.8	- 22.6	- 11.9
Credit insurance	- 245.4	- 17.0	+ 7.6	+ 10.1	+ 12.7
Extended coverage	+ 17.5	+ 3.9	- 22.4	- 54.0	+ 14.1
Business interruption insurance	- 303.4	- 72.4	- 4.4	- 30.0	- 14.2
Assistance benefits	+ 1.9	+ 18.9	+ 17.2	+ 2.9	+ 11.8
Aviation liability insurance	- 1,099.3	- 269.2	- 0.3	- 4.5	- 11.9
Other insurance	- 152.6	- 16.1	- 2.9	+ 8.0	+ 5.3
<b>Property and casualty insurance</b>	<b>- 11,423.0</b>	<b>- 35.4</b>	<b>- 10.2</b>	<b>- 19.7</b>	<b>- 5.4</b>
Life insurance	+ 35.0	- 0.4	- 2.6	- 0.5	+ 4.0
Health insurance	- 129.3	- 7.7	- 7.3	- 11.3	- 24.4
Total volume of insurance business					
Gross result	- 11,517.3	- 26.2	- 8.5	- 15.2	- 4.1
Retro result	+ 5,398.2	+ 44.8	+ 5.0	+ 27.0	+ 6.1
<b>Net result 1</b>	<b>- 6,119.1</b>	<b>- 19.2</b>	<b>- 9.8</b>	<b>- 11.2</b>	<b>- 3.4</b>
Change in the provision for impending losses	- 19.4	- 0.1	+ 0.1	- 0.2	+ 0.2
Change in the equalisation provision <sup>1)</sup>	+ 214.3	+ 0.7	- 0.2	+ 2.9	- 2.2
<b>Net result 2</b>	<b>- 5,924.2</b>	<b>- 18.6</b>	<b>- 9.9</b>	<b>- 8.4</b>	<b>- 5.4</b>

<sup>1)</sup> inclusive of similar provisions

Reinsurers were forced to record another gross underwriting loss in 2001.

As in the year before, reinsurers had to endure further gross underwriting losses, this time of €11.5 billion (26.2% of gross premiums earned). Only ten of the 36 reinsurers achieved a gross underwriting profit in the year covered by this report. Likewise primary insurers generated a gross underwriting loss of €1.2 billion from ceded insurance business in 2001 (42.1% of gross premiums earned). Insurance business accepted from both domestic and foreign ceding

insurers resulted in a gross underwriting loss of €2.3 billion (11.4% of domestic premiums earned) and €9.2 billion (38.7% of foreign premiums earned).

The largest gross loss occurred in fire insurance.

The most significant contribution to the aggregate result was the gross loss from fire insurance which amounted to €5.2 billion (75.1%). Other insurance segments generating gross losses in the billions of euros were personal liability insurance (€-1.5 billion), aircraft and spacecraft insurance (€-1.4 billion), and aerospace liability insurance (€-1.1 billion). Losses from transport insurance also verged on the billion euro mark, reaching €997 million.

The largest reduction in gross losses occurred in motor vehicle insurance, where losses fell by almost €700 million.

The most substantial improvement in results was achieved in motor vehicle insurance. The gross loss fell by €695 million to €188.7 million. Gross profits on any worthwhile scale were registered only in the €61.4 million result (4.1%) in casualty insurance and the €50.9 million (5.6%) generated from residential buildings insurance. In property and casualty insurance the professional reinsurers emerged with a gross loss of €11.4 billion (35.4%) on aggregate. The losses in health insurance coupled with no more than a minor gross profit from life insurance aggravated the reinsurers' losses.

As a proportion of the overall volume of business, the participation of retrocessionnaires in the year under review was high, at €5.4 billion (44.8% of earned reinsurance premiums). Reinsurers were left with a significantly higher net underwriting loss of €6.1 billion (19.2% of net premiums earned) in comparison to the previous year's figure (€-3.3 billion, down 8.5%).

In the year under review, €214.3 million (- 0.7% of net premiums earned) were withdrawn from the equalisation provision, the nuclear facility provision, and the pharmaceutical provision, all of which contributed favourably to the equalisation of risks during the period. Overall, €19.4 million (0.1% of net premiums earned) was allocated to provisions for impending losses. The net underwriting "loss 2" – i.e. loss after retrocessionnaires' participation and changes from allocations to or withdrawals from the equalisation provision and the provision for impending losses – amounted to €5.9 billion (- 18.6% of net premiums earned) and was thus significantly higher than the previous year's loss (€-2.85 billion; - 9.9%). The net underwriting results achieved in each insurance class during the year under review, with figures before and after changes to the equalisation provision and similar provisions, can be found in Table 641 of the Appendix.

### 3.5.5 Unappropriated retained earnings

The elements contributing to the reinsurers' unappropriated retained earnings in relation to net premiums earned are shown in the following overview.

Table 19

#### Elements of unappropriated retained earnings

Item	2001	2001	2000	1999	1998
	€m	as % of net premiums earned			
1. Net underwriting result 1	-6,119.1	-19.2	-9.8	-11.2	-3.4
9. Special allocation to provisions for claims	-244.7	-0.8	-0.9	-1.0	-1.2
2. Change in the equalisation provision, etc.	+214.3	+0.7	-0.1	+2.9	-2.2
3. Net underwriting result 1a	-6,149.5	-19.3	-10.9	-6.7	-6.7
(4. Current investment income <sup>1)</sup> )	+6,329.3	(+19.9)	(+20.5)	(+19.5)	(+15.0)
(5. Current investment expenses)	-1,346.8	(-4.2)	(-3.7)	(-2.9)	(-3.0)
6. Current net investment income <sup>1)</sup> )	+4,982.5	+15.7	+16.8	+16.0	+12.0
7. Other income from ord. activities	-779.3	-2.4	-2.7	-2.3	-1.6
8. = Operating result	-1,946.3	-6.1	+3.2	+5.0	+3.6
10. Extraordinary income (incl. provision for impending losses)	+2,287.7	+7.2	+6.0	+4.6	+7.9
11. = Annual result before taxes	+341.4	+1.1	+9.2	+9.7	+11.5
12. Taxes	-33.9	-0.1	-1.7	-4.2	-4.7
13. = Annual result after taxes	+307.5	+1.0	+7.5	+5.5	+6.8
14. Profits or losses carried forward	+7.6	+0.0	+0.1	+0.7	+0.0
15. Change in reserves	+461.7	+1.4	-1.7	-2.4	-1.9
16. = Unappropriated retained earnings	+776.8	+2.4	+5.9	+3.7	+4.9

<sup>1)</sup> not including income from technical interest (2001: €2.3 billion)

The volume of investment rose by almost 23% in 2001 to around €165 billion and produced a current yield of 5.8% on average.

The most significant category of investment returns was that from participating interests and shares in affiliated undertakings, which accounted for a good one-third of the total.

The reinsurers' investment volumes (including deposits with ceding insurers) rose by 22.8% in the year 2001 to €164.6 billion (previous year €134.1 billion). The current investment yields<sup>39</sup> increased by €650.2 million to €8.6 billion (27.1% of net premiums earned). The current rate of return on investments, based on the average size of the investment portfolio (incl. deposits with ceding insurers) was 5.8%.

25.6% of running investment yields came from interest on deposits with ceding insurers. A further 34.4% derived from participating interests and shares in affiliated undertakings, in other words from interest on loans and dividends. Other significant items were yields from bearer bonds and fixed-interest securities, making up 9.8%, and from equities, investment certificates, and other variable-yield securities, which accounted for 20.7%. The running investment expenses, i.e. for systematic depreciation/amortisation and administrative expenses, rose by €283.7 million to €1.35 billion.

<sup>39</sup> Including technical interest to be charged to the technical section of the income statement, but not including income from the disposal of investments or value re-adjustments on investments or release of special reserve.

The net yield on the average portfolio of investments held, including deposits with ceding insurers, was 6.2%.

The balance from currency transactions of €-191 million was considerably worse than the previous year's figure (€-16 million).

The operating result fell from €0.9 billion to €-1.9 billion.

The annual surplus before taxes amounted to €341 million.

Unappropriated retained earnings for the year – after withdrawals from reserves and profits carried forward – was €777 million, close to 2.5% of premiums.

In aggregate the current net investment income<sup>40</sup> achieved by reinsurers came to €7.3 billion (22.8% of net premiums earned). The current net yield in relation to the average portfolio of investments held, including deposits with ceding insurers, was 4.9%.

Taking into account other investment income such as gains from the disposal of assets, value re-adjustments on investments and income from the release of special reserves of €3.6 billion, as well as other expenses such as losses from the disposal of assets, extraordinary depreciation, and assumption of losses of €1.6 billion, the investment result was €9.2 billion. The net yield in relation to the average portfolio of investments held, including deposits with ceding insurers, was 6.2%.

An overview of the developments in each category of investment can be found in the Tables section (Table 610).

Registering a loss of €779.3 million (2.4% of net premiums earned), other income from ordinary activities remained at the level of the previous year (previous year: loss of €787.2 million, equivalent to - 2.7%). The balance from exchange rate gains and losses during the accounting year, at €-191.2 million, was significantly poorer than in the previous year (€-16.3 million). Along with various other items, the other income from ordinary activities includes interest payments amounting to €458 million.

The operating loss<sup>41</sup> of €1.9 billion was down on the previous year's figure (-6.1% of net premiums earned; previous year: profit of €932.1 million). The change in the net result had a substantial impact on the operating result.

The extraordinary result<sup>42</sup> amounted to €2.3 billion (7.2% of net premiums earned). The provision for impending losses was increased by €19.4 million. The balance from disposal of investments came to €2.9 billion. There was a significant increase in extraordinary depreciation, which rose to €946.0 million. During the year under review, the only extraordinary income and expenses recorded were on a small scale. Taken together with the operating result, this produced an annual surplus before taxes of €341.4 million (1.1% of net premiums earned).

The annual surplus after taxes amounted to €307.5 million (1.0% of net premiums earned). After taking into account withdrawals from reserves of €461.7 million (1.4%) and profits of €7.6 million carried forward, the reinsurers' aggregate unappropriated retained earnings for the year were €776.8 million (2.4% of net premiums earned (previous year: + €1.7 billion; 5.9% of premiums).

<sup>40</sup> Current investment income minus current investment expenses inclusive of technical interest.

<sup>41</sup> Total of current net investment income, other income from ordinary activities and net underwriting result 1a (after special allocation to the provisions for outstanding claims, after equalisation provisions but before provisions for impending losses).

<sup>42</sup> Essentially, change in the provision for impending losses, balance from the disposal of investments, value re-adjustments on investments and changes to the special reserves..

Out of all the reinsurers included in the analysis, twelve undertakings (previous year: two insurers) ended the year with a net loss, of which seven undertakings (previous year: one insurer) posted a deficit in unappropriated retained earnings.

### 3.5.6 Adequacy of own funds

The reinsurers' capital showed significantly stronger growth than in the previous year, rising to €31 billion.

The capital available to reinsurers, exclusive of unpaid subscribed capital, increased during 2001 by €6.4 billion to €31.45 billion (25.4%). This is considerably higher growth than in the previous year (+ 5.1%). With growth in premiums of 13.6%, the (aggregate) capital ratios increased accordingly: from 62.7% to 69.2% in relation to gross premiums written, and from 87.0% to 98.9% of net premiums written. Compared with the capital ratios of property and casualty insurers, those of the reinsurers are substantially higher. In the year 2001, the gross capital ratio of property and casualty insurers amounted to 44.3%; in relation to net premiums this equated to a ratio of 60.1%.

Competition forces reinsurers to establish adequate levels of capital.

Although reinsurers have not so far been subject to any statutory provisions concerning the adequacy of own funds, competition is forcing them to establish appropriate levels of equity, because, among other factors, a reinsurer's credit standing, which is important to the ceding undertaking, depends on solid capital resources. Only reinsurers in the legal form of a mutual insurance undertaking (VVaG) must comply with the same solvency requirements as property and casualty insurers. As in previous years, in 2001 only one mutual insurer was active as a reinsurer and subject to solvency inspections. The number of reinsurers who would not satisfy the standards of solvency which apply in the property and casualty insurance segment was confined, as in the previous year, to three undertakings. As for the primary insurers, this analysis only takes into account the own funds openly declared on the balance sheet. When eligible amounts of special reserves and (long-term) hidden reserves on investments were taken into account, the adequacy of reinsurers' own funds appeared all the higher.

## 3.6 “Pensionskassen” and pension funds

### 3.6.1 Supervision and occupational pension provision

The reform of statutory pension insurance brought new impetus to the occupational pensions business. The new legal position resulted in a wave of newly established companies and a need for almost all existing “Pensionskassen” to adjust their tariffs. The rising number of very long-term pensions is making supervision by BaFin increasingly important but also more difficult, both with regard to accounting principles and with regard to investment.<sup>43</sup> At the same time, growth in private pensions as a proportion of pension provision for the population as a whole also increases the importance of supervision. In order to do justice to these developments and the substantially raised workload they create, BaFin created a dedicated department for operative

<sup>43</sup> For the impact on capital markets, see Monthly Report of the German Bundesbank, July 2002, p. 25.

supervision of "Pensionskassen" and pension funds including group supervision, and boosted its staffing level considerably. Even so, the unusually high number of authorisation applications meant that long processing times could not always be avoided.

In 2002, BaFin authorised 22 "Pensionskassen" and 18 pension funds to do business.

Many financial services groups submitted simultaneous applications for "Pensionskassen" and pension funds. For most applicants, the applications for authorisation of the "Pensionskasse" had priority. In total, BaFin authorised 22 "Pensionskassen" and 18 pension funds to conduct business. 21 "Pensionskassen" were established in the legal form of a public limited company (AG), and only one is a mutual insurance company (VVG). Four application proceedings remained open by the year's end. BaFin authorised 17 public limited companies and one mutual association to operate as pension funds. Ten of these proceedings remained open by the year's end.

### 3.6.2 "Pensionskassen"

#### Financial position

In 2001, few "Pensionskassen" had made use of the possibility of valuing their securities according to the so-called "gemildertes Niederstwertprinzip" (modified or diluted lower-of-cost-or-market principle), whereby they avoid having to recognise write-downs of assets if the stock market price falls below the carrying amount but the impairment is probably only temporary (Section 341b (2) sentence 1 HGB).

The supervisory authority launched a survey on the impact of the bear market.

In the light of the poor stock market trend, BaFin questioned all "Pensionskassen" on their financial position. The undertakings were asked to provide current balance-sheet and forecast income data, and to report on the implications for coverage of the restricted assets and for solvency, two particularly relevant areas of concern in terms of statutory supervision. The data collected were based not only on actual developments up to the time of the survey, but also on scenarios concerning the likely development of capital markets to the end of the financial year.

The problems faced by most "Pensionskassen" have meanwhile been overcome.

The surveys revealed that, on the date of the survey, some "Pensionskassen" could cover the required "Deckungsstock" with assets at book values but had insufficient coverage as calculated at current investment values. The Management Boards had to present and immediately introduce measures to redress the deficiency (reallocating investments from the other restricted and unrestricted assets to the "Deckungsstock", calling in contributions from sponsoring companies, adjusting existing insurance policies in order to reduce the required "Deckungsstock" and raising surrogate forms of capital).

A "run" on the company, a conceivable risk for a life insurer, is impossible in the case of a "Pensionskasse".

"Pensionskassen" are only subject to a minor risk of being unable to honour their ongoing commitments from insurance contracts. In general these are already financed by premiums received and investment income. Neither do "Pensionskassen" have to pay any surrender value if a policy is cancelled by a sponsoring company or the policyholder. A "run" on the institution, which might be a conceivable risk for a normal life insurer, is impossible in the case of a "Pensions-

kasse". Due to the long-term nature of contracts, no liquidity problems are to be expected. Therefore, it was unnecessary to find a solution along similar lines to the establishment of the rescue company "Protektor" in the life insurance business.

Unlike the situation for life insurers, the profit participation within "Pensionskassen" depends mainly on the declaration of the supervisory authority that it has no objection.

The financial position of many "Pensionskassen" is additionally burdened by the expense associated with the continual increase in life expectancy. In combination with falling investment income, this is resulting in a decrease in profit participation within most of the "Pensionskassen". If on top of this substantial write-downs have to be recognised, profit participation may have to be suspended for one or several years. Profit participation within "Pensionskassen" – unlike life insurers – depends largely on the declaration of the supervisory authority that it raises no objections. BaFin will refuse to issue such a declaration if the proposed profit participation is not reconcilable with the financial situation of the "Pensionskasse" concerned.

### Allowing "Pensionskassen" to offer unit-linked products

Discussions are still taking place as to whether "Pensionskassen" should now also be allowed to offer unit-linked products.

A change in company pension law brought new business opportunities for "Pensionskassen" in 2002. The legislator decided to allow "Pensionskassen" to offer defined contribution plans with guaranteed minimum benefits, in line with other pension providers. Discussions then arose as to whether "Pensionskassen" should now also be allowed to offer unit-linked insurance policies. Until now this has been refused on the following grounds: unit-linked insurance is not thought to be a suitable vehicle for occupational pension provision, because with this type of insurance the chance of gains but also the risk of downturns in fund value are borne by the policyholder alone. This risk is thought to be incompatible with the purpose of retirement pension provision because the insured would not be able to count on certain benefits in old age.

If a "Pensionskasse" wishes to offer unit-linked products, this – on principle – represents an extension of the business plan and must receive the prior authorisation of the supervisory authority.

However, the legislator has now introduced the defined contribution plan with guaranteed minimum benefits. In doing so, it has decided that old-age pension benefits are not set at a definite, locked-in level of growth over and above the minimum guaranteed benefits. In this way, the defined contribution plan with guaranteed minimum benefits makes it possible for "Pensionskassen" to offer unit-linked products, shifting the risk onto the employee, at least for the part of the premium applying to benefits in excess of the minimum guarantee. If a "Pensionskasse" wishes to offer such products, this represents – on principle – an extension of the business plan since unit-linked life insurance policies are specifically listed in No. 21 Annex A to the VAG as a class in their own right. If a "Pensionskasse" wants to extend its business in that way, it may only do so once it has obtained authorisation from BaFin.

The only purpose of the "Pensionskasse" is to replace occupational income no longer available upon the occurrence of particular events (invalidity, old age, death) with benefits calculated on the merits of the individual case and in accordance with the amount applicable.

However this does not give rise to a fundamental reappraisal of the concept of the "Pensionskasse".<sup>44</sup> Particularly in the context of new authorisations, there was a noticeable trend for undertakings to wish to keep all the options of a life insurer open for the "Pensionskasse". BaFin therefore emphasised repeatedly that the sole purpose of the "Pensionskasse" is to replace occupational income upon the occurrence

<sup>44</sup> cf. most recently VerBAV 98, p. 15.

of particular events (invalidity, old age, death), with benefits calculated on the merits of the individual case. This restriction of business purpose is what distinguishes a "Pensionskasse" from a classic life insurance undertaking.

Nor is this affected by the introduction of the right to convert earnings into occupational pension contributions and the entitlement in tax and social security law to have such contributions subsidised according to the Act to Promote Private Old-Age Provision. The purpose of pension provision is not to generate retirement income which significantly exceeds the final earnings from employment. This applies particularly if pension entitlements have previously been built up for the insured in a "Pensionskasse". If every type of transaction is made possible within each form of pension provision, sooner or later it will be impossible to remember why all the different vehicles were necessary at all. Therefore, the premiums paid to a "Pensionskasse" should continue to be earnings-related, and the (hypothetical) annuitised capital benefits should not exceed expected final earnings.

### 3.6.3 Pension funds – the fifth form of occupational pension provision

The Insurance Supervision Law defines the pension fund as an institution for pension provision having legal capacity which

- on a funded basis
- has the purpose of supplying pensions
- in the form of defined benefits or a contribution-related plan with the guarantee of a minimum benefit
- for one or more employers
- in favour of employees.

Employees have an independent claim to benefits from the pension fund. The latter is obliged in all events to provide the employee with retirement benefits in the form of a life-long old-age annuity (or a payout scheme combining a capital payout with part-annuitisation). Besides retirement pension payments, payments may also be made for invalidity or surviving dependents.

Although the pension funds under the Act to Promote Old-Age Provision (Altersvermögensgesetz – AVmG) were introduced at the same time as the "Riester pension", a pension fund like a "Pensionskasse" does not require certification under the Act Governing the Certification of Retirement Provision Contracts (Altersvorsorgeverträge-Zertifizierungsgesetz – AltZertG). In spite of this, the employee can receive subsidies towards occupational pension provision under Section 10a of the Income Tax Act (Einkommenssteuergesetz – EStG). The only condition for the "Riester" subsidy under Sections 10a and 82 EStG is compulsory annuitisation of the payout (Section 1 (1) sentence 1 no. 4 and no. 5 AltZertG). There is no requirement to meet the other conditions in Section 1 (1) AltZertG.

The risk of employer insolvency is covered by the Mutual Insurance Association (Pensions-Sicherungs-Verein – PSV)

The pension fund may be run in the legal form of a public limited company (AG) or a mutual society (PVaG). While a similar list of permitted types of investment exists, no maximum investment limits are stipulated for these categories. There is, however, a limit on the proportion of investments earmarked for one (maximum 5%) or for all

(maximum 15%) employers. Unlike "Pensionskassen", when pension funds are the chosen vehicle for occupational pension provision, the risk of employer insolvency is covered by the Mutual Insurance Association (Pensions-Sicherungs-Verein – PSV).

Detailed provisions are laid down in implementation regulations for the most part. In 2001, the Federal Ministry of Finance (Bundesministerium für Finanzen – BMF) issued the essential regulations concerning adequate solvency margins, mathematical provisions, and quantitative and qualitative requirements on security, profitability, and liquidity of investments. The pension funds have to report annually to BaFin, stating the principles of their investment policy, details of their risk assessment and risk management procedures, and their strategy for each particular pension plan (Section 115 (3) VAG).

Inadequate statements concerning the financial situation were especially to blame for delays in authorisation proceedings

During authorisation proceedings, BaFin was often faced with the last-minute clarification of a large number of questions which were fundamental to the process. By and large, however, peculiarities of the legal status of pension funds were not to blame for delays in the authorisation proceedings. Additional enquiries were largely prompted by insufficient data on the financial situation of funds. BaFin was frequently unable to accept planned start-up and administrative expenses because the data provided by applicants was incomplete or not clearly comprehensible. The distinction between start-up and administrative expenses was not specified correctly. Hence BaFin had to take issue with nearly every application in respect of the adequacy of the organisation fund. The undertakings also frequently failed to take account of the fact that the operating costs of a pension fund must be financed from premiums and not from other sources.

BaFin was also initially unable to accept many remuneration arrangements found in outsourcing contracts which were commonly used. In several cases the planned own funds did not meet statutory minimum requirements.

Turning to the pension plans, the emphasis was on questions concerning the guarantee of minimum benefits for contribution-related plans, and the issue of financing annuity benefits. BaFin took the view that the minimum benefits must be guaranteed by the pension fund itself from the beginning of the retirement annuity payout phase. It also believed that at the start of the payout phase, the whole of the available capital must be converted into an annuity, the amount of which should be guaranteed by the pension fund in a similar way to an insurance arrangement. Therefore, the supervisory authority refused permission to make capital payouts, although this was requested repeatedly. BaFin only accepted arrangements of that kind in connection with income replacement and invalidity benefits, with payout schemes under the terms of the Act Governing the Certification of Retirement Provision Contracts (AltZertG), and in other exceptional cases to the extent that they would be permissible for certified pension insurance.

Finally, in terms of the competitive position of pension funds in relation to other types of occupational pension products, it was important to establish the conditions under which pension funds could assume the premiums for insuring the employer's contribution against insolvency.

The shortened vesting periods and the creation of the right to convert earnings into occupational pension contributions significantly widens the scope of statutory entitlements.

The supervisory authority rejected requests to make the pension fund the obligor liable for PSV contributions, rather than the employer. However, options were developed for integrating the pension funds into payment of PSV contributions.

### **Insolvency insurance**

The amendments to the laws described also brought key changes to the insolvency insurance framework in the Law on the Improvement of Company Pension Schemes (Gesetz zur Verbesserung der betrieblichen Altersvorsorge – BetrAVG) (Section 7 et seq. BetrAVG). Statutory insolvency insurance guarantees occupational pension provision in the event of an employer's insolvency, and is operated by the PSV. The shortened vesting periods and the creation of the right to convert earnings into occupational pension contributions significantly widens the scope of statutory entitlements. "Pensionskassen" and direct insurers continue to be exempted from insolvency insurance requirements. However, the new pension funds are brought within this regime due to their greater flexibility in the area of investment, and the higher concomitant risks. Employers who make use of pension funds must therefore pay premiums to the PSV.

In this area the supervisory authority found itself confronted with a host of enquiries and initiatives on the part of providers and employers, who viewed this aspect as a competitive disadvantage for pension funds in relation to "Pensionskassen". BaFin had to deny its consent for making the pension fund the obligor liable for PSV contributions, rather than the employer, in view of the clear rules in the BetrAVG. In consultation with those affected and with the Federal Ministry responsible, however, various options were developed to at least involve pension funds in the payment of these contributions. These contractual arrangements are based on an agreement between the employer and the employee, by which the employee takes responsibility for the costs of insolvency insurance. If such an agreement exists, pension plans can make arrangement for withdrawal and payment of the PSV contributions out of the pension fund surpluses or from accumulated capital, as long as the guaranteed minimum benefits remain unaffected.

### **Work on matters calling for administrative assistance**

The "Versorgungsanstalt des Bundes und der Länder", which is financed by means of current income ("pay as you go"), is gradually moving over to a funded basis (i.e. capital cover). It now also offers non-compulsory supplementary tariffs which qualify for subsidies under the AVmG when operated in tandem with the conversion of earnings into occupational pension contributions. Acting in an advisory capacity, BaFin provided administrative assistance on a considerable scale in connection with this reform, and with general questions concerning public service supplementary pension funds. In particular, BaFin reviewed the Articles of Association, the General

## VII Regulation of securities trading

- 1 Insider trading and price manipulation
  - 1.1. Prohibition of price and market manipulation
  - 1.2 Market analysis
  - 1.3 Insider trading investigations
- 2 Ad hoc disclosure and directors' dealings
  - 2.1 Extension of the ad hoc disclosure requirements
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- 3 Voting rights
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- 5 Corporate takeovers
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  - 5.2 Offer procedure
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### 1 Insider trading and price manipulation

The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) has been monitoring stock exchange and non-stock exchange transactions on a permanent basis, with the express purpose of detecting prohibited insider dealing. Since 1 July 2002, BaFin has also been responsible for the prosecution of price and market manipulation, thereby concentrating the monitoring of this form of market abuse at a federal level and closing a gap in the overall system of market supervision.

In its investigations of insider dealing and manipulation, BaFin can call on a comprehensive database of all transactions effected in transferable securities and derivatives. In addition, make use of all available internal and external information systems in order to obtain the necessary market and corporate information.

After the merging of the three former supervisory bodies to form BaFin, access to information about individual banks, financial services providers, and insurance undertakings has improved.

After the merging of the three former supervisory bodies to form BaFin, access to information about individual banks, financial services providers, and insurance undertakings has improved. This first-hand information has increased the quality of BaFin's preliminary analysis and investigations. The same applies to information on investment companies, whose trading conduct is a perennial subject of analysis. Access to specialist knowledge has also improved, for instance in the field of risk management. This is helpful in a variety of ways, for instance when judging the statements and testimonies of professional market participants on derivatives trading and associated trading strategies.

BaFin can also demand information from all relevant market participants. In addition to issuers and investment services companies, a wide variety of other individuals and bodies can be involved in the investigations, and the investment services companies or market

trading participants are prohibited from providing information about the nature of the enquiry or about an investigation procedure initiated by the competent authorities.

## 1.1 Prohibition of price and market manipulation

Since July 2002, making incorrect statements about listed enterprises which could affect their market price has been prohibited.

The 4th FMFG supplements Section 20a of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) by introducing a prohibition on making incorrect statements about facts which are germane to the valuation of an asset – for instance information related to the income, revenue, or capital of listed enterprises. The Securities Trading Act also prohibits parties from withholding information that is subject to disclosure, for instance by failing to issue ad hoc announcements or by submitting false announcements (Section 20a (1) no. 1 WpHG).

Dishonest or unfair trading practices and the spreading of rumours are also prohibited.

Also prohibited are various other dishonest practices designed to influence the price of an asset (Section 20a (1) no. 2 WpHG). These include unfair market trading practices such as so-called “wash sales”, in which there is no actual change of ownership, or pre-arranged trades, in which several players collude in terms of offers and volumes before placing an order, thus moving the price in a particular direction. The act of spreading rumours in order to influence the price has now also been prohibited.

Price manipulation can now be penalised either as a misdemeanour or as a criminal offence.

These two different legal circumstances are to be clarified in a Regulation currently being prepared by the German Federal Ministry of Finance (Bundesministerium der Finanzen – BMF). It is now also possible to penalise price manipulation as a misdemeanour rather than as a criminal offence, and as compared to the previous provisions of Section 88 of the Exchange Act (Börsengesetz – BG), the criteria for the former legal circumstance – false or undisclosed price-relevant information – are now less strict. Indeed, it is sufficient that the false information may be suitable to influence the price; it is no longer necessary for the information to have been given with the express intention of influencing the price. In contrast, to be penalised as a criminal act under the new law, it must be proven that the price was actually affected by the false information or withholding of information.

To be guilty of dishonest trading practice, the offender must have acted with intent to influence the price.

In the case of the second legal circumstance – for instance, dishonest trading practices or the spreading of rumours – the offender must have acted with intent to influence the price. In this case BaFin may penalise the offence as a misdemeanour. To be penalised as a criminal act, however, it must also be proven that the dishonest practice has actually affected the price.

BaFin can impose fines of up to €1.5 million.

Accordingly, the amended provisions governing the prohibition of manipulation raise the bar as regards the possibility of criminal prosecution. Indeed, proving that a price has actually been affected is extremely difficult in some individual cases. However, the new rules give BaFin the additional power to impose fines of up to €1.5 if the lesser criteria are met. Manipulations which are proven to be criminal acts are punishable by fines or up to five years' imprisonment.

The statutory prohibition against manipulation only includes the exploitation of deficiencies in a stock exchange trading system if such conduct influences the price.

The judgement that a given action is an instance of prohibited manipulation is made irrespective of how this action is classified under the trading rules of the stock exchange involved. A specific act may violate both the WpHG and the trading rules of a given stock exchange, but this is

not considered to be a precondition. The legal prohibition against manipulation only extends to conduct that exploits deficiencies in a stock exchange trading system if there is actual intent to influence the price.

In evaluating whether false information has been given or if information has been withheld contrary to statutory duties, there is a close working relationship with BaFin section responsible for supervising ad hoc disclosures. Such manipulations often go hand in hand with a violation of the ad hoc disclosure rules.

A good working relationship between the financial supervisory authority and the stock exchanges' trading surveillance offices is essential.

Particularly in the field of market manipulation, BaFin accords great importance to a good working relationship with other bodies. One of the key objectives within this respect is to bring about a uniform interpretation of the new provisions. At the end of 2002, BaFin held an initial meeting with the German stock exchanges' trading surveillance offices. The meeting looked into issues such as investigatory practices and the coordination of joint action. In future the dialogue will be continued at twice-yearly meetings, and in furtherance of these aims an exchange of staff has already taken place.

In face of the many different possible manipulation methods it is not feasible to plan investigations according to a pre-existing schema. Accordingly, the heading "other actions aimed at deception" requires particularly close collaboration with the stock exchanges' trading surveillance offices since these offices collect full and complete data on stock exchange dealings and the processing of stock exchange business. Moreover, these bodies have access to information regarding order books. Thus, they can scrutinise the order situation as it was before a given deal was made. In the medium term it would be desirable for BaFin to have direct access to order data to allow it to detect unusual trading patterns and investigate cases more directly.

In the case of price-relevant Internet rumours the early involvement of the public prosecutor's office is important.

In cases involving the Internet, for instance the spreading of rumours via Internet forums, it is important to involve the public prosecutor's office early on since BaFin does not have direct access to Internet connection data. Section 16 WpHG does give BaFin the power to order the storage of such data, for instance by investment services companies or participants in stock exchange dealings. However, such data may only be surrendered to BaFin after the public prosecutor's office obtains a corresponding court ruling to this effect. Talks with the competent public prosecutor's offices on coordinating working relationships have already taken place.

During the second half of 2002, BaFin instigated 17 new investigations of suspected price manipulation.

In 2002, the newly established section for the investigation of price manipulation instigated 17 new investigations. In three cases BaFin submitted reports to the competent public prosecutor's offices. BaFin also instituted proceedings for misdemeanours in four cases. At the end of the year these were still pending.

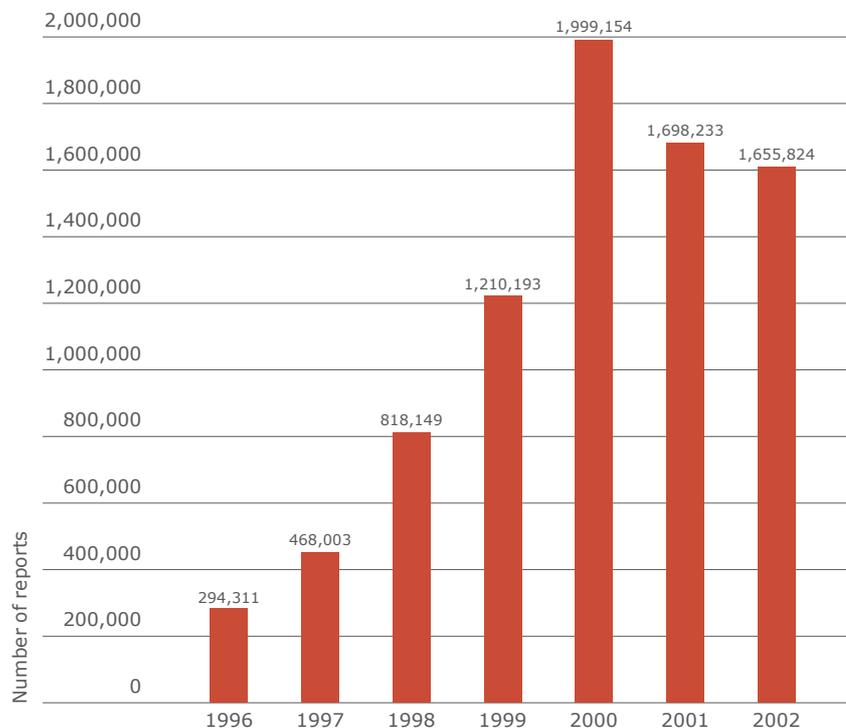
## 1.2 Market analysis

The first step in investigating manipulation and insider dealing is to analyse the price and turnover trends of the security in question, taking all available information into account.

Every securities transaction must be reported to BaFin. Last year there were 435 million such reports.

BaFin has access to a comprehensive database: Section 9 WpHG requires that every transaction in transferable securities and derivatives which are admitted to trading on a stock exchange in the European Economic Area (EEA) or are traded within the Freiverkehr (unofficial market/OTC) market must be reported. The bodies required to make such reports are credit institutions, financial services institutions licensed to trade on their own account, branches in accordance with Section 53 (1) sentence 1 KWG, as well as enterprises licensed to trade on a German domestic stock exchange.

Fig. 11  
Daily reporting volumes



In 2002, BaFin registered a total of 435 million reports (2001: 446 million), or an average daily volume of approx. 1.6 million reports.

In 2002, the number of analyses revealing possible irregularities was double the 2001 figure.

In 2002, more than 1,250 analyses were prepared (2001: approx. 1,000), of which 110 revealed possible indications of insider trading and/or price manipulation. The number of positive analyses, i.e. ones giving grounds for formal investigations, more than doubled from the previous year. This is chiefly due to the fact that in 2001, prior to 9/11, analysis of trading was the focal point of activity.

One third of all positive insider analyses related to adverse profit and revenue figures.

The positive insider analyses mostly related to certain types of offence. One third related to enterprises' periodic results, and particularly to unexpectedly adverse profit or revenue figures (2001: 61%). The growing number of enterprises with liquidity or debt problems contributed 18% of the cases (2001: 7%). Alongside takeover bids and buyout offers (16%), front running by brokers with the responsibility of determining prices (Skontroführer) – i.e. exploiting knowledge of the order position – was also significant, accounting for 15% of the total cases.

The "positive" stock exchange manipulation analyses mostly related to dishonest trading practices.

Five of the 17 "positive" price manipulation analyses related to false information or illicit failure to disclose information. However, the remaining 12 were cases of "other actions aimed at deception" (Section 20a (1) no. 2 WpHG). Particularly noteworthy were dishonest business practices such as wash sales and pre-arranged trades.

Market analyses can be triggered in a variety of ways. Systematic evaluation of ad hoc announcements is paramount. This is backed up by information submitted by investors and market participants (2002: 363), as well as press and media reports. Numerous tip-offs also originated from trading surveillance offices and the criminal prosecution authorities.

The Securities Watch Application IT system carries out automated market surveillance.

All transferable securities are also subjected to automated market surveillance via the Securities Watch Application (SWAP) IT system. Every trading day it uses mathematical and statistical methods to pick out the most conspicuous shares or derivatives. In this case "conspicuous" means that certain trading parameters for these securities have diverged significantly from their usual patterns.

As part of an insider analysis the first thing to be checked is whether the ad hoc announcement contains facts indicating insider activity, i.e. a hitherto unknown circumstance of significant price-sensitive potential. The second step is to analyse whether the reported transaction data reveal indications of conspicuous trading before publication of the announcement.

The procedure for the analysis of possible price manipulation is somewhat different. Here the task is to identify false information and circumstances which could significantly influence the prices of shares, bonds, or derivatives. Deceptions or the spreading of inaccurate rumours in order to influence the price also fall under this category. The next step is to determine to what extent the price has actually been influenced.

BaFin draws up expert reports in order to establish whether the price actually was affected.

In cases of manipulation BaFin regularly prepares expert reports to determine whether the manipulation has actually affected the stock exchange price. Proving that the price actually was affected can be difficult, particularly in the cases where information that should have been disclosed has been withheld. Notwithstanding this, in the cases uncovered to date it was possible to make a clear determination, either because when information that had originally been withheld was later published this led to corresponding price changes or because a comparison of the share prices of similar enterprises or appropriate indices allowed a causal connection to be inferred between the information and price movements.

In the year under review, BaFin prepared a series of expert opinions for courts and public prosecutor's offices on the considerable price-influencing potential of insider trading activities.

Share buyback programmes can also influence prices.

Share buyback also has the potential to influence share prices. Accordingly, share buyback programmes as referred to in Section 71 (3) sentence 3 of the Stock Corporation Act (Aktiengesetz – AktG) must be reported. BaFin must be notified if a General Meeting of Shareholder authorises the Management Board to buy back its own shares (so-called treasury shares). Since July 2002, failure to report this is a fineable offence. BaFin compiles these reports in a database on its website. During 2002 it prepared 230 such reports.

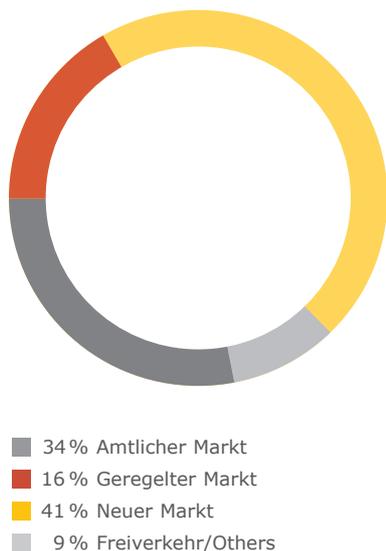
Following the terrorist attacks of 11 September 2001, special analyses of securities and futures transactions were carried out in close coordination with the Federal Office of Criminal investigation (Bundeskriminalamt) and the Chief Federal Prosecutor's Office (Generalbundesanwaltschaft). They were completed in spring 2002. No evidence was found of any connection between the market transactions and the attacks.

### 1.3 Insider trading investigations

Last year, 69 new insider trading investigations were instigated.

During 2002, BaFin instigated 69 new investigations into suspected breaches of insider trading regulations to add to the 61 investigations pending from the previous year. In total, 33 cases were referred to the respective public prosecutor's offices, and in 15 cases BaFin dropped the case due to lack of evidence. At the end of the year 82 investigations were still open.

Fig. 12  
**New investigations (insider trading and market manipulation) according to market segment**  
 (total: 86)



If the analysis of price changes, turnover, and information in relation to a security that has been affected by insider trading reveals possible violations, the section responsible for the investigation will initiate a formal investigation. First of all BaFin establishes the facts of the case by making enquiries with the exchange-listed enterprise and other parties involved in the investigation. As part of the second stage, all the credit and financial services institutions subject to a duty of disclosure are questioned in order to identify the parties originating the dubious transactions. If these investigations reinforce the suspicion that insider trading has taken place, BaFin will notify the competent public prosecutor's office.

In 2002, there were increasing numbers of charges and of full trials heard by magistrates' courts and district courts' economic offences divisions. This is a welcome sign that the courts are taking the problem of insider trading seriously.

Munich Magistrates' Court sentenced a person found guilty of insider dealing to a prison term, albeit a suspended one. For the first time the sentence was the outcome of a full trial. Magistrates also imposed fines on two insider traders after summary proceedings, and the public prosecutor's offices settled 13 preliminary proceedings in return for a suitable out-of-court payment. 37 other preliminary investigations were dropped by the public prosecutor's office.

A number of the cases concluded in 2002 are discussed in greater detail below:

### **Letsbuyit.com**

At 07:55 on 25 January 2001, the company LetsBuyIt.com N.V. announced via an ad hoc report that the company's administrators had withdrawn an application to initiate subsequent bankruptcy proceedings ("conversion of the suspension of payments into bankruptcy") after having received written commitments regarding the 4 million euros necessary to keep the company trading. In a subsequent ad hoc announcement issued 20 minutes later, LetsBuyIt.com explained that the four million euros had been furnished among others by Kimvestor AG, a German venture capital firm. The announcement stated that Kimvestor AG had sent the company a letter of intent expressing an interest in making a major contribution to the future financing of the company, and had expressed a formal interest in investing up to 50 million euros in LetsBuyIt.com before the end of February. Following these ad hoc announcements, LetsBuyIt.com shares rose by approx. 140%, from €0.25 to €0.60.

The accused, the founder of Kimvestor AG, exploited his knowledge that subsequent bankruptcy proceedings had been averted, a matter in which he had been personally involved, by buying 2,069,500 LetsBuyIt.com shares on 25 January 2001, before the publication of the ad hoc announcements. In February 2001 he sold the shares, making a profit of €1,192,787.60.

After being notified by BaFin on 27 November 2001, Munich public prosecutor's office issued an arrest warrant on 11 January 2002. The accused was arrested ten days later, and was kept in custody until his full trial on 27 May 2002. Munich Magistrates Court gave him a 20 month suspended sentence.

### **Debitel AG**

On 9 July 1999, Debitel AG published an ad hoc report announcing that the Swiss company Swisscom AG had acquired 58% of its share capital. On the same day Swisscom AG announced a takeover offer of €32 to the outside shareholders.

On 28 June 1999, the accused, an employee in a senior position, exploited his knowledge of the impending takeover by acquiring via his own safe custody account a total of 8,000 warrants for Debitel shares. Then, on 7 July 1999, two days before the publication of the ad hoc announcement, he purchased 850 Debitel shares at 29 euros each. On the same day also he used his wife's safe custody account to acquire 175 Debitel shares and 7,500 share warrants.

After summary proceedings, Stuttgart Magistrate's Court sentenced the accused to pay a DM20,000 fine, made up of 80 daily instalments of DM250 each.

**TFG Venture Capital AG**

The accused was the employee of a credit institution responsible for handling share transactions carried out by the asset management department. In the course of his work he found out in September 2000 that the asset management department had set a stop-loss order at €36.50 for 5,450 shares in TFG Venture Capital AG.

The accused himself owned 50 TFG Venture Capital shares, which he had purchased at a price of €40.50. He knew that the share price would fall significantly if the stop-loss order was triggered and the 5,450 shares were sold at the best available price (so-called "market order"). Accordingly, he also set a stop-loss order at €36.50 for his own shares.

At 12:17 on 21 September 2000 the price of TFG Venture Capital shares fell to €36.50, whereupon the trading system automatically generated the order to sell, at the best available price, the 5,450 shares held by the credit institute's asset management department and the 50 shares owned by the accused. According to this, the shares would have been sold at the next available price. However, the accused now cancelled his market order and put his 50 shares up for sale via XETRA at 12:26, with a limit of €35.50. The stock exchange executed his order at 12:26, before the market order for the 5,450 shares held by the credit institute's asset management department could come into play.

After summary proceedings, Leipzig Magistrate's Court sentenced the accused to a fine of €4,800, payable in 80 daily instalments of 60 euros.

**Gesundheits-Service AG**

On 19 June 2000, Gesundheits-Service AG published an ad hoc announcement revealing that the company had suffered a loss before interest and taxes of approx. DM3.3 million. Then on 15 September 2000, Gesundheits-Service AG announced in an ad hoc report that it had filed for insolvency after an investor had unexpectedly withdrawn from the restructuring plan.

The accused, a manager at the company, informed his wife about the financial results, and before 19 June 2000 she sold a total of 800 shares in small tranches, thus avoiding a loss of around €13,000. The accused also shared the insider information with his brother-in-law, who also sold his 250 shares in the company, thus avoiding a loss of around €4,800.

Pursuant to Section 153a StPO, with the court's agreement Heilbronn public prosecutor's office provisionally refrained from instituting public proceedings, and dropped the case in return for an out-of-court payment of €8,000 by the wife and €4,750 by the brother-in-law.

## 2 Ad hoc disclosure and directors' dealings

One of the main issues to be addressed in the year under review was the implementation of the new regulations introduced by the 4th FMFG in relation to ad hoc disclosure and the duty to publish information about directors' dealings. These regulations have further improved transparency for the investor, an indispensable requirement for a properly functioning capital market.

### 2.1 Extension of the ad hoc disclosure requirements

New, price-sensitive facts or circumstances must be published without delay.

The ad hoc disclosure requirements of Section 15 WpHG specify that new, price-sensitive facts or circumstances must be published without delay. The aim of the ad hoc disclosure rules is to ensure that all market participants are guaranteed access to the same information through rapid and uniform disclosure to the market. This should counteract the development of inappropriate share prices caused by some individuals having an information advantage. The disclosure duties are also aimed at preventing the use of insider information; once facts have been published, they can no longer be exploited for insider trading purposes. The ad hoc disclosure rules thus complement the rules requiring publication of annual financial statements, management reports, and interim reports.

The ad hoc disclosure duty applies to all issuers of securities admitted to trading on official or regulated markets.

The duty to issue ad hoc reports is incumbent on every issuer of securities licensed in Germany for trading on a stock exchange of the "Amtlicher Markt" (official market) or the "Geregelter Markt" (regulated market). Securities traded within the "Freiverkehr" segment (unofficial market, literally "free" market) are not covered, in contrast to the above-mentioned insider trading rules. Ad hoc announcements are required whenever a new fact arises in relation to the issuer's activities which is not in the public domain and which could have consequences for the assets or financial position or the general trading position of the issuer. The fact must also be likely to significantly influence the share price.

Since mid-2002, ad hoc announcements may only use figures which are in normal business use.

Since July 2002, the financial indicators used in the ad hoc announcements must be figures in normal business use and must allow comparisons to be drawn with the figures used previously (Section 15 (1) sentence 2 WpHG). To ensure uniform application of the law, BaFin has scrutinised the question of which financial indicators may be regarded as being in normal business use. In its Circular of 26 November 2002, BaFin notified market participants of its conclusions in this respect. It identified 11 key indicators as being "customarily used" within the meaning of Section 15 (1) sentence 2 WpHG: Sales/revenue, earnings per share, net profit, cash flow, earnings before interest and taxes (EBIT), earnings before taxes (EBT), dividends per share, earnings before interest, taxes, depreciation and amortisation (EBITDA), profit margin/profit ratio (in % of sales), equity ratio, and profit/loss from ordinary activities.

Either the figures from the previous comparable period or the changes must be stated alongside the new figures.

Alongside the key figures, the ad hoc announcement must specify either the corresponding figures from the previous comparable period or the percentage changes. This ensures the comparability required by law

with the key figures used previously. BaFin also recommends that any changes in the issuer's group of consolidated companies or accounting methods must be stated, as this is the only way of ensuring proper comparability and guaranteeing that all market participants have fast access and the ability to rapidly process all significant information.

False facts in ad hoc announcements must now be corrected immediately.

The 4th FMFG also makes more difficult the misuse of ad hoc announcements for advertising purposes and for the publication of false facts. Pursuant to Section 15 (1) sentence 4 WpHG, false facts in ad hoc announcements must now be corrected immediately. Furthermore, BaFin can now investigate and penalise erroneous or improper advertising procedures more effectively. In the event of violations of the rules governing these procedures, BaFin can now take effective measures under administrative law, for instance by imposing fines of up to €250,000. In some individual cases BaFin has already warned issuers to correct such abuses.

Another new legal provision within this context is that issuers may now be liable to pay damages if they are in breach of their ad hoc disclosure duties (Section 15 (6) WpHG).

## 2.2. Notification and disclosure

### Number and nature of announcements

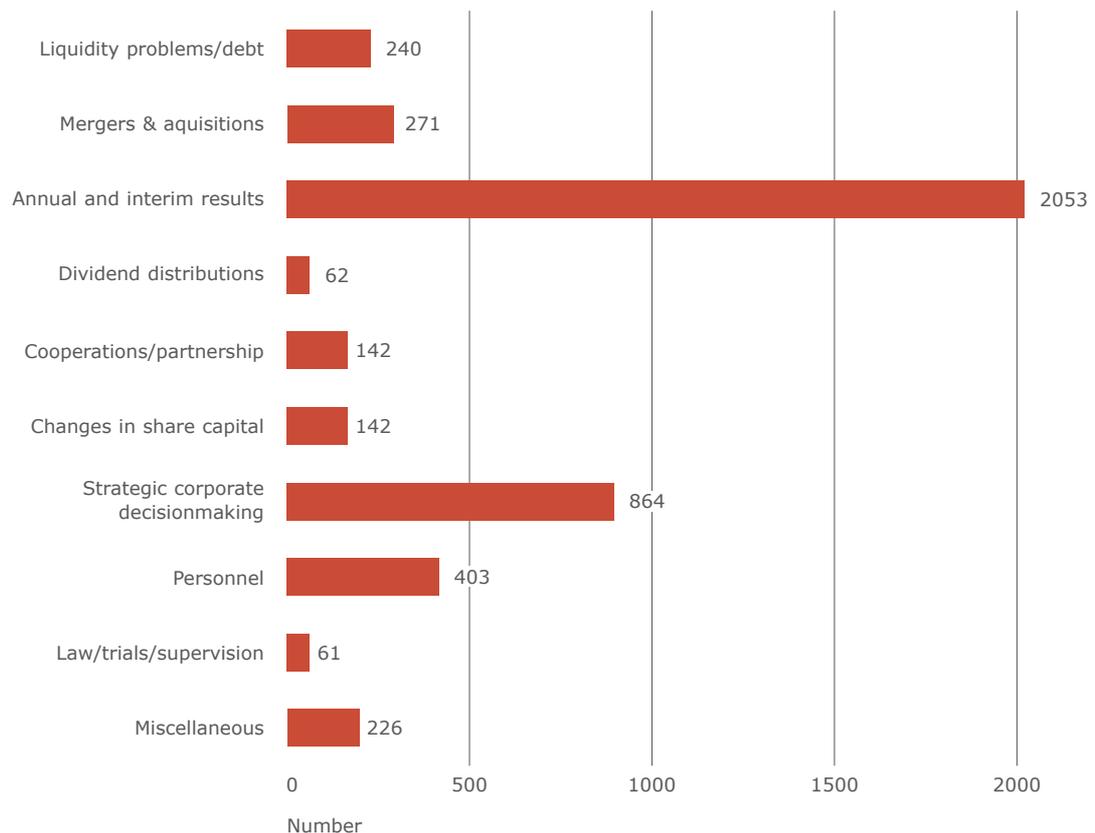
The number of ad hoc announcements once again fell in 2002.

In 2002, BaFin received 4,491 ad hoc announcements (2001: 5,421). Of these, 3,781 announcements (4,605) were from German issuers and 710 (816) from foreign issuers. Thus, the downward trend already observed in 2001 continued in the year under review. Alongside the prevailing weakness of the stock markets, one reason for this could be that companies are becoming more aware of the need to avoid superfluous ad hoc announcements. The vast majority of the ad hoc announcements (4,467 or 99.4%) were published on electronic information systems and only 24, or 0.6%, in supra-regional officially designated stock-exchange gazettes.

Reports of periodic figures make up the great majority of the ad hoc announcements.

As regards the nature of the ad hoc announcement, in 2002 a preponderance of them related to periodic figures, and in particular to annual financial statements and quarterly results. As in 2001, many of the announcements focused on strategic corporate decision-making. Often these related to divestment measures, for instance the abandonment of planned investment projects or the institution of restructuring programmes. Reflecting the generally poor economic climate in 2002, the number of ad hoc announcements of impending or actual insolvency rose sharply.

Fig. 13

**Nature of ad hoc announcements in 2002****Immediate notification and disclosure**

The majority of the cases investigated by BaFin concerned the suspicion of delays in disclosing ad hoc announcements.

The majority of the cases investigated by BaFin in 2002 related to suspicions of delays in the publication of ad hoc announcements. Facts subject to the duty of ad-hoc disclosure must be published immediately, i.e. without any culpable delay. After the fact arises the issuer may only delay publication for as long as may be justified by special circumstances in any given individual case.

Stock exchange trading times are irrelevant to the duty to immediately disclose price-sensitive facts or circumstances.

Stock exchange trading hours are irrelevant in determining whether facts have been published without delay. Accordingly, it is not generally acceptable for a circumstance arising after a stock exchange closes for the day not to be disclosed or published until early the following day before stock exchange trading begins. BaFin's Circular of 8 February 2002 expressly draws issuers' attention once again to their duty to publish price-sensitive facts or circumstances without delay irrespective of stock exchange trading hours. In 2001, well over half (approx. 60%) of all ad hoc announcements were published on working days between 7:00 a.m. and 9:00 a.m. Since then, a certain change in publication patterns can be observed, with increases in the number of ad hoc announcements being published during the day or late in the evening. However, the bulk of results for financial periods just ended continues to be published early in the morning before stock market trading begins.

The issuer may contract a service company to publish its announcements.

The publication method or medium chosen is irrelevant in deciding whether the issuer has discharged its duties punctually. This applies irrespective of the fact that the publication medium chosen (print or electronic information systems) may naturally influence the precise time at which market participants gain access to the information. BaFin and the stock exchanges must be notified of publication in advance. The issuer may contract a service company to assist in the fulfilment of its publication duties.

#### Access to electronically distributed ad hoc reports

Internet: [www.bafin.de/links](http://www.bafin.de/links)  
[www.vwd.de](http://www.vwd.de)  
[www.n-tv.de/wirtschaft](http://www.n-tv.de/wirtschaft)  
[www.dgap.de](http://www.dgap.de)  
[www.huginonline.de](http://www.huginonline.de)  
[www.euroadhoc.com](http://www.euroadhoc.com)

Teletext: ARD/ZDF (page 718)

When assessing exemption applications, BaFin must determine whether the enterprise's need for confidentiality should be deemed more important than the capital market's need for information.

#### Exemption from publication requirements

On application, BaFin may grant issuers temporary exemption their duties of disclosure if the publication of a given fact or circumstance could damage the issuer's legitimate interests (Section 15 (1) sentence 5 WpHG). When assessing each individual application, BaFin must determine whether the enterprise's need for confidential treatment should be deemed more important than the capital market's need for information. Any exemption must only be granted for a short period, under some circumstances for no more than a few days, since there is always a risk that awareness of the facts or circumstances will spread in uncontrolled fashion or be used for insider trading purposes. In this case BaFin reserves the right to withdraw exemption. Since BaFin's inception, charges have been levied for exemptions from ad hoc disclosure requirements.

In 2002, 18 out of 26 exemption applications were granted.

In 2002, the continuing weakness of the economy led to 26 applications for exemption from ad hoc disclosure duties (2001: 36). BaFin granted 18 applications and refused seven, while one was withdrawn by the issuer. In most cases the issuers were hoping to postpone publication of impending insolvency or excessive debt because of ongoing restructuring negotiations.

#### Audits and administrative fines

The ongoing supervision of ad hoc disclosure requirements unearthed several cases in which there was a suspicion that the issuers had used ad hoc announcements to paint a false picture of specific facts or circumstances requiring publication. If an issuer falsely portrays price-sensitive facts or circumstances in an ad hoc announcement, BaFin is authorised to exact a fine of up to €1.5 million. Such cases also often lead to investigations of possible price manipulation.

In two cases BaFin passed the investigation on to the public prosecutor's office.

In two cases in which there was a suspicion of false or incomplete ad hoc announcement by Neuer Markt issuers (ComRoad AG and Phenomedia AG) BaFin passed the investigation on to the competent

public prosecutor's office. In such cases, the competent courts then judge whether the enterprises have violated their ad hoc disclosure duties. In the course of 2002, BaFin registered an increasing number of cases in which indications of a violation of the ad hoc disclosure duty were coupled with suspicions of insider trading and price manipulation.

Five fines were imposed for violation of ad hoc disclosure requirements.

In 2002, 31 new cases were opened to add to the 17 administrative fine proceedings still pending from the previous year. In the year under review, BaFin imposed five fines pursuant to Section 15 WpHG for late publication of or failure to publish information subject to a duty of ad hoc disclosure. 13 cases were dropped, leaving 30 cases still pending at the end of the year.

### **Ad hoc disclosure and takeover law**

The entry into force of the new takeover law at the start of 2002 has had a palpable effect on the disclosure behaviour of exchange-listed issuers. In some cases issuers were uncertain as to the legal situation vis-à-vis the relationship between duties of disclosure under the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG) and ad hoc disclosure requirements under the WpHG. As a result, BaFin has encountered increasing numbers of ad hoc announcements in accordance with Section 15 WpHG in connection with takeover cases which did not meet the requirements for ad hoc disclosure. To prevent incorrect disclosure habits, BaFin informed market participants of the legal requirements in a letter dated 26 April 2002.

Bidder publications and ad hoc announcements.

Bidders' publications pursuant to Sections 10, 29, 34, and 35 of the WpÜG replace ad hoc announcements which would otherwise be necessary. Unlike ad hoc announcements, bidders' reports must be submitted in every case, i.e. irrespective of whether the report is price-sensitive or has consequences for the assets or financial position or the general trading position of the bidder. The precedence of publication pursuant to the WpÜG only extends to the subject matter published therein. In other words, if facts or circumstances are not included in a WpÜG disclosure but do fulfil the requirements for ad hoc disclosure, an ad hoc announcement must also be made. This relates, for instance, to additional information regarding the takeover bid. As a rule, the target company does not have to publish an ad hoc announcement since there are no new facts or circumstances within the meaning of Section 15 WpHG occurring within its own sphere of activity.

In the event of the exclusion of minority shareholders via a squeeze-out within the meaning of Section 327a et seq. AktG, the principal shareholder is only required to publish an ad hoc announcement in exceptional circumstances, if it is an enterprise licensed in Germany for stock exchange trading and if the decision to execute the squeeze-out or the act of determining of the cash settlement could significantly effect the stock exchange price of the main shareholder's listed securities.

## 2.3 Directors' dealings

Securities dealings by primary insiders must now generally be reported.

The provisions of the 4th FMFG mean that, for the first time, securities dealings in their own company by so-called primary insiders and their immediate relatives (Directors' Dealings) must be reported. Accordingly, since 1 July 2002 Management Board and Supervisory Board members of listed companies have been required to immediately notify BaFin and the company in question if they undertake dealings in the securities of their own company. This duty of disclosure also applies to spouses, registered partners, and immediate relatives. The enterprise is then obliged to publish these dealings (Section 15a WpHG).

The purpose of publication is to avoid the impression that the governing bodies of a company could be exploiting their knowledge of corporate activities for insider trading purposes. Furthermore, dealings by primary insiders may give the capital market indications of the management's view of their company's future business prospects.

There is, however, a threshold below which reports are not required.

Disclosure requirements are subject to a certain threshold: where the aggregate value of the dealings made by persons subject to the duty of disclosure does not exceed €25,000 over a 30-day period (in terms of the total number of transactions carried out), these dealings do not have to be reported. Furthermore, they do not have to be disclosed if shares are acquired in line with a contract of employment or as part of the person's remuneration package. Accordingly, the acquisition of employee shares and the granting of share options as part of an employee share option plan are not subject to disclosure requirements. However, if the above-mentioned persons subsequently sell the employee shares or exercise a share option, this is subject to a duty of disclosure.

BaFin may take administrative action to force companies to report such dealings and may also impose fines.

If a person or body subject to duties of publication or disclosure fails to comply with said duties, BaFin may take administrative action to force them to do so; BaFin may also impose fines of up to €250,000. If the parties affected contest any such orders made by BaFin, the case will be examined by Frankfurt am Main Administrative Court.

In the event of wilful or negligent breaches of disclosure or publication duties, BaFin may impose fines of up to €100,000.

### Specifying the new duties of disclosure

BaFin has published Circulars including a Directors' Dealings Report Form.

To ensure fulfilment of the new disclosure and publication requirements, on 27 June 2002 BaFin sent a Circular to the Management Boards of all listed enterprises setting out the nature of the disclosure and publication required in the case of directors' dealings. The Circular includes a report form to be used when notifying BaFin.

Indirect dealings conducted via a third party juristic person are not subject to a duty of disclosure.

In response to a substantial number of enquiries, BaFin issued a second Circular on 5 September 2002 on questions relating to the interpretation of Section 15a WpHG. This clarified the point that indirect purchases or disposals not conducted by the person or body itself subject to notification requirements but rather through a third party juristic person (such as a foundation or trust company) are not subject to disclosure requirements. This applies even if the person

subject to the duty of disclosure exercises effective influence over the third party's business activities. The inclusion of this state of affairs in the duty of disclosure is not covered by the wording of Section 15a WpHG. This would be problematic as regards subjection to fines and the principle of legal certainty (an act may be punished only if it was defined by a law as a criminal offence before the act was committed). In a second Circular BaFin also addressed the question of the threshold of €25,000. This relates to a period of 30 days, so that this period must be continually taken into consideration. The person subject to the duty of disclosure must check after each deal made whether his/her/its dealings in the own company's securities during the last 30 calendar days exceed an aggregate value of €25,000. If they do, all of the dealings effected within this period must be disclosed, if necessary retrospectively.

### Initial experiences

During the second half of 2002, BaFin was notified in accordance with Section 15a WpHG of 1,092 deals which were published by the issuers. In the course of its monitoring of disclosure and publication behaviour BaFin identified a number of shortcomings, particularly on the part of persons subject to a duty of disclosure. In some cases there were considerable delays in reporting dealings. A reason often cited within this area was ignorance that any duty of disclosure existed. Another reason given was that the party involved had not become aware of the securities transaction until a later date, for instance due to long absence.

In most cases the delay between effecting the deal and publication was between two and four days.

In contrast, delays among the issuers were few and far between. As a rule, the notification is published on the company's homepage on the same day that the notification of the deal is received from the board member or family member. In most cases the delay between effecting the deal and publication by the issuer was between two and four days.

By the end of 2002, BaFin had in five cases issued instructions to family members and board members to fulfil their disclosure duties towards the issuers and BaFin. The parties involved justified their omission by recourse to constitutional arguments against the inclusion of family members in the duty of disclosure and against family members' names being published by the issuer.

Three administrative fine proceedings instituted for breaches of the duty of prompt disclosure were still pending at the end of the year.

BaFin publishes the dealings of corporate insiders in an Internet database.

Since the new duties of disclosure and publication came into force, Deutsche Gesellschaft für Ad hoc-Publizität has offered the service of notifying issuers and BaFin and also of publishing the disclosure on the Internet at the issuer's address. Since September 2002, BaFin has published on its website a permanently updated database of all dealings published pursuant to Section 15a WpHG. This gives investors a central reference source of dealings by corporate insiders.

## 3 Voting rights

### Extension of the duty of disclosure

In 2002, not only were the reporting requirements extended to include holdings of voting rights in enterprises listed on the regulated market, additions were also made to the circumstances for the attribution of voting rights. The purpose of this legislative measure is to bring about more transparency regarding participations in listed companies. BaFin carried out a comprehensive evaluation of the current situation as of 1 April 2002 in relation to major voting rights within the meaning of Section 21 et seq. WpHG. This provides market participants with a complete overview of current participation relationships.

A notification requirement arises once thresholds of 5, 10, 25, 50, or 75% of the voting rights has been reached.

Holders of voting rights in stock corporations (Aktiengesellschaft – AG) or partnerships limited by shares (Kommanditgesellschaft auf Aktien – KGaA) are obliged to immediately notify both BaFin and the listed company in which they have a holding of the extent of their voting rights. This notification requirement arises once thresholds of 5, 10, 25, 50, or 75% of the voting rights have been reached or exceeded, and also when voting rights held fall below these levels. Within this context, the entire holding of voting rights must be reported, including voting rights attributable to third parties.

The report must be submitted without delay and must include the date, the threshold involved, the proportion of the voting rights, and the signature of the holder of the voting rights. It must be published by the company in a supra-regional officially designated stock-exchange gazette, and proof of publication must be sent to BaFin. Companies with their registered offices in foreign countries and whose shares are admitted to trading on an organised market of the German stock exchange must publish the percentage of the voting rights held by their shareholders if these figures are known to them.

BaFin's powers in this field have been further enhanced by the 4th FMFG. BaFin may now demand information and the submission of such documents as are necessary for the monitoring of the duties of disclosure and publication, including from collective security deposit banks. Previously BaFin's authority within this area had been limited to shareholders, former shareholders, and investment services enterprises.

BaFin publishes holdings of voting rights in an Internet database.

Major holdings of voting rights are published on BaFin's website, in a special database which is updated in accordance with notifications received.

### Notification and disclosure

The number of reports has risen by almost 70%.

In 2002, BaFin received 1,555 reports (2001: 922) of changes in major holdings of voting rights. In addition, 3,040 reports were received in relation to voting rights held as at 1 April 2002. At the end of 2002, 737 domestic and foreign companies were licensed on the "Amtlicher Markt" (official market) (2001: 632) and 436 companies on the "Geregelter Markt" (regulated market) of the German stock exchange. The number of reports of changes in holdings of voting rights increased by two thirds from the previous year. The reason for this growth was

chiefly the extension of notification and disclosure duties to enterprises listed on the regulated market. However, the extending of attribution circumstances in connection with the entry into force of the new Takeover Act, whereby loopholes in requirements governing the attribution of shares of voting rights were closed, has also contributed to the increase.

Specialised funds now also have to report to BaFin if they exceed the 5% threshold.

BaFin also received significantly more reports from investment companies due to the fact that the privileges conferred on specialised funds by the KAGG as regards disclosure duties have now been revoked. As a result, both shareholders and investment companies must observe the 5% threshold in relation to shares held in specialised funds, and also comply with the corresponding notification requirements. Since the beginning of 2002, European investment companies have also had to submit a report of their voting rights once the 5% threshold has been reached.

Changed methods of attributing voting rights within an enterprise have also contributed to increased reporting.

A third reason for increased reporting is that a growing number of enterprises are having to include their subsidiaries' voting rights in listed companies. This is because of a change in the definition of a subsidiary. For the provisions regarding disclosure to apply, enterprises are now deemed subsidiaries if they are regarded as such within the meaning of Section 290 of the German Commercial Code (Handelsgesetzbuch – HGB) or if a controlling influence can be exerted over them. Additionally, shareholders invested directly held shares in holding companies in order to realise the tax benefits granted to enterprises on the subsequent disposal of shares in incorporated companies.

Circulars to parties subject to a duty of disclosure.

As in 2001, many reports had to be corrected due to lack of details about such items as the relevant voting rights threshold, the actual percentage of the voting rights held, or the date of the change; in some cases the attribution circumstances were also ignored. In some other cases there were also significant discrepancies between the text of the notification and of the subsequent disclosure. In part this was because the parties involved were not sufficiently conversant with the regulations. A Circular published on 13 December 2001 informed listed companies of the changes in their duties of disclosure.

### Exemptions

Enterprises which provide investment services and are subject to a duty of disclosure may on application be exempted by BaFin from the duty of disclosure in relation to securities which they only hold for short periods. Up to the 10% threshold this also applies to enterprises wishing to exploit short-term differences between the buying and selling prices.

At the end of 2002, 100 enterprises had received exemption from the duty of notification.

In 2002, BaFin granted 17 applications for voting rights in a company's trading portfolio not to be taken into account. Including these, at the end of 2002 100 enterprises had been exempted from the notification requirement with respect to their trading portfolios. During 2002, no enterprises forwent their right to exemption. Each year the auditor must make a note confirming observance of the requirements for exemption, and this must be submitted to BaFin. Since the changes to the regulations brought about by the 4th FMFG, the auditor must also

verify that the shares exempted from the duty of disclosure are not used to influence the company's conduct of business (Section 23 (1) no. 3 WpHG).

### **Administrative fines**

In 2002, BaFin initiated 171 new cases due either to late or neglected reporting of significant holdings of voting rights or to late disclosure. Eighty of these cases related to breaches of the requirement to report on voting rights by 1 April 2002 (Section 41 (2) WpHG). A further 150 cases were still pending from 2001. BaFin imposed fines in 40 cases and dropped 55 cases. At the end of 2002, 226 cases were still open.

## 4 Prospectuses

The purpose of the prospectus is to provide the investor with important information to assist in making the investment decision.

A constituent element of overall investor protection is the duty of the offerer of securities to prepare and publish a prospectus in the event of a public offering. This is deemed particularly important because generally investors do not have direct access to precise information about the security on offer or the issuer's financial position. Accordingly, the prospectus is designed to give the investor useful information on which to base the investment decision. In addition, the prospectus is the central liability document in the event of claims under civil law arising from omissions or inaccurate information.

### **Sphere of application and procedure**

BaFin is responsible for the deposit of sales prospectuses.

A prospectus must be published whenever a security is being offered to the public for the first time in Germany, and also when an application is being made for a security to be admitted to trading on a stock exchange. Several terms are used in relation to prospectuses. Firstly, the document prepared to accompany a public offering is called the "Verkaufsprospekt" (prospectus/sales prospectus). Then there is the report prepared in relation to applications for a stock exchange trading licence, the name of which varies depending on which stock exchange segment is involved. For applications to trade on the "Amtlicher Markt" (official market) it is called "Börsenzulassungsprospekt", for applications to trade on the "Geregelter Markt" (regulated market) the "Unternehmensbericht", and for applications regarding the soon to be defunct "Neuer Markt" (new market) the "Emissionsprospekt". BaFin is responsible for depositing the prospectuses.

Issuers whose solvency is not in any doubt, for instance the federal government, are exempted from the requirement to issue prospectuses.

The obligation to publish a prospectus applies only to offerings of securities, which include equities, bonds, warrants, and certificates. They do not include shares representing either a silent partnership or status as a partner in a private limited liability company (Gesellschaft mit beschränkter Haftung), a limited partnership (Kommanditgesellschaft), or a civil-law partnership (Gesellschaft bürgerlichen Rechts). Also excluded from the duty to prepare prospectuses are issuers whose solvency is not in any doubt, for instance the federal government or other state agencies, since the sole purpose of the requirement to issue prospectuses is investor

protection. For this reason, securities may also be offered to institutional investors or employees of the issuing company without the need for a prospectus.

BaFin only checks the prospectus for completeness, not for factual accuracy.

If a public offering of securities is involved, the prospectus must be deposited, i.e. lodged, with BaFin, provided no application for a stock exchange trading licence is being made. BaFin checks prospectuses submitted to it according to the provisions of the Ordinance on the Prospectus for Securities Offered for Sale (Verordnung über Wertpapier-Verkaufsprospekte). It does not assess the factual accuracy of prospectuses, and accordingly their approval by BaFin does not allow any conclusions to be drawn about the quality of the offer or the solvency of the issuer. Consequently, BaFin may prohibit any advertisement giving the impression that said approval represents an "official seal of approval" for the securities in question or even an official recommendation to buy.

Once submitted, prospectuses must be checked within ten days.

After submission, BaFin must check the prospectus within ten working days. Often during this period the offerer will be notified of insufficient information, which must be submitted before the end of the period. If BaFin makes no comment during the ten-day period, it is deemed to have approved the publication of the prospectus. Following this procedure, the offerer has to have the prospectus published in a supra-regional officially designated stock exchange gazette before it can launch the public offering. There must be an intermission, i.e. a gap, of at least one working day between publication and the launch of the public offering, and the offerer must notify BaFin immediately in writing of the date and place of publication.

Bodies offering securities via electronic information systems must also publish the prospectus there.

The 4th FMFG has broadened the overall publication requirements. Anyone offering securities via an electronic information system must also publish the prospectus via this information system. As a rule, this is done by placing the electronic version on the website in a so-called pdf format. Interested persons must be able to locate the electronic version on the Internet quickly and be able to download it to their PCs and print it out. The offerer must notify BaFin of the exact location of the prospectus on the Internet.

Another new provision is that administrative acts towards persons based outside Germany must be performed via public announcement in the Federal Gazette if no authorised representative has been appointed in Germany. This applies not only to the usual case of "notification/announcement" (Bekanntgabe) but also to "service" (Zustellung). In view of the fact that publication in the Federal Gazette is time-consuming, BaFin generally attempts to arrange for the appointment of an authorised representative in Germany, which significantly simplifies the business of communicating with the offerer.

In the event of violation of the duty to publish a prospectus, BaFin will disallow the public offering.

If securities are offered in violation of the duty to publish a prospectus, BaFin will prohibit the public offering. Violations are detected via BaFin's own research, particularly on the Internet, or through information provided by members of the public or by other authorities. Violations of the Prospectus Act (Verkaufsprospektgesetz) represent misdemeanours which are subject to fines of up to €500,000.

Prospectuses deposited with BaFin are kept on file for ten years and may be made available to law enforcement agents or the public

prosecutor's office for their investigations. They may also be used in case of legal disputes, for instance in relation to prospectus liability. However, this does not free the offerer of the security from its obligation to keep the prospectus available free of charge for the duration of the offer period.

The deposit fee is 200 euros.

The fee for depositing a complete prospectus is 200 euros. The fee for a partial prospectus is 150 euros and for each supplement 50 euros. If BaFin disallows the public offering, the fees are reduced by 25%.

### **Internet database**

Since April 2002, BaFin has made available on the Internet a database of all prospectuses that it has checked and approved for publication. The databank facilitates research according to issuer, offerer, and security identification number in order to access information such as the date of the prospectus or when the shares were first offered for sale. The investor can also find out whether a prospectus was ever actually published and where it can be obtained. Thus, BaFin already meets the publication requirements proposed for the upcoming EU Prospectus Directive.

### **Deposit of prospectuses**

Continuing the trend of 2001, 2002 saw continuing high levels of issuance activity. Despite the stock market slump, the number of issues for which prospectuses have been deposited with BaFin rose to 29,160 after the submission of 310 complete prospectuses as opposed to 590 in 2001. The number of supplements, particularly ones containing conditions relating to a specific issue which become known shortly before the launch of the offering, has increased sharply. There have also been significant numbers of supplements containing changes of considerable importance in evaluating the issuer or the security. As regards the type of securities issue, there has been a relative increase in certificates as against warrants. Notwithstanding this, warrants continued to make up the bulk of the issues, with 22,185 deposited in 2002 (2001: 25,634).

### **Administrative fines and appeals**

In 2002, investigations were in place in relation to 50 cases of late publication or failure to publish securities prospectuses, of which 30 cases were carried over from the previous year. BaFin imposed five fines and suspended seven cases.

At the beginning of 2002, four protests were pending and eight further cases were instituted during the year. The protests were mostly in relation to requests for information and the submission of documents and also against the decision to prohibit a public offering. During 2002, three cases were closed after settlement, three further cases were suspended after the protest was withdrawn, and two other cases were settled via a ruling on the protest.

## 5 Corporate takeovers

### 5.1 Sphere of application of the Securities Acquisition and Takeover Act

On 1 January 2002, the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG) came into force along with various accompanying Regulations<sup>45</sup>. For the first time, these provide a binding legal framework for the takeover of listed enterprises.

A fair and transparent offer procedure will strengthen the position of minority shareholders.

The Act lays down guidelines for a fair, transparent, and orderly takeover process aimed at strengthening the position of minority shareholders and employees of the target company, i.e. the enterprise which is subject to the takeover offer. A further aim is to meet the financial markets' expectations in a suitable manner, thus reinforcing Germany's position as a financial centre and boosting its ability to compete with its international rivals.

The Act applies to public offers for the purchase of securities where the target company – a stock corporation or a partnership limited by shares – has its registered office in Germany and its securities are admitted to trading on an organised market in the EEA. In Germany these include the "Amtlicher Markt" (official market) and the "Geregelter Markt" (regulated market), Frankfurt Stock Exchange's Neuer Markt, and the Hamburg Stock Exchange's Start-Up-Markt. A review of all the organised markets in the EEA is published regularly by the European Commission.

In cases of squeeze-out, a mandatory offer must be made to the minority shareholders.

During the first year of monitoring the offer procedure, BaFin addressed a variety of questions regarding the sphere of application of the WpÜG. At the same time as the WpÜG was introduced, the Stock Corporation Act (Aktengesetz – AktG) was amended to permit a shareholder with at least 95% of the shares in a stock corporation to force the other shareholders, by means of a resolution passed by the General Meeting of Shareholders, to sell their shares to said shareholder in return for the payment of a cash settlement, a procedure known as squeeze-out. BaFin also applies the provisions of the WpÜG if the preconditions for such a squeeze-out resolution have been met and a shareholder intends to go ahead with the procedure. Anyone acquiring a holding of more than 95% is thus obliged to make a mandatory offer to the minority shareholders. By applying the WpÜG, shareholders are given a more advantageous procedure both by ensuring a rapid assessment of the offer price and allowing an immediate right of withdrawal. There are only limited exceptions here, for instance where there is an extremely small number of outside shareholders.

Regulations governing takeovers and transformation of companies go hand in hand.

In BaFin's view, if control has been gained via company transformation or merger, then the provisions of the WpÜG are applicable alongside

<sup>45</sup> WpÜG Offer Regulation (WpÜG-Angebotsverordnung), WpÜG Advisory Council Regulation (WpÜG-Beiratsverordnung), WpÜG Fees Regulation (WpÜG-Gebührenverordnung), and WpÜG Objections Committee Regulation (WpÜG-Widerspruchsausschussverordnung).

those regarding transformation. The legislature has left the clarification of this question to the test of practical experience. Indeed, here too, investor protection criteria were of prime importance, thus warranting the co-existence of the WpÜG on the one hand and transformation law and company law on the other. The sphere of application of the WpÜG and its various protective instruments would be severely limited if the bidder himself could determine whether or not the way in which he gained control fell under the Act's provisions.

The WpÜG must be applied to the acquisition of own securities.

The Act also applies to the acquisition by a listed enterprise of its own securities. In line with the protective purpose of the WpÜG, holders of these instruments, too, must be protected by a fair and transparent process. However, such buybacks of an enterprise's own shares (so-called treasury shares) often occur via the stock exchange, and purchasing via the stock exchange does not represent a public offer to purchase securities within the meaning of WpÜG.

Section 24 WpÜG specifies that, in exceptional circumstances, BaFin may permit an offer not to apply to shareholders in a specific country outside the EEA, for instance if it would be impossible for the bidder to comply both with regulations in place in that country and with the provisions of the WpÜG. To date, three such applications have been made, one of which was approved in full by BaFin and one other partially approved. The applications related to conflicting regulations in Australia, Japan, Canada, and the USA.

## 5.2 Offer procedure

### Offers for acquisition, takeover offers, mandatory offers

The law distinguishes between three kinds of procedure:

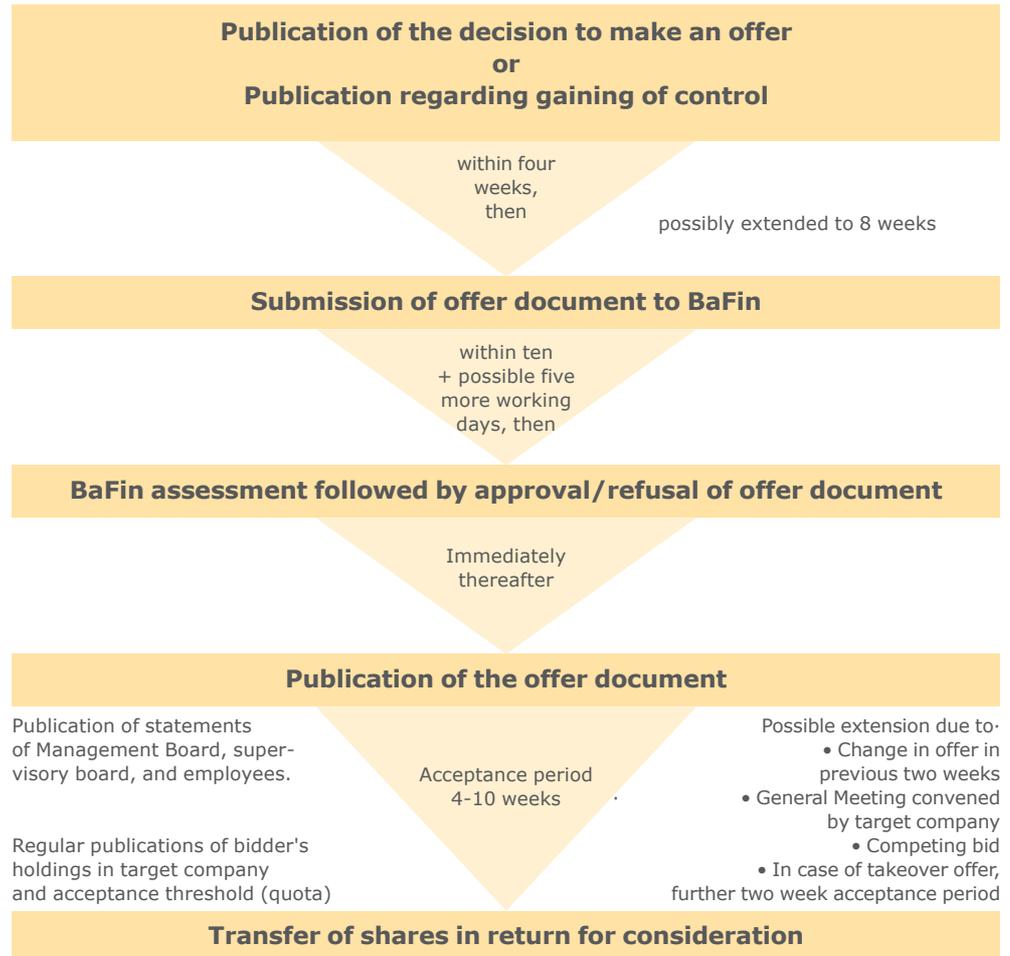
- The basic model is the simple offer for acquisition (Erwerbsangebot), in which the bidder wishes to acquire securities without gaining control of the target company, or aims to build on a pre-existing position of control. The minimum price regulations do not apply to offers of this kind, and so-called partial offers are also permitted in this connection.
- In the case of takeover offer (Übernahmeangebot), the bidder is attempting to reach or exceed the control threshold laid down in Section 29 WpÜG of 30% of the voting rights in the target company. The bidder may make its offer dependent on the acquisition of sufficient shares to reach a 30% holding in the target company. The takeover offer is also subject to minimum price rules which are determined by the target company's weighted average stock market price during the previous three months and also any possible previous acquisitions (Section 29 et seq. WpÜG).
- A mandatory offer (Pflichtangebot) is required from the bidder once he has achieved control of a target company. A party has achieved control if it has acquired at least 30% of the voting rights or if this level of voting rights is attributed to it pursuant to Section 30 WpÜG. The mandatory offer must relate indiscriminately to all shares in the target company and may not

be subject to any conditions. The minimum price rules also apply in this case.

The offer procedure involves the following steps:

Fig. 14

#### Offer procedure



#### The bidder's obligations

The decision to put forward an offer and the attainment of control must be published immediately.

If a bidder decides to make an offer to acquire securities, it must immediately publish this decision, as with an ad hoc announcement, in an officially designated stock exchange gazette or a widely available electronic information system. The same applies if the control threshold of 30% of the voting rights is reached.

The offer document must contain all details relevant for the shareholder's decision.

Thereafter the bidder has up to four weeks or, if an extension is granted by BaFin, up to eight weeks in which to submit his offer document for examination. The offer document must contain all details needed by the shareholder to make an informed decision on the matter. These details include essential details such as which securities are included in the offer or what action the shareholder must take with

its custodian bank in order to accept the offer. Additionally, the persons to whom the offer document is addressed, including the target company and its employees, requires information on the bidder's plans regarding the future business activities of the target company, for instance such matters as the location of important parts of the company and future employment prospects.

If BaFin approves the offer after inspecting the documents submitted to it, the bidder must publish it without delay and make it available to the target company. Publication must be both on the Internet and in a supra-regional officially designated stock exchange gazette. However, publication in the officially designated stock exchange gazette may be replaced by publication of a notice giving details of how copies of the offer document can be obtained free of charge.

The acceptance period begins once the offer document has been published.

On publication of the offer document, the acceptance period for the offer commences. This covers a period of four (minimum) to ten (maximum) weeks. During the offer period, the bidder must publish weekly updates of the progress of the offer and daily updates during the final week of the acceptance period. The bidder must publish details of all the securities it holds in its portfolio and for which acceptance statements have been made.

As part of takeover offers and mandatory offers, the bidder must offer the shareholders an appropriate

consideration. In the case of takeover offers and mandatory offers, the bidder must offer the shareholders an appropriate consideration, which may be either in euros or in the form of liquid shares admitted to trading on an organised market in the EEA. The consideration offered must be appropriate. The amount of the consideration is to be determined on the basis of the share's average stock market price. On grounds of equality of treatment, the bidder's previous acquisitions in the run-up to a takeover constitute a lower limit for the calculation of the minimum price. Once the minimum price has been determined on the basis of the target company's average share price during the three months prior to the takeover offer or prior to the attainment of control, it must be published in a database on BaFin's website.

### 5.3 Monitoring takeover procedures

BaFin monitors the entire offer procedure and acts to remedy any shortcomings that could impede or jeopardise the procedure or harm the securities market (Section 4 WpÜG). These tasks are performed by two specialist sections.

The most important task in monitoring offer procedures is to check offer documents and supervise the bidder's publication and disclosure duties.

BaFin checks the offer document for formal completeness, not for the accuracy of its content.

BaFin must check the offer document within ten days for formal completeness and any obvious violations of the WpÜG. However, it does not assess the accuracy of the factual information contained therein. In particular, it examines how the effects of a successful offer on the bidder's financial position, financial performance, and cash flows are portrayed. If it identifies deficiencies in the offer document, BaFin will set the bidder a deadline of up to five days to remedy them. If the bidder fails to do so, BaFin will not allow the offer to go ahead.

Although initial shortcomings were found in the majority of offer documents, almost without exception the bidders were able to correct them, allowing BaFin to approve their publication.

The target company's Management Board and Supervisory Board must express an opinion, giving their reasons.

BaFin also monitors the conduct of the target company. The target company's Management Board and Supervisory Board must express their opinion of the offer and also, if applicable, of any changes made, giving their reasons in each case. These opinions must be passed on to the Works Council (Betriebsrat) for comment and then submitted to BaFin along with the Works Council's comments. In the event of a hostile takeover bid, the target company can be expected to defend itself, and measures taken may possibly include an advertising campaign. In this case BaFin also has the task of monitoring the campaign and if necessary prohibiting unacceptable advertisements. To date, this situation has not arisen as previous offer procedures proceeded on the basis of mutual consent.

### Approval, refusal, and exemption

In 2002, there were 15 offers for acquisition, 14 takeover offers, and 15 mandatory offers.

In 2002, 44 offer procedures were initiated. There were 15 offers for acquisition, 14 takeover offers, and 15 mandatory offers. In total, 31 offer procedures progressed without significant difficulties from approval of publication of the offer document by BaFin through the actual procedure itself to finalisation. In one case BaFin refused to allow publication of the offer document as the bidder was unable to provide confirmation of financing by an investment services company independent of the bidder. In another case no offer document was submitted, naturally leading to refusal of the offer. The other 11 procedures were still pending at the end of 2002.

The offer documents for the procedures thus far carried out can be inspected in the database on BaFin's website, as can the announcements of decisions to make an offer or of the attainment of control over a company.

Most of the applications for exemptions related to planned restructuring of the target company.

In 2002, a total of 110 applications were made for exemption from obligations associated with mandatory offers or for the disregard of voting rights pursuant to Sections 36 and 37 WpÜG. The bulk of the applications were for the disregard of voting rights on grounds of group restructuring (Section 36 no. 3 WpÜG). In most cases, the rationale behind this approach was to obtain a tax-free gain on disposals. Applications for exemption from the obligation to publish announcements regarding the attainment of control and the requirement to make a mandatory offer (Sections 37, 35 WpÜG) largely related to intended restructuring of the target company. Furthermore, there were several exemption applications based on the general state of affairs referred to in Section 37 (1) WpÜG, in particular in relation to shareholder structure and the actual possibility of exercising control. This category of exemption application largely related to family-internal restructuring and also to the transfer of equity stakes held by several family members into a Family GmbH set up by them for this purpose.

The other grounds for exemption provided for in the WpÜG have not arisen in practice. Only one application was made relating to the possibility of exemption due to a case of transition. In this context it

was found that in some cases major shareholders had built up their holdings to over 30%, or acquired new holdings, shortly before the WpÜG came into force, thus avoiding the requirement to make a mandatory offer. In these cases a mandatory offer to protect the minority shareholders cannot be demanded.

All in all, BaFin granted 81 exemption applications and refused seven applications. Fourteen applications were withdrawn and eight applications were still being processed at the end of 2002.

### **The Advisory Board and the Objections Committee**

In 2002, the honorary Advisory Board and the Objections Committee provided for in the WpÜG took up office. BaFin consults the Advisory Board on such matters as the issuing of Regulations, and the Council also suggests persons with suitable expertise for appointment to the Objections Committee. The Advisory Board includes representatives from industry, investors, employees, and other experts<sup>46</sup>. It convened twice in 2002.

BaFin's Objections Committee is a special decision-making body that passes judgement on fundamental substantive decisions pursuant to the WpÜG. It is made up of the President of BaFin, two civil-servant members and three honorary members. As with the Advisory Board, the honorary members contribute special professional expertise from the relevant business community and interest groups.

### **Protest procedure and administrative fines**

In 2002, five protests were submitted to the Objections Committee for a ruling, while BaFin had to decide on ten further protests. Such decisions must be made within two weeks.

In three cases the Objections Committee upheld BaFin's decision.

In three cases the Objections Committee upheld the Takeover Sections' original decisions and in the other two cases the protest was withdrawn before a decision was made. The other ten cases on which BaFin decided were still open at the end of the year. Most of the protests were against requests for information and the submission of documents or subsequent enforcement action, or against the inspection of records. At the end of 2002, two cases arising from protest rulings were being heard by the competent Securities Acquisition and Takeover Division of Frankfurt am Main Higher Regional Court (Senat für Wertpapiererwerbs- und Übernahmesachen beim Oberlandesgericht Frankfurt am Main). The cases relate to a refusal to allow the inspection of records and BaFin's disallowing of a voluntary offer by a company to reacquire its own shares.

In 2002, BaFin initiated administrative fine proceedings in 19 cases for breaches of the WpÜG. One fine was imposed and three cases were suspended. In total, 15 cases remained open at the end of the year.

<sup>46</sup>A list of members of the Advisory Board is given in the Appendix.

The administrative fine proceedings related mainly to failures by the Management Board and Supervisory Board of the target company to submit an opinion without delay after publication of the offer (Section 27 WpÜG). In other cases bidders either failed to publish announcements that they had attained control of a target company, or failed to disclose the information in a timely manner (Section 35 WpÜG).

## VIII BaFin

- 1 Organisation
- 2 Governance
- 3 Staff
- 4 Budget
- 5 Information technology and location issues
- 6 Public relations

BaFin was surprisingly quick out of the starting blocks.

The rapid launch of BaFin took many people by surprise – not only the general public but also BaFin staff. When the draft bill on Integrated Financial Services Supervision (Entwurf zum Gesetz über die integrierte Finanzdienstleistungsaufsicht – FinDAG), also referred to as the Act Establishing the Federal Financial Supervisory Authority, entered the Bundesrat (the upper house representing the Länder), in March 2002, few of the 1,050 staff working at the various federal supervisory bodies for banking (BAKred), insurance (BAV), and securities (BAWe) would have predicted that a new integrated financial supervisory authority would be formed within a mere six weeks. The unexpected turn of events during the Bundesrat session (i.e. the issue of “immigration law”) resulted in the FinDAG being enacted surprisingly quickly.

Merging three separate bodies into a single federal regulator was a tall order.

After the official opening ceremony on 4 May, work began in earnest. The task was a formidable one: three independent bodies had to be merged as quickly and efficiently as possible. The Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen – BAKred) contributed 620 members of staff, the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV) had a total of 300 staff, and the Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel – BAWe) numbered a further 130 staff. In future, this team would be responsible for supervising the German financial market in a concerted effort. Apart from amalgamating the three major areas of banking, insurance, and securities, it was also a matter of combining three distinct organisational and staffing structures spread over two locations – Bonn and Frankfurt. Everyone involved was well aware of the enormity of the task, but there was widespread consensus about the purpose of this new integrated financial services authority.

Integrated financial services supervision is geared to today's market requirements.

The historically motivated division of supervisory responsibility is no longer appropriate. Credit institutions, financial services providers, and insurers are increasingly offering similar products and competing with one another for the same clients. Financial conglomerates are being formed to serve the needs of their clients. As the distinctions between services are increasingly disappearing, there is no sense in trying to keep them alive by maintaining separate supervisory bodies. This is why a single, cross-sectoral financial supervisory authority is so important as a central point of contact. It allows for pooling of expertise and harnessing of synergies to keep pace with the process of innovation in the financial markets. Germany as a financial centre also benefits from the new supervisory model – not only because dealing with a single federal regulator instead of three separate entities simplifies the process of collaborating with supervisory bodies abroad. It also means that the voice of the German federal regulator will carry more weight in international negotiations over financial market regulations.

# 1 Organisation

BaFin is chaired by a President and Deputy President. The three core directorates are each headed by Chief

BaFin is chaired by President Jochen Sanio (the former President of the BAKred) and Deputy President Karl-Burkhard Caspari (former subdivision head of the Banking, Insurance, Investment, Stock Exchange, and Securities department at the Federal Ministry of Finance) with the support of three Chief Executive Directors. The Banking Supervision directorate is presided over by Helmut Bauer (most recently of the Financial Services Authority), the Insurance Supervision directorate by Dr. Thomas Steffen (formerly Head of the Export Credit Insurance and Guarantees Section at the Federal Ministry of Finance), and the Securities Supervision/Asset Management directorate by Georg Dreyling (former Vice President of the BAWe).

There are three cross-sectoral departments dealing with issues affecting all directorates.

To maximise the synergies inherent in integrated financial services supervision, three cross-sectoral departments were created to deal with issues affecting all directorates. The duties of these departments include fundamental supervisory issues related to national and international financial markets, combating illegal banking, financial services and insurance practices, handling consumer complaints and investment protection issues, as well as the certification of pension contracts/retirement schemes.

The three core directorates largely correspond to the three former supervisory bodies.

The three core directorates for supervision of banking (BA), insurance (VA), and securities/asset management (WA) largely correspond to the three former supervisory offices – minus the collective tasks common to all three areas that are now handled by cross-sectoral departments. Supervision of asset management has also been added to the area of securities. The central administration unit, responsible for personnel, organisation, information technology and the budget of the new federal authority, is also an integral part of BaFin, along with four staff units directly reporting to management: the President's Office, Press and Public Relations/Management of Internal Information, the Internal Audit/Data Protection unit and, from March 2003 onwards, the Anti-Money Laundering Group.

An organisation chart is included in Appendix 5.

# 2 Governance

The Administrative Council monitors the management of BaFin.

At the time BaFin was founded, an Administrative Council and Advisory Board were also formed. The Administrative Council monitors the management of the federal authority and helps it fulfil its specific duties. The 21 members reflect the unique status of BaFin, poised as it is between executive, legislature and the industry it supervises. The Chairman and his representative are seconded from the Federal Ministry of Finance (Bundesministerium der Finanzen – BMF). The BMF has a total of four representatives on the Administrative Council, while the Federal Ministry of Economics and Labour and the Federal Ministry of Justice each supply one further representative. Five Members of Parliament represent the German Federal Lower House (Bundestag) on the Council. Companies monitored by BaFin – credit institutions, financial services providers, and insurance companies – supply a total of ten representatives. A list of all names of the members of the Administrative Council appears in Appendix 6.

The Advisory Board provides advice to BaFin.

The Advisory Board advises BaFin on how to carry out its specific tasks. It comprises 24 representatives from the banking and insurance industry, consumer protection associations, academic institutes, and the German Bundesbank.

The Forum for Financial Market Supervision, set up within BaFin and jointly run by BaFin and the German Bundesbank, coordinates collaborative work conducted by both organisations within the field of banking supervision. It also provides advice on issues relating to integrated financial services supervision that are significant to the stability of the financial system.

In addition, there are three further bodies with specific legal and supervisory roles and a committee with a variety of tasks:

- The Insurance Advisory Council deals with supervisory issues of an insurance nature and advises BaFin on the application and on-going development of supervisory law. A total of 41 representatives from the insurance industry belong to this advisory body.
- The Securities Council formed in accordance with Section 5 of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) advises BaFin on matters of securities supervision and related issues of international cooperation. This council is made up of representatives from the Länder.
- The Takeover Council formed in accordance with Section 5 of the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG) advises BaFin on the enactment of statutory orders. Of the fifteen members that make up this council, four represent issuing entities and two represent institutional and private investors. Three other representatives come from financial services providers and two each from employee groups and academic institutes.
- The Objections Committee formed in accordance with Section 6 of the WpÜG decides on objections lodged against orders made by BaFin in certain cases, e.g. when prohibiting a takeover offer. The President of BaFin acts as its Chairman with two other civil servant representatives from BaFin and three honorary members making up the balance. The committee is charged with resolving any objections within two weeks of their being lodged.

A list of these governance bodies and their members appears in Appendix 6.

BaFin works very closely with the German Bundesbank in meeting its responsibilities.

In meeting its responsibilities in the field of banking supervision, BaFin works very closely with the German Bundesbank. When the law enacting BaFin was passed, regulations governing collaboration between the two federal agencies were recast within the German Banking Act (Kreditwesengesetz – KWG). BaFin has particular responsibility for supervisory matters of national legal jurisdiction while the role of the Bundesbank focuses on operational banking supervision. Towards the end of the year under review, the legal guidelines of the KWG were given detailed definition in the form of an agreement between BaFin and the Bundesbank. This is designed to prevent duplication of effort and increase the efficiency of banking supervision in Germany.

### 3 Staff

BaFin quickly began the essential process of boosting staff numbers.

The Administrative Council not only monitors the management of BaFin but also decides on its budget. From the outset, BaFin has received no funding from the federal budget. Instead, it is financed entirely through levies and fees paid by the organisations it supervises. For this reason alone, BaFin was able to tackle one of its biggest problems just three months after its inception – boosting staff numbers.

The Administrative Council was constituted in August 2002, and at its inaugural meeting it was decided that 208 positions would be established to alleviate an acute staffing shortage. Of these 208 positions, 111 fall into the executive or management level, 90 are classed as senior public servant roles and seven as middle management public service positions. The Administrative Council also gave approval for limited tenure positions to be upgraded into permanent placements. This added degree of job security helped reduce the high staff turnover rates prevalent in banking supervision circles.

Some 3,000 applications were received for 208 advertised positions.

To fill these new positions, BaFin published a composite advertisement in September 2002 attracting around 3,000 applications. This high level of interest inevitably led to a time-consuming selection process, but fortunately most of the positions had been filled by the end of the year.

By late 2002 there were 1,277 positions at BaFin: 468.5 positions fell into the upper executive level, 464 were senior management roles, 284.5 were in middle management, and 60 at the junior public service level.

In order to keep pace with the rate of innovation in financial markets, the federal regulator will need a further boost in staffing levels.

New positions created last year are still not sufficient to fully address the vastly extended scope of BaFin, which now includes such tasks as approving pension funds, monitoring the work of reinsurers, prohibiting price manipulation, and scrutinising takeover procedures. In order to keep pace with the rate of innovation now occurring in financial markets and crucial international negotiations, a further boost in supervisory staffing levels will be required. The Administrative Council acknowledged this necessity in mid-November 2002 by approving the creation of a further 228 positions for the 2003 budget year. Appointments to these positions will be made in the course of the year 2003.

Apart from highly qualified supervisory professionals, a modern regulatory authority also relies on well-organised internal structures and procedures. With this in mind, the in-house financial controlling unit is being extended. Internal project management systems will also be enhanced along with the introduction of a professional development plan for all staff.

Following the move from Berlin to Bonn in the year 2000, the BAKred and BAV established "stay-put units" for employees exempted from transferring to the new location for personal reasons. By the end of 2002, the BAV unit was discontinued, just one year after the BAKred unit had been successfully dissolved.

## 4 Budget

BaFin is not funded from the federal budget but entirely financed from levies and fees paid by the organisations it monitors.

With the merger, the newly established BaFin was also removed from federal budget considerations. In accordance with the Act Establishing the Federal Financial Supervisory Authority (Finanzdienstleistungsaufsichtsgesetz – FinDAG), it is now completely financed by levies and fees paid by the organisations it monitors; BaFin receives no funding from the federal budget whatsoever.

As a legal entity with direct federal responsibility, BaFin is required to produce a budget that, in accordance with Section 12 of FinDAG, is determined by the Administrative Council.

BaFin covers all costs from its own income (Section 13 FinDAG). The most important source of revenue is the contribution paid by supervised organisations, which covers all costs incurred by BaFin, except where other sources of income – such as service fees – are applicable. Credit institutions, insurance companies, financial services providers, official brokers and other organisations admitted to trading on a domestic stock exchange, are all required to pay this levy. In addition, issuers based in Germany offering securities approved for trading on a domestic stock exchange or voluntarily involved in Freiverkehr trading (unofficial market/OTC) are also required to contribute levies, but at a reduced rate. Further details of the allocation and reimbursement of costs are contained in the Ordinance on the Imposition of Fees and Allocation of Costs Pursuant to the FinDAG (Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem Finanzdienstleistungsaufsichtsgesetz – FinDAGKostV).

BaFin charges fees for certain services.

BaFin also charges fees for certain official services in accordance with FinDAGKostV and on the basis of specially defined legal parameters, such as those governed by the Investment Companies Act (Gesetz über Kapitalanlagegesellschaften – KAGG). The imposition of fees is a new phenomenon in the field of insurance supervision. In the former BAV, cost recovery occurred solely via allocation of costs.

For the abbreviated reimbursement year from 1 May to 31 December 2002, companies made advance payments equivalent to the reimbursement figures determined for 1999, multiplied by a factor of 1.25 for banking sector and securities/asset management supervision and 1.2 in the case of the insurance sector. If companies were not liable for payments in 1999, BaFin determined their advance payments using all due discretion. Upon confirmation of the year-end statements for 2002 and with the approval of the Federal Ministry of Finance (Bundesministerium der Finanzen – BMF), BaFin calculates the actual amount payable for each liable entity. Overpayments arising from these advance sums are included with any other excess payments accumulated throughout the financial year 2002 and reimbursed in the course of 2003, while any underpayments are billed retrospectively.

In 2002, the provisional year-end statements recorded expenses totalling around 51 million euros, compared with an annual income of around 69 million euros.

For the abbreviated 2002 financial year, the BaFin budget for income and expenses was set at €72.3 million. According to provisional year-end accounts, yet to be adopted by the Administrative Council, around €51 million has been expended over the reporting period. This compares with income of around €69 million, primarily generated from

advance payments of the 2002 allocation of costs (€62 million) and service fees. The surplus, which has yet to be adopted by the Administrative Council, will be set off against allocation-of-cost prepayments.

## 5 Information technology and location issues

The key task for the IT team was to integrate the hardware and software of three former supervisory bodies.

The key task for BaFin's information technology (IT) team was to integrate hardware and software components of the three former supervisory bodies. This required a considerable amount of adaptive alignment, particularly of software programs that are used across all sectors. They also had to develop a reliable, fault-free electronic communication system (data and voice) linking the dual locations of Bonn and Frankfurt/Main.

Extra office space has already been leased in Frankfurt. In Bonn, certain sections of BaFin are poised for relocation in 2003.

Owing to the increase in staffing levels over 2002 and 2003, BaFin's existing premises lacked the necessary capacity. Extra office space in Frankfurt was leased at Lurgiallee 12, i.e. at the same location already used by BaFin. In Bonn, the former headquarters of the Federal Ministry of Finance (Bundesministerium der Finanzen – BMF), the same arrangement is not possible. Although BaFin scoured the Bonn commercial property market in search of further office space, only a few suitable premises could be found. Relocation of certain sections of BaFin office in Bonn is planned in the first half of 2003.

## 6 Public relations

BaFin received a host of enquiries as a result of the strained trading conditions for stock exchanges, banks, and insurance companies.

Public interest in the work of BaFin was particularly strong in the first year since its inception. A tough operating environment for stock exchanges, diminishing returns in the banking business, and changes in the security portfolios of insurance companies led to a host of enquiries. Overall there were several thousand enquiries fielded from the press and other media, from private investors and from companies. Spoken and written enquiries covered a broad spectrum of financial supervisory issues, with everything from basic legal questions to concrete cases being raised.

The supervisory authority has also taken a proactive approach in the public arena, e.g. by participating in investment trade fairs.

As part of its public relations work, BaFin also takes part in investment trade fairs and events. In March 2002, the INVEST tradeshow was staged in Stuttgart, with participation from the securities supervision directorate. At the November 2002 International Investment Fair (Internationale Anleger Messe – IAM), BaFin made its first appearance with its very own exhibition stand. BaFin was also involved at international stock exchange promotional events held in Frankfurt/Main and Dresden. Furthermore, are committed to maintaining direct contact with investors and providers of financial services to update them on matters of investment protection and aspects of banking and stock exchange law. Within the reporting period, a range of visitor groups also came to see for themselves what the work of the Federal Financial Supervisory Authority entails.

The range of online information available on BaFin website has been greatly expanded.

The development of a new, integrated website was still in full swing at the close of 2002. The range of online information available for downloading has been greatly expanded. Examples include new databases on Directors' Dealings, as well as on takeover offers deposited with BaFin and minimum prices calculated in accordance with the Securities Acquisition and Takeover Act.

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## Foreign banks

	Country	Subsidiaries	Subsidiaries of non-banks	Branches	Representative offices	Cross-border service
		(Figures as at 31 Dec. 2001 in brackets)				
1	Andorra				1 (1)	
2	Australia			1 (1)		
3	Austria	1 (1)		8 (5)	4 (4)	26 (24)
4	Bahrain	1 (1)				
5	Belarus				1 (1)	
6	Belgium	1 (1)		2 (2)		22 (20)
7	Bosnia-Herzegovina				1 (1)	
8	Brazil			1 (2)	1 (1)	
9	Bulgaria				1 (1)	
10	Canada		1 (1)		1 (2)	
11	China			3 (3)	2 (1)	
12	Croatia				1 (3)	
13	Czech Republic				1 (1)	
14	Denmark			4 (4)	1 (1)	8 (7)
15	Egypt	1 (1)				
16	Finland					3 (2)
17	France	9 (9)	6 (6)	17 (19)	12 (15)	72 (71)
18	Georgia				0 (1)	
19	Greece	1 (1)		3 (3)		
20	India			1 (1)		
21	Iran	1 (1)		3 (3)		
22	Ireland	1 (0)		1 (1)	3 (4)	29 (25)
23	Israel				4 (3)	
24	Italy	5 (4)	4 (4)	5 (5)	8 (9)	8 (8)
25	Japan	4 (4)	4 (4)	4 (5)	6 (6)	
26	Jordan	1 (1)				
27	Latvia				1 (1)	
28	Liechtenstein				1 (1)	2 (1)
29	Luxembourg	2 (3)	1 (1)	2 (1)	1 (1)	49 (47)
30	Mongolia				1 (1)	
31	Morocco				3 (3)	
32	Netherlands	5 (3)	6 (4)	10 (9)		28 (25)
33	Norway			1 (1)		3 (3)
34	Pakistan			1 (1)		
35	Philippines				3 (3)	
36	Portugal				9 (9)	6 (6)
37	Romania	1 (1)				
38	Russia	1 (1)			1 (2)	
39	Saudi Arabia				1 (1)	
40	Slovenia	1 (1)			1 (1)	
41	South Africa	1 (1)			1 (1)	
42	South Korea	2 (3)			3 (3)	
43	Spain	2 (2)		1 (1)	8 (10)	6 (5)
44	Sweden	4 (4)	1 (1)	1 (1)		3 (3)
45	Switzerland	7 (7)	8 (9)		4 (5)	
46	Taiwan			1 (1)	0 (1)	
47	Tunisia				1 (1)	
48	Turkey	5 (5)		1 (1)	6 (13)	
49	United Kingdom	4 (6)	4 (3)	13 (11)	6 (6)	53 (51)
50	United States	6 (6)	13 (12)	5 (7)	2 (2)	
51	Yugoslavia				1 (4)	
		67 (68)	48 (44)	89 (88)	102 (123)	318 (298)

## Statistic of complaints in connection with insurance undertakings

- 4.1 About this statistic
- 4.2 Life insurance
- 4.3 Health insurance
- 4.4 Motor insurance
- 4.5 General liability insurance
- 4.6 Casualty insurance
- 4.7 Home contents insurance
- 4.8 Insurers based in the EEA

### 4.1 About this statistic

In previous publications of its separate Annual Report, the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen - BAV), which is now part of BaFin, incorporated an insurance-related complaints statistic divided into insurance categories and actual insurance undertakings. The BAV had been ordered to include these details following a ruling by the Higher Administrative Court (Oberverwaltungsgericht) Berlin of 25 July 1995 (Case no.: OVG 8 B 16/94).

In order to define an appropriate indicator, the total volume of company-specific complaints submitted to BaFin in the course of 2002 was put in relation to the total number of contracts within the respective categories as at 1 January 2002. Data regarding the actual volume of contracts is provided by the individual insurance companies. Insurers experiencing above-average growth in the reporting period, e.g. new start-up companies, are at a disadvantage, for the simple fact that additional policies concluded in the course of the year (i.e. those exceeding the initial balance reported) are not taken into account when compiling the complaints statistic. Therefore, it should be noted that this statistic is of limited value when it comes to assessing the quality of specific insurance undertakings listed.

The initial balances reported within the non-life category relate to insured risks. In the case of group policies concluded with a number of parties, this approach will result in a higher initial balance of policies. Owing to limited disclosure requirements (Section 51 (4) number 1 sentence 4 RechVersV), the initial balance can only be specified for insurers whose gross premium income for 2001 exceeded €10 million in the respective insurance categories or segments.

As regards collective insurance within the category of life insurance, the figure specified relates to the number of insurance contracts.

Within the area of health insurance, the number of natural persons insured is used to calculate the initial balance, rather than the number of insureds under each policy section, which is usually higher. The indicator is not completely reliable.

The statistic does not include the names of insurance undertakings who operate within one of the categories listed but who have not been the subject of complaints.

In view of the fact that companies based within the European Economic Area are not subject to BaFin reporting requirements, no initial balance has been stated for EEA-based operators. The total volume of complaints submitted has been included in order to present a more complete overview.

## 4.2 Statistic of complaints in connection with insurance undertakings Life insurance

Ind. No.	Name of insurance undertaking	Complaints	Number of life insurance policies
1001	AACHENER/MCHN. LEBEN	356	4,515,329
1173	AEGON LEBENSVERS.-AG	14	113,661
1163	ALLG. RENTENANSTALT	11	73,714
1006	ALLIANZ LEBEN	258	9,201,757
1007	ALTE LEIPZIGER LEBEN	68	860,159
1035	ARAG LEBEN	47	472,581
1181	ASPECTA LEBEN	169	490,872
1144	ASSECURA LEBEN	1	8,920
1052	ASSTEL LEBENSVERS.	23	347,518
1020	AXA LEBEN	159	2,147,555
1011	BARMENIA LEBEN	16	242,203
1012	BASLER LEBEN	17	131,517
1013	BAYER. BEAMTEN LEBEN	15	514,782
1015	BAYERN-VERS.	66	1,473,830
1017	BERLINISCHE LEBEN	72	1,200,487
1145	BHW LEBEN	24	1,007,584
1192	BRUNSVIGA LEBENSVER.	3	61,079
1132	CIV LEBEN	47	1,414,155
1122	CONCORDIA LEBEN	5	125,409
1021	CONDOR LEBEN	7	213,339
1078	CONTINENTALE LEBEN	49	565,927
1022	COSMOS LEBEN	38	834,415
1146	DBV-WINTERTHUR LEBEN	113	2,447,796
1023	DEBEKA LEBEN	64	2,486,894
1167	DELTA DIREKT LEBEN	1	46,494
1136	DEVK ALLG. LEBEN	15	485,290
1025	DEVK DT. EISENBAHN LV	13	910,991
1113	DIALOG LEBEN	6	166,515
1110	DIREKTE LEBEN	6	66,057
1138	DT. HEROLD LEBEN	186	2,515,781
1148	DT. LEBENSVERS.	2	87,177
1028	DT. RING LEBEN	79	967,196
1180	DT. ÄRZTEVERSICHERUNG	7	187,663
1107	EUROPA LEBEN	13	314,351
1030	FAMILIENFÜRSORGE LV	24	244,902
1088	GENERAL ACCIDENT LEB.	1	34,915
1191	GERLING E&L LEBEN	22	267,854
1033	GERLING-K. LEBEN	36	1,472,643
1108	GOTHAER LEBEN AG	77	1,185,550
1162	GUTINGIA LEBEN	2	31,782
1040	HAMB. LEBEN	2	11,908
1184	HAMB. MANNHEIMER LV	263	7,159,306
1042	HANNOVERSCHE LEBEN	110	791,742
1114	HANSEMERKUR LEBEN	31	198,595
1142	HDI LEBENSVERS.	8	87,181
1137	HELVETIA LEBEN	4	107,883
1055	HUK-COBURG LEBEN	26	611,062
1047	IDEAL LEBEN	14	405,430
1048	IDUNA VEREINIGTE LV	170	2,551,027
1097	INTER LEBEN	11	241,755
1119	INTERRISK LEBENSVERS.	5	60,066

<b>Ind. Nr.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>	<b>Number of life insurance policies</b>
1128	ITZEHOER LEBEN	2	37,826
1045	KARLSRUHER HINTERBL.	2	99,698
1050	KARLSRUHER LEBEN	64	1,333,820
1130	KARSTADTQUELLE LV AG	20	1,097,159
1053	KRAVAG-LEBEN	1	41,307
1054	LANDESLEBENSHILFE	1	27,570
1170	LEBEN DIREKT (D)	3	8,175
1062	LEBENSVERS. VON 1871	19	716,301
1112	LVM LEBEN	32	603,043
1060	MANNHEIMER LEBEN	39	338,531
1109	MECKLENBURG. LEBEN	4	135,096
1158	MLP LEBEN	22	245,952
1064	MÜNCHEN. VEREIN LEBEN	7	149,341
1193	NECKERMANN LEBEN	3	26,764
1116	NECKURA LEBEN	13	66,021
1164	NEUE LEBEN LEBENSVERS	17	489,207
1131	NÜRNBG. BEAMTEN LEBEN	2	52,098
1147	NÜRNBG. LEBEN	337	2,736,521
1056	OEFF. LEBEN BERLIN	10	88,903
1115	ONTOS LEBEN	9	35,452
1194	PB LEBENSVERSICHERUNG	23	80,392
1123	PLUS LEBEN	14	48,418
1030	PROCURA FAMILIAE LV	14	312,690
1081	PROV. LEBEN HANNOVER	16	679,741
1083	PROV. NORD LEBEN	22	411,341
1082	PROV. RHEINLAND LEBEN	28	1,190,751
1111	PRUDENTIA-LEBEN	1	65,309
1085	R+V LEBEN, VAG	22	555,204
1141	R+V LEBENSVERS. AG	62	3,721,511
1018	RHEINLAND LEBEN	8	643,494
1150	SAARLAND LEBEN	4	102,484
1090	SCHWEIZERISCHE LEBEN	69	1,069,649
1168	SCHWESTERN VERS.	1	19,427
1034	SECURITAS GILDE LEBEN	11	106,279
1157	SKANDIA LEBEN	36	139,852
1153	SPARK.-VERS. SACHS. LEB	13	169,128
1104	STUTTGARTER LEBEN	52	476,324
1044	SV SPARKASSEN LV	29	483,930
1091	SV SPARKASSEN-VERS.	43	934,540
1063	THURINGIA GENERALI LV	80	996,787
1152	UELZENER LEBEN	1	7,062
1092	UNIVERSA LEBEN	9	291,843
1093	VER. POSTVERS.	47	1,428,326
1029	VEREINTE LEBEN	46	999,086
1140	VICTORIA LEBEN	112	2,503,906
1139	VOLKSFÜRSORGE DT. LV	244	4,240,909
1099	VOLKSWOHL-BUND LEBEN	70	914,624
1151	VORSORGE LEBEN	24	26,868
1160	VPV LEBEN	22	113,521
1102	WINTERTHUR LEBEN	2	31,446
1103	WWK LEBEN	89	891,657
1005	WÜRTT. LEBEN	69	1,834,647
1096	ZÜRICH LEBEN	7	393,103
1196	ZÜRICH LV AG	42	647,956

### 4.3 Statistic of complaints in connection with insurance undertakings Health insurance

<b>Ind. No.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>	<b>Number of persons insured 2001</b>
4034	ALLIANZ PRIV.KV AG	368	2,265,371
4010	ALTE OLDENBG. KRANKEN	16	50,448
4112	ARAG KRANKEN	42	153,394
4095	AXA KRANKEN	135	448,815
4042	BARMENIA KRANKEN	71	699,427
4134	BAYERISCHE BEAMTEN K	82	677,971
4127	BBV KRANKEN	1	13,272
4104	BERUFSFEUERWEHR HANN.	1	1,358
4004	CENTRAL KRANKEN	148	1,280,601
4118	CONCORDIA KRANKEN	5	97,338
4001	CONTINENTALE KRANKEN	84	1,117,848
4121	COSMOS KRANKEN	1	14,680
4101	DBV-WINTERTHUR KRANK.	116	798,925
4028	DEBEKA KRANKEN	110	2,752,969
4044	DT. KRANKENVERS.	423	2,834,062
4013	DT. RING KRANKEN	65	589,196
4089	EUROPA KRANKEN	10	180,384
4128	GLOBALE KRANKEN	12	73,640
4119	GOTHAER KV AG	131	502,972
4043	HALLESCHE KRANKEN	99	497,470
4018	HANSEMERKUR KRANKEN	37	378,583
4117	HUK-COBURG KRANKEN	47	351,023
4031	INTER KRANKEN	61	373,815
4126	KARSTADTQUELLE KV AG	12	159,880
4011	LANDESKRANKENHILFE	60	413,380
4109	LVM KRANKEN	8	174,824
4123	MANNHEIMER KRANKEN	5	75,649
4037	MÜNCHEN. VEREIN KV	35	215,794
4125	NÜRNBG. KRANKEN	6	123,693
4140	PAX-FAMILIENFÜRSORGE	9	92,244
4135	PROVINZIAL KRANKEN	2	57,245
4116	R+v KRANKEN	7	111,831
4002	SIGNAL KRANKEN	131	1,709,380
4039	SÜDDEUTSCHE KRANKEN	24	342,829
4108	UNION KRANKENVERS.	53	654,359
4045	UNIVERSA KRANKEN	55	333,322
4105	VICTORIA KRANKEN	57	787,810
4139	WÜRTT. KRANKEN	2	47,319

#### 4.4 Statistic of complaints in connection with insurance undertakings Motor insurance

Ind. No.	Name of insurance undertaking	Complaints	Number of motor insurance policies (2001)
5342	AACHENER/ MCHN. VERS.	100	1,965,596
5581	ADLER VERSICHERUNG AG	2	158,083
5312	ALLIANZ VERS.	166	14,532,232
5405	ALTE LEIPZIGER VERS.	21	415,979
5553	AUTO DIREKT VERS.	21	327,755
5515	AXA VERS.	131	3,533,043
5316	BAD. GEMEINDE-VERS.	3	481,003
5318	BASLER VERS.	34	188,414
5310	BAYER. BEAMTEN VERS.	6	195,217
5325	BAYER. VERS. BANK	32	2,322,119
5324	BAYER. VERS. VERB. AG	28	1,722,788
5333	BRUDERHILFE KASSEL	3	418,739
5338	CONCORDIA VERS.	20	864,860
5340	CONTINENTALE SACHVERS.	23	237,435
5552	COSMOS VERS.	28	324,762
5529	D.A.S. VERS.	38	500,472
5343	DA DEUTSCHE ALLG. VER.	70	759,277
5311	DBV DEUT. BEAM. VERS. AG	15	281,590
5037	DBV-WINTERTHUR	53	533,383
5549	DEBEKA ALLGEMEINE	12	486,278
5513	DEVK ALLG. VERS.	74	2,428,724
5344	DEVK DT. EISENB. SACH	7	925,346
5055	DIRECT LINE	76	215,617
5347	DT. HEROLD ALLG. VERS.	29	529,534
5350	DT. RING SACHVERS.	7	310,695
5508	EUROPA SACHVERS.	46	265,618
5470	FAHRLEHRERVERS.	2	278,271
5359	FEUERSOZIJETÄT BERLIN	21	176,120
5364	FRANKF. VERS.	128	5,194,427
5505	GARANTA VERS.	45	1,220,728
5599	GENERALI LLOYD VERS.	47	2,670,401
5368	GERLING-K. ALLGEMEINE	37	1,501,762
5531	GOTHAER ALLG.VERS.AG	41	1,495,502
5469	GVV-KOMMUNALVERS.	1	132,499
5585	GVV-PRIVATVERSICH.	7	199,564
5420	HAMB. MANNHEIMER SACH	21	679,700
5377	HDI HAFTPFLICHTV.	21	516,562
5085	HDI PRIVAT	93	2,694,744
5384	HELVETIA VERS.	8	287,843
5375	HUK-COBURG	94	7,106,836
5521	HUK-COBURG ALLG. VERS	106	4,632,539
5401	ITZEHOER VERSICHERUNG	13	634,778
5509	KARLSRUHER VERS.	23	514,233
5058	KRAVAG-ALLGEMEINE	14	490,672
5080	KRAVAG-LOGISTIC	29	588,783
5402	LVM SACH	41	4,388,594
5061	MANNHEIMER VERS.	5	204,239
5412	MECKLENBURG. VERS.	27	664,678
5793	NECKURA VERS.-AG	11	285,141

<b>Ind. No.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>	<b>Number of motor insurance policies (2001)</b>
5390	NOVA ALLG. VERS.	21	471,938
5426	NÜRNBG. ALLG.	12	339,913
5686	NÜRNBG. BEAMTEN ALLG.	12	357,163
5432	PATRIA VERS.	17	222,742
5436	PROV. FEUERVERS.	24	1,269,487
5446	PROV. NORD BRANDKASSE	10	822,702
5438	R+V ALLGEMEINE VERS.	65	3,331,764
5798	RHEINLAND VERS. AG	11	252,776
5450	SECURITAS BREMER ALLG	11	159,378
5451	SIGNAL UNFALL	5	302,437
5781	SPARK.-VERS. SACHS. ALL	14	153,017
5075	SUN DIRECT	35	152,933
5036	SV SPARK. GEB. BAD.-WÜR	9	531,635
5385	SV SPARKASSEN	10	373,507
5776	TELCON ALLGEMEINE	47	243,735
5456	THURINGIA GENERALI	49	1,036,040
5458	TRANSATLANT.ALLG.VERS	23	145,237
5441	VEREINTE SPEZIAL VERS	31	351,029
5327	VEREINTE VERSICHERUNG	41	1,258,309
5042	VERSICHERUNGSK. BAYERN	12	128,993
5400	VGH LAND. BRAND. HAN.	18	1,718,791
5598	VHV AUTOVERS.	110	2,913,910
5472	VICTORIA VERS.	71	1,667,378
5473	VOLKSFÜRSORGE DT. SACH	55	1,340,793
5525	WGV-SCHWÄBISCHE ALLG.	17	588,525
5479	WÜRTT. GEMEINDE-VERS.	9	880,193
5783	WÜRTT. VERS.	100	2,358,595
5050	ZÜRICH VERS. AG	44	1,487,342

#### 4.5 Statistic of complaints in connection with insurance undertakings Genral liability insurance

<b>Ind. No.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>	<b>Number of liability insurance polices (2001)</b>
5342	AACHENER/MCHN. VERS.	82	1,120,086
5312	ALLIANZ VERS.	114	4,641,379
5405	ALTE LEIPZIGER VERS.	21	273,583
5455	ARAG ALLG. VERS.	31	16,090,951
5515	AXA VERS.	91	1,820,694
5316	BAD. GEMEINE-VERS.	3	109,624
5318	BASLER VERS.	8	95,434
5325	BAYER. VERS. BANK	21	963,225
5324	BAYER. VERS. VERB. AG	20	931,370
5333	BRUDERHILFE KASSEL	3	226,830
5338	CONCORDIA VERS.	7	328,176
5340	CONTINENTALE SACHVERS.	13	199,896
5529	D.A.S. VERS.	12	225,488
5771	DARAG DT. VERS.U.RÜCK	5	48,747
5311	DBV DEUT. BEAM. VERS. AG	7	367,920
5037	DBV-WINTERTHUR	45	505,394
5549	DEBEKA ALLGEMEINE	25	848,188
5513	DEVK ALLG. VERS.	20	871,999
5344	DEVK DT. EISENB. SACH	4	663,490
5347	DT. HEROLD ALLG. VERS.	15	369,200
5350	DT. RING SACHVERS.	8	193,399
5359	FEUERSOZIETÄT BERLIN	9	122,679
5364	FRANKF. VERS.	23	1,292,397
5599	GENERALI LLOYD VERS.	52	511,858
5442	GERLING G&A	15	290,495
5368	GERLING-K. ALLGEMEINE	31	627,717
5531	GOTHAER ALLG.VERS.AG	42	1,384,169
5469	GVV-KOMMUNALVERS.	13	2,625
5374	HAFTPFLICHTK. DARMST.	22	348,815
5420	HAMB. MANNHEIMER SACH	25	604,401
5377	HDI HAFTPFLICHTV.	13	26,125
5085	HDI PRIVAT	21	465,616
5384	HELVETIA VERS.	8	400,326
5375	HUK-COBURG	19	1,579,097
5521	HUK-COBURG ALLG. VERS	15	672,241
5401	ITZEHOER VERSICHERUNG	3	180,983
5509	KARLSRUHER VERS.	10	214,711
5402	LVM SACH	21	1,055,012
5061	MANNHEIMER VERS.	5	134,923
5412	MECKLENBURG. VERS.	15	248,735
5414	MÜNCHEN. VEREIN ALLG.	2	33,374
5390	NOVA ALLG. VERS.	18	402,872
5426	NÜRNBG. ALLG.	28	319,983
5436	PROV. FEUERVERS.	11	817,063
5446	PROV. NORD BRANDKASSE	3	338,552
5438	R+V ALLGEMEINE VERS.	64	1,418,720
5798	RHEINLAND VERS. AG	11	144,296
5450	SECURITAS BREMER ALLG	11	200,428
5451	SIGNAL UNFALL	3	245,186
5036	SV SPARK. GEB. BAD.-WÜR	3	262,265

<b>Ind. No.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>	<b>Number of liability insurance policies (2001)</b>
5385	SV SPARKASSEN	11	316,951
5456	THURINGIA GENERALI	25	457,769
5458	TRANSATLANT. ALLG. VERS.	8	186,925
5459	UELZENER ALLG. VERS.	6	77,322
5327	VEREINTE VERSICHERUNG	20	728,046
5042	VERSICHERUNGSK. BAYERN	6	17,024
5400	VGH LAND BRAND. HAN.	11	684,464
5464	VHV	49	776,370
5472	VICTORIA VERS.	69	1,152,202
5473	VOLKSFÜRSORGE DT. SACH	45	1,020,594
5479	WÜRTT. GEMEINDE-VERS.	5	230,798
5480	WÜRTT. U. BADISCHE	3	96,112
5783	WÜRTT. VERS.	44	1,042,467
5050	ZÜRICH VERS. AG	40	538,198

#### 4.6 Statistic of complaints in connection with insurance undertakings Casualty insurance

Ind. No.	Name of insurance undertaking	Complaints	Number of casualty insurance policies (2001)
5342	AACHENER/MCHN. VERS.	92	1,363,173
5312	ALLIANZ VERS.	162	5,771,443
5405	ALTE LEIPZIGER VERS.	6	120,801
5455	ARAG ALLG. VERS.	42	16,231,178
5512	ASPECTA VERSICHERUNG	7	56,264
5515	AXA VERS.	49	1,105,932
5792	BADEN-BADENER VERS.	6	163,358
5317	BARMENIA ALLG. VERS.	10	129,443
5318	BASLER VERS.	10	92,135
5310	BAYER. BEAMTEN VERS.	1	111,448
5325	BAYER. VERS. BANK	22	1,043,001
5324	BAYER. VERS. VERB. AG	4	553,219
5062	BERLIN-KÖLNISCHE SACH	5	44,618
5040	CIC DEUTSCHLAND	17	19
5790	CIV VERS.	7	182,184
5338	CONCORDIA VERS.	7	298,222
5339	CONDOR ALLG. VERS.	2	38,903
5340	CONTINENTALE SACHVERS.	35	753,591
5552	COSMOS VERS.	7	155,738
5529	D.A.S. VERS.	25	288,075
5343	DA DEUTSCHE ALLG.VER.	1	38,696
5311	DBV DEUT. BEAM. VERS. AG	5	246,452
5037	DBV-WINTERTHUR	16	203,293
5549	DEBEKA ALLGEMEINE	17	1,457,820
5513	DEVK ALLG. VERS.	8	583,695
5344	DEVK DT. EISENB. SACH	3	306,075
5347	DT. HEROLD ALLG. VERS.	22	644,465
5350	DT. RING SACHVERS.	54	494,594
5508	EUROPA SACHVERS.	5	207,940
5516	FAMILIENSCHUTZ VERS.	82	313,877
5359	FEUERSOZIJETÄT BERLIN	4	41,966
5364	FRANKF. VERS.	21	1,331,481
5365	GEGENSEITIGKEIT VERS.	2	8,634
5599	GENERALI LLOYD VERS.	39	756,060
5442	GERLING G&A	11	157,851
5368	GERLING-K. ALLGMEINE	17	7,034,019
5531	GOTHAER ALLG.VERS.AG	33	891,646
5374	HAFTPFLICHTK.DARMST.	26	11,542
5420	HAMB. MANNHEIMER SACH	158	3,370,196
5501	HANSEMERKUR ALLG.	11	129,705
5377	HDI HAFTPFLICHTV.	3	30,716
5085	HDI PRIVAT	2	170,356
5384	HELVETIA VERS.	9	154,703
5521	HUK-COBURG ALLG. VERS	1	501,417
5573	IDEAL VERS.	1	8,120
5546	INTER ALLG. VERS.	9	108,636
5057	INTERLLOYD (D)	1	28,087
5780	INTERRISK VERS.	9	362,130
5401	ITZEHOER VERSICHERUNG	1	81,869
5509	KARLSRUHER VERS.	5	176,427

<b>Ind. No.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>	<b>Number of casualty insurance policies (2001)</b>
5562	KARSTADTQUELLE VERS.	7	352,962
5402	LVM SACH	26	891,699
5061	MANNHEIMER VERS.	12	84,647
5412	MECKLENBURG. VERS.	11	158,901
5334	MEDIENVERS. KARLSRUHE	2	923
5414	MÜNCHEN. VEREIN ALLG.	7	46,200
5070	NECKERMANN VERS.	2	9,133
5793	NECKURA VERS.-AG	6	72,030
5591	NEUE LEBEN UNFALL	1	564,464
5390	NOVA ALLG. VERS.	43	946,466
5426	NÜRNBG. ALLG.	103	582,950
5686	NÜRNBG. BEAMTEN ALLG.	9	100,930
5787	OVAG - OSTDT. VERS.	4	3,984
5074	PB VERSICHERUNG	8	56,444
5542	PLUS ALLG. VERS.	1	11,494
5436	PROV. FEUERVERS.	9	1,390,485
5446	PROV. NORD BRANDKASSE	4	375,086
5583	PVAG POLIZEIVERS.	7	353,471
5438	R+V ALLGEMEINE VERS.	35	1,423,677
5798	RHEINLAND VERS. AG	5	94,902
5448	SCHWEIZER NATION. VERS	1	15,129
5450	SECURITAS BREMER ALLG	4	57,433
5451	SIGNAL UNFALL	76	744,665
5781	SPARK.-VERS. SACHS. ALL	1	34,859
5586	STUTTGARTER VERS.	28	224,842
5036	SV SPARK. GEB. BAD.-WÜR	2	191,235
5385	SV SPARKASSEN	6	151,000
5776	TELCON ALLGEMEINE	9	99,042
5456	THURINGIA GENERALI	9	294,741
5458	TRANSATLANT. ALLG. VERS	4	31,610
5463	UNIVERSA ALLG. VERS.	3	149,799
5511	VER. VERS. GES. AMERIKA	12	229,274
5327	VEREINTE VERSICHERUNG	8	549,667
5400	VGH LAND. BRAND. HAN.	3	6,031,327
5464	VHV	7	108,112
5598	VHV AUTOVERS.	1	85,127
5472	VICTORIA VERS.	63	1,134,666
5473	VOLKSFÜRSORGE DT. SACH	12	592,765
5484	VOLKSWOHL-BUND SACH	4	197,265
5461	VPV ALLGEMEINE VERS.	1	113,984
5525	WGV-SCHWÄBISCHE ALLG.	9	61,546
5447	WINTERTHUR VERS.	5	56,848
5476	WWK ALLGEMEINE VERS.	5	149,746
5479	WÜRTT. GEMEINDE-VERS.	2	146,478
5480	WÜRTT. U. BADISCHE	30	180,390
5783	WÜRTT. VERS.	27	763,663
5590	WÜRZBURGER VERSICHER.	8	70,005
5050	ZÜRICH VERS. AG	24	1,078,417

#### 4.7 Statistic of complaints in connection with insurance undertakings Home contents insurance

Ind. No.	Name of insurance undertaking	Complaints	Number of home contents insurance policies (2001)
5342	AACHENER/MCHN. VERS.	57	796,431
5312	ALLIANZ VERS.	101	2,853,419
5405	ALTE LEIPZIGER VERS.	7	186,802
5455	ARAG ALLG. VERS.	14	191,274
5515	AXA VERS.	24	1,130,034
5318	BASLER VERS.	7	94,528
5325	BAYER. VERS. BANK	4	574,772
5324	BAYER. VERS. VERB. AG	6	531,290
5338	CONCORDIA VERS.	5	212,144
5340	CONTINENTALE SACHVERS	2	105,225
5529	D.A.S. VERS.	7	142,842
5311	DBV DEUT. BEAM. VERS. AG	9	182,191
5037	DBV-WINTERTHUR	16	194,292
5549	DEBEKA ALLGEMEINE	20	533,744
5513	DEVK ALLG. VERS.	10	741,782
5344	DEVK DT. EISENB. SACH	2	476,460
5347	DT. HEROLD ALLG. VERS.	8	304,064
5350	DT. RING SACHVERS.	1	216,148
5364	FRANKF. VERS.	22	850,168
5599	GENERALI LLOYD VERS.	14	307,773
5368	GERLING-K. ALLGEMEINE	11	394,527
5531	GOTHAER ALLG.VERS.AG	15	884,901
5420	HAMB. MANNHEIMER SACH	25	574,982
5085	HDI PRIVAT	4	230,570
5384	HELVETIA VERS.	11	310,235
5375	HUK-COBURG	13	1,136,201
5521	HUK-COBURG ALLG. VERS	9	422,918
5509	KARLSRUHER VERS.	4	122,523
5402	LVM SACH	20	577,762
5061	MANNHEIMER VERS.	6	97,448
5412	MECKLENBURG. VERS.	6	152,517
5390	NOVA ALLG. VERS.	14	276,238
5426	NÜRNBG. ALLG.	18	193,585
5436	PROV. FEUERVERS.	6	582,967
5446	PROV. NORD BRANDKASSE	1	288,958
5438	R+V ALLGEMEINE VERS.	19	668,489
5798	RHEINLAND VERS. AG	6	102,720
5450	SECURITAS BREMER ALLG	6	167,686
5036	SV SPARK. GEB. BAD.-WÜR	9	130,559
5385	SV SPARKASSEN	4	231,497
5456	THURINGIA GENERALI	14	282,671
5327	VEREINTE VERSICHERUNG	17	612,400
5400	VGH LAND. BRAND. HAN.	6	492,522
5464	VHV	9	163,687
5472	VICTORIA VERS.	29	774,643
5473	VOLKSFÜRSORGE DT. SACH	27	988,876
5461	VPV ALLGEMEINE VERS.	5	183,647
5783	WÜRTT. VERS.	22	746,695
5050	ZÜRICH AGRIP. VERS. AG	14	327,811

#### 4.8 Statistic of complaints in connection with insurance undertakings Insurers based in the EEA

(Branch offices and service providers from the EEA, who are merely subject to legal supervision)

Ind. No.	Name of insurance undertaking	Complaints
5533	ABELLE ASSURANCES	1
7402	ABN AMRO LIFE (L)	1
7552	ACCENT EUROPE (IRL)	11
5487	ACE INSURANCE	24
5595	AIG EUROPE S.A.	5
7197	ALGEMENE LEVENS. (NL)	1
7203	ATLANTIC LUX (L)	56
5090	AXA CORPORATE SOL	2
5056	CARDIF VERSICHERUNG	5
7362	C.E.G.I. (F)	1
5574	CHUBB INSURANCE COMP.	6
7453	CLERICAL MED. INV. (GB)	4
7281	DKV INTERNATIONAL (B)	1
5048	DOMESTIC AND GENERAL	1
1161	EQUITABLE LIFE	12
7481	FORTUNA LEBEN	1
7410	FOYER INTERNAT. (L)	2
5535	GARANTIE MUTUELLE I.L.	1
5030	GOUDSE SCHADENV.	5
5789	HAMPDEN INSURANCE	3
5079	HISCOX INSURANCE	2
7611	IHRE ZUKUNFT N.V. (NL)	1
7685	LANDMARK INS. (GB)	6
7007	LLOYD'S OF LONDON (GB)	18
5592	LLOYD'S VERSICHERER	4
7734	METLIFE EUROPE (IRL)	1
7237	MUTUELLE DES ARCH. (F)	1
7579	NEMIAN LIFE & P. (L)	4
5680	NIPPON INSURANCE COMP	2
5066	N.V. WAARBORGMIJ	4
7723	PRISMALIFE AG (FL)	1
7455	PROBUS INSURANCE (IRL)	1
7215	PRUDENTIAL/SALI (IRL)	33
5045	RELIANCE NATIONAL	4
7415	R + V LUXEMBOURG L (L)	3
7235	SALZBURGER LANDES (A)	13
7544	SKANDIA LEBEN AG (A)	1
1172	SKANDIA LIFE	2
1174	STANDARD LIFE	12
7518	SUN LIFE ASS. SOC. (GB)	32
7406	TIROLER LANDES (A)	1
7289	UNUM LIMITED (GB)	1
5067	VER. VERS. VON EUROPA	1
7456	VDV LEBEN INTERN. (GR)	5
7483	VORSORGE LUXEMB. LEBEN	38
7683	WÜSTENROT (A)	1
5088	XL WINTERTHUR (GB)	2

# BaFin

## 5.1 Members of the Administrative Council of the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin)

### **Representatives of the Federal Ministry of Finance (Bundesministerium der Finanzen)**

Caio Koch-Weser (Chairman)  
Jörg Asmussen (Deputy Chairman)  
Werner Gatzler  
Peter Görß

### **Representatives of the Federal Ministry of Economics and Labour (Bundesministerium für Wirtschaft und Arbeit)**

Dr. Thomas Hardieck

### **Representatives of the Federal Ministry of Justice (Bundesministerium der Justiz)**

Erich Schaefer

### **Representatives of the German Bundestag (Lower House of Parliament)**

Nina Hauer  
Bartholomäus Kalb  
Christine Scheel  
Heinz Seiffert  
Jörg-Otto Spiller

### **Representatives of credit institutions**

Dr. Rolf E. Breuer  
Dr. Dietrich Hoppenstedt  
Dr. Karsten von Köller  
Dr. Christoph Pleister  
Hans Dietmar Sauer

### **Representatives of insurance undertakings**

Dr. Jürgen Förterer  
Dr. Frank von Fürstenwerth  
Dr. Lothar Meyer  
Dr. Helmut Perlet

### **On behalf of investment companies**

N/A

As at: 15 April 2003

## 5.2 Members of the Advisory Board of Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin)

### Representatives of the banking sector

Dr. Wolfgang Arnold	Bundesverband Deutscher Banken
Dr. Holger Berndt	Deutscher Sparkassen- und Giroverband
Karl-Heinz Boos	Bundesverband Öffentlicher Banken Deutschlands
Jochen Lehnhoff	Bundesverband der Deutschen Volksbanken und Raiffeisenbanken
Dr. Jan Marwede	Verband der Auslandsbanken in Deutschland
Andreas J. Zehnder	Verband der Privaten Bausparkassen

### Representatives of investment companies and financial services institutions

Rüdiger H. Päsler	Bundesverband Investment und Asset Management
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### Representatives of the German Insurance Association

Dr. Bernd Michaels	Gesamtverband der Deutschen Versicherungswirtschaft
Dr. Rainer Hagemann	Allianz Versicherungs AG
Dr. Hans-Jürgen Schinzler	Münchener Rückversicherungs AG
Dr. Heiko Winkler	Westfälische Provinzial Versicherungs AG

### Representatives of the Association of Private Health Insurers

Reinhold Schulte	Signal Krankenversicherung a.G.
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### Representatives of the Task Force for Occupational Retirement Provision

Joachim Schwind	Pensionskassen der Mitarbeiter der Hoechst-Gruppe
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### Representatives of academic groups

Prof. Dr. Dr. Ann-Kristin Achleitner	DTA-Stiftungslehrstuhl für Unternehmensgründung/ Entrepreneurial Finance, TU München
Prof. Dr. Theodor Baums	Johann Wolfgang Goethe Universität - Institut für Wirtschaftsrecht und Bürgerliches Recht
Prof. Dr. Fred Wagner	Universität Leipzig - Institut für Versicherungswissenschaft

### Representatives of consumer protection associations

Dr. Christian Balzer	Bankenombudsmann
Beate-Kathrin Bextermöller	Stiftung Warentest
Prof. Wolfgang Römer	Versicherungsombudsmann

### Representatives of the German Bundesbank

Gerhard Hofmann

**Representatives of legal and business professionals**

Alexander Pohle                      Arbeitgeberverband der  
finanzdienstleistenden Wirtschaft

**Representatives of associations for SMEs**

Ulrike Diehl                              Deutsche Vereinigung für Finanzanalyse  
und Asset Management

**Representatives of trade unions**

Hinrich Feddersen                      ver.di Vereinigte  
Dienstleistungsgewerkschaft

**Representatives of industry**

Holger P. Härter                          Dr. Ing. h.c. F. Porsche AG

As at: 9 April 2003

### 5.3 Members of the Insurance Advisory Council of the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin)

<b>Herbert Alles</b>	Deutscher Gewerkschaftsbund
<b>Dr. Martin Balleer</b>	Chairman of the Deutsche Aktuarvereinigung (DAV)
<b>Beate-Kathrin Bextermöller</b>	Stiftung Warentest Financial Services Department
<b>Dr. Jan Boetius</b>	Chairman of the Board of Directors of Deutsche Krankenversicherung AG
<b>Prof. Dr. Harald Brachmann</b>	Fachhochschule Köln Department of Insurance
<b>Dr. Georg Büchner</b>	Member of the Supervisory Board of Wüstenrot und Württembergische AG
<b>Dr. Claus-Michael Dill</b>	Chairman of the Board of Directors of AXA Colonia Konzern AG
<b>Prof. Dr. Dieter Farny</b>	Director Institut für Versicherungswissenschaft bei der Universität zu Köln Seminar für Versicherungslehre bei der Universität zu Köln Deputy Chairman of the Deutscher Verein für Versicherungswissenschaft e. V.
<b>Johannes B. Fischer</b>	Chairman of the Bundesverband firmenverbundene Versicherungsvermittler und -gesellschaften e.V.
<b>Dr. Leberecht Funk</b>	President of the Bundesverband Deutscher Versicherungsmakler Funk Gruppe GmbH
<b>Dr. Gerd Geib</b>	Member of the Board of Directors of KPMG Deutsche Treuhand-Gesellschaft
<b>Dr. Reiner Hagemann</b>	Chairman of the Board of Directors of Allianz Versicherungs-AG
<b>Carl-Detlev Freiherr von Hammerstein</b>	Chairman of the Supervisory Board of CONCORDIA Versicherungsgruppe

<b>Prof. Dr. Elmar Helten</b>	Ludwig-Maximilian-Universität München Institut für betriebswirtschaftliche Risikoforschung und Versicherungswirtschaft
<b>Prof. Dr. Klaus Heubeck</b>	Chairman of IVS Institut der Versicherungs- mathematischen Sachverständigen für Altersversorgung e.V.
<b>Dr. Sylvia Heyser</b>	Lawyer President of the Landesverband der Freien Berufe Sachsen e.V.
<b>Susanne Hille</b>	ver.di - Vereinte Dienstleistungsgewerk- schaft e. V. / HBV Specialist Department Insurances
<b>Rolf-Peter Hoenen</b>	Chairman of the Board of Directors of HUK-Coburg Haftpflicht- Unterstützungskasse kraftfahrender Beamter Deutschlands a.G. HUK-Coburg-Krankenversicherung HUK-Coburg-Leben
<b>Andrea Hoffmann</b>	Head of Financial Services Department Verbraucherzentrale Sachsen
<b>Dr. Eckhart Jung</b>	Lawyer Allgemeiner Deutscher Automobil-Club e.V. Head of Juristische Zentrale Interessenvertretung Recht
<b>Dr. Stefan Lippe</b>	Chairman of the Supervisory Board of Swiss Re Germany Holding AG
<b>Prof. Dr. Egon Lorenz</b>	Universität Mannheim Faculty of Law Managing editor of the journal "Versicherungsrecht"
<b>Dr. Lothar Meyer</b>	Chairman of the Board of Directors of ERGO Versicherungsgruppe AG
<b>Dr. Bernd Michaels</b>	President of Gesamtverband der Deutschen Versicherungswirtschaft e. V.
<b>Dieter Philipp</b>	President of Zentralverband des Deutschen Handwerks
<b>Dr. Heike Ratajczak</b>	Head of Department of VAWE Thuringia Generali Versicherung AG

<b>Klaus H. Rathjen</b>	Director, Bundesverband des Deutschen Groß- und Außenhandels e.V. (BGA)
<b>Mario Remmel</b>	Director Deutscher Gewerkschaftsbund
<b>Dr. Gerhard Rupprecht</b>	Chairman of the Board of Directors of Allianz Lebensversicherungs-AG
<b>Hauptrecht Freiherr Schenck zu Schweinsberg</b>	Chairman of the Versicherungsausschuss des Bundesverbandes der Deutschen Industrie e. V. (BDI), Cologne Managing Director of Thyssen Krupp Versicherungsdienst GmbH, Industrieversicherungsvermittlung
<b>Dr. Hans-Jürgen Schinzler</b>	Chairman of the Board of Directors of Münchener Rückversicherungs-Gesellschaft
<b>Prof. Dr. Helmut Schirmer</b>	Freie Universität Berlin Department 9 5
<b>Günter Schlicht</b>	Lawyer Member of the Board of DVS Deutscher Versicherungs-Schutzverband e.V.
<b>Joachim Schwind</b>	Laywer Head of Department at Hoechst AG Chairman of Pensionskasse der Mitarbeiter der Hoechst-Gruppe VVaG
<b>Wolfgang Spinler</b>	Managing Director Automobilclub von Deutschland (AvD) e.V.
<b>Holger Stubbe</b>	Versicherungskaufmann, DAG, Chairman of the General Works Council of Hamburg-Mannheimer-Versicherungs-AG
<b>Ludger Theilmeier</b>	President of the Bundesverband Deutscher Versicherungskaufleute e. V.
<b>Elke Weidenbach</b>	Specialist consultant for insurance issues Verbraucherzentrale NRW
<b>Manfred Westphal</b>	Lawyer Verbraucherzentrale Bundesverband e.V. Financial Services Department

**Dr. Heiko Winkler**

Chairman of the Board of Directors of  
Westfälische Provinzial-Feuersozietät

**Prof. Dr. Wolfram Wrabetz**

Senior authorised signatory and  
Chairman of the Board of Directors of  
HELVETIA Insurance in Germany  
Member of the Management Board of  
HELVETIA PATRIA  
Gruppe, Switzerland

As at: 2 April 2003

## 5.4 Members of the Takeover Council of the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin)

### On behalf of the issuers

Dr. Werner Brandt	Member of the Board of Directors of SAP AG
Dr. Karl Ludwig Kley	Member of the Board of Directors of Deutsche Lufthansa AG
Dr. Hermann Küllmer	Member of the Board of Directors of ALTANA AG
Dr. Henrik-Michael Ringleb	Senior Corporate Attorney at Thyssen Krupp AG

### Representatives of institutional and private investors

Dr. Paul Achleitner	Member of the Board of Directors at Allianz AG
Udo Behrenwaldt	Spokesperson for the Management of DWS Investment GmbH
Jella Benner-Heinacher	Deutsche Schutzvereinigung für Wertpapierbesitz e.V.
Klaus Schneider	Chairman of Schutzgemeinschaft der Kleinaktionäre e.V.

### Representatives of investment services enterprises

Dr. Stephan Schuster	Deutsche Bank AG
Karsten Klupsch	WestLB AG
Andreas Körnlein	Goldman, Sachs & Co. OHG

### Employee representatives

Heinz Putzhammer	National Executive Committee of DGB
Marie Seyboth	National Executive Committee of DGB

### Representatives of academic groups

Prof. Dr. Uwe H. Schneider	Department 1, Civil Law II Technische Universität Darmstadt
Prof. Dr. Dr. Dres.h.c. Klaus J. Hopt	Max-Planck-Institut

As at: 9 April 2003

## International bodies

Basel Committee on Banking Supervision (BCBS)  
 Conference of Pension Supervisory Authorities (CPSA)  
 Enlarged Contact Group on Investment Supervision  
 Financial Action Task Force on Money Laundering (FATF)  
 Financial Stability Forum (FSF)  
 International Accounting Standards Board (IASB), Insurance Advisory Committee  
 International Association of Insurance Supervisors (IAIS)  
 International Commission on Holocaust Era Insurance Claims (ICHEIC)  
 International Network of Pension Regulators and Supervisors (INPRS)  
 International Organisation of Securities Commissions (IOSCO)  
 Joint Forum on Financial Conglomerates (JF)

## European bodies

Banking Supervision Committee (BSC)  
 Banking Advisory Committee (BAC)  
 Committee of European Securities Regulators (CESR)  
 Erfahrungsaustausch Deutschland, Österreich, Schweiz, Liechtenstein (Erfa-DACHL)  
 Ecofin Council Working Group  
 Groupe de Contact (GdC)  
 Joint Working Group on Full Fair Value Accounting  
 Money Laundering Contact Committee at the European Commission  
 Conference of EU Insurance Supervisory Authorities  
 UCITS Contact Committee  
 Insurance Committee (IC)

## Other official bodies

Arbeitstagung der Versicherungsaufsichtsbehörden des Bundes und der Länder (Conference of Insurance Supervisory Authorities of the Bund and Länder)  
 Arbeitskreis der Versicherungsbehörden der Länder (Working Group of Länder Insurance Authorities)  
 Arbeitskreis der Länder für Börsen und Wertpapierfragen (Länder Working Group for Issues Relating to Exchanges and Securities)  
 Börsensachverständigenkommission (Exchange Expert Commission)

As at: 31 December 2002

## Memoranda of Understanding

The Federal Financial Supervisory Authority has signed Memoranda of Understanding (MoU) with the supervisory authorities of the following countries:

### 1. Within the area of banking supervision:

Belgium, Denmark, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden, the United Kingdom.

Norway

Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia, the Czech Republic, Romania, Jersey, Australia, South Korea, and Argentina.

The United States of America (Federal Reserve Bank of New York, Federal Reserve Board, and Office of the Comptroller of the Currency, as well as New York State Banking Department)

### 2. Within the area of insurance supervision:

Latvia, Estonia, the Czech Republic, and Hungary.

### 3. Within the area of securities supervision:

Belgium, Denmark, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden, the United Kingdom.

Argentina, Australia, Brazil, China, Hong Kong, Jersey, Poland, Russia, Singapore, South Africa, the Czech Republic, Taiwan, Turkey, Hungary.

The United States of America (Securities and Exchange Commission, Commodities and Futures Trading Commission)

In 1999, within the framework of CESR (Committee of European Securities Regulators), a multilateral agreement on the exchange of information was signed between the supervisory authorities of the fifteen EU Member States, as well as Iceland and Norway as signatories to the EEA Agreement, thus redefining the bilateral agreements previously signed between individual EU countries (by name Spain, France, Italy and Portugal in the area of securities supervision).

## Abbreviations

<b>A</b>	<b>ABS</b>	Asset-Backed Securities
	<b>AG</b>	Aktiengesellschaft (German stock corporation)
	<b>AktG</b>	Aktiengesetz (Stock Corporation Act)
	<b>AltZertG</b>	Altersvorsorgeverträge-Zertifizierungsgesetz (Act Governing the Certification of Retirement Provision Contracts)
	<b>AO</b>	Abgabenordnung (Tax Code)
	<b>AS-Fonds</b>	Altersvorsorge-Sondervermögen (special investment fund for pension provision subject to statutory requirements)
	<b>ATS</b>	Alternative Trading Systems
	<b>AuslInvestmG</b>	Auslandinvestment-Gesetz (Foreign Investment Act)
	<b>AVmG</b>	Altersvermögensgesetz (Act to Promote Old-Age Provision)
	<b>B</b>	<b>BaFin</b>
<b>BAKred</b>		Bundesaufsichtsamt für das Kreditwesen (Federal Banking Supervisory Office)
<b>BAnz</b>		Bundesanzeiger (Federal Gazette)
<b>BAV</b>		Bundesaufsichtsamt für das Versicherungswesen (Federal Insurance Supervisory Office)
<b>BAWe</b>		Bundesaufsichtsamt für den Wertpapierhandel (Federal Securities Supervisory Office)
<b>BerVersV</b>		Verordnung über die Berichterstattung von Versicherungsunternehmen gegenüber dem Bundesaufsichtsamt für das Versicherungswesen (Ordinance Concerning the Reporting by Insurance Undertakings to the Federal Insurance Supervisory Office )
<b>BetrAVG</b>		Gesetz zur Verbesserung der betrieblichen Altersversorgung (Law on the Improvement of Company Pension Schemes)
<b>BfA</b>		Bundesversicherungsanstalt für Angestellte (Federal Insurance Institute for Salaried Employees)
<b>BGB</b>		Bürgerliches Gesetzbuch (Civil Code)
<b>BGBI</b>		Bundesgesetzblatt (Federal Law Gazette)
<b>BGH</b>		Bundesgerichtshof (German Federal Court of Justice)
<b>BiRiLiG</b>		Gesetz zur Durchführung der 4., 7. und 8. Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts (Bilanzrichtlinien-Gesetz 1985) (Accounting Directives Act 1985)
<b>BKA</b>		Bundeskriminalamt (Federal Office of Criminal Investigation)
<b>BMF</b>		Bundesministerium der Finanzen (Federal Ministry of Finance)
<b>BMJ</b>		Bundesministerium der Justiz (Federal Ministry of Justice)

	<b>BSI</b>	Bundesamt für Sicherheit in der Informationstechnik (German Information Security Agency)
	<b>BSpkV</b>	Bausparkassenverordnung (Building and Loan Association Regulation)
	<b>BT</b>	Bundestag (Germany's Lower House of Parliament)
	<b>Bund</b>	Federation or Federal Government (the Federal Republic of Germany consists of so-called Länder)
	<b>BVA</b>	Bundesversicherungsamt (Federal Insurance Office)
	<b>BVI</b>	Bundesverband Deutscher Investment- und Vermögensverwaltungsgesellschaften e.V. (Federal Investment and Asset Management Association)
	<b>BVR</b>	Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (central organisation of the German cooperative banking group)
	<b>BVerfG</b>	Bundesverfassungsgericht (Federal Constitutional Court)
	<b>BVG</b>	Bundesverwaltungsgericht (Federal Administrative Court)
<b>C</b>	<b>CESR</b>	Committee of European Securities Regulators
	<b>CFTC</b>	Commodities Futures Trading Commission
	<b>CP</b>	Core Principles
	<b>CPSA</b>	Conference of Pension Supervisory Authorities
<b>D</b>	<b>DAV</b>	Deutsche Aktuarvereinigung (German Actuarial Society)
	<b>DAX</b>	Deutscher Aktienindex (Blue Chip Index listing the 30 major German companies)
	<b>DGAP</b>	Deutsche Gesellschaft für Ad-hoc Publizität mbH (news service for information from exchange-listed)
	<b>DMBiG</b>	D-Mark-Bilanzgesetz (D-Mark Accounting Act; relates to companies with a registered office in the German Democratic Republic as at 1 July 1990)
<b>E</b>	<b>EC</b>	Extended Coverage
	<b>EdB</b>	Entschädigungseinrichtung deutscher Banken GmbH (Compensation Scheme of German Banks)
	<b>ESAEG</b>	Einlagensicherungs- und Anlegerentschädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
	<b>et seq.</b>	et sequentes or et sequentia meaning "and the following"
	<b>EU</b>	European Union
	<b>EUROSTAT</b>	EU statistical office
	<b>e.V.</b>	eingetragener Verein (registered society)
<b>F</b>	<b>FATF</b>	Financial Action Task Force on Money Laundering
	<b>FCSM</b>	Federal Committee on Statistical Methodology
	<b>FED</b>	Federal Reserve Board
	<b>FESCO</b>	Forum of European Securities Commissions

	<b>FHC</b>	Financial Holding Company
	<b>FinDAG</b>	Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht (Act Establishing the Federal Financial Supervisory Authority)
	<b>FinDAGKostV</b>	Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem Finanz- dienstleistungsaufsichtsgesetz (Ordinance on the Imposition of Fees and Allocation of Costs Pursuant to the FinDAG)
	<b>FSA (UK)</b>	Financial Services Authority
	<b>FSA (JP)</b>	Financial Supervisory Authority
	<b>FSAP</b>	Financial Sector Assessment Program
<b>G</b>	<b>GATS</b>	General Agreement on Trade in Services
	<b>GDV</b>	Gesamtverband der deutschen Versicherungs- wirtschaft (German Insurance Association)
	<b>GG</b>	Grundgesetz (Basic Law)
	<b>GmbH</b>	Gesellschaft mit beschränkter Haftung (private limited company)
	<b>GroMiKV</b>	Großkredit- und Millionenkreditverordnung (Regulation Governing Large Exposures and Loans of 1.5 Million Euros or More)
	<b>GS I</b>	Grundsatz I (Principle I)
	<b>GS II</b>	Grundsatz II (Principle II)
	<b>GwG</b>	Geldwäschegesetz (Money Laundering Act)
<b>H</b>	<b>HBG</b>	Hypothekendarlehenbankgesetz (Mortgage Bank Act)
	<b>HGB</b>	Handelsgesetzbuch (Commercial Code)
	<b>HR</b>	Handelsregister (Commercial Register)
	<b>HUK</b>	Haftpflicht-Unfall-Kraftfahrtversicherung (third-party/accident/motor vehicle insurance)
<b>I</b>	<b>IAIS</b>	International Association of Insurance Supervisors
	<b>IAPC</b>	International Auditing Practice Committee
	<b>IAS</b>	International Accounting Standards
	<b>IASC</b>	International Accounting Standards Committee
	<b>IDS</b>	International Disclosure Standards
	<b>IdW</b>	Institut der Wirtschaftsprüfer (German Institute of Chartered Accountants/Certified Public Accountants)
	<b>IMF</b>	International Monetary Fund
	<b>INPRS</b>	International Network of Pension Regulators and Supervisors
	<b>IOSCO</b>	International Organization of Securities Commissions
	<b>IPO</b>	Initial Public Offering
	<b>IRBA</b>	Internal Ratings-Based Approach
	<b>ISA</b>	International Standards of Auditing
	<b>ISD</b>	Investment Services Directive
<b>K</b>	<b>KAGG</b>	Gesetz über Kapitalanlagegesellschaften (Investment Companies Act)

	<b>KaIV</b>	Kalkulationsverordnung (Ordinance on the Actuarial Methods for Calculating Premiums and the Ageing Provision in Health Insurance (Calculation Ordinance))
	<b>KonTraG</b>	Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (Law Concerning the Control and Transparency of Corporations)
	<b>KWG</b>	Gesetz über das Kreditwesen (Banking Act)
<b>L</b>	<b>LAB</b>	Landesaufsichtsbehörde (Land Supervisory Authority)
	<b>Land</b>	State within the Federal Republic of Germany (also referred to as Bundesland)
	<b>Länder</b>	Plural of Land; Germany has 16 Länder in total (also referred to as Bundesländer)
<b>M</b>	<b>MaK</b>	Mindestanforderungen an das Kreditgeschäft (minimum requirements for the credit business of credit institutions)
	<b>M &amp; A</b>	Mergers & Acquisitions
	<b>MoU</b>	Memoranda of Understanding
<b>N</b>	<b>NAIC</b>	National Association of Insurance Commissioners
	<b>NCCTs</b>	Non-Cooperative Countries and Territories
<b>O</b>	<b>OECD</b>	Organisation for Economic Cooperation and Development
	<b>OLG</b>	Oberlandesgericht (Higher Regional Court)
	<b>OTC</b>	Over-the-Counter
	<b>OVG</b>	Oberverwaltungsgericht (Higher Administrative Court)
	<b>OWiG</b>	Gesetz über Ordnungswidrigkeiten (Act on Breaches of Administrative Regulations)
<b>P</b>	<b>PflegeVG</b>	Pflege-Versicherungsgesetz (Long-Term Care Insurance Act)
	<b>PrüfbV</b>	Prüfungsberichtsverordnung (Audit Reports Regulation)
<b>R</b>	<b>RBerG</b>	Rechtsberatungsgesetz (Legal Advice Act)
	<b>RechKredV</b>	Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute (Regulation on the Accounting of Credit Institutions and Financial Services Enterprises)
<b>S</b>	<b>SEC</b>	Securities and Exchange Commission
	<b>SGB</b>	Sozialgesetzbuch (Social Code)
	<b>SPV</b>	Special Purpose Vehicle
	<b>SRP</b>	Supervisory Review Process

	<b>StGB</b>	Strafgesetzbuch (Penal Code)
	<b>StPO</b>	Strafprozessordnung (Criminal Procedure Code)
	<b>StVG</b>	Straßenverkehrsgesetz (Road Traffic Act)
	<b>SWAP</b>	Securities Watch Applications
<b>U</b>	<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities
	<b>UmwG</b>	Umwandlungsgesetz (Transformation Act)
	<b>UNCTAD</b>	United Nations Conference on Trade and Development
	<b>UWG</b>	Gesetz gegen den unlauteren Wettbewerb (Unfair Competition Act)
<b>V</b>	<b>VAG</b>	Versicherungsaufsichtsgesetz (Insurance Supervision Law)
	<b>VerbrKrG</b>	Verbraucherkreditgesetz (Consumer Credit Act)
	<b>VersStG</b>	Versicherungssteuergesetz (Insurance Tax Law)
	<b>VVaG</b>	Versicherungsverein auf Gegenseitigkeit (insurer with the legal form of a mutual society)
	<b>VVG</b>	Versicherungsvertragsgesetz (Insurance Contract Act)
<b>W</b>	<b>WpHG</b>	Wertpapierhandelsgesetz (Securities Trading Act)
	<b>WpÜG</b>	Wertpapiererwerbs- und Übernahmegesetz (Securities Acquisition and Takeover Act)
<b>Z</b>	<b>ZPO</b>	Zivilprozessordnung (Code of Civil Procedure)



## Statistical data (insurance supervision)

### About the statistical data

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#### Property and casualty insurance

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## About the statistical data

### Introduction

As of Annual Report 1995 Part B of the former Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen - BAV), the figures presented in the following tables are based on cumulative industry data. These figures are presented as an aggregate of company data per segment, as furnished by the companies in question via so-called „Formblätter“ (forms) and „Nachweisungen“ (documentary proof). Therefore, it is possible not only to reconstruct the data at any time but also to ascertain other pertinent details if required.

One of the main disadvantages of this approach is that the number of insurance undertakings included in each table may fluctuate depending on the actual number of *Formblätter* and *Nachweisungen* submitted. However, this has no material effect on the sector-specific data because the figures are only published once all companies within a specific segment have forwarded the appropriate figures. This ensures comprehensive statistical results at all times.

### Scope of the statistics

The statistical appendix of the Annual Report includes all undertakings which are engaged in insurance business but are not institutions involved in Germany's social security scheme. The data does not include minor mutual insurance societies with limited activity (so-called *kleinere Versicherungsvereine auf Gegenseitigkeit*) insofar as supervision was transferred to the Länder (Section 3 BAG). Furthermore, the statistics do not include undertakings domiciled in another Member State of the European Economic Community or another signatory to the EEA Agreement (European Economic Area), supervision of which is incumbent upon the competent authority of the home Member State (pursuant to Section 1 10a(3) VAG. Insofar as subsidiaries of foreign undertakings have been included in the following statistics, this data only applies to subsidiaries of non-EEC states, unless otherwise stated.

### General note to the statistical tables

Please refer to the notes in the Annual Reports 1995 Part B and 1996 Part A and B, as published by the Federal Insurance Supervisory Office.

The following Tables 141, 441, 533, and 534 are based on *Nachweisungen*; it should be noted that the deadline for submitting this information to the BaFin is later than the date of publication of Annual Report Part B. This information supplements Sections 1, 4, and 5 of Part B of the previous year.

**Surplus<sup>1</sup> listed by source of income**  
– Life insurance undertakings –

Table 141

Source of income	2001		2000		1999	
	in € '000	in % <sup>2</sup>	in € '000	in % <sup>2</sup>	in €'000	in % <sup>2</sup>
1	2	3	4	5	6	7
1. Direct insurance business:						
a) Risk and early withdrawal:						
1. Mortality	3,237,531	5.3	3,214,956	5.3	3,086,571	5.5
2. Other risk	940,894	1.5	973,098	1.6	862,935	1.5
3. Early withdrawal	152,502	0.2	63,433	0.1	-28,670	-0.1
b) Investments <sup>3</sup> :						
1. Interest <sup>4</sup>	7,441,214	12.2	12,193,131	20.0	11,001,265	19.5
2. Other investment income	2,403,419	3.9	4,659,250	7.6	4,754,123	8.4
c) Expenses:						
1. Acquisition costs	-2,038,974	-3.3	-1,787,828	-2.9	-1,894,789	-3.4
2. Administration	2,211,527	3.6	2,197,875	3.6	2,029,251	3.6
d) Difference between tariff and standard premium <sup>5</sup>	-38,034	-0.1	-25,658	0.0	-33,080	-0.1
e) Reinsurance:						
1. Mortality	-273,731	-0.4	-256,271	-0.4	-222,263	-0.4
2. Other risk	-90,010	-0.1	-68,893	-0.1	-87,880	-0.2
3. Other reinsurance income	344,960	0.6	377,163	0.6	354,826	0.6
f) Other income	-774,240	-1.3	-1,294,595	-2.1	-1,444,125	-2.6
Surplus	13,517,059	22.1	20,245,660	33.2	18,378,166	32.6
Gross expenditure on premium refunds	12,689,502	20.7	19,364,641	31.8	17,661,291	31.3
Result of direct insurance business	827,557	1.4	881,018	1.4	716,876	1.3
2. Insurance business accepted	-24,360		-2,710		3,991	
3. Net profit/loss <sup>6</sup>	803,197		878,308		720,866	
<b>Total number of companies</b>	<b>118</b>		<b>122</b>		<b>122</b>	

<sup>1</sup> surplus is the sum of gross expenditure on premium refunds and the net profit/net loss

<sup>2</sup> in % of gross premiums earned from direct insurance business

<sup>3</sup> actual income and expenses in accordance with the attribution used in NW 201 BerVersV

<sup>4</sup> after deduction of total direct credit (mainly interest-related direct credit)

<sup>5</sup> in the case of different calculation bases when computing premium and mathematical provision

<sup>6</sup> corresponds with item II. 11 Formblatt 3 RechVersV

**Surplus listed by source of income**  
– Health insurance undertakings –

Table 441

Source of income 1	2001		2000		1999	
	in € '000	in % <sup>1</sup>	in € '000	in % <sup>1</sup>	in € '000	in % <sup>1</sup>
	2	3	4	5	6	7
1. Direct insurance business:						
a) Risk	-607,906	-2.8	-171,187	-0.8	114,069	0.6
b) 1. Direct acquisition costs	-21,033	-0.1	22,782	0.1	28,368	0.1
2. Indirect acquisition costs	-14,820	-0.1	3,381	0.0	47,715	0.2
c) Claims settlement expenses	-72,007	-0.3	-50,085	-0.2	-33,176	-0.2
d) Administrative expenses	110,858	0.5	107,951	0.5	110,718	0.6
Result 1	-604,909	-2.8	-87,159	-0.4	267,695	1.3
e) Safety loading	1,447,601	6.7	1,373,356	6.6	1,328,987	6.7
f) Premium and claims equalisation	11,701	0.1	11,291	0.1	-3,715	0.0
Result 2	854,393	3.9	1,297,489	6.3	1,592,967	8.0
g) 1. Interest income <sup>2</sup>	2,290,686	10.5	2,614,868	12.6	2,305,265	11.6
2. Other income from investments <sup>2</sup>	179,013	0.8	310,007	1.5	535,311	2.7
h) Non-performance-related premium refunds	241	0.0	1,101	0.0	865	0.0
i) Other income and expenses	-200,743	-0.9	-383,867	-1.9	-397,935	-2.0
j) Suppl. alloc. for negative aggregate mathematical provisions	-	-	-	-	1,266	0.0
Result 3	3,123,590	14.4	3,839,598	18.5	4,035,207	20.3
k) Direct credit as per Section 12a(2) VAG	620,529	2.9	681,318	3.3	450,736	2.3
l) Amounts determined as per Section 12a(3) VAG	572,439	2.6	680,815	3.3	450,715	2.3
m) Non-performance-related premium refunds (group ins.)	342,261	1.6	369,085	1.8	351,593	1.8
n) Gross expenditure on performance-related prem. refunds	1,386,882	6.4	1,811,212	8.8	2,491,183	12.5
Result of direct insurance business	201,480	0.9	297,168	1.4	290,980	1.5
2. Insurance business accepted	6,253		3,925		-1,281	
3. Net profit/loss <sup>3</sup>	207,733		301,092		289,699	
<b>Total number of companies</b>	<b>48</b>		<b>48</b>		<b>49</b>	

<sup>1</sup> in % of gross premiums earned from direct insurance business

<sup>2</sup> actual income and expenses in accordance with the attribution used in NW 201 BerVersV

<sup>3</sup> corresponds with item II. 11 Formblatt 3 RechVersV

**Overview of gross claims provisions (CP)<sup>1</sup>  
for direct business in 2001**  
– Property and casualty insurance undertakings –

Table 533

Insurance segment	No.	Gross CP for claims in the financial year						Gross CP for claims in previous years						Total gross CP	
		Known claims <sup>2</sup>		Related claims		Settlement expenses		Known claims <sup>3</sup>		Related claims		Settlement expenses		€m	%
		€m	%	€m	%	€m	%	€m	%	€m	%	€m	%		
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Health	10	18.5	14.2	4.2	3.2	1.5	1.1	0.8	0.6	0.5	0.4	0.1	0.1	25.7	19.6
Casualty	137	1,594.6	29.0	367.1	6.7	150.6	2.7	1,921.9	35.0	455.8	8.3	134.2	2.4	4,624.2	84.1
Liability	137	2,233.3	32.9	1495.9	22.1	501.2	7.4	4,096.6	60.4	7,057.8	104.1	878.7	13.0	16,263.5	239.8
Motor (total)	121	5,679.9	26.5	1284.5	6.0	766.4	3.6	20,490.4	95.7	2,293.2	10.7	951.2	4.4	31,465.7	147.0
of which:															
liability	119	4,794.6	36.1	874.9	6.6	673.0	5.1	20,350.4	153.3	2,191.1	16.5	931.4	7.0	29,815.4	224.6
full own damage	117	738.4	11.9	330.2	5.3	66.9	1.1	83.4	1.3	77.0	1.2	11.7	0.2	1,307.7	21.1
partial own damage	115	131.5	7.6	69.4	4.0	24.0	1.4	24.8	1.4	13.0	0.8	4.3	0.3	267.1	15.5
accident	114	15.4	6.9	9.9	4.5	2.5	1.1	31.8	14.3	12.1	5.5	3.7	1.7	75.5	33.9
Aviation	19	36.3	37.3	2.7	2.8	0.5	0.5	30.2	31.0	4.9	5.0	0.7	0.8	75.3	77.3
Legal expenses	47	698.9	24.6	693.8	24.4	150.6	5.3	682.3	24.0	1,552.5	54.7	170.8	6.0	3,948.9	139.1
Fire	114	717.0	39.1	113.3	6.2	27.2	1.5	455.0	24.8	101.3	5.5	22.8	1.2	1,436.7	78.3
Burglary / theft	89	84.7	21.4	27.3	6.9	8.0	2.0	34.0	8.6	15.2	3.8	4.1	1.0	173.2	43.8
Water damage	89	61.0	24.2	27.7	11.0	6.8	2.7	24.8	9.8	10.0	4.0	2.7	1.1	132.9	52.8
Plate glass	118	18.6	3.3	28.9	5.2	7.2	1.3	4.7	0.8	3.7	0.7	1.5	0.3	64.6	11.5
Storm	88	19.7	8.2	18.9	7.9	2.9	1.2	11.8	4.9	10.9	4.5	2.0	0.8	66.2	27.6
Comp. home contents	132	207.8	8.6	99.4	4.1	29.1	1.2	51.1	2.1	20.2	0.8	6.5	0.3	414.1	17.2
Comp. residential bldg.	123	605.8	17.2	245.1	6.9	57.7	1.6	256.8	7.3	120.8	3.4	28.4	0.8	1,314.6	37.3
Hail	9	0.9	0.7	0.2	0.1	0.0	0.0	0.5	0.4	0.0	0.0	-	-	1.5	1.3
Livestock	10	17.9	28.8	5.4	8.7	1.1	1.7	2.7	4.3	2.7	4.3	0.2	0.4	30.0	48.3
Engineering	79	459.2	33.2	179.0	13.0	36.7	2.7	437.7	31.7	172.0	12.5	27.6	2.0	1,312.3	95.0
Multiple peril	13	1.4	9.6	1.8	12.0	0.4	2.5	3.5	23.8	0.7	4.9	0.5	3.1	8.3	55.9
Transport	67	594.8	41.4	75.0	5.2	26.6	1.9	656.5	45.7	168.5	11.7	33.2	2.3	1,554.6	108.1
Credit	16	660.6	61.2	167.0	15.5	27.3	2.5	522.1	48.4	176.2	16.3	31.6	2.9	1,584.8	146.8
Extended coverage	49	198.3	38.3	54.4	10.5	8.6	1.7	80.5	15.5	43.9	8.5	5.9	1.1	391.7	75.6
Business interruption	70	332.7	75.5	52.9	12.0	9.3	2.1	123.2	28.0	72.3	16.4	9.7	2.2	600.1	136.2
Assistance benefits	63	25.3	7.1	7.1	2.0	4.1	1.2	2.2	0.6	0.5	0.1	0.6	0.2	39.9	11.2
Aviation liability	26	223.4	175.2	10.9	8.5	13.6	10.7	195.3	153.1	23.8	18.6	7.9	6.2	474.9	372.3
Other	168	731.1	25.9	237.3	8.4	40.2	1.4	365.1	12.9	540.2	19.1	49.9	1.8	1,936.8	69.5
<b>Total</b>	<b>254</b>	<b>15,221.7</b>	<b>28.0</b>	<b>5,199.7</b>	<b>9.6</b>	<b>1,877.8</b>	<b>3.5</b>	<b>30,449.7</b>	<b>56.0</b>	<b>12,847.4</b>	<b>23.6</b>	<b>2,371.1</b>	<b>4.4</b>	<b>67,967.4</b>	<b>125.1</b>

<sup>1</sup> excl. gross provision for surrenders, refunds, and withdrawals outstanding

<sup>2</sup> including mathematical provisions for annuities, less receivables due to recourse claims, salvage recoveries, and loss-sharing agreements attributable to financial-year claims settled

<sup>3</sup> including mathematical provisions for annuities, less receivables due to recourse claims, salvage recoveries, and loss-sharing agreements attributable to previous years' claims settled

<sup>4</sup> in % of gross premiums earned

**Gross claims provisions (CP) used for settlement of insurance claims from previous years<sup>1</sup>**  
 – Direct business of property and casualty insurers in 2001 –

Table 534

Insurance segments	No.	CP carried forward from previous year <sup>2</sup>		Gross payments in FY for claims attr. to the previous years		Result from gross CP used for settl. of ins. claims from prev. years <sup>3</sup>		Premiums from sub. offs. in € '000 <sup>7</sup>	Interest alloc. to MP for annuities in € '000 <sup>13</sup>	Net settlement result in € '000 <sup>8</sup>
		Known claims <sup>4</sup> in € '000	Settlement expenses in € '000	Known claims <sup>5</sup> in € '000	Settlement expenses in € '000	Known claims <sup>6</sup> in € '000	Settlement expenses in € '000			
Health	2	15,911	4,372	12,197	1,079	2,866	725	75	-	3,760
Casualty	10	3,439,907	786,074	1,037,075	143,806	480,787	111,243	185	30,164	614,658
Liability	137	5,571,648	8,223,110	962,201	314,491	514,456	252,232	61	4,741	871,879
Motor (total), of which:	121	25,778,349	3,273,050	3,494,806	786,439	1,764,836	221,658	5,797	22,822	2,138,677
liability	119	24,774,279	2,797,474	2,957,055	413,358	1,466,841	65,276	6,006	22,507	1,711,603
full own damage	117	787,642	371,373	71,704	83,556	226,455	108,977	-220	0	311,647
partial own damage	115	163,864	82,036	69,128	27,480	64,867	39,741	12	-	100,642
accident	114	52,563	22,167	12,964	2,777	6,672	7,664	135	315	14,785
Aviation	19	47,505	5,550	28,560	3,982	11,233	-3,306	16,109	-	-50
Legal expenses	47	1,325,902	2,155,366	478,412	152,585	165,210	96,203	7	-	254,780
Fire	114	1,206,605	162,644	523,941	72,713	214,125	2,153	4	-	199,161
Burglary / theft	89	123,999	37,546	46,293	17,569	40,359	8,141	-	-	45,747
Water damage	89	83,947	32,058	34,983	19,217	21,763	5,265	-	-	25,063
Plate glass	118	24,658	29,810	7,875	10,311	3,435	7,331	-	-	6,820
Storm	88	41,461	31,336	17,628	4,420	7,951	10,063	-	-	15,868
Comp. home contents	132	257,596	115,650	141,273	36,124	59,035	36,835	-	-	86,874
Comp. residential bldg.	123	888,384	362,731	475,235	95,980	131,583	44,308	-	-	125,906
Hail	9	2,828	214	2,303	31	34	41	-19	-	56
Livestock	10	15,672	6,377	4,856	870	8,130	1,602	17	-	9,749
Engineering	79	918,952	316,409	312,969	47,714	150,131	43,348	600	-	180,325
Multiple peril	13	5,504	2,498	1,933	785	39	982	723	-	1,303
Transport	67	1,248,798	170,950	620,909	166,645	-28,520	-164,261	308,362	-	88,618
Credit	16	1,057,533	160,083	223,010	64,674	183,911	47,717	741	-	216,451
Extended coverage	49	255,393	106,834	114,264	73,235	54,687	-4,407	-	-	40,963
Business interruption	70	368,008	59,431	159,394	32,329	83,128	-42,842	1,895	-	36,199
Assistance benefits	63	25,712	8,192	16,022	6,071	7,101	3,456	-	-	8,828
Aviation liability	26	254,380	29,829	69,586	4,507	-11,187	2,263	24,461	21	16,554
Other	168	1,125,450	576,424	502,589	150,700	43,558	8,620	5,375	3	134,705
<b>Total</b>	<b>254</b>	<b>44,084,101</b>	<b>16,656,536</b>	<b>9,294,646</b>	<b>3,482,197</b>	<b>3,977,287</b>	<b>689,369</b>	<b>364,396</b>	<b>57,750</b>	<b>5,122,894</b>

<sup>1</sup> excluding gross provision for surrenders, refunds, and withdrawals outstanding

<sup>2</sup> after exchange rate changes

<sup>3</sup> taking into account gross claims provisions for claims from previous years (Table 533)

<sup>4</sup> including mathematical provisions for annuities, less receivables due to recourse claims, salvage recoveries, and loss-sharing agreements from insurance claims settled

<sup>5</sup> taking into account payments received from recourse claims, salvage recoveries, and loss-sharing agreements attributable to insurance claims from previous years

<sup>6</sup> taking into account payments received from recourse claims, salvage recoveries, and loss-sharing agreements (CPL) and the change in CPL receivables from previous years' claims settled

<sup>7</sup> Subsequent premiums received in the financial year (for previous claims/underwriting periods)

<sup>8</sup> Aggregate of columns 9 to 13

**Consolidated balance sheet for the industry**  
– Reinsurance undertakings –

Table 600

Balance sheet items	2001		2000		1999	
	in € '000	in % <sup>1</sup>	in € '000	in % <sup>1</sup>	in € '000	in % <sup>1</sup>
1	2	3	4	5	6	7
<b>Assets</b>						
1. Subscribed capital paid	131,904	0.07	142,769	0.10	155,675	0.11
2. Intangible assets	125,063	0.07	141,176	0.10	135,467	0.10
3. Investments, if not reported under no. 4	120,559,768	66.49	93,796,062	63.61	86,962,808	64.10
4. Dep. held by others under reinsurance contracts	44,029,665	24.28	40,269,338	27.31	37,708,645	27.79
5. Receivables (dir. ins. bus.) from policyholders	-	-	-	-	-	-
6. Receivables (dir. ins. bus.) from intermediaries	-	-	-	-	-	-
7. Prepaid expenses for interest and rent	490,076	0.27	488,247	0.33	535,469	0.39
8. Other assets	15,989,448	8.82	12,610,691	8.55	10,174,625	7.50
<b>Equity and Liabilities</b>						
1. Equity	31,582,030	17.42	25,225,119	17.11	24,031,332	17.71
2. Capital repr. by part. rights and subord. liabilities	997,846	0.55	835,692	0.57	815,159	0.60
3. Special item with reserve component	284,661	0.16	615,153	0.42	708,881	0.52
4. Technical provisions, net	94,763,375	52.26	84,558,654	57.35	79,129,341	58.32
5. Dep. held for others under reinsurance contracts	8,650,371	4.77	7,472,068	5.07	7,196,957	5.30
6. Payables (dir. ins. bus.) to policyholders	-	-	-	-	-	-
7. Other liabilities	45,047,641	24.84	28,741,597	19.49	23,791,020	17.54
<b>Balance sheet total</b>	<b>181,325,925</b>	<b>100.0</b>	<b>147,448,283</b>	<b>100.0</b>	<b>135,672,689</b>	<b>100.0</b>
<b>Number of companies</b>	<b>38</b>		<b>36</b>		<b>41</b>	

<sup>1</sup> in % of balance sheet total

## Investments schedule (excl. deposits with ceding insurers) 2001

– Reinsurance undertakings –

Table 610

Type of investment	Balance at beginning of period <sup>1</sup>		Additions			Reversal of impairment losses €m	Reclassifications €m	Disposals €m	Write-downs €m	Balance at end of period					
	€m	% <sup>2</sup>	€m	% <sup>2</sup>	% <sup>3</sup>					€m	€m	€m	€m	% <sup>2</sup>	% <sup>4</sup>
1															
Land, leasehold rights, and buildings	1,908	2.0	157	0.2	8.3	-	-	77	351	1,637	1.4	-14.2			
Interests in affiliated enterprises	45,081	47.9	25,195	36.6	55.9	-	+217	10,978	124	59,391	49.3	+31.7			
Loans to affiliated enterprises	4,163	4.4	3,589	5.2	86.2	57	+80	1,872	0	6,017	5.0	+44.6			
Participating interests	1,426	1.5	4,231	6.1	296.8	-	-4	1,433	14	4,207	3.5	+195.0			
Loans to undertakings linked by virtue of participation	132	0.1	22	0.0	16.7	3	-60	2	0	95	0.1	-28.1			
Equities	3,126	3.3	9,049	13.1	289.5	42	-227	5,358	267	6,364	5.3	+103.6			
Investment units	16,313	17.3	4,231	6.1	25.9	253	+13	3,527	116	17,167	14.2	+5.2			
Other, variable-yield securities	300	0.3	49	0.1	16.2	1	+2	81	3	268	0.2	-10.7			
Bearer bonds and other fixed-interest securities	13,566	14.4	18,612	27.0	137.2	111	-20	16,003	120	16,146	13.4	+19.0			
Loans secured by mortgages, land charges, and capital annuity charges	41	0.0	6	0.0	15.1	0	-	12	-	35	0.0	-13.8			
Registered bonds	4,047	4.3	553	0.8	13.6	0	+3	1,067	2	3,562	3.0	-12.6			
Certificates of debt and loans	2,091	2.2	391	0.6	18.7	-	+2	955	-	1,528	1.3	-26.9			
Loans and prepayments on insurance certificates	-	-	-	-	-	-	-	-	-	-	-	-			
Other loans	247	0.3	60	0.1	24.4	-	-5	0	1	301	0.2	+21.8			
Deposits with credit institutions	1,405	1.5	2,663	3.9	189.6	10	-	517	-	3,561	3.0	+153.5			
Other investments	207	0.2	81	0.1	39.1	29	-1	30	4	282	0.2	+36.4			
<b>Total investments</b>	<b>94,077</b>	<b>100.0</b>	<b>68,890</b>	<b>100.0</b>	<b>73.2</b>	<b>506</b>	<b>-</b>	<b>41,911</b>	<b>1,002</b>	<b>120,560</b>	<b>100.0</b>	<b>+28.2</b>			
<b>Number of companies</b>															

38

<sup>1</sup> exchange rate value as at end of financial year

<sup>2</sup> in % of total investments

<sup>3</sup> in % of balance at beginning of period

<sup>4</sup> change (balance at beginning less balance at end of period) in % of balance at beginning of period

**Equity, capital represented by participation rights,  
and subordinated liabilities  
– Reinsurance undertakings – (in € '000)**

Table 620

Balance sheet items	Total 2001	Total 2000
1	2	3
1. Issued capital <sup>1</sup>	3,389,687	3,242,308
2. Capital reserves	22,114,793	15,279,005
of which pursuant to Section 5(5) no. 3 VAG	-	-
3. Revenue reserves		
a) legal reserves <sup>2</sup>	8,238	8,832
b) reserves for treasury shares	210,856	2,387
c) statutory reserves	48,818	47,380
d) reserves pursuant to Section 58(2a) AktG	-	-
e) other reserves	5,071,994	4,921,677
4. Acc. profit carried forward <sup>3</sup>	1,464	6,927
Acc. loss carried forward <sup>3</sup>	5,221	4,372
5. Net profit for the period <sup>3</sup>	11,661	120,822
Net loss for the period <sup>3</sup>	59,288	9,845
6. Unappropriated retained earnings [acc. profit available for distribution] <sup>3</sup>	862,981	1,609,999
Accumulated losses <sup>3</sup>	73,952	-
Total equity	31,582,030	25,225,119
Less capital not yet paid in	131,904	142,769
Total equity available	31,450,126	25,082,350
Equity in % of gross premiums written	69.5	63.0
Equity in % of net premiums written	95.0	85.6
Capital represented by participation rights	730,701	738,547
Subordinated liabilities	267,145	97,145
<b>Number of companies</b>	<b>38</b>	<b>36</b>

members' funds in the case of VVaG; in the case of public insurance undertakings, the item equivalent to issued capital loss reserve pursuant to Section 37 VAG in the case of VVaG; safety reserve in the case of public insurance undertakings pursuant to Section 268(1) HGB, items 4 and 5 are replaced by item 6 if the principle of "teilweise Gewinnverwendung" (partial appropriation of profits) is applied

**Technical provisions**  
– Reinsurance undertakings –

Table 630

Balance sheet item	2001		2000		1999	
	Gross in € '000	Net in € '000	Gross in € '000	Net in € '000	Gross in € '000	Net in € '000
1	2	3	4	5	6	7
1. Unearned premiums	7,904,314	6,564,563	6,278,889	5,048,941	5,537,235	4,396,441
2. Mathematical provisions	39,325,445	32,744,631	37,405,829	31,396,053	34,523,148	28,497,800
3. Provisions for claims outstanding, surrenders, refunds, and sums granted upon withdrawal	66,924,048	47,638,013	52,605,570	40,245,232	50,424,771	38,384,367
4. Provisions for premium refunds	170,226	101,351	167,413	100,526	163,263	101,194
5. Equalisation provision and similar provisions	6,511,462	6,511,462	6,698,633	6,698,633	6,617,975	6,617,975
6. Other technical provisions	1,470,517	1,262,310	1,369,302	1,069,270	1,428,427	1,140,580
Total	122,306,011	94,822,328	104,525,634	84,558,654	98,694,818	79,138,357
<b>Number of companies</b>		38		36		41

**Technical provisions**  
– Reinsurance undertakings 2001 –

Table 631

Insurance segments	No.	Gross unearned premiums		Gross mathematical provision		Gross provision for claims outstanding <sup>1</sup>			Gross provision for premium refund		Other gross technical provisions <sup>2</sup>		Equalisation provision and similar provisions		
		€m	% <sup>3</sup>	€m	% <sup>3</sup>	€m	% <sup>3</sup>	€m	% <sup>3</sup>	€m	% <sup>3</sup>	€m	% <sup>4</sup>	€m	% <sup>4</sup>
		3	4	5	6	7	8	9	10	11	12	13	14	15	16
1	2														
Life	25	1,950.2	19.6	36,175.5	363.4	1,092.60	11.0	908.8	9.1	-	-	210.0	2.1	-	-
Health	23	71.4	4.2	899.7	53.4	211.9	12.6	573.1	34.0	11.1	0.7	16.4	1.0	-	-
Casualty	28	172.7	11.5	2,262.3	150.2	535.6	35.5	1,142.7	75.8	132.1	8.8	39.0	2.6	91.4	7.9
Liability	28	846.0	21.0	-	-	3,160.0	78.4	15,350.1	380.7	6.5	0.2	54.3	1.3	1,604.6	53.4
Motor	29	847.4	10.9	-	-	3,278.1	42.2	12,212.6	157.1	0.7	0.0	320.8	4.1	931.9	15.8
Aviation	21	332.3	29.2	-	-	834.4	73.3	2,002.8	175.8	0.0	0.0	0.8	*****	24.5	4.5
Legal expenses	17	81.4	22.2	-	-	180.8	49.4	266.5	72.8	0.4	0.1	2.7	0.7	59.6	22.7
Fire	28	1,290.7	18.6	-	-	7,690.4	111.0	3,911.50	56.5	0.9	0.0	399.7	5.8	1,325.9	28.3
Burglary / theft	22	46.3	19.8	-	-	64.4	27.6	64.8	27.7	0.1	0.0	1.2	0.5	46.8	25.3
Water damage	20	7.1	11.8	-	-	25.5	42.5	14.6	24.4	0.0	0.0	1.0	1.6	15.0	32.2
Plate glass	13	15.1	24.3	-	-	5.3	8.4	0.7	1.2	0.0	0.0	6.0	9.6	0.6	1.3
Storm	25	73.4	12.1	-	-	342.9	56.6	229.6	37.9	0.0	0.0	34.5	5.7	393.7	107.3
Comp. home contents	24	103.8	22.0	7.5	1.6	68.5	14.5	77.9	16.5	0.1	0.0	45.4	9.6	62.5	17.4
Comp. residential bldg.	26	155.7	17.2	-	-	222.0	24.6	90.2	10.0	0.2	0.0	30.7	3.4	364.5	61.9
Hail	19	9.5	2.1	-	-	76.1	17.3	16.6	3.8	-	-	3.1	0.7	75.9	19.9
Livestock	12	9.2	13.5	-	-	18.8	27.7	8.7	12.9	-	-	0.1	0.2	29.0	62.8
Engineering	25	723.2	37.1	-	-	1,008.7	51.7	1,894.3	97.1	2.2	0.1	22.2	1.1	311.5	21.7
Multiple peril	4	0.3	19.1	-	-	0.3	17.0	0.3	19.2	-	-	0.0	0.2	2.6	158.4
Transport	28	169.2	8.3	-	-	1,328.9	64.8	1,859.4	90.7	2.3	0.1	8.8	*****	108.5	7.4
Credit	20	433.0	30.0	-	-	688.3	47.7	1,095.7	75.9	12.9	0.9	13.2	0.9	512.8	44.9
Extended coverage	19	31.8	7.1	-	-	174.8	39.3	127.0	28.5	-	-	9.6	2.2	48.8	20.4
Business interruption	21	76.1	18.2	-	-	373.6	89.2	345.9	82.5	0.3	0.1	10.0	2.4	189.4	73.3
Assistance benefits	8	1.8	17.3	-	-	1.0	9.9	0.4	3.9	-	-	0.1	0.5	0.6	8.5
Aviation liability	15	213.4	52.3	-	-	919.6	225.2	943.7	231.1	0.0	*****	5.9	1.5	1.2	0.9
Other	33	227.8	24.0	0.0	0.0	442.1	46.5	565.3	59.5	0.3	0.0	255.1	26.8	312.6	55.4
Total	36	7,889.8	18.0	39,345.0	89.6	22,760.6	51.8	43,713.0	99.5	170.2	0.4	1,471.3	3.4	6,513.80	20.5

<sup>1</sup> including mathematical provisions for annuities and gross provision for surrenders, refunds, and withdrawals outstanding

<sup>2</sup> including provision for impending underwriting losses

<sup>3</sup> in % of gross premiums earned

<sup>4</sup> in % of net premiums earned

**Income statement (selected items)**  
– Reinsurance undertakings –

Table 640

Items	2001		2000		1999	
	in € '000	in % <sup>1</sup>	in € '000	in % <sup>1</sup>	in € '000	in % <sup>1</sup>
1	2	3	4	5	6	7
1. Gross premiums written	45,459,921		40,011,882		35,595,735	
of which accepted from foreign ceding insurers	25,233,912	55.5	20,427,324	51.1	16,703,345	46.9
2. Gross premiums earned	43,912,267	100.0	39,329,662	100.0	35,354,143	100.0
3. Net premiums earned	31,808,193	72.4	28,842,800	73.3	26,147,368	74.0
4. a) Gross claims expense of the financial year	35,818,816	81.6	26,089,663	66.3	27,946,064	79.0
b) Net claims expense of the financial year	24,484,647	77.0	19,641,189	68.1	19,594,866	74.9
5. a) Gross claims expense in the financial year <sup>2</sup>	40,507,606	92.2	28,348,568	72.1	28,530,651	80.7
b) Net claims expense in the financial year <sup>2</sup>	26,684,739	83.9	20,822,635	72.2	19,755,472	75.6
6. a) Gross insurance operating expense	13,257,861	30.2	12,099,369	30.8	10,530,547	29.8
b) Net insurance operating expense	10,003,035	31.4	9,126,207	31.6	7,953,178	30.4
7. a) Gross underwriting result <sup>3</sup>	-11,517,267	-26.2	-3,339,641	-8.5	-5,377,826	-15.2
b) Net underwriting result <sup>4</sup>	-6,119,129	-19.2	-2,794,618	-9.7	-2,940,625	-11.2
8. Investment income	12,228,685	38.4	10,716,362	37.2	9,684,363	37.0
of which: current income <sup>5</sup>	8,613,097	27.1	7,962,402	27.6	7,174,754	27.4
9. Investment expense	2,992,323	9.4	2,098,172	7.3	1,977,376	7.6
of which: current expense <sup>5</sup>	1,346,756	4.2	1,063,099	3.7	767,763	2.9
10. Net profit/loss for the period <sup>6</sup>	307,510	1.0	2,173,642	7.5	1,435,956	5.5
<b>Number of companies</b>		<b>37</b>		<b>36</b>		<b>39</b>

<sup>1</sup> in % of gross premiums earned; of which item in 1. in % of total gross premiums written; items 4. b), 5. b), 6. b), 7. b), 8. b), 9. b) and 10 in % of net premiums earned

<sup>2</sup> including result from gross claims provisions (CP) carried forward from previous year and used for settlement of insurance claims outstanding

<sup>3</sup> before gross expense for performance-related premium refunds

<sup>4</sup> before change in equalisation provision and similar provisions; corresponds with item 1.9 Formblatt 2 RechVersV

<sup>5</sup> in accordance with attribution in NW 201 of BerVersV

<sup>6</sup> corresponds with item II. 14 Formblatt 2 RechVersV

**Summary of individual insurance segments**  
– Reinsurance undertakings 2001 –

Table 641

Insurance segment	No.	Gross premiums earned		Net premiums earned		Insurance claims expense of the FY		Insurance claims expense in the FY <sup>1</sup>		Insurance operations expense		Underwriting result		
		in € '000	% <sup>2</sup>	in € '000	% <sup>3</sup>	gross in % <sup>3</sup>	net in % <sup>4</sup>	gross in % <sup>3</sup>	net in %	gross in % <sup>3</sup>	net in %	gross in % <sup>3</sup>	net <sup>4</sup> in % <sup>5</sup>	net <sup>4</sup> in % <sup>6</sup>
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Life	25	9,955,539	22.7	7,754,054	77.9	50.4	56.6	49.0	51.8	37.1	34.3	0.4	2.5	2.5
Health	23	1,685,197	3.8	1,231,139	73.1	46.4	59.2	83.5	84.0	21.9	26.0	-7.7	-13.1	-13.1
Casualty	28	1,506,712	3.4	1,164,514	77.3	43.8	44.8	41.8	43.0	36.9	37.6	4.1	4.8	5.5
Liability	28	4,031,922	9.2	3,003,787	74.5	88.7	92.3	107.2	99.2	31.5	32.6	-38.2	-32.0	-27.4
Motor	29	7,772,012	17.7	5,879,951	75.7	82.6	84.1	79.2	81.5	23.0	22.7	-2.4	-4.6	-9.1
Aviation	21	1,138,992	2.6	549,504	48.2	89.0	58.6	210.3	184.1	16.0	27.9	-125.8	-111.9	-97.4
Legal expenses	17	366,067	0.8	262,823	71.8	67.1	71.9	55.9	54.8	39.5	40.3	4.4	4.9	-2.6
Fire	28	6,926,505	15.8	4,689,280	67.7	139.2	116.3	146.9	124.1	28.1	32.4	-75.1	-59.1	-59.9
Burglary / theft	22	233,727	0.5	184,784	79.1	59.5	61.2	60.4	62.5	38.8	41.2	0.7	-3.8	1.6
Water damage	20	59,942	0.1	46,560	77.7	78.6	85.0	67.0	68.1	34.9	37.0	-2.6	-5.9	-1.2
Plate glass	13	62,275	0.1	44,056	70.7	43.8	44.3	43.3	43.6	47.1	46.4	6.5	5.6	5.4
Storm	25	605,922	1.4	367,000	60.6	66.9	82.0	78.1	98.8	19.3	25.1	2.0	-24.9	-33.6
Comp. home contents	24	471,360	1.1	359,134	76.2	47.0	48.2	45.7	46.3	45.9	48.6	4.3	10.2	7.4
Comp. residential bldg.	26	903,546	2.1	588,450	65.1	60.8	63.0	58.4	61.4	35.0	39.1	5.6	-1.6	-1.9
Hail	19	439,971	1.0	380,842	86.6	77.1	79.4	84.1	83.6	18.6	19.4	-2.4	-2.8	-6.8
Livestock	12	67,807	0.2	46,180	68.1	53.2	49.2	60.0	62.5	29.4	28.9	10.5	8.6	-5.7
Engineering	25	1,950,500	4.4	1,436,588	73.7	71.2	68.0	86.3	89.2	35.5	38.1	-21.9	-27.4	-25.8
Multiple peril	4	1,654	0.0	1,622	98.1	34.8	35.2	23.1	23.1	44.8	45.4	32.1	31.5	27.3
Transport	28	2,050,149	4.7	1,462,236	71.3	86.9	69.4	123.5	106.3	25.9	31.1	-48.6	-36.3	-34.2
Credit	20	1,443,462	3.3	1,141,881	79.1	65.5	66.1	77.3	78.3	39.2	41.1	-17.0	-19.7	-5.0
Extended coverage	19	445,252	1.0	239,026	53.7	72.8	72.1	69.2	68.9	26.1	31.4	3.9	-0.9	-7.6
Business interruption	21	419,092	1.0	258,204	61.6	129.9	91.3	141.9	112.3	27.5	29.9	-72.4	-45.0	-31.9
Assistance benefits	8	10,245	0.0	7,530	73.5	38.4	44.1	33.1	38.2	48.1	45.3	18.9	16.2	10.1
Aviation liability	15	408,335	0.9	139,755	34.2	230.3	147.7	353.2	208.8	15.6	-17.5	-269.2	-92.8	-49.2
Other	33	950,925	2.2	564,140	59.3	78.4	77.3	84.7	85.0	33.6	33.4	-16.1	-19.9	-7.9
<b>Total</b>	<b>36</b>	<b>43,911,951</b>	<b>100.0</b>	<b>31,808,024</b>	<b>72.4</b>	<b>81.6</b>	<b>77.0</b>	<b>92.2</b>	<b>83.9</b>	<b>30.2</b>	<b>31.4</b>	<b>-26.2</b>	<b>-19.2</b>	<b>-18.6</b>

<sup>1</sup> including result from gross claims provisions (CP) carried forward from previous year and used for settlement of insurance claims outstanding

<sup>2</sup> in % of total gross premiums earned

<sup>3</sup> in % of gross premiums earned

<sup>4</sup> in % of net premiums earned

<sup>5</sup> before change in equalisation provision and similar provisions; corresponds with item 1.9 Formblatt 2 RechVersV

<sup>6</sup> before change in equalisation provision and similar provisions; corresponds with item 1.11 Formblatt 2 RechVersV

**Selected financial ratios of reinsurers 2001<sup>1</sup>**  
 – ranked according to gross premiums earned –

Table 660 (1)

Ranking	Name of insurer	Gross premiums earned €m	Net premiums earned €m	Claims ratio <sup>2</sup>		CP ratio <sup>3</sup>		Expense ratio <sup>4</sup>		Net u.w. result		Investments <sup>5</sup>			Net result FY <sup>6</sup> % <sup>12</sup>
				gross % <sup>11</sup>	net % <sup>12</sup>	gross % <sup>11</sup>	net % <sup>12</sup>	gross % <sup>11</sup>	net % <sup>12</sup>	before eq. pr. <sup>7</sup> % <sup>12</sup>	after eq. pr. <sup>8</sup> % <sup>12</sup>	Balance at end of FY €m	Current yield <sup>9</sup> %	Net yield <sup>10</sup> %	
1	2	43,912	31,808	5	6	7	8	9	10	11	12	13	14	15	16
	<b>Industry Σ</b>														
1	MÜNCHEN RÜCK.	14,533	12,789	95.3	87.3	152.4	149.8	30.2	31.4	-19.2	-18.6	164,589	5.8	6.2	1.0
2	ALLIANZ AKTIENGESLL.	5,642	3,502	99.3	93.0	141.5	128.2	27.5	26.8	-21.1	-18.4	48,655	7.4	9.2	3.4
3	HANNOVER RÜCK	5,452	2,736	97.5	74.8	160.7	188.5	30.0	27.0	-12.0	-8.9	60,489	4.5	4.3	15.6
4	GERLING-K. GLOB. RÜCK	3,065	2,530	108.1	93.8	165.3	148.5	27.4	30.0	-28.7	-25.6	9,116	4.4	5.7	0.0
5	GE FRANKONA RE	2,767	1,629	144.2	112.0	246.2	169.9	22.9	34.2	-45.9	-49.5	7,095	4.5	4.4	-17.4
6	KOELNISCHE RÜCK	2,692	2,239	83.2	82.1	147.5	154.9	31.2	31.3	-16.0	-14.2	5,238	5.0	5.4	-18.0
7	E+S RÜCK	1,859	1,041	83.4	80.5	188.9	229.5	35.2	25.9	-14.3	-12.0	6,432	5.4	5.6	-1.9
8	SWISS RE GERMANY	1,744	1,634	87.1	79.4	162.9	165.6	31.6	32.7	-14.1	-13.5	3,603	4.6	6.6	1.2
9	AMB GENERALI HOLDING	1,058	366	64.5	55.8	80.1	66.7	30.6	35.8	-1.1	-8.6	4,830	4.6	3.4	-
10	R+V VERS.	1,011	599	66.8	68.8	80.1	70.6	29.7	31.5	-5.6	-7.4	3,617	9.4	10.1	39.4
11	CONVERIUM RÜCK	594	486	96.0	90.5	102.3	99.5	28.6	30.7	-18.2	-16.3	2,449	6.1	6.0	6.1
12	WÜSTENROT & WÜRTEMB.	592	373	70.5	75.3	98.2	97.5	30.4	31.2	-5.0	-5.1	1,371	8.9	8.9	-5.0
13	DT. RÜCKVERSICHERUNG	519	225	54.6	55.6	69.0	105.5	28.7	27.2	10.0	2.0	3,417	5.0	-0.5	-43.2
14	VICTORIA RÜCK	379	343	73.4	73.8	137.7	139.4	29.1	29.4	-8.6	-10.4	589	5.2	5.6	4.3
15	VERS.BAYERN K.-RÜCK	334	176	72.7	65.5	112.3	108.0	22.6	23.3	11.7	7.4	963	6.3	6.6	-
16	GOTHAER RÜCK	313	280	76.8	80.7	209.6	169.9	28.9	30.0	-12.3	-13.7	301	4.6	0.2	3.4
17	VERBAND OFFENT. LEBEN	293	262	62.6	65.8	305.8	313.8	38.3	39.5	-4.9	-15.1	719	6.4	7.8	0.0
18	SCOR DEUTSCHLAND RÜCK	219	150	58.0	55.2	145.9	179.3	26.4	16.0	-21.5	-16.7	926	5.6	6.2	0.6
19	EUROPA RÜCK	183	163	131.7	115.7	157.3	143.7	16.4	18.1	-33.9	-22.8	448	4.1	3.5	-9.8
20	MANNHEIMER AG HOLDING	157	33	63.7	68.9	75.6	68.2	35.2	27.8	1.7	13.5	290	5.6	7.3	-11.7
21	DBV-WINTERTHUR RÜCK	146	102	75.2	75.5	117.2	89.6	28.7	33.1	-11.0	-10.1	498	8.2	8.6	93.0
22	ZÜRICH-AGRIPPINA BET	95	25	147.1	146.3	180.9	143.3	15.1	10.6	-56.9	-66.5	336	5.1	-0.1	-20.0
23	SPARK.-VERS. BADEN-W.	70	21	21.5	58.0	67.4	155.7	14.4	34.4	2.3	-4.9	1,245	14.7	10.6	268.3
24	DEVK RÜCKVERSICHER.	45	39	54.2	55.0	35.6	36.6	35.4	35.8	8.3	12.1	636	4.7	4.8	107.4
25	DELVAG RÜCK	41	25	66.6	75.3	128.6	116.4	17.9	21.9	-14.1	-7.1	615	3.1	2.7	9.3
26	D.A.S. INTERNAT. RÜCK	38	18	65.1	67.0	99.4	102.3	35.3	36.6	-2.3	-2.3	85	4.2	3.0	-2.9
27	RISICOM RÜCK	21	9	134.0	131.3	204.7	361.8	9.2	20.8	-52.3	-0.7	102	5.6	5.0	1.4
28	LUCURA RÜCK	17	2	230.3	274.5	120.9	282.0	5.8	-54.0	-155.1	-97.8	42	2.3	0.1	-1.4
29	KRAVAG-HOLDING AG	13	1	5.2	-27.0	*****	*****	5.2	-4.3	145.4	112.3	138	5.2	4.5	208.7
30	KIELER RÜCK	13	3	38.8	38.4	22.2	21.1	37.6	24.1	37.6	30.4	5	6.9	5.5	274.1

**Selected financial ratios of reinsurers 2001<sup>1</sup>**  
 – ranked according to gross premiums earned –  
 (continued)

Table 660 (2)

Ranking	Name of insurer	Gross premiums earned		Net premiums earned		Claims ratio <sup>2</sup>		CP ratio <sup>3</sup>		Expense ratio <sup>4</sup>		Net u.w. result			Investments <sup>5</sup>			Net result FY <sup>6</sup>	
		€m	3	€m	4	gross % <sup>11</sup>	net % <sup>12</sup>	gross % <sup>11</sup>	net % <sup>12</sup>	gross % <sup>11</sup>	net % <sup>12</sup>	before eq. pr. <sup>7</sup> % <sup>12</sup>	after eq. pr. <sup>8</sup> % <sup>12</sup>	Balance at end of FY	Current yield <sup>9</sup> %	Net yield <sup>10</sup> %	% <sup>12</sup>		
1	2																		
	<b>Industry Σ</b>	43,912	3	31,808	4	95.3	5	87.3	6	7	8	9	10	11	12	13	14	15	16
31	HANSEATICA RÜCK	12		11		114.5		134.0		321.0		39.8	43.3	-74.9	-18.6	164,589	5.8	6.2	1.0
32	MANULIFE EUROPE RÜCK	5		397.7		397.7		662.6		662.6		26.5	26.5	-324.2	-75.5	50	5.0	4.9	-56.3
33	PREUSSAG GMBH	3		71.9		71.9		33.3		103.0		24.4	43.2	19.8	-0.5	37	3.0	3.0	-
34	HUK-COBURG HOLDING	2		43.9		43.9		13.7		13.7		46.7	46.7	9.4	9.4	188	9.3	5.7	0.0
35	ARAG INTERNATIONAL	0		247.0		247.0		247.0		*****		23.9	23.9	-171.0	-171.0	49	4.9	5.5	215.5
36	GERMANIA REASSEC.	-		-		-		-		-		-	-	-	-	-	-	-	339.0
37	DIEHL ASSEKUR. RÜCK.	-		-		-		-		-		-	-	-	-	-	-	-	-
38	GENERALI LLOYD AG	-		-		-		-		-		-	-	-	-	-	-	-	-
39	RACE CAR COVER RÜCK	-		-		-		-		-		-	-	-	-	-	-	-	-
40	EUROPEAN SPECIALITY	-12		-12		102.5		108.8		*****		0.9	0.9	-9.7	-6.3	7	3.9	2.7	-

<sup>1</sup> includes annual financial statements as at September and December of the reporting period, as well as June of the subsequent year

<sup>2</sup> including expense for surrenders, refunds, and withdrawals

(claims ratio in FY including result from gross claims provisions (CP) carried forward from previous year and used for settlement of insurance claims outstanding)

<sup>3</sup> provision for claims outstanding, including surrenders, refunds, and withdrawals (item E III. of Formblatt 1 RechVersV)

<sup>4</sup> total insurance operating expense

<sup>5</sup> including funds held by others under reinsurance contracts

<sup>6</sup> net profit/net loss (item II. 14 of Formblatt 2 RechVersV)

<sup>7</sup> before change in equalisation provision and similar provisions (item I. 9 of Formblatt 2 RechVersV)

<sup>8</sup> after change in equalisation provision and similar provisions (item I. 11 of Formblatt 2 RechVersV)

<sup>9</sup> item II. 1. a), b), and e) of Formblatt 2 RechVersV in % of arithmetic mean of investments at beginning and end of reporting year

<sup>10</sup> item II. 1., less item II. 2 of Formblatt 2 RechVersV in % of arithmetic mean of investments at beginning and end of reporting year

<sup>11</sup> in % of gross premiums earned

<sup>12</sup> in % of net premiums earned