

BaFin



'06

**Annual Report**

**Federal Financial Supervisory Authority**

**(Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)**





## President's Statement



Last year was marred by a serious case of in-house corruption which shook BaFin and affected me personally. The matter tarnished our reputation and overshadowed the excellent performance of BaFin's employees in the public's eyes. The situation is extremely regrettable, since last year we further enhanced the quality of our supervisory services.

During 2006, we enthusiastically focused our efforts on modernising our services. The report at hand details the progress we made last year. Our aim is to provide principle-based, risk-oriented and high-quality supervisory services. We are already well on the way to achieving our aim – a view which those involved also appear to share: around 40 per cent of the banks the German Institute for Economic Research questioned anonymously in 2006 thought that German supervisory services had improved since the foundation of BaFin. Moreover, three-quarters of those questioned regard our services as an "opportunity to structure their business procedures in line with the market".

We are, of course, delighted about the positive response. However, this is no reason for us to relax our efforts. Everyone wants to improve. At a time when ongoing changes in the financial markets seem the only constant, we must continue to develop in order to meet new multifaceted requirements. A large number of them originate from Brussels, where most financial market regulations are devised.

For the European financial sector, the regulations must be implemented uniformly and applied consistently in order to fulfil the objectives of the single European market, also with regard to supervisory services. The target can be reached only if national controllers develop a pan-European supervisory culture. This year, all the EU committees and bodies concerned will be focusing on this task. BaFin, too, will remain committed to helping achieve this aim as quickly as possible.

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 Highlights



Karl-Burkhard Caspari,  
Deputy President

## Basel II

Summer 2006 marked the end of a long process, as the revised Banking Directive and the Capital Adequacy Directive came into force on 20 July 2006, implementing the provisions of Basel II throughout the Member States of the European Union and the European Economic Area. In Germany, the directives were transposed into national law on schedule. The act to implement the redefined European Banking Directive and redefined European Capital Adequacy Directive now ensures that the necessary amendments have been made to various German laws, most notably the Banking Act (Kreditwesengesetz – KWG). The German Solvency Ordinance (Solvabilitätsverordnung – SolvV) transposes into national law the detailed requirements for calculating minimum regulatory capital for credit risks, market risks and operational risks of financial institutions, as well as the disclosure requirements. The amended Ordinance governing large exposures and loans of €1.5 million or more (Großkredit- und Millionenkreditverordnung – GroMiKV) now includes the details of the rules governing large exposures as defined in the two EU directives. The national laws transposing Basel II mostly came into force on 1 January 2007. The exceptions to this, however, include some provisions of SolvV and GroMiKV, which will not apply until 1 January 2008.

In transposing the Directives into German national law, policymakers took advantage of the margin of discretion provided by the Banking Directive and the Capital Adequacy Directive to take account of the particular characteristics of German institutions. Proposals on how to ensure that the new regulations could be implemented in a practical fashion were contributed by, among others, the Implementation of Basel II Working Group. This group is composed of members representing BaFin and the Bundesbank, as well as other institutions and their associations.

## Transparency Directive Implementation Act

The Transparency Directive Implementation Act (Transparenzrichtlinie-Umsetzungsgesetz – TUG) entered into force on 20 January 2007 and marked the transposition of the provisions of the EU Transparency Directive into German law. The aim of the TUG is to improve transparency on the capital market, in the interests of both market efficiency and investor protection.

The TUG modifies the obligation on shareholders to disclose and publish changes in their voting rights. Furthermore, it redefines the rules regarding publication of important capital-market information.

● National characteristics considered.

The aim is to keep investors informed with regard to key participating interests of holders of voting rights and to provide investors with access to reliable, complete and up-to-date information on the issuers of securities. This information should help investors to assess the operating results and economic situation of a given company. The main criterion for application of the new rules is that the issuer's registered office is located in Germany. Previously, the criterion was that an issuer was licensed on an exchange in Germany. The advantage of this redefinition as far as issuers are concerned is that, in most cases, they now need deal with only one legal system and one supervisory authority.

### **VVG Reforms**

In October 2006, the Federal Cabinet agreed the draft legislation to reform the Insurance Contract Act (Versicherungsvertragsgesetz – VVG). The intention of policymakers in introducing these reforms is to improve consumer protection, achieve a better balance of interests between insurers and policyholders and to modernise the life insurance system. BaFin too submitted a position on this bill. One of the most important proposed changes is the removal of the all or nothing or full compensation principle. Currently, insurers do not have to pay out if breaches of duties and obligations can be attributed to gross negligence on the part of the policyholder. In the future, the severity of the fault of the policyholder will determine the amount that the insurer can be expected to pay.

The reforms also target revision of the current method of concluding insurance policies – the so-called Policenmodell. This means that, in future, insurers will be obliged to provide copies of their terms and conditions and other consumer information before customers agree to conclude an insurance contract. Until now, it has been normal practice for this information only to be sent out with the policy document.

The draft law contains a further improvement in the area of life insurance. New customers should now have a legally defined claim to a surplus bonus, while departing customers will be entitled to participate in the hidden reserves when their contract ends. Until now, customers have only been able to share in any valuation reserves that have been realised. Furthermore, the bill also defines minimum surrender values.

A further innovation has been introduced in the realm of private liability insurance. Claimants can now make claims directly against the liability insurer, as was previously only the case in relation to vehicle liability insurance. This direct claim route improves protection of claimants, when, for example, they are unable to reach agreement with the damaging party.

### **Open-ended real estate funds**

Capital investment companies saw the significant outflow of funds during the first quarter of 2006 as an opportunity to realign their portfolios. Investments in overweight locations – mainly within

Germany – were reduced. With demand from foreign investors for real estate in Germany at very high levels, these companies were able to make spectacular sales of high-volume sub-portfolios, achieving prices above the book values. For example, in December 2006 DB Real Estate sold property from its Grundbesitz-Invest fund amounting to over €2 billion to a subsidiary of Fortress. DB Real Estate valued the additional proceeds from the sale at around €200 million.

● Inflow of funds normalised.

Since the second quarter of 2006, the inflow of investment into real estate retail funds has largely returned to normal. It appears that the confidence of investors in open-ended real estate funds has not suffered, and that the temporary suspension of the redemption of unit certificates has not had any long-term effect on the results of the funds. At the start of 2006, the suspension of the redemption of unit certificates in the case of DB Real Estate's Grundbesitz-Invest fund and two funds of the KanAm company did give rise to a short period of unease. During the year under review, however, the situation of open-ended real estate funds became calm once more, and since April 2006, there have no longer been any restrictions on the redemption of fund units for either company.

### **Privatbank Reithinger**

During the year under review, BaFin withdrew permission for Privatbank Reithinger GmbH & Co. KG to conduct banking operations. The reason for this action was that the institution had recorded sustained losses and was enmeshed in a corporate structure that was so unclear as to compromise supervision. In order to protect the Bank's creditors, BaFin accompanied the withdrawal of its permission with the declaration of a moratorium. It transpired that the Reithinger bank was no longer in a position from which it could be saved. In the interim period, insolvency proceedings have been started against the institution at the request of BaFin.

### **Guarantee funds**

It has been possible to issue guarantee funds in Germany since the end of 2005. The aim of this move was to improve the competitive situation of German funds. During the year under review, in order to complete the supervisory framework for guarantee funds, BaFin consulted on a circular that regulates the capital adequacy requirement for investment companies' minimum commitment. BaFin published this circular in February 2007.<sup>1</sup> Guarantee funds are a form of investment fund. The investment company that manages the fund guarantees investors that they will receive a minimum specified percentage of the issue value when they redeem their units. This guarantee applies irrespective of how the fund subsequently performs.

<sup>1</sup> Circular 2/2007 (BA).



## II Economic environment

### 1 Financial markets

● Stable growth.

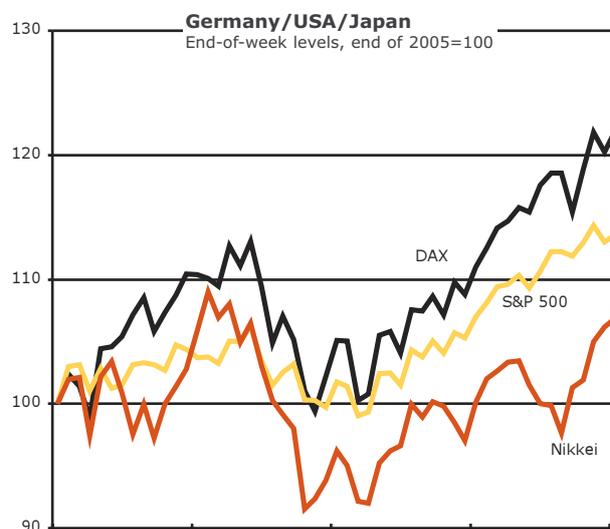
International capital markets proved very robust in 2006. The primary reason can be traced to the stability of growth in the global economy. Even international crises, such as when the conflict in the Middle East intensified around the middle of the year, could only put a temporary brake on the generally upwards trend on the stock exchanges. The volatility of the stock markets fell during the second half of the year to its lowest level for many years. The corporate bond markets registered no problems, owing to low loan default rates and mainly positive business prospects, even though spreads increased slightly over the year from a low initial level. The general trend of growth and stability carried over to the German financial sector, which gained in value overall in 2006.

● Robust upward movement on the international stock markets.

Trends on stock exchanges around the world developed in the same direction. The largest international stock indices started 2006 with the same momentum enjoyed during the previous year. At the mid-year point, prices fell, due to factors such as the conflict in the Middle East and the rising price of oil. Nevertheless, positive economic reports from around the world and a flourishing M&A market with continued expectations of mergers soon buoyed the global stock markets again. The easing of tension in the Middle East and the ensuing slight drop in the price of oil also pushed equity prices upwards. At the end of November, surprisingly

Figure 1

#### Stock markets in comparison, 2006



Source: Bloomberg

● Positive development of DAX.

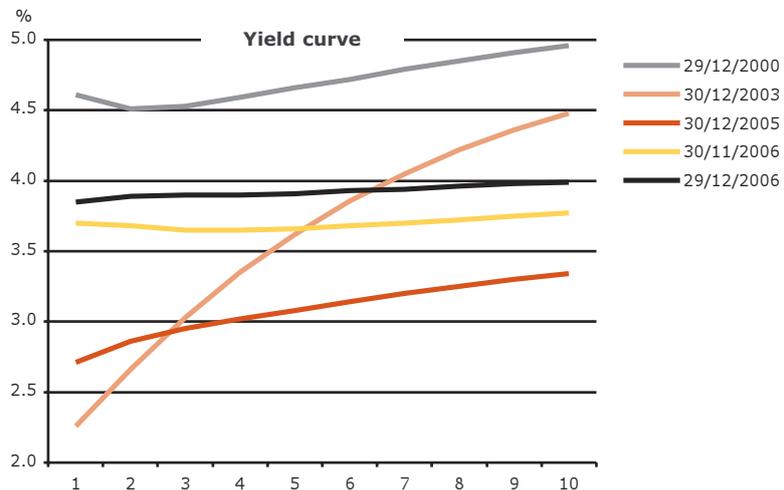
negative figures from the US economy led to slight falls around the world, but prices had returned to their previous levels by the end of the year. By 2006, stock markets had already experienced four years of growth, and they were to end the year at new all-time dollar highs in Europe and the USA. It is notable that the stock exchanges continued to develop positively despite continual hikes in short-term interest rates in Europe and the USA during 2006.

● Ever flatter yield curve in Europe.

As with the international markets, the performance of the German DAX stock index was also characterised by a general upward trend that was interrupted only by a slight fall in the middle of the year. In the autumn, the DAX broke the 6,000 point barrier for the first time since 2001, and hit almost 6,600 points by the year-end. The stable economic situation was reflected in the performance of the VDAX volatility index, which rose towards the middle of the year but then dropped to a historic low at the end of 2006 following the general calming of the markets.

In November, the yield curve in Europe inverted slightly for a short while, for the first time in six years. In contrast, this inversion has been more marked and has lasted much longer in the USA. The resulting small reversal in the interest spread at the end of the year did not have any significant impact on the flat course of the yield curve in Germany.

Figure 2  
Yield curve German bond market\*



\* Interest rates for (hypothetical) zero bonds without loan loss risk.

Source: Deutsche Bundesbank

● Key interest rates continue to rise.

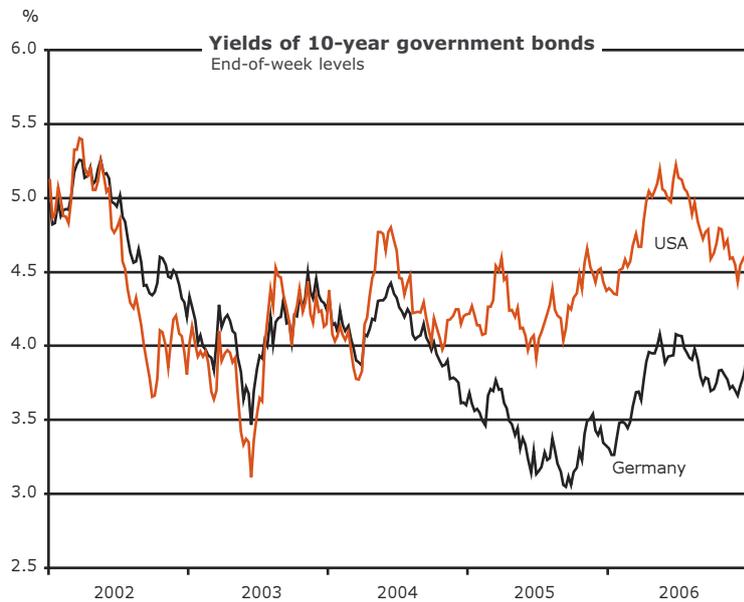
Both the European Central Bank and the Federal Reserve raised their key interest rates several times during the year. The reasons for these hikes were primarily worries about inflation fuelled by the high price of oil, and expectations that the interest rate rises would have only minor negative effects on the economic cycle. At the end of the year, the ECB key rate was 3.5%, while in the US it was 5.25%.

- Yields on long-term government bonds fluctuated over the year.

In both the USA and Germany, the yields on long-term government bonds were up on the previous year at the year-end. However, the highest level of the year, experienced in the summer, was followed by a significant fall over the second half of 2006. This can be primarily attributed to the sustained demand for US government bonds, especially from Asia. In addition, the uncertainty surrounding political developments in the Middle East on the part of many market participants led temporarily to a retreat to stable securities. Nevertheless, positive economic forecasts allowed the yields on long-term government bonds in both the USA and Germany to rise again by the end of the year.

Figure 3

### Comparison of capital market returns in USA and Germany

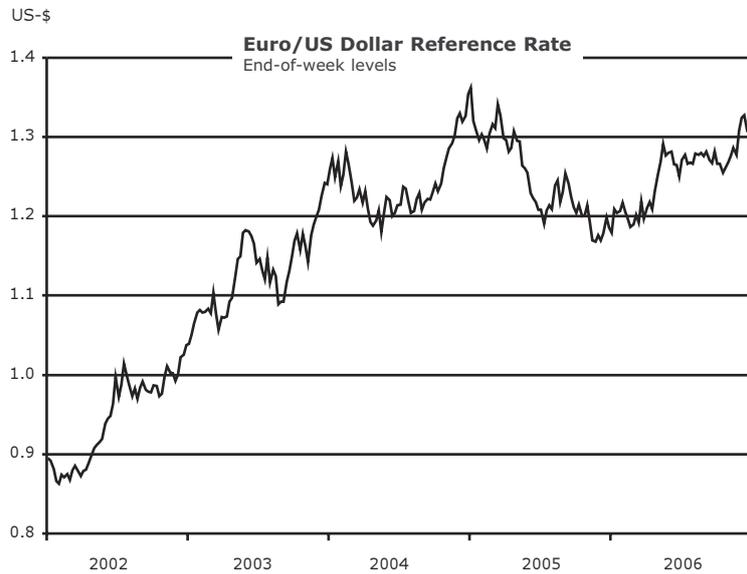


Source: Bloomberg

- Falling interest spread compared with USA and a rising euro.

At the end of 2006, yields on 10-year US government bonds were 4.7%, while their German counterparts were just under 4.0%. A particularly improved economic prognosis for Europe and relatively weak data from the US economy cut the interest spread over the year to 70 basis points. This development helped the euro to gain in value. At a level of US\$ 1.32 at the end of 2006, having started the year at US\$ 1.20, prospects for 2007 indicate that the euro will continue to appreciate, even though the cyclical forecast for the USA has recently improved somewhat.

Figure 4  
**Exchange rate development**



Source: Bloomberg

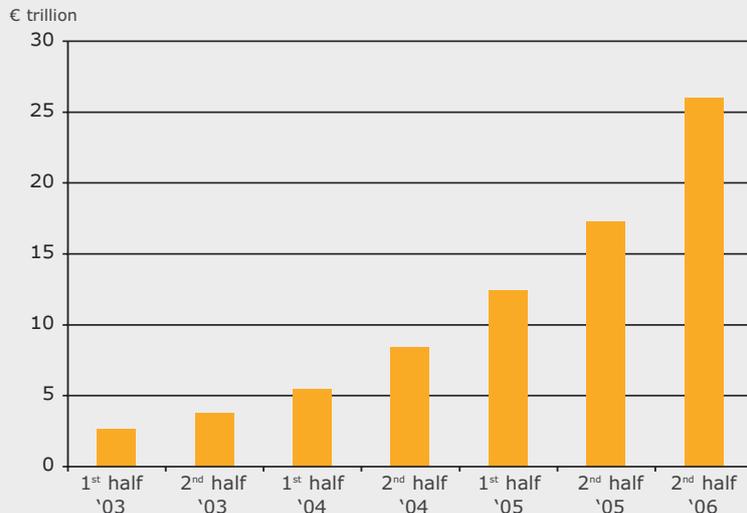
● High growth on derivatives markets.

With risk premiums for corporate and emerging market bonds remaining low, many investors have turned towards the high-growth derivatives markets. Issuers have responded to this increased demand with new, complex risk products that target correspondingly high yields.

**Credit derivatives**

Over the past few years, the outstanding volume on the credit derivatives markets has almost doubled year for year, and there are, as yet, no signs of a halt to this trend. In the first half of 2006

Figure 5  
**Growth in the credit derivatives market**



Source: International Swaps and Derivatives Association (ISDA)

alone, the outstanding nominal volume rose by 52% from US\$ 17.1 trillion to US\$ 26 trillion.

Bonds and credit derivative index contracts, in particular, are among the fastest-growing credit derivative products. The introduction of listed credit derivatives on the EUREX exchange in March 2007 should contribute in the long term to further growth in terms of market participants and volumes, thus also accelerating this trend.

Other drivers of growth include established portfolio products such as collateralised debt obligations (CDO), which lead the arranging banks on the credit derivatives market to carry out corresponding hedging activities. The high demand for these products was a major reason for the record low levels of risk premiums for credit derivative indexes and individual stocks in 2006.

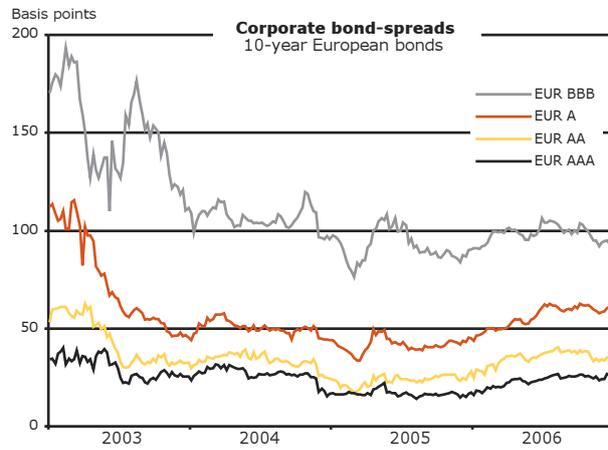
Also worthy of note is the growth of innovative, complex, leveraged portfolio products with excellent rating levels and attractive returns, such as constant proportion debt obligations (CPDO). Investors should be aware that these products, despite their good rating, are associated with risk, especially in relation to market value and liquidity. BaFin is monitoring this development very carefully.

Other aspects requiring attention from a supervisory perspective are problems in the operational area of the derivatives markets, since settlement in these markets often struggles to keep pace with the fast growth of transactions. Comparable difficulties also exist in the equity and interest-based derivatives markets.

● Danger of sudden spread increases.

Corporate credit spreads and spreads for emerging market bonds continued to move at very low levels in 2006. The sustained global imbalances expressed, for instance, in the trade balance deficit of some 7% in the USA or the trade balance surplus of a similar 7% in China, carry the risk of a sudden hike in interest rates and the collapse of the dollar. The rising credit spreads and global irritation on the financial markets in relation to the problems on the Chinese financial market in February 2007 underline these potential risks. In the case of greater corrections of risk premiums, there may also be some overspill on to the German financial sector, triggering distortion on the financial market. Some players on the financial market may be unable to prepare themselves for abrupt increases in risk premiums. As a result, financing conditions would worsen, whilst equity and bond volatility would strongly increase. If investors were forced, for liquidity reasons and due to price hikes, to exit their positions at a loss, this could lead to an increased number of bonds defaulting and falling share prices.

Figure 6  
**Development of spreads in the corporate sector**



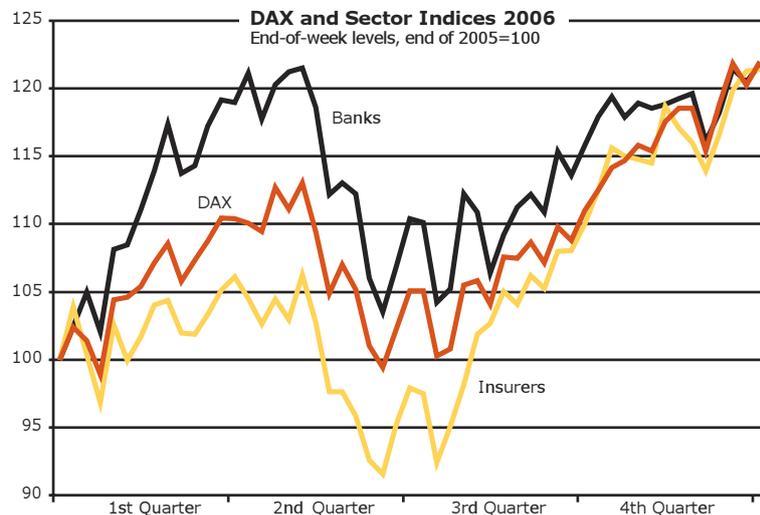
Source: Bloomberg

## 2 Banks

Market indicators painted favourable picture.

Despite fluctuations on the stock markets, market indicators in 2006 once again conveyed a positive impression of developments in the German banking sector. As a complement to the mandatory reporting for regulatory purposes, market indicators provide an up-to-date reflection of sentiment among market participants regarding the future development of a company, thus providing valuable additional information for the regulators. Share prices for German banks climbed much more strongly than the index for the market as a whole during the first half of the year, due to high revenues from the volatile trading business. However, heavy losses

Figure 7  
**German financial sector stock indices**



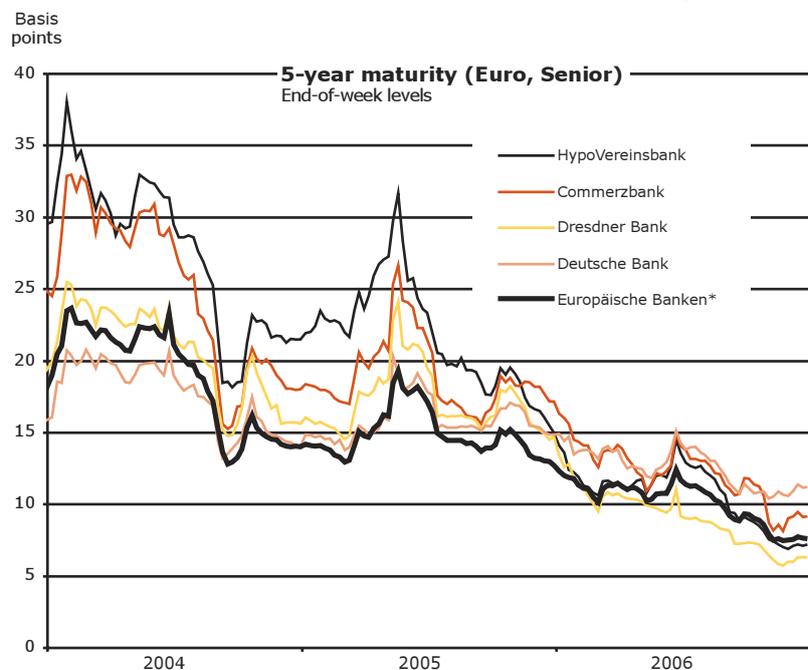
Source: Bloomberg

in the summer interrupted this above-average development. Nevertheless, the banking sector index achieved growth of 22% – the same historically high level as the insurance sector index and the DAX – during 2006.

Credit default swap (CDS) spreads were situated at historically low levels in 2006. At the end of 2006, around €10,000 was a sufficiently high amount to hedge debts of €10 million. In contrast, over €100,000 was required to cover the same amount at certain periods during 2003. It was only in the summer that a minor, short-lived spike was observed, as high commodity prices in particular caused uncertainty on financial markets. The reduction in the risk spread compared with international competitors highlights the relative improvement in German banks.

Figure 8

### Credit default swap spreads for Germany's major banks



\* Unweighted average of CDS spreads for 16 major European banks.

Sources: Bloomberg, BaFin calculations

Improvements in the credit ratings for the long-term liabilities of non-public sector banks in Germany were seen as early as 2005. In 2006, the rating agencies confirmed their assessments of the previous year. Some banks, such as Commerzbank and Aareal Bank, still managed to improve their rating slightly. Nevertheless, a couple of exceptions aside and despite the progress made, German banks still receive poorer ratings than their international competitors.

Landesbanks after the abolition of government guarantees.

The Landesbanks responded in different ways to the abolition of government guarantees in 2005. With just a few exceptions, however, the various strategies have a common denominator, as the Landesbanks seek closer cooperation with their local savings banks (Sparkassen). Their aim is to strengthen the less volatile

retail business and broaden their earnings base. In view of the high competitive pressure that predominates in Germany, the Landesbanks, having begun to withdraw from international business in 2005, have halted this withdrawal in some areas so they, too, can exploit external earnings potential to a greater extent again.

While the reorientation process is not fully complete, the banks have come far enough for the rating agencies to award a long-term A-range rating in most cases. Low-cost refinancing should therefore remain available in the future, enabling the banks to continue their business models even with the high pressure on margins in lending business.

● Stabilisation of earnings situation.

Thanks largely to higher trading results in the first half of the year, and the improved state of the economy as a whole, the earnings situation of the German banking sector stabilised further in 2006. However, the volatility of the market and falling share prices during the summer still generated large fluctuations during the year, especially in the case of the major banks. Increased business volumes hardly generated higher interest earnings, and only partially resulted in higher levels of net commission income. In the private customer segment, consumer loans supported partially higher interest margins prior to the VAT rate increase. However, these have either been eroded again, or were in any case vital within the context of risk-oriented pricing, depending on the competitive situation. In addition to strengthened offerings from direct banks, the arrival of various foreign banks on the market also had a negative impact on margins and thus the earnings of domestic institutions.

Moreover, the flat interest rate curve caused the previously high earnings from maturity transformation to fall heavily – especially in the case of savings banks and cooperative banks (Genossenschaftsbanken). Therefore, the spread between yields on one- and 10-year German federal securities at the end of 2006 was only 10 basis points, a year-on-year drop of 50 basis points. With customer deposits tending to be shorter term and loan agreements longer term, this situation led to a considerable drop in earnings.

With their current level of earnings power, German institutions have still not regained their previous strength or achieved the standard typical of the rest of the world. Nevertheless, positive signs that German financial institutions have started to tap new sources of income after the massive clean-up of their balance sheets still persist. Risk assets are increasing once again. The current, relatively low level of risk provision, combined with improved risk control, for example by means of securitisation of loans and advances, has enabled banks to relax their standards somewhat in respect of awarding credit. Moreover, the major banks especially, though not exclusively, have cleaned up their credit portfolios drastically with the comprehensive sale of non-performing loans.

Alongside the traditionally strong focus of the savings banks and cooperative banks (Volksbanken) on retail business, the major banks are also expanding their activities in this sector. In contrast to the previous trend, this development has led in some cases to the creation of new jobs in customer-facing positions. Nevertheless, the capacity for innovation among German banks appears less marked than among their international competitors, who are still surging onto the German market with new financial products.

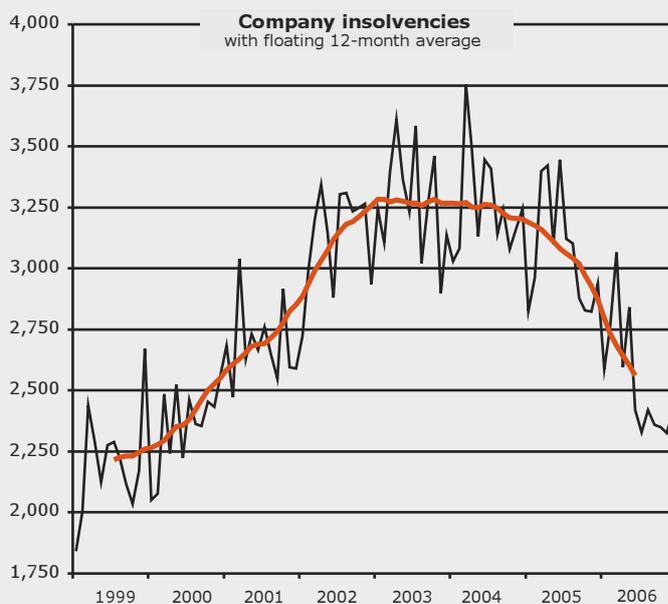
In terms of costs, the potential for savings is increasingly smaller following years of restructuring. This can be seen in the slight year-on-year rise in administration costs. A significant portion of this rise can be traced, in the private banking segment at least, to performance-related bonuses. Following the often major cost reductions in previous years, increases are now once again required in order to access new areas of business. In the past, a reduction in risk provisioning was one of the central factors contributing to increasing profits. However, risk provisioning can hardly be reduced further, since corporate bankruptcies at least are at their lowest for six years.

### Change in number of insolvency cases

Corporate insolvency cases are on a downward trend. In 2006, 30,462 companies failed – around 17% fewer than the previous year. This means that the frequency of insolvency has fallen to a level last seen in 2000. The associated probable claims of creditors fell by 15% to around €19.4 billion.

Figure 9

### Company insolvencies



Source: Federal Statistical Office, as at 7 March 2007

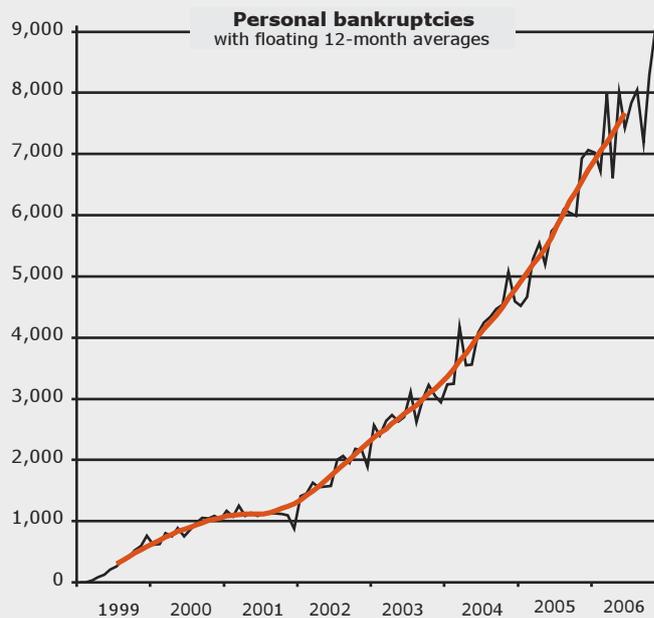
In contrast, private bankruptcies are continuing to skyrocket due to higher levels of household indebtedness and the reform of the insolvency legislation carried out some years ago, simplifying the bankruptcy process. Alongside unemployment, the more concerted selling of consumer credit is probably an additional factor in this development.

At 92,844 cases, an increase of 35%, consumer insolvencies reached record levels in 2006. The volume of expected claims rose by 20% to €5.7 billion. These claims may be significantly lower than in the corporate sector (for the moment), but are already forming a barrier to the award of consumer credit and will probably lead to greater risk orientation in price-setting.

It is also feared that the previously announced increase in value-added tax, brought into effect in 2007, persuaded many households to spend more on consumer goods in 2006, which could have negative effects in future.

Figure 10

### Personal bankruptcies



Source: Federal Statistical Office, as at 7 March 2007

### 3 Insurers

● Positive development in the insurance sector.

In the year under review, the German insurance sector managed to further strengthen its risk-bearing capacity and maintain its solvency at high levels. At the same time, the insurance sector has reinforced its earnings strength and capital base. Various market indicators underline this positive assessment of the sector from a supervisory point of view.

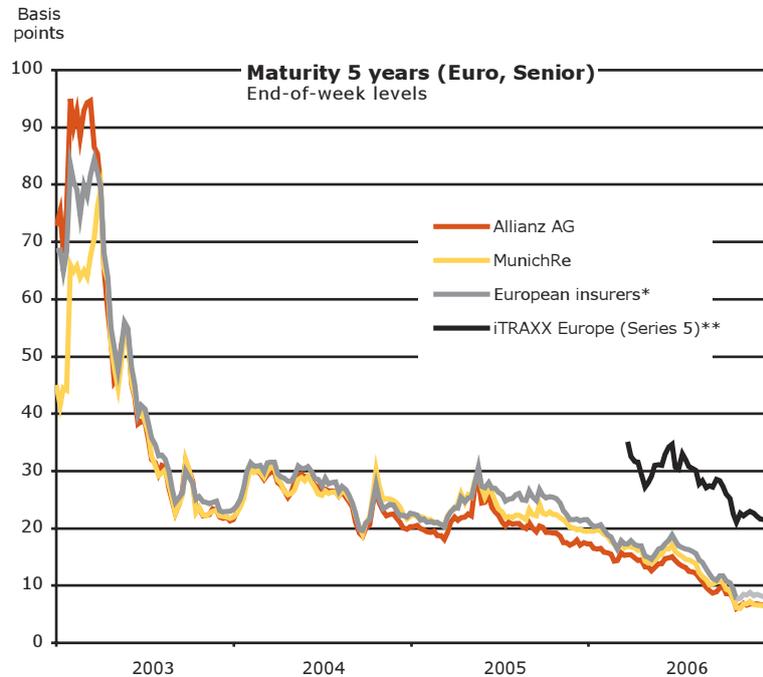
The insurance sector share index was significantly outperformed by the DAX up to the start of the third quarter of 2006. This weak development can be traced to factors such as the less positive earnings forecasts of reinsurance companies following the severe natural disasters of the previous year. From the third quarter, the insurance sector index made up a great deal of ground, reaching the level of the blue-chip index by the end of the year. Compared with its value at the start of the year, the insurance sector index registered growth of a good 20%.<sup>2</sup> The stock markets were regarded by insurance companies in a positive light in the second half of the year, owing to the low development of claims following the USA's mild hurricane season and the resulting good business prospects.

● Risk premiums of German insurers low by international comparison.

Over the year as a whole, CDS spreads for insurance companies fell significantly by more than ten to under seven basis points in places, thus reaching new record lows. Risk premiums grew somewhat between the start of May and the middle of June. This rise was in line with the overall behaviour of the market and increased global market uncertainty. In the second half of the year, risk premiums continued their descent with renewed vigour. German insurers' risk premiums remained lower than those of their international competitors during 2006. The market obviously views the default risk of German insurers as low, and as advantageous by international comparisons. Nevertheless, it must be noted that the strong growth in the global CDS markets of the past few years, and the demand that has increased in the search for yields, may also be responsible for a general tightening of risk premiums.

<sup>2</sup> Figure 7, German financial sector stock indices.

Figure 11  
**Credit default swap spreads of selected insurers**



\* Unweighted average of the nine most liquid CDS spreads of European insurers.

\*\* Unweighted average of the 125 most liquid CDS spreads over the six months prior to publication of series 5 of the index.

Source: Bloomberg

● Positive assessment by the rating agencies.

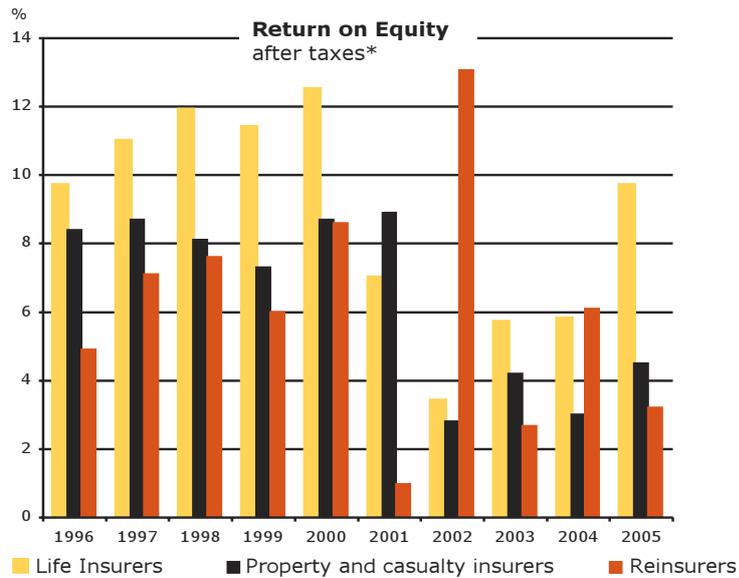
After the large number of downgrades in the years following the capital market crisis, strong financial strength ratings since 2004 point to a positive change in the assessment of German insurance companies by rating agencies. The trend towards upgrades – improvements in ratings – also continued in 2006, with the number of upgrades in most segments exceeding the number of downgrades. This applies in particular to German reinsurers. The ratings outlook for German primary insurers and reinsurers is mainly stable or positive, with just a very low number of low forecasts. The outlooks of the rating agencies for the corresponding segments are also largely stable. Only one agency maintained its negative outlook for life insurance companies – who admit sustained pressure on income and strategic challenges – for 2006.

● Renewed advances in profitability.

In 2005, the earnings position of German insurance undertakings remained solid. Primarily the life insurance companies were once again able to achieve returns on equity at levels last recorded in the mid-1990s. Property and casualty insurers also improved their performance. Costlier damage events, including the hitherto almost unparalleled series of hurricanes in Central and North America during autumn 2005, have nevertheless left a significant mark on the profits recorded by reinsurers. While some companies failed to achieve their profit targets as a consequence of the catastrophic weather, others reached their goals, albeit sometimes only by realising hidden reserves. In terms of the sector average, however,

reinsurers' return on equity for 2005 was once again above the level of 2003. It is anticipated that the results for 2006 will be significantly better, following the lower-than-average number of hurricanes.

Figure 12  
**Profitability of German insurance companies by class**



\* Net profit after taxes, divided by equity.

● Proportion of investment in shares more or less unchanged.

In 2006, total investment by all German insurance companies (including reinsurance companies) increased slightly by 4.9% to €1,246 billion over the previous year. The largest investment block remains fixed-income investments. The proportion invested by primary insurers in shares barely changed in 2006, and formed between 9.0% and 10.4% of restricted assets at the year-end. In the life insurance class, the proportion of investments in equities was between 8.3% and 9.7% (previous year between 8.4% and 9.6%). Therefore, the risk arising from a sudden fall in share prices is relatively limited for these companies. A similar pattern can be seen in the hedge fund investments of German insurers, the rate of which is significantly lower than the regulatory maximum level of 5%. Only two pension funds have reported, with the approval of BaFin, investment rates of somewhat higher than 7%. At around €3.5 billion, total investment by German primary insurers in hedge funds was unchanged year on year at the end of 2006. This figure corresponds to just under 0.4% of their restricted assets.

● Largely stable economic development among primary insurers.

Relatively low interest rates are affecting the balance sheets of life insurance companies. Some companies had already attempted to counter this at earlier stages by purchasing long-term bonds and derivatives. Although the yields on 10-year government bonds at the end of 2006 were around 95 basis points higher than their lows of the previous year (3%), the upward trend started at the

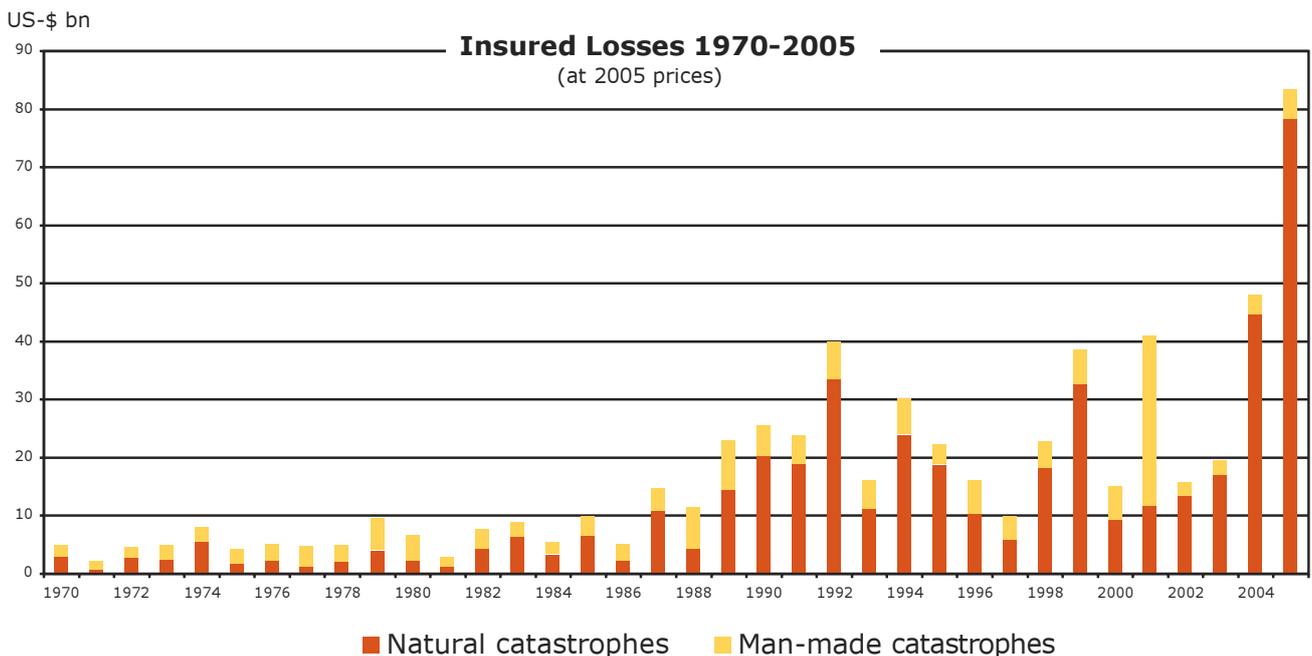
beginning of the year was interrupted as yields lost around 42 basis points from the interim year high between mid-June and the end of November. This scenario somewhat reduced the earnings of life insurers from new investment in fixed-income securities once again.

The earnings situation of property and casualty insurers worsened slightly in 2006, following three consecutive years of growth. In particular, strong competition on prices in the motor vehicle insurance sector caused income from premiums to fall by 1.0% overall. In contrast, most branches of the insurance industry experienced a rise in expenditure related to claims. The combined ratio of claim costs rose according to provisional findings by some three percentage points to 92.5%.

The global reinsurance sector's financial situation eased after 2006 elapsed without a higher number of severe storms in Central and North America. In some areas, the high levels of damage due to natural catastrophes in the previous year caused an increase, or at least stabilisation, of prices for reinsurance. Reinsurance companies have reacted to the trend of more frequent and more highly insured catastrophic damage experienced over the past few years by modifying their risk assessment and their natural disaster risk models. These factors had a positive effect on the business development of German reinsurance companies. The rating agencies therefore confirmed the stabilisation of financial strength and paid tribute to the sector's efforts to improve its risk management techniques. Some agencies modified their rating outlook for the entire sector from negative to stable, and changed the outlooks for individual companies to positive.

● Economic situation of reinsurers improved owing to favourable developments in claim levels.

Figure 13  
**Insured catastrophe damage around the world**



Source: Swiss Re, sigma No 2/2006

## 4 Retail market developments

- Renaissance in private customer business.

Providers focused more strongly again on the retail segment of the financial market in 2006. The reasons include the population's increased awareness of the need to strengthen private old-age pension provision. Moreover, the retail segment is also attractive for providers as they are able to make relatively high margins in comparison with their institutional business.

- More aggressive competition between providers ...

Competition for market share has intensified in private customer business. Some providers are focusing on selected customer segments. Some direct banks are attempting, with increasing success, to position themselves as a main bank by gradually offering more and more classic bank products, such as payment accounts, at favourable conditions. While pressure of competition and pressure on margins is leading to standardisation in the sector, parts of the market, such as structured investment products, are seeing an increase in product diversity.

- ... entails risks for customers.

An increase in product diversity as a result of keener competition is generally seen as a positive trend for customers. However, this development also entails risks. The massive diversity of products with different characteristics alone could overwhelm many customers. In addition, products are increasingly complex, a trend which is usually accompanied by a decrease in transparency. Many private investors can no longer properly assess the core profit and risk characteristics of products based on the capital market, since they do not possess the necessary knowledge of the workings of the financial sector.

In many cases, commission-based sales and aggressive marketing seek to exploit the different levels of knowledge between the product suppliers and consumers. More responsible providers are setting the quality standard in responding to this problem by setting out detailed, clear information in easy-to-understand language, thereby making an important contribution to consumer information and increased transparency. As transparency increases, customers are better placed to understand the mechanisms of the products on offer and to demand quality.

- Continuation of existing trends of investor behaviour.

In 2006, the investment patterns of private investors followed the trend of making risk-aware investments while seeking above-average returns. Products that provide access to attractive profit opportunities, and which also have a capital guarantee component or some other loss-limiting element, have increasingly been in demand. The market for certificates, the growth of which appears to continue unabated, also profited from this preference on the part of investors.

As in previous years, 2006 also witnessed further attempts to transfer credit and insurance risks from institutional business to retail investors. Since these are highly complex products, issuers and their sales departments face stern challenges in terms of transparency and provision of information to customers.

Three years following their approval, funds of hedge funds have still not fulfilled the high sales expectations. During the past year, providers went so far as to withdraw their initial products from the market. One reason for this move may be that many investors are using the barely regulated vehicle of certificates to invest in single hedge funds, thereby circumventing funds of funds. The performance of many funds of hedge funds also failed to match that of other forms of investment that are more common in the market, and was unable to further stimulate the placement of fund products.

Closed-end funds are still extremely important with regard to private wealth investment. This market, which is rather opaque on the whole, is associated with high risk, especially for retail customers. However, it also profited in 2006 from the historically low level of interest rates and a search among investors for profits. Real estate funds and funds relating to ship financing and second-hand life insurance policies remain the most important segments of the closed-end fund market.

Table 1  
Economy and financial sector overview for Germany\*)

Selected economic data	Units	2000	2001	2002	2003	2004	2005	2006
GDP growth <sup>1)</sup>								
Global economy	%	4.7	2.4	3.0	4.1	5.3	4.9	5.1
U.S.	%	3.7	0.8	1.6	2.5	3.9	3.2	3.4
Euro-area	%	3.8	1.7	0.9	0.8	2.1	1.3	2.4
Germany	%	3.2	1.2	0.1	- 0.2	1.2	0.9	2.0
Corporate insolvencies	number	28,235	32,278	37,579	39,320	39,213	36,843	30,462
DAX (End of 1987=1000) <sup>2)</sup>	points	6,434	5,160	2,893	3,965	4,256	5,408	6,597
Interest rate money market <sup>3)</sup>	%	4.39	4.26	3.32	2.33	2.11	2.19	3.73
Interest rate capital market <sup>3)</sup>	%	5.28	4.86	4.81	4.08	4.04	3.36	3.95
Exchange rate of the €	1 €=...\$	0.92	0.90	0.95	1.13	1.24	1.24	1.32
Gross-sale of fixed-income securities <sup>4)</sup>	€ bn.	659	688	819	959	990	989	926
<b>Credit institutions</b>								
Credit institutions <sup>5)</sup>	number	2,912	2,697	2,593	2,466	2,400	2,344	2,301
Branches <sup>5)</sup>	number	56,936	54,089	50,868	47,244	45,467	44,100	40,332
Credit loans <sup>6)</sup>	€ bn.	2,187	2,236	2,241	2,242	2,224	2,227	2,242
Net interest margin <sup>7)</sup>	%	1.14	1.12	1.20	1.16	1.18	1.17	-
Commission surplus	€ bn.	28.1	25.3	24.3	24.4	25.3	27.8	-
Operational costs	€ bn.	77.7	81.0	78.3	77.3	75.8	78.8	-
Risk provisioning	€ bn.	15.9	19.6	31.2	21.8	17.2	14.1	-
Cost-income ratio <sup>8)</sup>	%	68.4	71.4	67.2	66.5	65.5	61	-
RoE <sup>9)</sup>	%	9.3	6.2	4.5	0.7	4.2	12.7	-
Solvency ratio <sup>10)</sup>	%	11.7	12.1	12.8	13.4	13.3	13.1	13.3
<b>Private banks</b>								
Credit loans <sup>6)</sup>	€ bn.	600	605	594	579	575	580	587
Net interest received <sup>7)</sup>	%	1.17	1.15	1.34	1.17	1.25	1.27	-
Cost-income ratio <sup>8)</sup>	%	75.4	80.4	74.2	74.0	73.5	59.7	-
RoE <sup>9)</sup>	%	8.2	4.7	1.0	- 6.2	- 0.4	21.8	-
Solvency ratio <sup>10)</sup>	%	13.0	13.6	14.4	14.5	13.7	12.7	13.7
<b>Savings banks</b>								
Credit loans <sup>6)</sup>	€ bn.	545	563	572	577	573	574	576
Net interest received <sup>7)</sup>	%	2.33	2.28	2.38	2.40	2.35	2.29	2.19
Cost-income ratio <sup>8)</sup>	%	68.9	69.9	66.5	66.4	64.9	65.8	63.1
RoE <sup>9)</sup>	%	13.4	9.2	8.2	10.9	9.7	10.5	8.7
Solvency ratio <sup>10)</sup>	%	10.7	10.8	11.2	11.5	12.1	12.6	13.1
<b>Credit unions</b>								
Credit loans <sup>6)</sup>	€ bn.	327	331	335	338	342	348	353
Net interest received <sup>7)</sup>	%	2.45	2.41	2.49	2.51	2.51	2.46	2.32
Cost-income ratio <sup>8)</sup>	%	74.5	76.7	73.1	69.6	68.7	69.9	66.2
RoE <sup>9)</sup>	%	8.6	7.5	9.7	10.6	10.3	13.9	14.5
Solvency ratio <sup>10)</sup>	%	11.2	11.1	11.0	11.7	12.1	12.2	12.3
<b>Insurance companies</b>								
<b>Life insurance companies</b>								
Hidden reserves in the investment portfolio (IP) <sup>11)</sup>	€ bn.	62.9	31.3	6.2	14.9	35.6	44.0	35.2
as % of IP book value	%	11.4	5.5	1.1	2.4	5.5	6.5	5.3
Ratio of fund units in IP <sup>12)</sup>	%	21.4	22.5	23.0	23.3	22.0	23.2	23.1
Ratio of borrower's notes and loans in IP <sup>12)</sup>	%	16.6	17.1	18.1	19.3	22.0	22.2	23.0
Net rate of return on IP <sup>13)</sup>	%	7.4	6.0	4.4	5.0	4.8	5.0	-
Net technical provisions	€ bn.	445.5	476.4	502.8	520.6	536.2	551.2	-
as % of balance sheet totals	%	83.7	83.7	83.8	79.4	78.8	78.1	-
Surplus <sup>14)</sup>	€ bn.	20.3	13.4	5.1	9.2	9.7	14.2	-
as % of gross premiums earned	%	33.1	21.5	7.9	13.6	14.1	19.5	-
Eligible own funds (A+B+C)	€ bn.	42.9	44.2	39.8	42.3	43.9	49.1	-
Solvency margin <sup>15)</sup>	€ bn.	20.5	22.2	23.3	24.0	24.8	25.9	-
Coverage of solvency margin <sup>16)</sup>	%	209.5	199.0	170.4	176.2	177.4	190.0	-
Return on net worth <sup>17)</sup>	%	12.5	7.0	3.4	5.7	5.8	9.7	-
<b>Property and casualty insurance companies</b>								
Hidden reserves in the investment portfolio (IP) <sup>11)</sup>	€ bn.	37.1	31.7	22.3	26.0	26.6	27.7	29.8
as % of IP book value	%	38.1	31.4	21.3	23.8	22.6	22.2	22.4
Ratio of fund units in IP <sup>12)</sup>	%	23.5	25.3	27.0	27.3	26.5	29.8	30.5
Ratio of borrower's notes and loans in IP <sup>12)</sup>	%	13.3	13.2	13.2	14.1	16.6	18.3	15.6
Net combined ratio <sup>18)</sup>	%	101.0	100.2	103.2	94.7	92.2	92.6	-
Eligible own funds (A+B)	€ bn.	20.7	24.4	25.0	27.1	24.1	22.5	-
Solvency margin <sup>15)</sup>	€ bn.	7.5	7.1	7.4	7.8	8.4	8.8	-
Coverage of solvency margin <sup>16)</sup>	%	277.1	342.7	336.9	346.0	286.3	255.3	-
Return on net worth <sup>17)</sup>	%	8.7	8.9	2.8	4.2	3.0	4.5	-
<b>Reinsurance companies</b>								
Hidden reserves in the investment portfolio (IP) <sup>11)</sup>	€ bn.	101.8	89.2	35.8	34.3	37.2	49.9	57.7
as % of IP book value	%	75.9	54.2	18.5	15.6	17.2	22.0	26.4
Net combined ratio <sup>18)</sup>	%	103.8	115.3	101.6	92.8	93.5	-	-
Gross technical provisions	€ bn.	104.5	122.3	130.6	135.8	140.8	-	-
as % of gross premium income	%	265.7	278.6	244	264.4	298.5	-	-
Net profit for the year <sup>19)</sup>	€ bn.	2.2	0.3	5.4	1.4	3.4	1.8	-
Available capital <sup>20)</sup>	€ bn.	25.1	31.5	40.2	51.4	55.1	56.1	-
Return on net worth <sup>17)</sup>	%	8.6	1.0	13.3	2.7	6.1	3.2	-

Sources: BaFin, Deutsche Bundesbank, Eurostat, IMF

\*) Annual totals or averages, unless otherwise specified.

a) Year-end level.

1) Year-on-year change in real GDP.

2) 3-month Euribor.

3) 10-year government bond yields.

4) Domestic issuers.

5) According to section 1 (1) KWG (including Postbank, investment companies and all branches of foreign banks).

6) Current account loans to domestic companies and private individuals.

7) Net interest income as percentage of total assets.

8) Administrative expenses in relation to operational income.

9) Net profit before taxes as percentage of the average reported equity capital.

10) Liable equity capital in relation to weighted risk assets (solvency indicator pursuant to Principle 1).

11) Fair values - book values of entire investment portfolio (IP).

12) Percentage of total IP excluding deposits with ceding undertakings.

13) (Returns on IP - expenses for IP) / arithmetic mean of IP (beginning/end of year).

14) Net profit for the year + gross expenses for bonuses and rebates.

15) Minimum own funds free of foreseeable liabilities.

16) Eligible own funds / Solvency margin.

17) Net profit for the year / equity.

18) Net expenses for claims and insurance operations / net premiums earned.

19) Corresponds to item II.4 form 2 RechVersV.

20) Total capital - unpaid capital contributions.

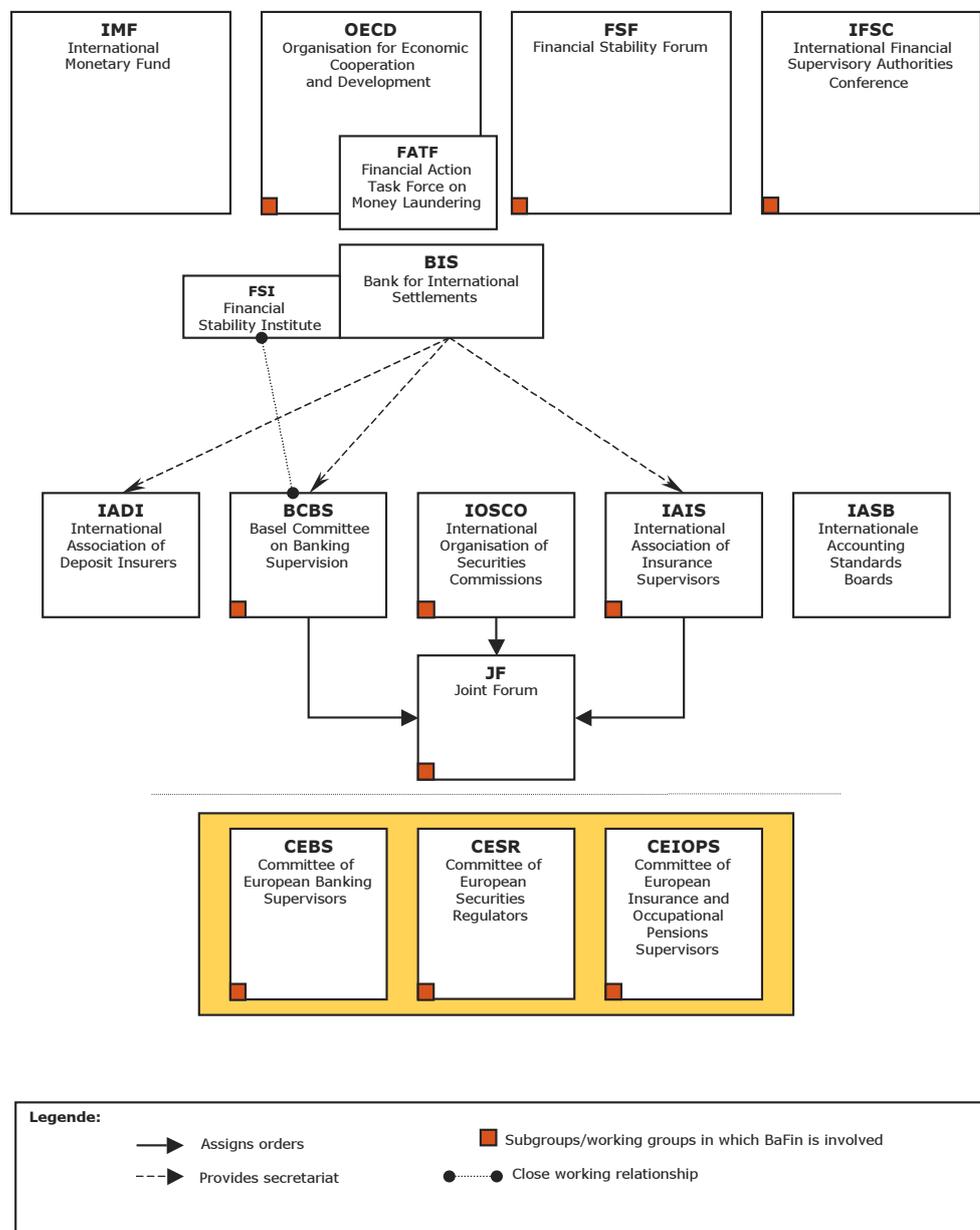




# III International

## 1 International harmonisation

Figure 14  
International institutions and committees<sup>3</sup>



<sup>3</sup> A detailed overview of the individual organisations and bodies can be found in our 2004 Annual Report. The documents referred to in the text are located on the websites of the corresponding organisations ([www.bafin.de](http://www.bafin.de) » English Version » Links » International Organisations).

### European bodies

CESR, CEBS and CEIOPS are committees composed of high-level representatives from Europe's national supervisory authorities. These committees form part of the Lamfalussy process. This is a four-level approach which aims to produce EU legislation quickly and efficiently in the area of financial services. It integrates the expertise of supervisory authorities and the economy and builds on the comitology procedure practised in the EU since 1987. CESR, CEBS and CEIOPS are located at level 3 of this process. CESR stands for the Committee of European Securities Regulators, and CEBS is the Committee of European Banking Supervisors. CEIOPS refers to the Committee of European Insurance and Occupational Pensions Supervisors. CESR, CEBS and CEIOPS not only advise the European Commission on the drafting of framework directives and associated detailed provisions, but are also responsible for ensuring a coherent and effective system of supervision in Europe. They must ensure that national supervisors organise the required exchange of information among each other, and that European directives and all associated subordinate legislation are applied consistently throughout Europe.

#### **New decision-making rules and mediation process at CESR**

While until recently the main duty of CESR was to advise the European Commission at level 2 of the Lamfalussy process, it is now increasingly developing into a committee that is taking on the operational responsibility for supervisory convergence within the EU. CESR has changed its structure to enable it to fulfil this new role.

The new CESR Charter sets out detailed rules on the decision-making process within the CESR Chairmen meetings. As a general rule, CESR decisions are based on consensus. In this respect, consensus means that no more than two members have voted differently. Members who do not implement a measure agreed by means of this consensus process must explain the reasons for their actions. All members retain the right to formulate their own opinion and convey this opinion to the European Commission. When CESR is working in direct relation to the European legislative process or is involved with a level-3 measure according to a point of EU legislation, an individual member may demand that decisions be reached unanimously. If no unanimous decision can be reached, the CESR then informs the European Commission of this fact.

The Review Panel, which is responsible for reviewing the implementation and application of EU legislation, is a fixed component of the committee thanks to its integration into the CESR Charter. Moreover, a mediation mechanism for disputes between supervisory authorities is being incorporated into the Charter. The mediation mechanism is intended to enable disputes to be resolved between supervisory authorities, for example in relation to the exchange of information between authorities or in

relation to enforcement of the financial information obligations of issuers, or when other disputes occur for which EU legislation requires unanimity on the part of the authorities. Only supervisory authorities are permitted to participate in this confidential process, although any market player can provide the impetus to initiate the process. Two different processes for resolution may be applied in the event of a dispute. Either a committee of three senior experts can present the parties with a written resolution of the dispute, or a single mediator can attempt to reach a resolution in agreement with both of the parties. All negotiations and findings of the process are subject to rules on confidentiality, and each process should be completed within a maximum of six months.

Mediation also plays a role in the other two level-3 committees. CESR forms a role model in this respect. A CEBS taskforce has already submitted detailed proposals for implementing a mediation process based on the CESR mechanism, and has also conducted initial deliberations for a review panel to open up discussions within CEBS.

### International bodies

The IAIS (International Association of Insurance Supervisors) develops international principles for exercising effective supervision of insurance companies, and verifies compliance with these principles at regular intervals. IOSCO (International Organization of Securities Commissions) develops international supervisory standards for supervising securities and derivatives markets.

## 1.1 Market transparency and integrity

### Handling data

At the beginning of 2007, the TUG was introduced to transpose the EU Transparency Directive into German law. The EU Directive requires each Member State to create a database of capital market information. The European Commission gave CESR the task of preparing suggestions for access to the data stored in this way. This involves ensuring the security of the data and developing models for networking the national systems, as also required by the Directive.

The exchange of data is also a core topic with regard to implementing MiFID. MiFID proposes a completely new regime for reporting trades in securities and derivatives. These new rules are due to come into force on 1 January 2008. Currently, all companies allowed to trade on a German stock exchange have to report to BaFin. However, reporting from 2008 onwards will be based strictly on the country of origin principle. In September 2006, the European Commission issued a regulation that defines which data must be exchanged between supervisory authorities, the channels through which companies subject to reporting rules may submit their reports to supervisory authorities and the ways in which

● EU Transparency Directive: Minimum standards for storage systems.

● MiFID: Exchanging data on securities and derivatives trades.

supervisory authorities should inform each other. This exchange of data is intended to plug any loopholes that arise from implementation of the strict country of origin principle. CESR has established a group to develop and refine these data exchange mechanisms.

- Tight schedule for MiFID implementation.

In December 2006, the CESR Project Group submitted its proposals on standards. Work on the hub, the technical platform through which reports will be exchanged, is still continuing. This system is already being used by the French supervisory authority AMF, which will continue to operate the system on behalf of CESR. It is also conceivable that the service will later be outsourced to an external provider. At the end of the year, the question was still open as to how the master data needed for several hundred thousand financial instruments would be procured and collated. The supervisory authorities are deploying significant resources in the Project Group. Nevertheless, the requirement to complete the project by 1 November 2007 currently seems very ambitious. This is all the more relevant since there is a close interrelationship between the work being carried out and the national reporting systems. There are already signs of delays in the legal and de facto implementation of MiFID in the EU Member States. Delays are hindering the Project Group's progress with the creation of national reporting systems, for example, especially in relation to defining data standards and technical specifications. The creation and modification of national reporting systems is, however, not the responsibility of the CESR Project Group; this is left to each CESR member alone.

- MiFID: Publication and consolidation of transparency data in share dealing.

MiFID is not only intended to ensure that transactions involving securities and derivatives are reported to the responsible supervisory authority. The Directive also requires that purely share-based deals are published in an anonymised format. A distinction is made in this regard between pre-trade and post-trade transparency. A major innovation for the German market is that post-trade transparency also applies to the OTC trades of investment firms. In the scope of level 3 of the Lamfalussy process, CESR is primarily working on specifying the requirements of the EU Directive in greater detail. The aim of CESR is to provide market participants with legal certainty that their publication corresponds to the requirements of MiFID.

- Guidance Paper on combating illicit actions of insurers.

The IAIS Fraud Subcommittee has developed a Guidance Paper on illicit actions for the insurance industry. The Guidance Paper, to which BaFin also contributed, is based on IAIS core principle 27 on insurance fraud. It is designed to make the insurance industry aware of the areas in which it is susceptible to illicit actions and to provide it with tools to help curtail such risks.

## Intermediaries

- Guidelines for regulation by MiFID of financial intermediaries.

MiFID specifies the future legal framework for Europe's financial markets. In summer 2006, CESR started work in relation to MiFID at level 3 of the Lamfalussy process. In 2007, CESR intends to publish guidelines that will be accepted throughout Europe in relation to regulating financial intermediaries, regarding: obligations relating to record-keeping, European passport, inducements and best execution. CESR has agreed its core areas of work with the industry. The securities supervisors' committee has also formed an advisory group comprising representatives from the industry to provide a critical commentary on the draft level-3 papers at all stages of their development.

- IOSCO – Conflicts of interest among intermediaries.

IOSCO is also dealing with the regulation of financial intermediaries. On the initiative and under the patronage of BaFin, IOSCO has been fulfilling a new mandate since the end of 2006. Its task has been to uncover the significantly divergent supervisory practices among the Member States in relation to enforcing rules of conduct for intermediaries. During the year under review, IOSCO has also dealt with conflicts of interest affecting intermediaries in relation to bond issues. These may arise, for instance, if an issuer wishes to use the income from an issue to repay loans that have been awarded to it by members of the issuing consortium. The IOSCO Technical Committee aims to have the report approved at the start of 2007, and will place it on the IOSCO website after a public consultation. Furthermore, the group is currently investigating the various record-keeping obligations applicable in the different jurisdictions, and the associated technological demands.

- CEIOPS agrees on supervision of intermediaries.

In April, CEIOPS agreed a protocol on collaboration of participating authorities in all questions relating to cross-border activities and the registration of insurance intermediaries. The Luxembourg Protocol clarifies questions relating to registration, supervision of intermediaries, exchange of information between supervisors and the complaints process.

## Prospectus legislation

- More detailed requirements for information in the case of complex prior history.

On 1 March 2007, a European Commission regulation governing the specific information requirements regarding prospectuses in the case of issuers with a complex financial history entered into force. The European Commission prepared the details of these requirements on the basis of proposals made by CESR. Issuers are deemed to have a complex financial history, if their operational business is not duplicated comprehensively and conclusively in their own financial information and therefore the investor is unable to form a well-founded opinion of the issuer's assets, financial and earnings position and the missing financial information is contained in the financial information of another company.

- New operational working group.

In January 2006, CESR set up an operational expert group, comprising representatives from the CESR Member States. Its aim

was to ensure that the EU rules on the preparation of prospectuses were being applied uniformly. The group published its first joint positions on the CESR website in June 2006. The group's work has two main aims. On the one hand, the supervisory authorities should implement suitable technical measures to make it simpler to use the EU Passport scheme, by which prospectuses can be notified from one Member State to another. On the other hand, the group should hold regular meetings to establish and publish joint positions on the questions that market players and supervisors frequently ask when applying the Prospectus Directive. The intention is to further encourage the harmonisation of prospectus legislation. BaFin regularly exchanges information on topics relating to prospectus legislation with other European supervisory authorities, at regular meetings, for example.

### Secondary markets

The IOSCO committee concerned with regulating secondary markets is chaired by BaFin. In 2006, it published a report on the regulatory effects and requirements that may arise from competition-related changes to the stock exchange environment. The report makes five concluding recommendations for supervisory authorities. Among other topics, the group's work during the period under review involved determining the requirements of national supervisory authorities in terms of information in relation to licensing traders based abroad, and in relation to cross-border trading in securities and derivatives. The group is currently preparing a report that will explain the requirements for information between supervisory authorities for supervisory purposes.

### Consumer protection

In 2005, the OECD submitted a complete system of recommendations on the topic of financial education. These recommendations form the basis for the OECD Principles, which are intended to ensure that the general public in the Member States has the vital knowledge required in relation to finance. The OECD will adopt the recommendations at the end of the consultation phase. The recommendations have been formulated by the OECD Insurance Committee after a study conducted by the OECD into the current levels of understanding of financial concepts on the part of the general public in the Member States revealed dramatic findings.

● OECD financial education.

● Joint forum on customer suitability.

The Customer Suitability Group, of which BaFin is a member, was set up at the suggestion of the Technical Committee of IOSCO. The group's aim is to establish which financial products and services are the subject of retailisation (increasing penetration of the retail market), and in what volumes and through what channels they are sold. Initially, the group will focus on how companies can ensure customer suitability and avoid mis-selling – in other words, how companies can be sure that consumers are offered appropriate financial products and services. The group is approaching the topic from the point of view of both the supervisor and the companies. A

survey is being conducted to establish the legislative and supervisory requirements that companies must take into account and to determine ways in which they can avoid mis-selling. The group is currently evaluating the responses it has received.

### **Financial conglomerates and company mergers**

In 2006, the Interim Working Committee on Financial Conglomerates (IWCFC), a joint committee of European banking and insurance supervisors (with the ECB and CESR as observer members), commenced work on supervision in accordance with the Financial Conglomerates Directive. The IWCFC hopes to contribute to the uniform and full implementation of the Financial Conglomerates Directive in the Member States.

● Comparison of banking and insurance supervision legislation.

Working on behalf of the European Commission, the IWCFC has collaborated with CEBS and CEIOPS to author a report. In the report, the IWCFC contrasts the capital instruments of each Member State that can be used as equity according to banking and insurance supervisory legislation (including the use of hybrid capital). The comparison of banking and insurance supervisory legislation will be used to draw conclusions and make recommendations for supervising financial conglomerates in accordance with the Financial Conglomerates Directive.

● Mergers in the financial sector.

In March 2007, the EU Member States came to an agreement on a draft directive published by the Commission last September. This proposal redefines the powers of EU supervisors to carry out an investigation in the case of acquisitions and increases in holdings in the financial sector. Directives relating to banking, insurance and securities supervision are to be modified, with greater detail on both the investigative process and the criteria on which the investigation is based. The draft directive adheres to the principle of maximum harmonisation, and aims to establish widespread convergence of the national supervisory regimes.

The key points of the draft directive involve establishing a conclusive list of criteria to be used to investigate the suitability of potential buyers of a holding, shortening the investigation period and regulating collaboration of supervisory authorities in relation to the assessment of potential purchasers of holdings.

### **Investment funds**

In January 2006, CESR made recommendations to the European Commission to clarify which assets may be acquired for funds that conform to the provisions of the UCITS Directive. These recommendations formed the basis of an implementing directive that was adopted in March 2007. The directive aims to clarify the uncertainties experienced previously by the Member States in deciding whether or not a specific asset may be included in a UCITS fund.

● Financial innovations as an investment asset for UCITS.

This problem arose primarily with innovative products. The implementing directive now clearly specifies the specific

circumstances under which, for example, a UCITS may invest in closed-end funds or in commodity index derivatives. The draft bill issued in January 2007 by the Federal Ministry of Finance (BMF) on the reform of the Investment Act (InvG) contains the legal reforms required to implement the provisions of the directive. Guidelines issued by CESR will complement the implementing directive and give further details of the directive's practical application. BaFin already takes the recommendations of CESR into account in discharging its administrative duties, to the extent that the recommended approach is permitted by law.

● Notification procedures simplified.

In June 2006, CESR published guidelines on simplifying the notification procedure for UCITS. This notification procedure refers to the Product Passport, introduced through the UCITS Directive. According to the Directive, UCITS must be subject to a notification procedure in the Member State in which they are to be sold before any sale may be initiated. The guidelines are intended to simplify the procedure in the Member States and add transparency. They are also intended to add legal security. BaFin has already implemented the guidelines to a certain extent in its own administrative procedures. Legislative reforms will also be required for effective implementation, for which the aforementioned draft bill on the reform of the Investment Act makes provision.

In November 2006, the Commission published a White Paper containing an impact assessment of the further development of the single market framework for investment funds. In its White Paper, the Commission announced reforms to the UCITS Directive in the following areas: notification procedure, cross-border fund mergers, techniques to save costs by managing assets of various UCITS in real or virtual pools (the technique of pooling), the setting up of a UCITS in another Member State, reworking of the simplified prospectus, and a Europe-wide, uniform private placement regime for open-ended investment funds. BaFin will contribute actively to further debate on these topics.

● IOSCO: Corporate governance of investment funds.

In 2006, IOSCO dealt with the governance of investment funds. The establishment of a corporate governance regime for investment funds should improve aspects such as the safeguarding of investors' rights – through division of functions and independent supervision, for example. The report is based on a survey conducted in the Member States. It describes the principles of sound corporate governance for investment funds, and takes account of the views of the market players.

● IOSCO publishes opinion on fee sharing.

IOSCO has published a consultation report on soft commissions. The document reports on the supervisory rules in the Member States on fee-sharing agreements, and on non-cash benefits to be gained in the administration of investment funds. It also describes the potential associated conflicts of interest.

● IOSCO recommendations on the valuation of assets of hedge funds.

In 2006, the Technical Committee of IOSCO also published its final report on hedge funds. Following on from this, IOSCO worked closely during the year under review with industry experts to produce recommendations on the valuation of hedge fund assets.

The paper was published for consultation in March 2007. It will contain practical recommendations on the implementation of structures and processes intended to help value hedge fund portfolios appropriately. A wide range of investment strategies is available to hedge funds, which are largely unregulated on the international stage. Correspondingly, it is difficult to calculate the value of individual assets within a hedge fund portfolio.

#### **Market Abuse Directive – Survey on practical experiences**

In 2006 CESR-Pol, a sub-group of CESR, surveyed market participants on their practical experience of the Market Abuse Directive (MAD). Most of those surveyed were positive in their assessment of the scope of regulation implemented by the EU's Directive. In some areas, participants even expressed a desire for yet greater assistance. CESR-Pol will evaluate the reactions, and, if necessary, further explain the provisions of the Directive. During the year under review, CESR had already continued the programme it started in 2005<sup>4</sup> of issuing commentaries on Directives and has published these new commentaries for consultation.<sup>5</sup> These commentaries aim to define inside information, the justified postponement of its publication and mutual recognition of lists of insiders. When required, CESR-Pol forms so-called Urgent Issues Groups to coordinate action in the case of cross-border market abuse.

#### **Competition**

● IAIS takes account of German position on captives.

In 2006, IAIS published a paper containing recommendations for supervisors on the treatment of captives. Captives are insurance companies that belong to a group or a company and serve solely or mainly to insure the risks of that group or company. BaFin succeeded in ensuring that the paper took sufficient account of German positions.

● BaFin prevents distortion of competition.

Originally, the draft version of the Captives Paper recommended that lower supervisory standards be applied for captives that had limited dealings with third parties (diversified captives). Germany's representatives in IAIS rejected this proposal. The proposal could possibly have put diversified captives at an advantage over traditional reinsurers. Although the companies operate a comparable business, they would have been subject to different supervisory frameworks. This would have created competitive disadvantages for reinsurance companies of the conventional type. The resulting consequence could have been supervisory arbitrage which, in turn, could have led to a reduction in the level of protection for German customers of captives.

● IAIS report on the global reinsurance market.

In November 2006, IAIS published a new report on the global reinsurance market. Germany was one of the countries that had

<sup>4</sup> Level-3-Guidance-Paper - First Set of CESR-Guidance and Information on the Common Operation of the Directive Paper.

<sup>5</sup> MAD Level-3-Guidance-Paper - Second Set of CESR Guidance and Information on the Common Operation of the Directive Paper (Ref. CESR/06-562).

prepared and discussed written contributions to this report. Alongside Germany, data for the report was supplied by the reinsurance locations of Bermuda, France, Japan, Switzerland, the United Kingdom and the USA. In its report, the IAIS describes the global reinsurance market as having remained stable, despite the fact that insured losses in 2005 were higher than ever. The IAIS report also documents the relatively high capital strength of the reinsurers supervised in Germany compared with their international counterparts. Germany is one of the world's largest reinsurance markets.

● IAIS publishes opinion on G30 report on reinsurance companies.

BaFin collaborated on the development of an opinion that IAIS submitted in 2006 on a report by the Group of Thirty (G30). At the start of the year, G30 published a report, "Reinsurance and International Financial Markets".<sup>6</sup> IAIS welcomed the proposals of G30 in its published response, and will take account of suitable suggestions in its future work on international supervisory standards. IAIS did, however, also state points on which its members held a differing opinion to G30. These included the continued, unmodified application of purely economic criteria to solvency supervision, and the neglect of the supervisory principle of prudence in such cases. Moreover, differing opinions were also held on the possible effect on the solvency capital of an insurance undertaking if its reinsurer were to disclose its risk management.

G30 is an independent international committee comprising representatives from the private and public sectors, including academics and governors of various central banks. It investigates the context and possible consequences of decisions for the economy and financial sector.

● Paper on financial reinsurance revised.

At the instigation of and with the support of BaFin, IAIS has revised its guidelines on financial reinsurance (Guidance Paper on Risk Transfer, Disclosure and Analysis of Finite Reinsurance). The new version, which was adopted at the IAIS annual conference in October 2006, contains clearer guidelines than the original paper, which dated from 2005. The Guidance Paper takes greater account of supervisory systems outside the USA, and deals with life reinsurance as a distinct topic. In so doing, the revision updates two aspects of the previous version that had been subject to criticism. Practitioners from reinsurance companies and the press have already welcomed the improvements in the revised version. IAIS intends to continue to observe developments in the financial reinsurance sector. By the end of 2008, IAIS will issue a condensed Standard Paper to replace the present Guidance Paper.

The first Guidance Paper on financial reinsurance was issued in autumn 2005 after US insurer AIG had caused a scandal around the world following its improper accounting in relation to a finite reinsurance contract.

<sup>6</sup> www.group30.org » publications, „Reinsurance and International Financial Markets“, Washington (DC) 2006.

● NAIC proposes reform of collateral requirement.

For several years, the US National Association of Insurance Commissioners (NAIC) has been seeking to bring about a partial reform of the US supervisory system, especially with regard to the rules on collateral. A CEIOPS Task Force is now supporting the US insurance industry supervisor in this task. Established in April 2006, the Task Force is led by Germany and the UK. In December 2006, NAIC finally issued a majority-backed statement stipulating that the requirements for collateral should be reformed. Under the current system, foreign reinsurers operating in the USA must provide collateral for 100% of their business. In contrast, reinsurers based in the USA do not need to provide any collateral, irrespective of their financial strength. In this respect, BaFin has impressed the structure of the new and significantly stronger German reinsurance supervisory system upon NAIC on numerous occasions.

● Reinsurers should be evaluated on the basis of risk.

The draft reforms of the US insurance supervisor include the establishment of a Reinsurance Evaluation Office (REO). The role of the REO will be to evaluate reinsurance companies on the basis of risk, if they so wish. Evaluation is free of charge for US companies. The multi-stage evaluation results in the collateral requirement for the individual reinsurance company. The underlying data should include recognised rating sources and information gathered by the domestic supervisor. The draft reform is still subject to approval by an extended NAIC Committee.

## 1.2 Organisational requirements and rules of conduct

### Rating agencies

On behalf of the European Commission, a CESR Working Group has investigated rating agencies to determine whether and to what extent they have incorporated the IOSCO Code of Conduct, published in 2004, into their own codes. The CESR Working Group has reached the conclusion that the IOSCO Code of Conduct has, in the main, been implemented. However, the Working Group also pinpointed potential for improvement. Four rating agencies have declared that they are prepared to participate in the inspection: Dominion Bond Ratings Service, Fitch Ratings, Moody's Investors Service and Standard & Poor's Ratings Service. In 2007, CESR aims to investigate the influence in Europe of the US Credit Rating Agency Reform Act 2006. In mid-2006, IOSCO also launched its investigation into the extent to which rating agencies were implementing the rules proposed by the IOSCO Code of Conduct in their own codes. IOSCO investigated the areas in which agencies were deviating from the IOSCO rules, and what their reasons were for doing so. This will enable IOSCO to modify its Code of Conducts so that it reflects market practices more accurately. IOSCO released its provisional report for consultation at the beginning of 2007. The final report is expected by mid-2007.

### **Role of independent directors in listed joint stock corporations**

In February 2007, the IOSCO Technical Committee adopted a report on the role of independent directors in listed companies. BaFin participated in the Task Force that carried out this investigation. Among other factors, a restriction of the independence of board members is listed as a cause of some of the large company collapses over recent years. The investigation is the result of one of the terms of reference of the Parmalat report prepared by IOSCO. In the next stage, the Task Force will focus on the protection of minority shareholders.

### **1.3 Risk management and capital**

In 2006, IAIS published a paper describing the framework for risk-based assessment of the solvency of insurers. The Committee published the paper in February 2007, after revising it on the basis of comments received from the Member States. The paper forms a module of the international solvency system being developed by insurance supervisors who collaborate in IAIS. The solvency system comprises a range of standards and guidelines – its aim is to become a globally recognised benchmark to promote transparency and convergence of supervisory systems.

● Liquidity risks grow increasingly important.

Liquidity management and the liquidity risk of supervised companies and institutions are topics that are gaining in importance for supervisors around the world. The Joint Forum has determined that it is not appropriate to regulate these topics using a cross-sector approach, as different sectors involve very different risk elements. Nevertheless, all areas are working towards modernising the existing rules, albeit at different speeds. Until now, no European rules on supervising liquidity management have been formulated. At most, the tasks of the liquidity supervisors have been regulated. So far, it has been the responsibility of the Member States to determine the details of how this should be done. Supervisory authorities, central banks and those under supervision are all interested in modernising the rules governing liquidity control. Their aim is to bring up to date the work on liquidity risk undertaken by the Basel Committee on Banking Supervision, the Groupe de Contact, the Joint Forum and the Banking Supervision Committee, and to minimise the burden on banks and financial institutions. Moreover, efforts are to be made to establish whether or not banks' liquidity management has changed over recent years, to the extent that supervisory rules must be reformed. BaFin is striving to achieve close integration of the banks through their international associations and national forums, creating a proportional and efficient liquidity supervisor. Topics that must be discussed include the centralisation or decentralisation of liquidity risk management, the approval of more advanced internal models, the use of stress testing and scenario analyses, as well as the new liquidity supervision regulations affecting EU branches.

- CEBS guidelines on interest rate and concentration risks.

At the start of the year under review, CEBS published its general guidelines on the Supervisory Review Process (SRP). Within the framework of the SRP, the interest rate risk in the banking book and concentration risk must both be handled. Since these are very specialist fields, discussed separately in the guidelines, CEBS has issued guidance on them in two separate guidelines: the Guideline on the Management and Supervision of Interest Rate Risk in the Banking Book and the Guideline on Technical Aspects of the Management and Supervision of Concentration Risk under the Supervisory Review Process. These contain both an overview of the processes currently used by financial institutions to manage these risks, and also the qualitative requirements for supervisors and institutions which monitor and manage the risks. Both guidelines expressly underline the principle of flexibility in methodology and of proportionality. The Guideline on Management of Concentration Risk takes account of the findings collated by CEBS from a survey of financial institutions conducted by the Committee for a different purpose.

- Trading in commodity derivatives.

The European Commission has been occupied with aspects of commodity trading in conjunction with two European Directives, MiFID and the Capital Requirements Directive (CRD). Both Directives contain exemption provisions for the trade in commodity derivatives that are being reviewed. For this reason, the European Commission has involved CEBS in the work to prepare a report due to be submitted to the European Parliament and the Council in 2008. CEBS has investigated the supervisory situation of the Member States on behalf of the Commission. In a second report, the Committee is investigating the risks of commodity trading. The findings of the CEBS reports will be integrated into the recommendations on banking supervisory treatment of commodity transactions. CESR received a request from Brussels in spring 2007. BaFin aims to coordinate the work of the Committees of the banking and securities supervisors of the EU Member States, CEBS and CESR.

### **Crisis prevention**

- Recommendations of BSC and CEBS on crisis management.

Enormous progress has been made towards integrating the financial markets of the European Union in recent years. The introduction of the euro has made the markets more efficient, more diversified and more liquid. However, there is also increased interdependency and the risk that systemic crises will spread to several states. Numerous initiatives at European level are aimed at countering these risks. A joint working group of BSC and CEBS is seeking to make recommendations that will help central banks and supervisory authorities in the EU to overcome systemic, cross-border banking crises. The recommendations of the working group were adopted at the beginning of 2007. However, the report has not been published for fear that it could generate the false impression that in the event of a crisis the state would intervene, and that the main responsibility for overcoming such a crisis would not lie with the banks themselves.

Moreover, other works on crisis management are in the pipeline. A crisis simulation undertaken in early 2006 by the Economic and Financial Committee (EFC) demonstrated, for instance, that collaboration between authorities was in need of improvement, at both national and international level. Building on the conclusions of this exercise and other findings, CEBS and BSC will undertake further studies in relation to crisis management. BSC will concentrate mainly on analytical tasks, while CEBS will focus on more practical aspects.

● Joint Forum formulates business continuity principles.

A paper written for supervisory authorities and the financial sector, with seven principles formulated by the Joint Forum, is concerned with business continuity – i.e. the continuation of core business functions in the event of a crisis. The purpose of the paper is to improve the resilience of the financial system in times of crisis. Following the terrorist attacks of recent years, the outbreak of the SARS virus and various natural disasters, the risks of such events for the financial system have become more obvious. The report also reveals the extent to which individual countries have prepared business continuity strategies and plans.

#### **Emergency planning for pandemics**

In November 2006, the Financial Stability Forum held an international workshop dealing with the precautions to be taken in the case of a pandemic. The core points comprised the range of supervisory actions available in the case of financial crisis and disaster situations, and the options for international cooperation in the case of cross-border crises.

BaFin and the German Bundesbank had already considered the topic of pandemics at the beginning of 2006. In collaboration with BaFin, the Bundesbank had surveyed banks relevant to the system about the precautionary measures they had in place for the possibility of an avian flu pandemic. The findings of the survey indicated that they were all aware of the consequences of a pandemic and had taken preparatory measures. However, while all the banks questioned in the survey had general contingency plans in place, specific preparations were at various stages of development.

All insurers relevant to the system are apparently also aware of the topic. That was the finding of a survey conducted by BaFin in spring 2006, in which 15 system-relevant insurance groups were approached. The responses showed that all insurance groups had given consideration to dealing with a pandemic. All companies have a general business continuity plan for crises and natural disasters. Most insurers are aware of the possible risk to their business operations due to the spread of a highly contagious disease, and have taken preparatory measures.

### Definition of equity

On behalf of the European Commission, CEBS is working on a study on the importance of the individual components of regulatory capital, and on a proposal to harmonise these components throughout Europe. At the beginning of the year, a CEBS Working Group observed significant disparities with regard to the implementation by individual EU Member States of EU directives concerning regulatory capital. The Commission now wishes to have these disparities quantified. Moreover, it wishes to achieve greater convergence in relation to hybrid core capital instruments (i.e.

those combining the characteristics of equity capital and liabilities) as quickly as possible. CEBS is to

determine how further supervisory convergence in the recognition of hybrid core capital instruments can be achieved without

modifying existing EU directives. The

reason is that reforming the existing EU legislation would not be in line with the

European Commission's announcement that it was calling a temporary halt to

the phase of regulation. In addition, the

banking sector is justifiably demanding a period devoid of far-reaching new

supervisory rules. BaFin therefore

welcomed the fact that the discussions

regarding recognition of hybrid core capital

instruments would occur only in the wider

context of the planned reformulation of the

definition of equity. EU legislators have planned

this task for 2009.



The BCBS, too, has formed a Working Group devoted to the topic of defining capital. In order to achieve uniform competitive conditions throughout the EU, an important and difficult challenge must be met, namely the formulation of regulations on using capital to absorb losses. On this point, the supervisory rules of the various EU Member States still differ greatly. Furthermore, the widely differing fiscal rules among the Member States further complicate the task of achieving uniformity of competition.

German supervisors will be paying particularly close attention to how the situation regarding contributions to capital made by silent partners develops. Due to their importance in terms of regulatory core capital, these contributions will have to be discussed. BaFin is anticipating the impending discussions with confidence, since investigations conducted by CEBS to date have demonstrated that such contributions to capital can withstand comparison against components of core capital, which are recognised in other EU Member States for example, especially given the strict loss participation of silent partners and the durability of the issues.

● Focus on assets invested by silent partners.

## 2 Basel II

● Basel II and CRD adopted: Agreement at EU level.

On 20 July 2006, the revised Banking Directive and the modified Capital Adequacy Directive<sup>7</sup> came into force. The two directives are referred to together using the unofficial title, the Capital Requirements Directive (CRD). This completes implementation of Basel II within the Member States of the EU and the EEA. Since their implementation, collaboration and agreement among supervisors at EU level has focused on questions relating to the application and interpretation of these two directives. The European Commission has formed the Capital Requirements Directive Transposition Group (CRD TG) to answer these queries, within a period of three months if possible. In relation to questions of practical application of the new body of legislation in particular, the group draws on the technical expertise of the national banking supervisory authorities represented on CEBS.

Together with the Bundesbank and the BMF, BaFin is working within CRD TG to ensure that the experience gained in Germany during transposition of the directives into national law (KWG, SolvV and GroMiKV) is available in the responses to queries. BaFin, BMF and the Bundesbank are lobbying CRD TG to adopt the approaches applied during transposition in Germany. Within this context, BaFin may refer to the proposals drawn up through dialogue with the industry in the specialist committees of the Implementation of Basel II Working Group to ensure practical implementation and interpretation of the requirements of the EU directives. These proposals have already been taken into account in the transposition of the Banking Directive and Capital Adequacy Directive into German national law. BaFin can also lend its understanding of the practical issues, gained from IRBA approval processes, and approaches it has developed in solving any questions of interpretation that have arisen in the course of this work.

● Basel II intensifies cooperation among European supervisors.

Basel II, and its EU counterpart, the CRD, have not only greatly modified supervisory law and practice in individual countries. Cooperation among EU authorities in the supervision of banking groups that operate on a Europe-wide level has also been reformed. From 1 January 2007, the EU Member States must apply the provisions of the CRD, as transposed into their own national body of law. The new legal requirements lay the foundations for a more qualitative, heavily risk-oriented supervisory regime that assesses such factors as companies' individual risk management and risk controlling systems and demands that institutions meet quantitative capital requirements that are more closely linked to the actual levels of risk faced.

<sup>7</sup> Directive 2006/48/EC (EU OJ No. L 177, p. 1).

Supervisory practice must also adapt dynamically to the circumstances of the institutions. Within banking groups, risk control is increasingly a function that is provided centrally, at group level. BaFin has to react to this development. At national level, supervisors' focus is therefore moving increasingly from an analysis of the individual institutions belonging to the group to a broader supervision at group level, which nevertheless also takes account of each individual component institution.

● Cross-border groups put European supervisors to the test.

To meet the challenge of this development at international level, and also save companies from unnecessary additional burdens, all authorities involved in the supervision of international banking groups must work closely together. The supervisor in whose jurisdiction the parent company of a group is located is allocated responsibility for supervision of the group on a consolidated basis (the consolidating supervisor). Since the risks of the entire group are clearly influenced by those facing the subsidiaries, it is vital that the consolidating supervisor works closely with the supervisory authorities responsible for supervising the group's affiliated companies abroad at the level of each individual institution. To the same extent, supervisors of foreign subsidiaries are also required to work closely with the consolidating supervisor, since many decisions that affect the subsidiaries are actually made centrally at group level. With this interplay between the consolidating supervisor and the supervisory authorities responsible for foreign subsidiaries of the group, BaFin must meet the challenge of ensuring effective supervision according to German standards, while also dealing appropriately with the specific characteristics of other legal systems and markets.

The Banking Directive specifies how supervisors in Europe should overcome the challenge of supervising European banking groups. However, concerted consultation will also be required among EU supervisors, since there are still particular national characteristics in some areas, due partially to the national discretions available when implementing the Directive. The authorities will be able to find a sound overall solution, which is in line with European intentions despite such differences, only if they agree pragmatic approaches among themselves.

The directive already contains provisions for cooperation. For example, Article 129, paragraph 2 of the Banking Directive specifies a procedure according to which the consolidating supervisor acting in application procedures must agree with the competent supervisors for foreign members of the group any use of internal rating systems used for calculating the regulatory capital requirements.

● Joint acceptance and approval processes make high demands.

From 1 January 2007, institutions may use their own rating systems to measure specific risk parameters for counterparty risks and determine their regulatory equity capital requirements on this basis (IRBA). A prerequisite for the use of this procedure is that the supervisory authorities have approved the institution's use of the IRBA in advance and found the rating systems in place to be suitable. If a parent company makes a corresponding group

application for permission to use the IRBA, where this use also includes determining capital requirements for individual group-affiliated companies in other Member States of the EU, BaFin must collaborate with the EU supervisors participating in supervision of the affected companies in the group to determine whether permission to use the systems may be granted. If the parent company of the group is located in Germany, BaFin coordinates the procedure in its capacity as consolidating supervisor. If an institution that belongs to a group in which the parent company is located in another EU Member State is subject to German supervisory authority, BaFin will become involved in the capacity of supervisor responsible for supervision at institutional level. If the participating supervisors fail to reach an agreement within a period of six months, the consolidating supervisor has the final right of decision and, in such a case, may decide on the application alone.

The joint acceptance and approval process is extremely demanding for the participating supervisory authorities, especially since international groups of banking institutions frequently apply statistical models in rating systems across several countries. In practice, there are numerous cross-border examples – subsidiaries have to use systems developed at group level, systems developed by subsidiaries are only used by those subsidiaries, systems that subsidiaries have developed are to be used throughout the group.

Both the consolidating supervisor and the supervisors responsible for the affected institutions at institutional level may be required to trust the assessments made by the other supervisor in each case. In order to take due account of the corresponding legal systems and markets in relation to specific risk items, the consolidating supervisor and other supervisors affected must work closely together.

The fact that Article 129, paragraph 2 of the Banking Directive gives the consolidating supervisor the final right of decision if no agreement can be reached within six months means, as far as BaFin is concerned, that concerted consultation is required, especially in procedures in which it has the role of supervising at institutional level companies belonging to a group based abroad. After all, BaFin's responsibility is to ensure that sufficient attention is paid to specific German characteristics.

● Open communications create trust.

Cross-border cooperation can, therefore, succeed only if communications are transparent and open, and specific national requirements can be discussed at an early stage. This is the only way to ensure the vital levels of trust among all participants.

● First joint IRBA acceptance successfully concluded.

During the year under review, BaFin successfully conducted its first cross-border IRBA application review (including the required assessment of the suitability of rating systems), acting as the supervisor at institutional level of a company affiliated to a group, cooperating with the Swedish supervisory authority in its capacity as the consolidating supervisor. The application procedure was characterised by open discussion of the findings gathered and of

how the supervisors could proceed together. It is a real example of good cooperation with foreign supervisory authorities.

Numerous European IRBA approval processes underway.

In a further European IRBA approval procedure, Banca d'Italia and BaFin are working closely to minimise the supervisory burden generated for the affected group of institutions by the approval procedure. A number of joint meetings have already been held. Cooperation with the Dutch supervisor is also developing in a positive vein. Here, again, BaFin is contributing its expertise as the local banking supervisor in the approval process.

Implementation of Basel II is not yet complete in a number of third states. Nevertheless, BaFin is already working with the authorities in these states, especially those responsible for supervising banking groups that have significant holdings in institutions in Germany. The aim in this approach is to coordinate the application of the capital requirements that have been modified by Basel II within the banking group.

International cooperation holds the key to successful supervision.

The changed requirements for cross-border cooperation are not simply limited to the acceptance procedure. The ongoing supervision of institutions, the Brussels SREP (Supervisory Review and Evaluation Process) also demands concerted cross-border cooperation between the supervisory authorities. Ongoing supervision also demands effective cooperation, and requires the burden of supervision to be limited to an appropriate level. So far, BaFin's experience has demonstrated that European supervisory authorities have a definite capacity and willingness to cooperate. BaFin is therefore confident with regard to the prospect of cooperation in SREP.

### 3 Solvency II

The Solvency II project redefines the regulatory solvency requirements for insurers in Europe. It marks a move towards a principles-based supervisory system, geared more strongly towards actual insurer risks than the current rules-based system. The aim is to create incentives for further improving risk management and harmonising supervision in Europe in an appropriate way. To date, various implementation options in the insurance directives have led to varying levels of safety within the EU.

CEIOPS, which is advising the European Commission on the development of Solvency II, submitted the responses to the third wave of Calls for Advice to the Commission in early 2006. Additionally, CEIOPS has published further proposals on issues that are still outstanding or that require resolving in greater detail.

Framework directive planned for 2007.

The European Commission plans to submit a proposal for a framework directive on Solvency II in July 2007, setting out the fundamental key points of the new rules. The framework directive

is based on a summary of the key points of most of the directives in existence in the area of insurance. This summary is already available in draft form. Amendments necessitated by Solvency II are still to be made to this summary.

### Impact studies

Quantitative Impact Studies (QIS) have an important role to play in the Solvency II project. These studies are used for investigating the specific impact that the Solvency II proposals would have on insurers, in an effort to ensure that Solvency II can be implemented in practice.

The first impact study (QIS 1) with regard to Solvency II was carried out at the end of 2005, looking at technical provisions. These were calculated on the basis of the planned new valuation principles. The provisions calculated in this way were compared with provisions calculated on the basis of the currently applicable national accounting principles. The second impact study (QIS 2) was carried out in mid-2006. Over and above the valuation of reserves, this looked at the change in the solvency balance sheet including equity and capital requirements.

Some 92 German insurers were involved in QIS 1, with as many as 159 taking part in the second study. Compared with the rest of Europe, this is an exceptionally high level of participation. The principles and formulas tested showed that provisions generally fell, whilst valuations of investments and equity rose. Capital requirements rose on a comparable basis.

Based on the test results, the German insurance industry appears to be well equipped for Solvency II. The CEIOPS working groups have incorporated the results of the impact studies into their recommendations on the framework directive and proposals for harmonisation. The third impact study is due to be implemented in the middle of 2007. This will look at the solvency balance sheet in more detail, fine-tune the calibration of the MCR (minimum capital requirement) and SCR (solvency capital requirement) and also encompass group aspects.

### CEIOPS Pillar I working group

The Pillar I Expert Group is formulating the quantitative requirements to be made of insurers, and reports to the European Commission. In 2006, the group fine-tuned its existing advice with regard to the Directive. It provided a detailed statement on the principles used for valuating technical provisions, on the structure and design of the standard formula and on the application of internal models. Additionally, the working group voiced its opinion on the rules on available own funds, various classes of capital and the limits placed on each quality class, and on minimum capital requirements. Its advice incorporated, among other information, the findings from the impact studies.

Major involvement of German insurance industry.

German insurance industry well equipped.

Quantitative requirements for insurers.

● Solvency II aims to harmonise technical provisions.

The plan under Solvency II, for supervisory purposes, is to harmonise the methods used for calculating technical provisions at European level. This marks a move away from the current fragmented system with different approaches at national level. Under Solvency II, technical provisions will comprise two components: the best estimate and the risk margin.

The best estimate is the expected present value of future cash flows. This means that future cash flows for claim payments are estimated and discounted. Thus, Solvency II uses statistical methods in order to calculate the provisions.

The risk margin is a risk buffer to be provided by the companies in addition to the best estimate. If a market price is available for the technical provisions, it is taken as the best estimate, within which the risk margin is already included. Otherwise, the risk margin should be calculated as closely to the market as possible. The risk margin is calculated using the cost-of-capital (CoC) approach, the present value of the cost for future required capital.

The modelling process is based on conservative assumptions, which guarantee a sufficient degree of safety. Key parameters and assumptions should be stipulated.

● Plans for a standard formula with a modular design.

The standard formula with which insurers will be able to calculate their solvency capital requirement will be modular in design. This offers the advantage of transparent capital allocation and also facilitates the transition to an internal model. The standard formula takes account of compensatory effects between different risk types, such as market risks and technical risks, by stipulating linear correlations. The solvency capital requirement (SCR) is determined in two stages. A correlation matrix is used for linking risks that belong to the same overriding risk class. A second matrix is then used for linking the individual risk classes together.

The risk modules of the standard model – such as market, technical and operational risks – have matching parameters through calibration of the SCR with regard to confidence level, time horizon, probability of ruin and valuation of assets. Market risk measures the volatility resulting from the market prices of financial instruments. It is composed of various different factors such as interest rate, equity and real estate risk. Market risk also encompasses the volatility of spreads over the risk-free curve, risk concentration and the currency risk. The value for individual market risks such as equity price risk is calculated by applying a particular scenario, such as a particular fall in the equity prices, to the underlying variables.

The value of the technical risk in life insurance is determined by considering scenarios for mortality, longevity, invalidity, cost, error and catastrophe risk. In terms of non-life insurance, the technical risk is determined by considering premium, reserve and catastrophe risk. For health insurance, the standard formula encompasses a separate module for calculating technical risks. This is based on the sub-risk categories of costs, death, termination, epidemics and cumulative effect.

The module for operational risk is defined as the suffering of losses due to internal processes that contained errors or were caused by people, systems or external events. No risks that have already been covered in other modules should be taken into account. The value for operational risk is calculated with a simple function. The value for operational risk is derived from two variables: technical provisions and earned premiums. It makes sense to limit the value for operational risk, as the calculation approach is simple in structure. This limitation avoids a situation where this risk class dominates the SCR.

Internal models subject to various tests.

Insurers may also use their own internal models in place of the standard model to demonstrate that they have sufficient capital. Compared with the standard model, the internal model's view of the company's risk situation is closer to the real situation. Any internal model must be reviewed and approved by the supervisory authority. This similarly applies to any modifications that a company wishes to make once its model has been recognised. Insurers must continuously review their internal model and, with the aid of various testing processes such as statistical quality tests, calibration tests and benefit tests, carry out regular analyses.

Capital separated into three quality classes.

Under Solvency II, the available capital is determined from a solvency balance sheet. The difference between assets measured at market values and the liabilities measured using Solvency II rules is the available capital. This is then subdivided into three quality classes: Tier 1, Tier 2 and insurance Tier 3.

Specific principles have been established to ensure the consistent application and allocation of the different tiers. Basically, the greater the extent to which the capital can be used to absorb losses, the higher the tier. Consequently, capital elements that are unlimited in terms of time are to be preferred over elements that limited in time. The highest tier must completely absorb losses both in the case of a going concern and in the event of liquidation.

The capital elements under core Tier 1, such as paid-up basic capital, are the highest quality class. Tier 2 capital elements are generally not as permanent or do not have the same potential to offset losses as Tier 1 capital. Insurance Tier 3 includes capital elements that can only be used for covering losses subject to certain conditions. This includes, for example, non-paid-up basic capital and potential additional contributions in the case of mutual insurance associations. This quality class is not permitted as coverage for the MCR. Recognition is subject to principle-based criteria being fulfilled, which must be formulated clearly and transparently.

The limit system restricts the potential recognition of capital elements that are not included in the highest quality class, in a bid to guarantee overall capital adequacy. A clear structure for the capital and limit system will ensure the existence of a level playing field in Europe.

### CEIOPS Pillar II working group

In 2006, the Pillar II Expert Group worked on further developing the qualitative requirements applicable to insurers and the supervisory authorities. Key focuses of its work included capital add-ons and risk/capital management and assessment, as well as reinsurance, the harmonisation of supervisory processes and the powers of the supervisory authorities.

Decision on capital add-ons to be harmonised on a Europe-wide basis.

Provision is made under Solvency II for the supervisory authorities to demand capital add-ons with regard to the insurer's capital requirements, in particular where circumstances such as an incomplete risk management system prevail.

This should be an exceptional demand rather than a routine request. Should the supervisory authority establish that the risk profile of a particular company is not covered by the standard formula or that the risks of the insurer are not captured correctly by adopting the standard formula, the supervisor will be able to request additional capital.

Furthermore, a request may be made for capital add-ons if the qualitative requirements relating to risk management and internal controls are not met. A capital add-on due to established qualitative shortcomings will be used in order to increase the SCR only until the deficits have been eliminated. The company or supervisor should not publish the level of and reason for an individual capital add-on.

To guarantee a uniform procedure for decision-making on capital add-ons across Europe, a five-stage process is being proposed. Using a decision tree, this produces a clearly documented yes/no decision. The process is to be identical at both solo and group level. If the solo supervisor decides in favour of additional capital, it will inform the group supervisor of the reasons so that the latter can decide whether, due to the recognised shortcoming, a higher capital requirement is also needed at group level.

Insurers must actively manage risk and capital.

As part of their commercial strategy, insurers must implement their own measures in relation to solvency capital, material risks, risk reduction and transfer of risk. Furthermore, internal control mechanisms and processes are required that can provide qualitative and quantitative measures of the risks identified and their likelihood of occurring. Information on the influence of the risk on the amount and quality of capital relevant to achieving the company's own objectives must also be provided.

With regard to solvency capital, the insurer must analyse how the business plan influences fulfilment of the regulatory requirements. Consequently, insurers must inform the supervisor immediately if the SCR or MCR is undershot, or if there is a threat of the minimum level not being reached. Based on further analysis, companies must demonstrate the amount of capital they believe they need for their business operations, comparing this against the

result obtained using the standard formula. The analysis as a whole must be forward-looking. This is the only way to ascertain whether the solvency requirements will also be met in subsequent years. Stress testing, analysis relating to the continuation of business and dynamic financial analysis can also be used in this respect.

- Insurers and reinsurers subject to the same rules.

To date, CEIOPS has operated on the assumption that, generally speaking, reinsurers should be subject to the same rules as insurers. This relates to verifying the suitability of managers, corporate management, internal controls and risk management. The same rules should also apply to managing technical provisions, investment policy and reinsurance.

- Supervisory processes and powers to be harmonised.

The way in which European supervisory authorities are organised and equipped is based solely on the decision taken by national policymakers. To harmonise and streamline supervision, CEIOPS deems certain standards necessary. The supervisor must be able to operate without interference from policymakers or industry. Moreover, the financing of supervision must be arranged in such a way that policymakers and industry cannot intervene, and to ensure that sufficient personnel and material resources are made available. Additionally, the supervisor must have suitable internal workflows and audit measures at hand. Supervisory processes must be clearly defined, transparent and consistent.

It is the responsibility of the Member States to ensure the supervisory authorities are equipped with all of the powers they need to perform their tasks. In the first instance, the supervisor must be able to enforce the laws and regulations affecting the insurance undertakings. Then, it must have the power to introduce standards, recommendations and guidelines. Furthermore, it is the supervisor's task to define the principles for a proportionate supervision of companies and to implement these, whilst also guaranteeing a consistent approach to the stipulated exemptions.

### **CEIOPS Pillar III working group**

- Public disclosure growing ever more important.

The Pillar III Expert Group has drawn up recommendations on reporting by insurance undertakings, with regard to both reporting to the supervisory authorities and public disclosure obligations.

The aim of supervisory reporting is to support the risk-oriented approach of insurance supervision. Public disclosure, on the other hand, relates to the need to let market forces unfold. If an insurer is required to publish information on, say, its capital adequacy situation, it will be in that insurer's interest to ensure its operations are conducted on an efficient and robust basis. Under Solvency II the significance of public disclosure will therefore rise.

The working group has drawn up far-reaching principles for both types of reporting. The duty to provide information applies to the individual insurer and to the insurance group. The insurer must guarantee a reasonable quality of data in compliance with specific criteria such as appropriateness (in terms of being up-to-date

information), importance and comprehensibility. In this regard, the company must stipulate formal procedures to ensure the reports are appropriate and suitable.

With regard to public disclosure obligations, the insurer must provide an annual report. In terms of supervisory reporting, the criteria vary according to the type of information.

The working group has identified a minimum list of contents for both types of report. The aim is to assess the company's solvency and financial situation more effectively. It is a case of each company providing an overview of its operations and performance data, objectives and strategies. The insurers must describe the internal control system used for assessing solvency and evaluate the financial situation. They must also communicate the valuation basis relevant to solvency and incorporated into the solvency system (provisions, investments and equity). Strategies and processes used for identifying, measuring and limiting individual risk classes should be described. Information on the permitted supervisory capital and on any differences compared with the external accounting figures is also required.

#### **CEIOPS working group on groups**

● MCR not required at group level.

The Groups/Cross Sectoral working group developed recommendations in 2006 focusing on group MCR and dealing with diversification effects, subgroups and links with third states. One of the main results of this work is that an MCR is not required at group level. However, as a floor for an SCR, a "proxy MCR" should be created at group level. The idea is that the total solo MCRs should be used, multiplied by a factor of greater than/equal to one. Additionally, within a group context, it is also important to ensure that supervisory requirements can be controlled and enforced. These aspects must also apply to holding parent companies that are not insurance undertakings.

● Diversification effects at group level may be taken into account.

Group diversification effects are defined as the difference between the total of all individual SCRs and the group SCR, based on consolidated figures. Account should be taken in this regard of the specific risks facing groups and the transferability of the capital. Diversification effects should be used where the available capital of the individual company is increased. The working group rejected the alternative solution of reducing the capital requirements.

● Supervision at subgroup level a possibility.

If a subgroup finds itself in financial difficulties or holds a high market share on a national market, that subgroup may be subject to special supervision. Overall, however, no more than two levels of group supervision, national and EU level, are permitted. The additional supervision of a subgroup must be approved in advance with the group supervisor of the entire group.

● Dealing with parts of groups located in a third state.

CEIOPS is to issue its members with recommendations on the question of whether the supervision of a third state is to be regarded as equivalent supervision. This excludes the possibility of varying valuations. The issue of equivalent supervision by a third

state has implications for the manner in which supervision is conducted within the EU.

In the case of a subgroup or company being supervised in a third state in which there is no equivalent supervision, the supervisory authority of an EU Member State may demand that the standard model be calculated for the companies in the third state or that a capital add-on be imposed. The supervisor may also demand that an EU holding be used.

However, if there is no equivalent supervision, the information from the third state may be used for group supervision and with regard to the input data for internal models.

#### **BaFin Internal Models Working Group**

Through its Internal Models Working Group, BaFin began by bringing the German Insurance Association (GDV – Gesamtverband der Deutschen Versicherungswirtschaft) and companies together in 2006 in order to facilitate a gentle form of introduction to the use of internal models so that they could be approved upon the entry into force of Solvency II.

The working group provides a framework within which the insurer and BaFin can exchange first-hand information. The companies learn how BaFin plans to audit internal models, whilst BaFin is informed about the aims being pursued by the companies with their internal models, learns which form of implementation is preferred and is updated on the progress made hitherto. In this way, the insurers reduce the level of uncertainty surrounding the approval process and avoid making poor investments.

## 4 Accounting and enforcement

The International Accounting Standards Board (IASB) and its US equivalent, the Financial Accounting Standards Board (FASB), have agreed to work together to harmonise their standards. To this end, the Boards presented the first part of a new conceptual framework in summer 2006. The medium-term aim is for this new conceptual framework to replace its predecessor, which dates from the 1980s. Given that the balance sheet forms the basis for numerous key figures relevant to supervision, the international supervisory authorities have shown a keen interest in the discussion paper on the new conceptual framework. The Basel Committee on Banking Supervision, IAIS and European bodies such as CEBS have all commented on the proposals in the discussion paper on the conceptual framework.

This new conceptual framework is not the essential basis on which balance sheet issues will be resolved within the IASB hierarchy of standards, as the individual IAS or IFRS standards and their

● Gradual introduction to applying internal models possible.

● IASB and FASB cooperate to converge standards.

interpretations will remain the critical source of information in the first instance. However, its design is relevant in terms of how future standards are set out. Therefore, the conceptual framework has played an important role in setting the future course for the concept of accounting. The draft of the new conceptual framework formulates general basic assumptions and qualitative criteria for accounting. These include the going-concern principle, as well the principles of comprehensibility, significance and comparability. The principle whereby accounts should provide a true and fair view and the principle of substance over form have also been incorporated into the conceptual framework. Furthermore, the draft stipulates that the actual aim of accounting is to provide pertinent information when taking decisions.

Supervisors sceptical about parts of the new conceptual framework.

Supervisors have been extremely sceptical about two of the proposals in the new concept. The first involves integrating the principle of reliability and of substance over form into the overall concept to form a faithful representation. The second involves reducing the accountability requirement, which was previously an accounting objective in its own right, to a component of the comprehensive provision of information that will be useful for decision-making. If these proposals are put into practical effect in the form of individual standards, accounting may well become significantly more subjective. The principle of reliability was always a key argument in earlier debates with the IASB, so as to be able to demand that values were still calculated in a transparent and comprehensible way for accounts based more strongly on fair values. Moreover, it is difficult for the supervisors to understand why an important balance sheet principle such as substance over form should no longer be explicitly mentioned. This similarly applies to the accountability function of preparing the balance sheet. In addition, the supervisors have spoken out in favour of making the conceptual framework a binding document in contrast to its previous status, so there is less scope from deviating from the principles in future. The dialogue with the IASB must be continued.

IASB – Differentiating between equity and borrowed capital the subject of debate.

The IASB's concept for classifying equity instruments and financial liabilities is the subject of debate. Developments in this regard are being monitored by the supervisory authority, affecting as they do the equity of the institution being supervised. IAS 32 deals with the disclosure of financial instruments, and provides information on how to distinguish between equity and liability instruments. One of the consequences of these rules is that all puttable instruments constitute a financial liability. Particularly in the case of legal forms such as partnerships or cooperatives, the rules mean that the company cannot report any equity (or very little), as the partners in such legal forms may put back major portions of the equity.

Criticism of IASB proposal for amendment of IAS 32.

The IASB submitted a proposal for the amendment of IAS 32 in summer 2006. However, it was merely suggesting that specific puttable financial instruments previously regarded as liabilities be classed as equity instruments subject to corresponding prerequisites being met. Numerous experts have made negative comments on this very detailed proposal, mainly because of its

deviation from the IASB conceptual framework and due to the lack of accounting principles contained therein. The claim is that it deals with a specialist solution, which would be difficult, if not impossible, to apply on a general basis. Additionally, it is claimed that the proposal is not a suitable way to resolve the long-term difficulties facing partnerships in reporting equity.

● IASB insurance project.

The International Association of Insurance Supervisors (IAIS) is following the work being carried out under the auspices of the IASB insurance project. The IAIS has a representative on the relevant IASB working group, for example. The IAIS has an interest in specific items on the external balance sheets prepared by insurers being calculated in such a way that they can also be used for supervisory reporting. It is therefore attempting to exert an influence on the discussions being held by the IASB working group. Its actions in this regard have included drawing up a paper. Whether the IASB takes up the proposals in this paper will probably emerge in the second quarter of 2007, when its own discussion paper is due to be published.

In its paper the IAIS makes the case for a fair value model for the valuation of an insurer's liabilities to be accepted only on condition that the fair value is derived as far as possible from liquid markets. The IAIS is also calling for an appropriate risk margin that must be transparent and comparable across different insurance undertakings. Moreover, the IAIS does not believe that the surrender value should be the lower limit for the valuation. The IAIS rejects the IASB's idea that the insurance undertaking's own credit-standing should be incorporated into the valuation of liabilities.

● Basel Committee for Banking Supervision on fair values and the valuation of credit risks.

The Basel Committee for Banking Supervision published two documents on accounting-related themes during the year under review. Both papers deal with important basic parameters for reliable accounting, based primarily on internal control systems and risk management. These fundamental principles are already enshrined in MaRisk, ensuring German institutions are very well prepared for these documents.

The first paper sets out principles on the use of the fair value option, the allowed alternative treatment under IAS 39. As far as the supervisors are concerned, it is important that this allowed alternative treatment does not lead to unreliable valuations in the case of instruments that are not particularly liquid. Such valuations would distort the figure for annual profit, thus also influencing equity. The Basel document therefore sets out seven principles in relation to use of the fair value option. These should guarantee that this fair value option is integrated into a bank's risk management system and that fair values are calculated reliably. The Basel Committee paper relates back to a debate on the design of the right to use fair values under IAS 39. Based on the allowed alternative treatment under IAS 39, a decision may be made for each financial instrument at the time of its first inclusion in the accounts, determining whether it is to be valued at fair value. This also applies if the instrument is not traded and is therefore not

very liquid. It also involves the direct recognition in the income statement of all changes in fair value. The background to the allowed alternative treatment relates to the simplification of otherwise very complex accounting rules for hedging transactions.

- Paper aimed at banks and supervisory authorities.

The second paper deals with the valuation of credit risks and replaces a document published in 1999. It is aimed at banks and supervisory authorities. The paper contains considerations that supervisors should make when assessing a bank's credit risks in order to assess the appropriateness of its regulatory capital. It formulates principles for internal control and the proper management of credit risks, also dealing with the management's responsibility to ensure there is an adequate level of risk provisioning for lending business. Given the validity of these principles, irrespective of the accounting standards being used, they are consistent with the provisions of IFRS.

- Moving towards uniform enforcement of international accounting.

The CESR agenda for 2007 included a report on initial experiences gained during the introduction and monitoring of IFRS. Listed companies subject to the law of an EU Member State must prepare their consolidated financial statements for financial years commencing on or after 1 January 2005 in accordance with IFRS. In this regard, CESR drew up a working programme with the SEC in August designed to lead to a standardised exchange of information for enforcement purposes.

- Part of enforcement decisions to be published in 2007.

The database of enforcement decisions made by CESR members, maintained since 2005, now contains over 90 decisions. CESR has published some of these in anonymised form during the first half of 2007. Preparations for a comparable electronic data collection were also concluded at IOSCO in February 2007. The IFRS will be implemented on a uniform basis not just in Europe but worldwide. This database of decisions should be accessible in 2007.

## 5 International cooperation

### 5.1 Groups operating on a cross-border basis

- Lead Supervisors for all insurance groups with cross-border operations.

The Insurance Group Supervision Committee (IGSC), which forms part of CEIOPS, made a strong case in 2006 for appointing one lead supervisor for every insurance group operating on a cross-border basis as a key point of contact for all activities relating to the supervision of that insurance group. This is an important step towards avoiding redundancies in supervision and also with regard to intensifying cooperation between the different supervisory authorities in Europe. A coordination committee comprising the responsible EU supervisors for the insurance undertakings within the insurance group exists for each insurance group. The lead supervisor is appointed by means of an unanimous decision made by all members of this committee. The statutory responsibilities of the individual regulators as currently specified by law remain

unaffected. It is merely the case that specific tasks are assigned to the lead supervisor. For example, he has an important role to play in assessing an insurance group's risk profile. Further roles include organisational and coordinating duties. CEIOPS issued a statement on the role of the lead supervisor in December 2006 which is available for consultation on its website.<sup>8</sup>

BaFin has applied to be lead supervisor for all 15 insurance groups with cross-border operations whose main focus is in Germany. It currently performs this function for 12 insurance groups. Conversely, BaFin supports any application from another EU supervisory authority to adopt the position of lead supervisor for insurance groups whose main focus of activity is in that particular state.

● New supervisor forum facilitates implementation of Basel II.

During the reporting year, CEBS commissioned its Groupe de Contact to set up a Subgroup on Operational Networks (SON) for banking groups operating on a cross-border basis. SON comprises the supervisors of 10 banking groups with significant cross-border operations in Europe, and includes savings and cooperative banks. Its aim is to address questions raised by the implementation of Basel II and the related CEBS guidelines as an interface between the supervisors of the different states and as an interface between the supervisors and the banks. In the first six months of its existence, the new forum of specialist supervisors has helped make experience gained from cooperation in supervising a cross-border banking group available to other supervisors and banking groups. In this way, the group is making an important contribution to the efficient implementation of Basel II within the EU. In this respect, the priority is to develop pragmatic solutions that comply with the regulatory requirements, and are practical in their design, by drawing on the experiences of other supervisory authorities. The European Banking Federation has set up an informal working group composed of representatives of the 10 SON bank groups to coordinate and follow the work of SON from a banking perspective.

● 2007 to focus on implementation of the second pillar.

In 2006, SON examined the cooperation between specialist supervisors in implementing Basel II. The group looked, for instance, at the problems caused by differences in the implementation of the CRD in the Member States, particularly in cases where supervisors in the Member States adopt a different approach to accepting advanced rating procedures under the first pillar of Basel II. During 2007, SON will also be looking at questions that arise in relation to implementing the second pillar. The findings of the work carried out by SON hitherto reveal that practical cooperation between different supervisory authorities in accepting advanced procedures has proved easier than the banks and supervisors anticipated. Difficulties arising from the application of different supervisory regimes and cultures have generally been resolved in a pragmatic way. Cooperation between different supervisory authorities has meant that resources can be used efficiently and has avoided any unnecessary burden being placed on the institutions. Furthermore, different requirements and

<sup>8</sup> Statement on the role of the lead supervisor.

definitions appear less relevant to everyday practice than was initially feared. To date, compromises have been reached or different requirements and definitions have reflected different customary practices in the respective markets, making them appropriate both from a regulatory perspective and in terms of risk management. There have already been cases of advanced procedures for assessing credit risk being accepted.

Table 2

**Foreign banks in the Federal Republic of Germany**

(Figures in brackets indicate numbers of banks as at 31 December 2005)

	Country	Subsidiaries of banks	Subsidiaries of non-banks	Branches	EU subsidiaries	Representations
1	Afghanistan					
2	Andorra					1 (1)
3	Australia			1 (1)		
4	Austria	1 (1)			10 (10)	5 (5)
5	Azerbaijan			1 (0)		1 (0)
6	Bahrain					
7	Belarus					1 (1)
8	Belgium	2 (2)			1 (2)	
9	Bosnia-Herzegovina					1 (1)
10	Brazil			1 (1)		1 (1)
11	Canada		1 (1)		1 (0)	0 (1)
12	China			3 (3)		2 (2)
13	Croatia					
14	Czech Republic					1 (1)
15	Denmark				3 (3)	1 (1)
16	Egypt	1 (1)				
17	Finland				1 (1)	
18	France	4 (5)			17 (17)	11 (11)
19	Gibraltar					
20	Great Britain	3 (5)	0 (5)		8 (16)	2 (3)
21	Greece	1 (1)			1 (2)	
22	Iceland			1 (0)	1 (0)	
23	India			1 (1)	1 (0)	
24	Iran	1 (1)		3 (3)		
25	Ireland				3 (3)	3 (4)
26	Israel					3 (3)
27	Italy	3 (2)			4 (4)	2 (2)
28	Japan	2 (2)		3 (4)		4 (4)
29	Jordan	0 (1)				
30	Latvia				1 (1)	
31	Liechtenstein	1 (1)				
32	Luxembourg	1 (1)			0 (1)	
33	Mongolia					1 (1)
34	Morocco					
35	Netherlands	5 (6)	0 (1)		16 (16)	
36	Norway				1 (1)	
37	Pakistan			1 (1)		
38	Philippines					3 (3)
39	Portugal					6 (6)
40	Romania					
41	Russia	1 (1)				4 (3)
42	Saudi Arabia					
43	Slovenia	1 (1)				
44	South Africa	0 (1)				0 (1)
45	South Korea/Rep. Korea	2 (2)				3 (3)
46	Spain	1 (1)			1 (1)	8 (7)
47	Sweden	1 (0)	0 (1)		2 (1)	
48	Switzerland	4 (6)	0 (2)			0 (2)
49	Taiwan					
50	Tajikistan					1 (1)
51	Tunisia					
52	Turkey	4 (4)	0 (1)			6 (4)
53	U.S.A	8 (7)	7 (5)	5 (5)	8 (6)	
54	Yugoslavia					1 (1)
		<b>47 (52)</b>	<b>8 (16)</b>	<b>20 (19)</b>	<b>80 (85)</b>	<b>72 (73)</b>

## 5.2. Memoranda of Understanding and technical cooperation

- BaFin and supervisory authority in Dubai agree on MoU.

BaFin concluded a cross-sector Memorandum of Understanding (MoU) with the Dubai Financial Services Authority in 2006. It also extended its MoU with the Korean Financial Supervisory Commission. Previously restricted to the banking sector, this MoU now also encompasses cooperation arrangements for insurance supervision. In the area of banking supervision, new MoU were signed with Banco Central do Brasil and the Central Bank of the Russian Federation. In the USA, the Federal Deposit Insurance Corporation joined the existing MoU on the banking sector in place with the Federal Reserve System and the Office of the Comptroller of the Currency.

- BaFin joins Swiss MoU.

A central element of the efficient supervision of insurance undertakings that form part of an insurance group or financial conglomerate is consideration of their financial links with companies in other countries. BaFin joined an MoU concluded by the Swiss insurance supervisory authority, the Swiss Federal Office of Private Insurance and CEIOPS in the capacity of representative of the responsible authorities of the EU and EEA Member States. The Memorandum deals with the general principles of cooperation, the exchange of information and rules governing protection of confidentiality and the use of exchanged information.



Table 3  
Bilateral MoU

Banking supervision		Insurance supervision		Securities supervision	
USA (FDIC)	2006	South Korea	2006	Dubai	2006
Dubai	2006	Dubai	2006	Slovakia	2004
Brazil	2006	Australia	2005	Canada (Quebec)	2003
Russia	2006	Malta	2004	Cyprus	2003
USA (OTS)	2005	Canada	2004	Jersey	2001
Australia	2005	Romania	2004	Russia	2001
Canada	2004	Lithuania	2003	South Africa	2001
Malta	2004	Estonia	2002	Austria	2000
China	2004	Czech Republic	2002	Singapore	2000
Hong Kong (HKMA)	2004	Hungary	2002	Turkey	2000
Poland	2004	China	2001	Brazil	1999
South Africa	2004	Latvia	2001	Poland	1999
USA (Fed Board/OCC)	2003	Slovakia	2001	Argentina	1998
Romania	2003			Australia	1998
Czech Republic	2003			China	1998
Estonia	2002			Hong Kong	1998
Slovakia	2002			Portugal	1998
USA (NYSBD)	2002			Czech Republic	1998
Argentina	2001			Hungary	1998
Lithuania	2001			Italy	1997
Slovenia	2001			Spain	1997
South Korea	2001			Taiwan	1997
Jersey	2000			USA SEC	1997
Latvia	2000			USA CFTC	1997
Hungary	2000			France	1996
Hong Kong (SFC)	1997				
Portugal	1996				
Finland	1995				
Norway	1995				
Austria	1995				
Sweden	1995				

IAIS drafts new multilateral MoU.

An IAIS working group, chaired by BaFin, drafted a Multilateral Memorandum of Understanding which was adopted in February 2007. Since the working group had a German chair, the essential interests of BaFin were upheld. The aim of the agreement is to improve the exchange of information and cooperation between insurance supervisory authorities worldwide. This applies, in particular, to the supervision of insurance and reinsurance undertakings with international operations and to insurance and reinsurance groups. The minimum confidentiality requirements with which the standards applicable in Europe must comply form a core area of the Memorandum. IAIS members may join the agreement on a voluntary basis.

New signatories to IOSCO and CESR multilateral MoU.

The IOSCO multilateral MoU now has 36 signatories, with Israel and Dubai among the new additions in 2006. There is a further multilateral MoU managed by CESR-Pol in the EU, binding the securities supervisors of all of the EU Member States to each other. Due to the far-reaching harmonisation based on directives, cooperation within Europe is far simpler than with third countries. No third countries have as yet signed the CESR and IOSCO multilateral MoU.

Twinning project with Turkey.

During the year under review, BaFin also advised and supported foreign supervisory authorities on the creation of a new supervisory system.

Since late autumn 2005, Germany has been the partner of the Turkish capital market supervisory authority, the Capital Markets Board (Sermaye Piyasası Kurulu, SPK), as part of the EU twinning project. BaFin has made available approximately 20 short-term experts to provide support. The main priority is to support the Turkish partner as it implements relevant EU directives into national law. One key focus, for example, is on looking at how to estimate the consequences of regulation, whilst other issues covered include audits of annual accounts, market abuse, prospectuses, investor protection, clearing and settlement and the Directive on harmonised investment funds.

The current legislation in Turkey corresponds only to the relevant EU directives in a few areas, so that there is a major need for new rules to be implemented in Turkey. During working groups and seminars, the German experts introduced their Turkish partners to the corresponding directives and used the German example to demonstrate how the directives could be transposed into domestic law. The subproject dedicated to estimating the effects of regulation was concluded during the year under review. Training seminars were held and a manual was drawn up. Draft legislation on implementing the Market Abuse Directive, Prospectus Directive and Directive on Investor Compensation has also been prepared. Thanks to the hard work and high level of dedication on both sides, this project between Turkey and Germany has progressed very well to date.

● Cooperation with China.

The Chinese financial market is becoming increasingly significant. BaFin staff travelled to Beijing last year to investigate the specific needs of the Chinese insurance supervisory authority with regard to advice on occupational and private old-age pension provision. Additionally, BaFin employees staged training courses on deposit protection systems at the People's Bank of China. During the reporting year, delegations from the Chinese supervisory authorities and staff from Chinese financial institutions travelled to Germany for fact-finding visits and seminars arranged by BaFin. This cooperation will be continued in 2007.

● Good links with Russia, South Korea and Pakistan.

With regard to cooperation with Russia, contacts were consolidated in 2006 with the Duma's Economics Committee. In September, two BaFin employees travelled to Russia to discuss and field questions on the setting up of an integrated financial supervisory authority. In November, a delegation from the Russian Federal Financial Markets Service travelled to Frankfurt to learn about selected areas of securities supervision. Good links with the Financial Market Supervisory Authority in South Korea were maintained in 2006, with employees from this authority completing securities and insurance supervision placements in Bonn and Frankfurt for several weeks in June and October. Representatives from Pakistan's insurance supervisory authority were also welcomed to Germany on fact-finding visits.

● Round table on microinsurance providers in the Third World.

In its capacity as an IAIS member, BaFin organised its first round table devoted to developments in the regulation and supervision of microinsurance providers in Third World countries in October of

2006. Together with the insurance industry and German and international development organisations, BaFin is currently preparing an assessment report on the regulation and supervision of microinsurance providers. The report will be adopted by IAIS in May. BaFin and the Gesellschaft für Technische Zusammenarbeit (GTZ) are playing a leading role in this issue. Other participants in the working group include the World Bank and further IAIS members, including the USA. The aim is to develop an IAIS guideline on the regulation and supervision of microinsurance. BaFin is playing a key role in this work.

● Improvement in cooperation with offshore financial centres.

Again in 2006 BaFin worked intensively to achieve a better exchange of information with countries seeking to make their financial services sector more attractive by means of a low level of regulation. An IOSCO group is in talks with three offshore centres, with the dialogue centred on a new footing with all three countries in 2006. One of the countries has already adopted a new law designed to eliminate the few legal loopholes that have been identified. Preparations for a proposed law are at a very advanced stage in another country. BaFin has crucially shaped the dialogue with these countries, believing it important that the risks from OFCs continue to be reduced. IOSCO will hold further talks with OFCs in 2007, with plans for further countries to be involved in the discussions. The project is supported politically by the Financial Stability Forum, whose members have been coordinating their projects relating to uncooperative jurisdictions in a working group since 2005.



## IV Risk-oriented supervision

### 1 Risk-oriented approach to supervision

#### 1.1 Risk identification and classification

If BaFin is to monitor the risks of undertakings and institutions properly, it must maintain a comprehensive picture of the risks involved. Only in this way can it recognise problems as they occur in its approach. The most important source of information for the supervisor is the audit report on the annual financial statements, prepared each year by the company's auditors, followed closely by notices and reports issued by the supervised company. If it requires more detailed information, or information on specific topics, BaFin may conduct its own inspections of companies, or hold meetings relating to supervision. In obtaining this information, the use of any instrument that may hamper supervision of the undertaking is strictly controlled by the supervisor according to the undertaking's activities and level of risk.

● Classifying risk in two dimensions.

BaFin has developed a model of risk classification, which it uses for the companies and institutions it supervises. This model forms a core part of BaFin's risk-oriented approach to supervision. In 2005, BaFin began to classify the companies and institutions being supervised using a 12-position risk matrix. The horizontal axis of the risk matrix shows the quality of the supervised company, on a four-level scale. The vertical axis indicates the company's relevance to the system, previously also referred to as impact, on a three-level scale (cf. Table 4).

The quality and system relevance of the supervised company or institution are assessed by the competent supervisory department. The "quality" axis takes account of both qualitative and quantitative elements. Qualitative elements include, for instance, the findings of the annual financial statements or on-site inspections, while quantitative elements include key figures from solvency supervision.

The supervisory departments allocate scores or ratings for each individual quantitative and qualitative element, which are then combined to produce an overall score that is mapped to the four-level scale from A to D.

The system relevance of a supervised company or institution is determined primarily from its relative size compared with its peers, and from its market share if the relevant market is of significance for the economy as a whole. The scale of the system relevance dimension has three levels: high, medium and low.

Table 4

**Twelve-position risk matrix for financial institutions, insurance undertakings, pension funds, investment companies and financial service providers**

		Quality			
		A	B	C	D
System relevance	High				
	Medium				
	Low				

In general, financial service providers are not associated with the same levels of system risk as credit institutions. The “high” risk level in relation to system relevance is therefore not used in this case. In such cases, BaFin uses the “medium” or “low” levels to indicate the impact of the specific risks within the financial service providers’ sector, including the sale of particularly high-risk products, the deployment of a large number of affiliated agents, the number of customers and a strong foreign element. In contrast, some financial services institutions that are permitted to obtain possession or ownership of money or securities for their customers, or that trade on their own account in financial instruments (own business) or operate own account trading subject to authorisation, embody a level of system risk similar to financial institutions. For this reason, BaFin uses the positions within the risk matrix reserved for financial institutions for these companies.

## 1.2 Audit planning

Each year, BaFin evaluates the auditor’s report of each company’s or institution’s annual financial statements as a means of monitoring the respective risk situation. The findings of this evaluation then form the basis for the risk classification. A change in the risk situation of the supervised company or institution may prompt BaFin to move the company to a different risk class. Information collated during the year may also affect the risk situation of the supervised company or institution, necessitating a change to another risk class. The depth and focus of supervision for each supervised company or institution is dependent on its risk classification. This, therefore, forms a significant basis for BaFin’s annual audit planning. It allows BaFin to establish its priorities in even greater detail than before, and avoid imposing unnecessary workloads.

● Risk classification allows priorities to be set.

● Risk classification helps control resources.

BaFin also uses the results of the risk classification process to manage its own resources. The risk classification allows the supervisory authorities to direct its resources to those institutions and companies that require more intensive supervision than others, due to their risk profiles. The actual extent of this more intensive supervision is decided by BaFin according to the risk situation of the supervised company. In other words, BaFin's approach to supervision is both case-based and risk-oriented. Moreover, it fulfils the requirements Basel II and Solvency II impose upon modern supervisory authorities. Both sets of regulations stipulate, for instance, that supervisors' actions must be transparent and more heavily geared towards the actual risk of the individual target of supervision.

● Implementation of audits.

BaFin's right to carry out audits of supervised companies is enshrined in section 44 of the Banking Act (Kreditwesengesetz – KWG), section 83 of the Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG) and section 35 of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG). In planning these audits, supervisors refer to the risk situation they encounter in each individual case, reflecting the current state of affairs and need for action at each company and institution. In the area of banking supervision, BaFin and the Bundesbank draw up the audit plans jointly. Before BaFin formally adopts these plans, they undergo a final control stage to ensure that an institution will not be unnecessarily burdened by audits carried out by different divisions of the supervisory authority.

## 2 Banks

### 2.1 Risk classification

With its risk-oriented approach to banking supervision, BaFin is implementing the European requirements for the Supervisory Review Process (SRP) as defined in the Banking Directive and the Capital Adequacy Directive which, together, are known as the Capital Requirements Directive. BaFin tailors the intensity of its supervision according to the risk level of the supervised institution, assessed on the basis of its risk classification. At least once each year, the quality of each institution and the institution's relevance for the financial market are assessed and the results are converted into a matrix. After assigning the institution to one of the 12 fields in the matrix, BaFin can then determine the information it requires along with the number of supervisory meetings and audits. BaFin assesses the appropriate level of supervisory action required for each institution, thus complying with the principle of proportionality. Owing to this principle, the supervisor must supervise and inspect large, complex institutions more often than smaller banks with narrower-ranging business, for example. The same applies to problematic institutions, which must be observed more closely than simpler ones.

● Close cooperation with the Bundesbank.

In the area of banking supervision, BaFin collaborates with the appropriate Regional Office of the Bundesbank to determine the risk classification. For most German banks, the classification is based on two foundations: a statistical system of ratings based on the banking supervisory reporting system and the uniformly prepared findings of the auditors of the banks' annual financial statements. Once this has been done, the quality of an institution in the classification can be derived from the findings of the risk profile. The profile is drawn up by the Bundesbank, and is finalised and adopted by BaFin, if necessary after further consultation with the Bundesbank. The profiles constitute an assessment of the risk situation and capital adequacy, and also provide an insight into the risk management, organisation and management of the institution.

Table 5

**Results of 2006 risk classification  
(previous year's figures in brackets)**

Institutions in %		Quality of the institution*				Total
		A	B	C	D	
System relevance	High	0.6% (0.9%)	1.2% (1.0%)	0.2% (0.5%)	0.0% (0.0%)	2.0% (2.3%)
	Medium	2.6% (1.8%)	3.2% (3.3%)	1.4% (1.3%)	0.3% (0.5%)	7.5% (7.0%)
	Low	35.6% (24.1%)	37.2% (41.9%)	12.6% (16.8%)	5.2% (7.9%)	90.5% (90.7%)
<b>Total</b>		38.8% (26.7%)	41.6% (46.2%)	14.2% (18.5%)	5.5% (8.5%)	100%**

\* Including financial service institutions that are permitted to obtain possession or ownership of money or securities for their customers, or that carry out business or trading for their own account.

\*\* Differences in the overall total are due to rounding differences.

## 2.2 Special audits

● Different types of audit.

A distinction can be made between two types of audit with regard to supervisory special audits conducted until the end of 2006: those done on request and those initiated by the supervisor. In the first instance, BaFin conducts an inspection following a request by the institution concerned, in the second the supervisor alone initiates supervisor-initiated audits. In addition, there are audits that have been initiated solely for statutory reasons, in particular in relation to the Pfandbrief Act (Pfandbriefgesetz – PfandBG). In total, the banking supervisor conducted 287 special audits during the year under review.

● 226 supervisor-initiated special audits.

Supervisor-initiated audits are normally conducted for a specific reason, for example due to specific notes in the auditor's report of a company's annual financial statements. In addition, however, such audits can also be conducted as a matter of routine. These audits enable the supervisor to obtain his own, in-depth view of the risk situation of an institution at periodic intervals. During the year under review, the supervisor conducted 226 supervisor-initiated audits. Of these, 103 were special lending-related audits (Kreditsonderprüfungen – KSP), in which the supervisor verifies the value of the loan portfolio and compliance with the large-exposure provisions of section 13 KWG. 98 of the audits focused on verifying proper business organisation in accordance with the minimum requirements in relation to risk management (section 25a (1) KWG). A further 14 audits relating essentially to the general organisational structure of the institution, primarily with regard to outsourcing, were conducted. Furthermore, 11 audits dealt with other specific topics, such as the management of interest rate risk. As the development of the economy as a whole was comparatively stable, the number of supervisor-initiated audits, in particular special lending-related audits, was further reduced. Year-on-year, the banking supervisory authority ordered 15% fewer audits during the year under review.

● Significant increase in requested audits.

The number of audits requested by financial institutions rose considerably in 2006. The preparations made by institutions for the impending transition to Basel II caused the increase. During the year under review, therefore, 29 audits were conducted on IRBA (Internal Ratings Based Approach) and five on AMA (Advanced Measurement Approach). With IRBA audits, BaFin's task is to establish, at the supervised company's or institution's request, whether the ratings systems and equity investment risk models in place are suitable for determining the capital adequacy requirements for the institution's counterparty risks. In addition, BaFin verifies that the institution is complying with the minimum requirements relating to the use of the internal ratings-based approach as defined in the Solvency Ordinance (Solvabilitätsverordnung – SolvV). With requested AMA audits, it is a matter of verifying whether an advanced measurement approach is suitable for calculating the capital adequacy requirement for the institution's operational risk. Here, too, the supervisor verifies whether the institution is complying with the corresponding minimum requirements of SolvV.

● Twelve requested audits of market risk models.

During the year under review, the supervisor also audited 12 cases relating to internal market risk models of the supervised institutions – in each case conducted at the request of the institution concerned. During these audits, the institution ensured that its own models were sufficient to measure capital adequacy for market price risk. In terms of content, the audits take the form of either suitability audits or follow-up audits. While the supervisor uses the suitability audits to conduct an initial investigation and acceptance of the risk models, the purpose of the subsequent follow-up audits is to ensure that the accepted risk models continue to meet regulatory requirements. In 2006, the supervisor performed four initial suitability audits and eight follow-up audits.

Two follow-up audits were performed by BaFin, while the supervisor commissioned the Bundesbank for the remaining six.

### Credit institutions' risk models

As at the end of 2006, 15 credit institutions (2005: 16) were in possession of a confirmation notice from BaFin stating that their internal market risk model met supervisory requirements. As in the previous year, six institutions selected the "full use" variant rather than "partial use", to enable them to make full use of their own internal market risk models.

Backtesting of these market risk models once again revealed satisfactorily accurate forecasting. The results of the backtesting indicated just 13 anomalies from 15 model banks (2005: 15 anomalies from 16 model banks). The backtesting process compares the maximum loss forecast by the risk model with a 99% confidence level against the actual loss on a given trading day.

Under the new SolvV, institutions will now also be required to calculate event and default risks. This requirement affects all institutions that started using, on 1 January 2007, an internal model to calculate the partial capital charge for the specific market risk. For those already using an internal model on that date, SolvV provides for a transition period until the end of 2009.

In 2006, BaFin was presented for the first time with an institution's internal model for calculating the credit event VaR (value at risk). This model takes account of the credit risk component contained within the specific market risk of the net interest position. The approaches and findings of this model were very satisfactory. The institution proved it had created a valid tool for identifying and analysing the credit risks of its trading book.

Table 6

### Risk models and factor spreads

Year	New applications	Withdrawn applications	Rejections	Number of model banks	Minimum add. factor	Maximum add. 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
2003	0	0	0	15	0.0	1.8	0.20
2004	1	1	0	15	0.0	1.0	0.30
2005	2	1	0	16	0.0	1.0	0.25
2006	0	1	0	15	0.0	1.0	0.20

 Pfandbrief Act requires audits of cover assets.

The PfandBG requires BaFin to conduct audits of cover assets for all issuers of Pfandbriefe. During these statutory audits, which are as a general rule to be carried out every two years, BaFin verifies that the assets used to cover Pfandbriefe comply with the legal requirements and are sufficiently secure. In order to comply with this requirement, BaFin set up a new audit department at the start

of 2006. Its role is to coordinate cover asset audits in consultation with the institutional supervisors. During the year under review, BaFin conducted a total of 15 cover asset audits. For the first time, the Landesbanks and savings banks (Sparkassen) were audited in addition to the former mortgage banks (Hypothekenbanken).

Table 7  
**Number of special audits\***

	2006	2005
KSP	103	167
Section 25a (1) KWG	98	130
Organisation	14	20
Coverage	15	7
Others	11	10
Risk models	12	4
IRBA	29	2
AMA	5	0
<b>Total</b>	<b>287</b>	<b>340</b>

\* The audits of the MaK (minimum requirements for the credit business of credit institutions – Mindestanforderungen an das Kreditgeschäft), MaH (Minimum requirements for the trading activities of credit institutions – Mindestanforderungen an das Betreiben von Handelsgeschäften) and MaIR (Minimum requirements for the internal audit function of credit institutions – Mindestanforderungen an die Ausgestaltung der Internen Revision) detailed in the 2005 Annual Report are summarised this year under the new audit category "Section 25a (1) KWG". The total number of audits differs slightly from that specified in the 2005 Annual Report due to adjustment of the data.

The risk matrix shows how the audits are distributed over the risk classes. For example, in 2006, 18% of the institutions with average system relevance were audited, and only 10% of the institutions with low system relevance. BaFin investigated only 5% of institutions with high system relevance because of the particularly high number of requested audits performed during the year under review with regard to IRBA and AMA. The table below, in contrast, contains only the audits performed on the initiative of the banking supervisor, since the direct effect of the risk classification is only seen among this group of audits.

Table 8  
**Distribution by risk class of supervisor-initiated special audits in 2006**

Supervisor-initiated special audits		Quality of the institution*				Total	Institutions in %
		A	B	C	D		
System relevance	High	2	0	0	0	2	5%
	Medium	7	13	6	1	27	18%
	Low	29	93	52	22	196	10%
Total		38	106	58	23	225**	11%
Institutions in %		5%	11%	15%	16%	10%	

\* Including financial services institutions that are permitted to obtain possession or ownership of money or securities for their customers, or that carry out business or trading for their own account.

\*\* Plus one audit that has not yet been entered into the matrix.

The risk matrix also demonstrates the risk-oriented audit strategy of BaFin. The rate of audits increases as the quality of the institution decreases. A clear concentration of audits can be seen among the institutions assessed as C and D. However, even in the case of category A institutions, it is not possible for the supervisory authority to refrain from carrying out any audits at all. At appropriate intervals, an in-depth view of the institutions' actual risk situation must be obtained.

- Increased audit rates among lending institutions and savings banks (Sparkassen).

Table 9 below indicates another point of view. The table shows how the audits conducted during the year under review are distributed among the different groups of institution. In absolute terms, the highest number of audits was conducted for institutions in the cooperative sector. The primary reason can be traced to the large number of institutions in this group. The actual audit rate, in contrast, is only 10%. The significantly higher audit rate among lending banks and institutions in the savings bank (Sparkassen) sector reflects the higher level of system relevance of these institutions, and is also a result of the requested IRBA and AMA audits.

Table 9

#### Distribution by group of institutions of special audits in 2006

	Lending Institutions	Institutions in the saving bank sector	Institution in the cooperative bank sector	Other Institutions	Total
Number of Institutions	199	469	1,306	188	2,162
Bal in € billions	3,282.1	2,686.1	839.7	1,466.7	8,274.5
KSP	6	29	67	1	103
Section 25a (1) KWG	12	23	60	3	98
Organisation	6	1	0	7	14
Coverage	3	5	0	7	15
Others	3	1	6	1	11
Risk models	8	4	0	0	12
IRBA	12	10	4	3	29
AMA	3	2	0	0	5
<b>Total</b>	<b>53</b>	<b>75</b>	<b>137</b>	<b>22</b>	<b>287</b>
<b>in %</b>	<b>27</b>	<b>16</b>	<b>10</b>	<b>12</b>	<b>13</b>

The banking sectors stated in the table also include the corresponding central banks. For example, the Landesbanks are counted in the Sparkassen sector. The group called Other Institutions includes mortgage banks (Hypothekenbanken), building societies (Bausparkassen), banks with special functions (Institute mit Sonderaufgaben) and guarantee banks (Bürgschaftsbanken). It also includes some other specialist banks and financial services institutions that are permitted to obtain possession or ownership of money or securities for their customers, or that carry out business or trading for their own account.

## 3 Insurers

### 3.1 Risk classification

BaFin is also making its approach to supervision of insurance companies increasingly risk-oriented. This move is in anticipation, where possible, of future European requirements with regard to a new quantitative and qualitative supervisory regime for solvency. Risk classification is used for assessing the intensity of supervision, and thus influences the supervisory process.

● Automated valuation system planned.

The insurance supervisor is planning to develop an automated valuation system to carry out the task of risk classification, taking into account the particular characteristics of each branch of the insurance industry. The valuation system will provide up-to-date information to support risk-oriented solvency supervision. It will supply quantitative key performance indicators as well as qualitative indicators, enabling the supervisor to allocate companies to risk classes at each stage of the supervisory process. The system will not only consider single insurers in isolation. The plan is also for it to carry out peer-group comparisons, and time-sequence and sector analyses.

● Risk class of insurers determined by impact and quality.

Until the automated process has been implemented, BaFin staff will carry on allocating supervised companies to a risk class using a survey-based methodology. The allocation is affected both by the impact of the company in the market – i.e. its system relevance – and by the company's quality. The system-relevance factor for life insurers, death-benefit funds and Pensionskassen, health insurers and pension funds is determined by the supervisor on the basis of total investments. In the case of property and casualty insurers and reinsurers, the relevant factor is gross premium income. System relevance is categorised as high, medium or low.

The assessment of company quality is based on four scored categories: safety, success, growth and quality of management. Each of these scores reflects specific insurance-industry indicators or qualitative criteria. The evaluation system combines the scores in each area to form an overall score, which is then transferred to a four-level scale from A (high) to D (low).

In autumn 2006, BaFin carried out this sort of risk classification for insurers for the third time.

Table 10

**Results of 2006 risk classification  
(previous year's figures in brackets)**

Companies in %		Quality of the company				Total
		A	B	C	D	
System relevance	High	1.6% (1.1%)	6.3% (5.0%)	1.4% (2.8%)	0.0% (0.0%)	9.3% (8.8%)
	Medium	4.6% (4.0%)	11.9% (10.4%)	2.8% (4.6%)	0.2% (0.5%)	19.5% (19.5%)
	Low	13.0% (17.0%)	43.5% (40.1%)	12.7% (10.8%)	2.0% (3.9%)	71.2% (71.8%)
Total		19.2% (22.1%)	61.7% (55.4%)	16.9% (18.3%)	2.2% (4.3%)	100%*

\* Differences in the overall total are due to rounding differences.

No company that was of high relevance in the market was categorised as low in the "quality" criterion in 2006. There was a heavy concentration of companies in the fields indicating "low system relevance" and high or medium-high quality. In total, 56.5% of the companies were located in this area.

In comparison with the previous year, it can be seen that the main movements involved companies moving to quality B (medium-high). At the same time, the proportion of companies classified as green (low system relevance and high quality) decreased. Overall, there is a clear movement of companies from the green and orange quality levels towards yellow.

### 3.2 On-site inspections

BaFin has incorporated findings from the risk classification process into its 2007 supervision planning for insurers and Pensionskassen – the supervisor has planned the on-site inspections by taking account of the risk classification findings. For 2007, BaFin has prioritised the audit of companies that indicate increased risk potential and that have not been audited recently.

The risk matrix shows the risk-class distribution of audits performed in 2006. Planning of on-site inspections took account of the findings of the risk classification for the first time: 64% of insurers audited were in the low quality category and 7% in the high quality category.

Table 11

**Distribution by risk class of on-site inspections in 2006**

On-site inspections		Quality of the company				Total	Companies in %
		A	B	C	D		
System relevance	High	1	5	7	0	13	22%
	Medium	4	7	6	1	18	15%
	Low	3	20	14	8	45	10%
Total		8	32	27	9	76	12%
Companies in %		7%	8%	25%	64%	12%	

## 4 Investment companies

During the year under review, BaFin continued its work in relation to risk-oriented supervision of investment companies. It analysed the risk factors pertaining to the investment companies, and developed a methodology for aggregating the results of this analysis to produce an overall risk position. In addition to facing solvency risks, investment companies have to deal with market risks arising from the management of their funds. In order to value both risk positions appropriately and produce an overall risk position, BaFin has also developed a risk matrix for supervising investment companies.

 New IT system designed.

In 2006, BaFin produced the framework for a technical concept of a new software system to replace the InvRisk prototype developed in 2005. The aim was to support the process of classifying the risk of an investment company. The valuation takes account both of operating and organisational areas (solvency supervisory risk factors) and of fund-specific criteria (market supervisory risk factors), which combine to form the basis of the classification in the 12-field matrix. The system is intended to produce realistic proposals for risk classification, from which potential supervisory actions can be derived. The successful InvRisk pilot project, carried out with a few selected investment companies in the year under review, provided key results showing how the developed risk model could be further adapted to the specific characteristics of the investment sector.

There are plans for a workflow-oriented application that will gather and evaluate risk-related information on an ongoing basis, enabling the existing risk indication to be updated. The information that will be collected and evaluated includes notifications, complaints, audit

findings, business type and volume. At the aggregate level of the entire sector, the software uses the 12-field matrix. At this stage, information gathered through both solvency and market supervision is incorporated into the assessment of the individual investment companies. With this process, the risks facing an investment company can be considered in their entirety. Moreover, sectors, trends and individual companies can be analysed, enabling the risk structure to be evaluated both at the aggregate level of the investment sector and of the individual institution. The findings of these analyses form the basis of the risk-oriented planning and management of the intensity of supervision for the coming year.

## 5 Financial services institutions

● Risk classification launched.

During the year under review, BaFin used a newly developed concept for risk classification of financial services institutions for the first time, thus starting the process of recording the supervised institutions using the risk matrix. All financial services institutions that provide investment and contract brokering services and financial portfolio management services are recorded, provided they are not authorised to obtain ownership or possession of funds or securities from customers, and not permitted to trade in financial instruments for their own account. Currently, this group comprises 631 institutions. This risk classification process makes it easier for BaFin to supervise financial services institutions at appropriate levels, in accordance with their individual risk situations. No institution should be subject to excessive supervision. However, those that show deficiencies must be supervised more intensively than those that do not.

Risk classification enables all information on a company to be collated and evaluated appropriately, providing an improved overview of the supervised institutions. Accordingly, BaFin can deploy its supervisory instruments such as audit monitoring visits, prioritising or scheduling on-site inspections more precisely, and thus define corresponding targets for supervision.

● Risk classification takes account of capital situation and audit reports.

To calculate the risk classification of an institution, BaFin considers quantitative factors such as the company's capital situation, and takes account of qualitative aspects, encompassing all the information available on the institution. In doing so, the supervisor evaluates the specific risks in the financial services institution's area of operations. BaFin obtains information primarily from the reports on audits of the securities business, as well as from the interim monthly returns, notices and reports, and from customer complaints.

<sup>9</sup> Cf. Chapter IV 1.1.

Currently, data is gathered from 464 financial services institutions, representing around 73% of the total number. The "high" risk level in relation to system relevance is not applied to the institutions covered here.<sup>9</sup> With the risk classification completed, the following results were obtained:

Table 12

**Provisional results of 2007 risk classification**

Institutions in %		Quality of the institution				Total
		A	B	C	D	
System relevance	High					
	Medium	8.8%	3.9%	0.4%	0.4%	13,5%
	Low	64.4%	18.1%	3.5%	0.4%	86.4%
Total		73.2%	22.0%	3.9%	0.8%	100% (464)*

\* Differences in the overall total are due to rounding differences. Figures in brackets indicate the absolute number of financial services institutions classified so far.

Classification of the remaining financial services institutions should be completed during the first half of 2007. Only then will it be possible to produce a final assessment of the supervised institutions.

 Institutions with increased risk subject to special observation.

Institutions that report a particular level of risk in their operational area comprise approximately 10% of the supervised financial services providers. This 10% includes institutions with particularly volatile or risk-encumbered products, a large number of customers or affiliated agents, or institutions whose operations indicate a strong foreign element. On account of these particular risks, the institutions are subject to increased supervision.



# V Supervision of insurance undertakings and pension funds

## 1 Basis for supervision

### 1.1 Amendment of the Insurance Supervision Act

#### Implementation of the Reinsurance Directive



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Through the 2006 amendment to the Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG), German policymakers transposed the European Reinsurance Directive into national law. The aim of the directive is to create a harmonised legal framework for reinsurers in the European Economic Area (EEA). The directive applies – with a few exceptions – only to those insurers who exclusively write reinsurance business.

At the heart of the new legal provisions lies the principle of supervision by the home country for reinsurers. As in the case of primary insurers, the supervisory authority of the home country now also has sole responsibility for financial supervision of those commercial activities performed by reinsurers in the EEA under the freedom to provide services and the right of establishment. Other legal supervision is carried out in cooperation with the respective host authorities. The concept of supervision by the home member state is supplemented by the application of the home member state principle with regard to authorisations. The authorisation entitles the reinsurers to operate reinsurance business in all member states and contracting states through branches or under the freedom to provide services. An additional authorisation is no longer required in the host country.

● Principle of home supervision also applicable to reinsurers.

● Rules governing finite reinsurance for the first time.

The amendment to the VAG saw the policymakers introduce supervisory provisions governing finite reinsurance for the first time, making use of an option provided in the Reinsurance Directive: the new framework provisions on finite reinsurance (section 121e VAG) stipulate that only contracts with sufficient risk transfer can be classed as reinsurance contracts for supervisory purposes. The Act also includes a right to issue ordinances so that the requirements in terms of sufficient risk transfer, the accounting process and reporting duties can be regulated. In Germany, one of the world's leading reinsurance markets, the foundation has therefore been laid for regulating finite reinsurance, thereby creating legal security in an area that has hardly been regulated at all hitherto.

- Rules governing special purpose vehicles also introduced.

The provision on special purpose vehicles (section 121g VAG) makes it easier for such vehicles to be located in Germany in that it declares only some fundamental provisions of the VAG to be duly applicable to such companies. Special purpose vehicles are companies set up specifically to assume risks from insurance or reinsurance undertakings without being insurance or reinsurance undertakings. These undertakings fully fund the claim risks through the proceeds of a debt issuance or by means of some other financing mechanism. The repayment rights of the providers of this debt are subordinated to the reinsurance obligations of such a vehicle.

- New regulations harmonise the reinsurance market.

Further new regulations will lead to harmonisation of the market in essential areas, namely with regard to the European company (SE) as a permitted corporate form for insurance undertakings and reinsurance undertakings (section 7 (1) and section 120 (1) VAG), limiting the company object to reinsurance and related activities (section 120 (1) VAG), the introduction of a portfolio transfer institution (section 121f VAG), additional supervision of reinsurance undertakings within insurance groups (section 104a et seq. VAG) and the supervision of branches of reinsurance undertakings from third states (section 121i VAG). The German supervisory system has therefore been completed and is keeping pace with international standards and developments.

- New rules make it easier for pension funds and Pensionskassen to engage in foreign business.

### Implementation of the Pension Fund Directive

Much of the Pension Fund Directive was transposed into German law in 2005.<sup>10</sup> The 2006 amendment to the VAG made it easier for pension funds and Pensionskassen to engage in foreign business, thereby strengthening Germany's position as a financial centre. Pension funds and Pensionskassen may now, when operating abroad, offer all forms of occupational old-age pension that are permitted abroad (section 117 (1) in conjunction with section 112 (1) VAG). To date, undertakings, when engaging in the cross-border provision of services, have only been able to offer occupational pension products approved in Germany. The new rules mean that undertakings that employ staff in several EU Member States can offer all their employees occupational old-age pension products via pension funds and Pensionskassen in Germany.

- Submission obligations for pension plans simplified.

### Further changes

The 2006 amendment to the VAG has changed the supervisory rules on pension plans with regard to pension funds and deregulated Pensionskassen. BaFin's right of objection following submission of the plans no longer applies (section 113 (2) no. 5 and section 118b). Pension plans therefore become effective three months after their submission to the supervisory authority, unless BaFin determines they are unobjectionable at an earlier stage. If a pension plan is in breach of the applicable law, action may still be taken against that plan through the provisions for supervision of irregularities.

<sup>10</sup> BaFin 2005 Annual Report, p. 79.

## 1.2 The new system for supervising insurance intermediaries

The new legislation on insurance mediation<sup>11</sup>, which enters into force as of May 2007, has transposed the EU Insurance Mediation Directive into German law. The aim of this European Directive is to facilitate the cross-border provision of services by harmonising the rules on the registration and pursuit of the activities of insurance intermediaries. A further aim is to improve consumer protection by introducing uniform rules on areas such as the advice given to insurance policyholders.

● Insurance intermediaries to be listed in a central register.

Insurance mediation now requires authorisation. Anyone wishing to operate as an insurance intermediary must be listed in a central register of intermediaries in future. The register is to be managed by a central office of the chambers of industry and commerce. To avoid unnecessary administrative work, the German implementing legislation sets out different rules for the newly introduced authorisation process, depending on the type of intermediary concerned. Insurance brokers and multi-tied agents, without exception, require an authorisation to exercise their activity, issued by the chambers of industry and commerce responsible for the area in which they wish to operate. Tied agents who act for only one company for each branch of insurance are free to decide, however, whether or not they wish to apply for authorisation. If they decide not to submit an application, they may operate only as an insurance intermediary if their insurance undertaking assumes full liability for their activity. Additionally, the respective undertaking must review the intermediary's reliability and guarantee that the intermediary possesses the necessary knowledge to carry out insurance mediation activities.

● BaFin not engaging in general supervision of intermediaries.

Implementation of the Directive does not mean that BaFin has taken on the task of supervising the 500,000 or so German insurance intermediaries. Rather, the insurance brokers and multi-tied agents are supervised by the chambers of industry and commerce, since they are responsible for issuing these groups with authorisations to operate. For tied agents, however, a system of indirect supervision has been introduced. BaFin's previous role in supervising insurance undertakings has now been expanded to include these insurers' legal relationships with their tied insurance intermediaries. This means that, in future, BaFin will be required to verify, above all, whether insurance undertakings have reviewed the reliability of the agents operating on their behalf. Additionally, the supervisory authority is responsible for monitoring the internal training principles applied by insurers to their tied agents in order to guarantee that the intermediaries used by insurance undertakings have the requisite level of knowledge. Should BaFin detect any deficits in this regard, it will request the insurer to comply with the statutory requirements.

<sup>11</sup> 2006 Federal Law Gazette, p. 3232.

### 1.3 Healthcare reform

The policymakers adopted their plans to reform healthcare in early 2007. The reform, in addition to numerous changes in the sphere of statutory health insurance, also provides for a fundamental reform of private health insurance. The law is due to enter into force in spring 2007, although most of the provisions relating to private health insurance are not due to take effect until 1 January 2009.

● Compulsory health insurance for all.

It will be compulsory for all Germans to have health insurance cover in future. Under the new law, anyone who has previously been uninsured is assigned to the statutory or private health insurance system. Those who are obliged to have private health insurance cover must take out a policy that at least covers outpatient and hospital treatment. The agreed policy excesses, in percentage and absolute terms, must not exceed €5,000 per person, or, in the case of those entitled to benefits, it must not exceed a proportion calculated on the basis of the rate of benefit. Those who are already insured meet the insurance obligation.

● All private insurers must offer a basic rate.

According to the new law, insurers operating a substitutive form of health insurance must, as of 1 January 2009, offer a basic rate calculated uniformly across the industry with various different excess levels, in addition to their conventional rates. The basic rate will be based on the scope of benefits available under statutory health insurance. Individual risk premiums and exclusions may not be agreed. This rate will be open in particular to voluntary holders of statutory insurance, those entitled to benefits and new private health insurance customers. Those who have already held private insurance should be able, with effect from 1 January 2009, to switch to the basic rate within six months. After this period, the right to change will apply only to such private insurance holders if they are over 55 years old, pensioners or people in need. With effect from 1 July 2007, non-insured persons can take out insurance with a modified standard rate until the introduction of the basic rate. These policies will automatically be transferred to the basic rate with effect from 1 January 2009.

The premium under the basic rate is limited to the maximum amount under statutory health insurance. It will be reduced for policyholders in need of assistance. The costs of limiting and reducing premiums are to be borne by the companies involved on an equal basis. Additional expenses arising with regard to the basic rate due to existing medical conditions are to be shared equally by means of a risk balancing system among all of those insured under the basic rate. The way in which this balancing system is designed and implemented will be monitored by BaFin, as in the case of standard rate insurance.

● Switching health insurer to be made easier.

Under the reform, new customers who enter into agreements with effect from 1 January 2009 will be able to take their ageing reserves with them if switching to a different private healthcare provider (portability). However, the maximum amount of portable

imputed reserves is the benefit level provided by the basic rate. Any surplus portion of the ageing reserves may be used by the policyholder for additional cover. Existing customers, from 1 January to 30 June 2009, have the right to change to the basic rate offered by another private health insurance undertaking.

- Right to switch from statutory to private health insurance restricted.

To date, employees have been able to switch to private health insurance at the end of the calendar year in which their gross annual earnings exceed the taxable wage base. In 2006, the general taxable wage base was €47,250. For those whose annual earnings on 31 December 2002 exceeded the taxable wage base for 2002, and who were privately insured as at that date, the taxable wage base for 2006 was €42,750. Under the reformed law, however, it is only possible to switch once the taxable wage base has been exceeded for three consecutive years.

## 1.4 Reform of VVG

In October 2006, the Federal Cabinet agreed the draft legislation to reform the Insurance Contract Act (Versicherungsvertragsgesetz – VVG). The intention of policymakers in introducing these reforms is to improve consumer protection and achieve a better balance of interests between insurers and policyholders. A further core area is the modernisation of life insurance.

The draft law is based on preliminary work by the Commission on the Reform of Insurance Contract Law. Additionally, the bill also takes account of the judgements handed down by the Federal Constitutional Court (BVerfG – Bundesverfassungsgericht) on surplus bonuses and by the Federal High Court of Justice (BGH – Bundesgerichtshof) on minimum surrender values.<sup>12</sup>

### General rules

- All-or-nothing principle to be abolished.

The bill includes the abolition of the all-or-nothing principle. Currently, insurers are not required to make a payment if the policyholder has committed a grossly negligent breach of his duties or obligations and if he causes the insured event due to gross negligence. In future, the obligation to pay out in the case of gross negligence will be based on a gradual model taking into account the degree of fault. Practice will show which rates of performance are appropriate.

- Requirement to pay compensation for violation of consultation duties.

Further new additions to the law include the imposition of consultation and documentation obligations on insurers. Both duties are closely related to those of intermediaries. Insurers are required to provide specific advice prior to the contract being concluded and during the term of the contract, unless the customer requests otherwise. Should the insurer breach its obligations to provide advice and with regard to documentation, the policyholder is entitled to compensation.

<sup>12</sup> BaFin 2005 Annual Report, p. 12 onwards and p. 91.

● Abolition of Policenmodell.

All insurers should provide policyholders with general terms and conditions of insurance and consumer information prior to the customer agreeing to conclude an insurance contract, although the customer may opt to waive his right to information at this early stage. In this case, however, the information must be provided immediately following conclusion of the agreement. Until now, the Policenmodell (policy model) has been commonplace, according to which the insurer is only required to provide the general terms and conditions of insurance and consumer information along with the policy itself.

● Replacement of invalid provisions.

In future, life and health insurers will be required to take responsibility for replacing invalid provisions. The legal trustee is no longer obliged to cooperate in replacing invalid provisions. The institution of the legal trustee is nevertheless maintained in health insurance to the extent that a change in the circumstances of healthcare necessitates an amendment to the conditions.

● Further information duties possible.

In future, a legal ordinance shall also stipulate which further information is to be provided by personal insurers to policyholders on initial and sales costs.

● Participation in hidden reserves.

### Life insurance

In 2005, the Federal Constitutional Court (BVerfG) criticised the practice adopted by life insurers of not including non-realised hidden reserves when calculating the final surplus payable to departing customers.<sup>13</sup> The Court called on the policymakers to introduce new rules by the end of 2007.

In future, customers will participate in the hidden reserves upon the termination of their contract, unless this jeopardises the life insurer's capital situation.

A particular need for discussion emerged in conjunction with the distribution of hidden reserves in the case of fixed-income securities. The distribution of this type of reserve is basically problematic as these investments are often held until final maturity and repayment made at the nominal value, thus excluding any reserves that may have accrued in the meantime.

However, as these fixed-income investments generally account for more than 80% of the investments made by life insurers, any form of rule that excluded this type of assets would take the greatest share of assets out of the calculation of hidden reserves. In the past, life insurers have also in some cases realised hidden reserves from fixed-income investments on a significant scale. Thus hidden reserves in fixed-income investments are not always temporary.

BaFin has expressed its support for incorporating hidden reserves from all investments into the calculation provided the obligation to distribute does not jeopardise the life insurer's capital situation and impair its risk-bearing capacity.

<sup>13</sup> BVerfGE [Fed. Constitutional Court], Judgement of 26/07/2005; Ref.: 1 BvR 80/95.

- Premiums and benefits could be recalculated in future.

In future, there will be the option, for all new policies, for the premium agreed upon the commencement of the contract to be recalculated under certain conditions, such as a change in expected mortality. Instead of a premium increase, the policyholder may demand a reduction in the benefits to be provided by the insurer under the policy.

- Minimum surrender values.

A minimum surrender value is to be stipulated in future. A change to the law was required following the Federal High Court of Justice's criticism of the lack of transparency surrounding the current calculation of the surrender value as the present value. The Court called for a balancing of interests between the contractual parties upon termination of the contract.

- Premiums also to be adjusted for changes in expected mortality in future.

The bill extends the options for premiums to be adjusted in private health insurance. In future, it will be possible to adjust premiums not just on the basis of claims made but also in response to changes in expected mortality. BaFin will be monitoring the use made by insurers of these extended options.

- Efficiency principle.

In a reaction to the Alphaklinik judgement of the Federal High Court in March 2003<sup>14</sup>, an efficiency principle is to be introduced. As a result, insurers will not be obliged to provide benefits if the expenses are clearly out of proportion to the payments made.

- Option of amending general terms and conditions of insurance of existing contracts.

The general terms and conditions of insurance under which existing contracts were taken out may be brought into line with the new legal situation with effect from 1 January 2008. There are no plans to involve a trustee.

- Direct claim in the case of all compulsory insurance.

### Third-party liability insurance

The right to a direct claim by the injured third party against the third-party liability insurer, previously only applicable to motor vehicle third-party liability insurance, is to be extended to cover all areas of compulsory liability insurance. In addition, future compulsory third-party liability insurance contracts may make provision for excesses and exemptions, provided this is not expressly excluded by the legal regulation on which the compulsory nature of the insurance is founded, and provided such provision does not jeopardise achievement of the respective purpose of the compulsory insurance. Exemptions, unlike excesses, can also work against the injured third party.

<sup>14</sup> BaFin 2004 Annual Report, p. 161.

## Pension funds

The draft legislation clearly states that the VVG is not to be applied to pension funds. The provision agreements of the pension funds are governed by general civil law.

## 1.5 Ordinances

### Mathematical Provisions Ordinance

As a result of the amendment of the Mathematical Provisions Ordinance, the maximum technical interest rate for life insurance contracts concluded with effect from 1 January 2007 was reduced from 2.75% to 2.25%. This reduction was needed as a result of the prolonged period of low interest rates. The reduction of the maximum rate also applies to accident insurance contracts with guaranteed return of premium concluded as of 1 January 2007 and for provisions for pension benefits from accident and third-party liability insurance with regard to which the obligation to pay is determined as of this cut-off date. Further amendments to the Ordinance affect Pensionskassen, which are now all covered by the ordinance – provided the contracts are not based on rates approved by the supervisors – and insurance agreements with interest rate guarantees that are not denominated in euros.

### Mathematical Provisions Ordinance for pension funds

In amending the Pension Fund Mathematical Provisions Ordinance in October 2006<sup>15</sup> the policymakers transferred the reduction to 2.25% in the maximum technical interest rate for life insurers to pension funds, to the extent that the funds are required to make provisions due to insurance-type business.

### Capital Resources Ordinance for pension funds

The Pension Fund Capital Resources Ordinance was brought into line with the Pension Fund Directive in the 2006 amendment to the VAG. The main change relates to calculating the required solvency margin. Pension funds can now reduce the solvency margin for benefit-based pension plans by taking account of capital in excess of the guaranteed benefit. The limit on the reduction of the solvency margin stipulated in the Pension Funds Directive through the additional purchase of insurance cover now also applies to pension funds.

● New VVG not applicable to pension funds.

● Maximum interest rate down to 2.25%.

● New maximum interest rate for pension funds.

● New regulations on calculating capital.

<sup>15</sup> 2006 Federal Law Gazette I, p. 2262.

## 1.6 Supervisory practice

### Adjusted solvency

● Circular on adjusted solvency revised.

Insurers operating within an insurance group, in addition to documenting the capital resources of the individual insurer, must also calculate a figure for adjusted solvency. They must calculate a variable specific to the insurance group, derived from a prescribed calculation method. The capital resources must at least reach this variable, adjusted to take account of intragroup capital creation. Circular 20/2002 (VA) on calculating adjusted solvency applicable to date was revised by BaFin during the year under review and replaced with Circular 2/2006 (VA). The new circular contains information on carrying out the calculation and contains modified calculation forms. In particular, holdings in credit institutions, financial services institutions and financial companies are now to be included in the calculation. This change was needed in response to the revision of the Solvency Adjustment Ordinance in March 2006 following on from the Financial Conglomerates Directive.

### Exemption of death benefits funds

During the reporting year, BaFin published new administration principles according to which death benefits funds may be exempt from ongoing supervision irrespective of number of members, sphere of activity and volume of contributions. In so doing, BaFin and the supervisory authorities at Land level responsible for insurance brought their existing principles on the exemption of small businesses from insurance supervision into line with the new legal situation (section 157a (1) sentence 2 VAG). However, none of the 41 supervised death benefits funds were granted exemption in 2006.

## 2 Ongoing supervision

### 2.1 Authorised insurance undertakings and pension funds

● Number of insurers down slightly in 2006.

In 2006, the number of insurance undertakings subject to supervision by BaFin fell further to 636, of which 23 were not actively conducting business. The fall in the number of authorised life and property/casualty insurers was striking. Compared with 121 life insurance companies and 266 property/casualty insurers with active operations subject to supervision in 1996, there were 100 and 222 respectively in 2006. This development is an expression of a slow but ongoing process of consolidation.

The following information on business development in 2006 includes the 11 public-law insurance undertakings subject to supervision by the individual federal states (nine of which were actively conducting business and two of which were not). A sector breakdown is provided in the table below:

Table 13

### Number of supervised insurance undertakings (IU) and pension funds<sup>16</sup>

	IU with business activity			IU without business activity		
	Federal supervisor	State supervisor	Total	Federal supervisor	State supervisor	Total
Life insurers	100	3	103	10	0	10
Pensionskasse	153	0	153	3	0	3
Death benefits funds	41	0	41	1	0	1
Health insurers	52	0	52	0	0	0
Property and casualty insurers	222	6	228	5	2	7
Reinsurers	45	0	45	4	0	4
Total	613	9	622	23	2	25
Pension funds	24	0	24	0	0	0

Table 14

### Life insurers from the EEA

United Kingdom	5
of which Gibraltar	0
Belgium	3
Luxembourg	3
Netherlands	3
France	2
Italy	2
Lithuania	2
Liechtenstein	1
Malta	1
Hungary	1

### Life insurers

During 2006, BaFin authorised one public limited company to conduct life insurance business. Three branches were set up by companies from the UK, Ireland and the Netherlands. As in the previous year, 23 foreign life insurance companies from within the EEA registered to provide services in Germany. A number of service providers extended their business operations.

### Property and casualty insurers

BaFin granted three public limited companies permission to conduct property and casualty insurance business in 2006. Foreign property/casualty insurers from the EU established five branches, of which three were from France, one from the UK and one from Ireland. In total, 52 insurance undertakings from the EEA registered to commence the provision of services in Germany (previous year: 62). Additionally, a number of insurance undertakings that were already authorised registered expansions in their business operations. Compulsory insurance is still only offered on a small scale and is generally limited to motor vehicle liability insurance. Again in 2006, some insurers ceased their service activities in Germany.

### Reinsurers

BaFin authorised one public limited company to conduct reinsurance business during 2006.

Table 15

### Property and casualty insurers from the EEA

United Kingdom	15
of which Gibraltar	1
France	4
Ireland	4
Liechtenstein	4
Poland	4
Hungary	4
Denmark	3
Lithuania	3
Netherlands	3
Belgium	2
Italy	2
Sweden	2
Luxembourg	1
Malta	1

<sup>16</sup> The data does not include small mutual societies (kleinere Versicherungsvereine auf Gegenseitigkeit) which operate on a mainly regional basis (BaFin statistics for 2005 – primary insurance undertakings, page 8, Table 5).

## Pensionskassen and pension funds

There were no instances of Pensionskassen being authorised by BaFin to conduct business operations during the year under review. One new pension fund was authorised. For the first time, three occupational pension institutions based in another EU Member State registered to operate in Germany, two of which were from the UK and one from Luxembourg.

## 2.2 Interim reporting

Since the 1995 financial year, insurance undertakings have been reporting selected accounting and portfolio data to BaFin, or to the former Federal Insurance Supervisory Office (BAV), on a quarterly basis. Experience with the data from previous financial years shows that, partly for systematic reasons, the preliminary figures submitted to BaFin frequently differ from the final figures. Consequently, this chapter will compare the preliminary data for 2006 with that of the previous year.

### 2.2.1 Business development

#### Life insurers

After a fall in 2005, the volume of newly activated policies in the area of direct life insurance rose again in 2006, up from 7.2 million to 7.9 million. This rise can be attributed to the stronger level of new business in annuities and other forms of life insurance. The underwritten amount of new insurance policies rose by 10% to €231.6 billion (previous year: €210.6 billion).

The share of mixed endowment policies as a proportion of new contracts dropped from 22.2% to 21.4%. Term insurance accounted for 26.8% compared with 30.5% in the previous year, whilst the share of annuities and other life insurance rose from 47.2% to 51.8%. Endowment insurance comprised 11.9% of the underwritten amount on new policies, compared with 12.9% in 2005. Term insurance accounted for 34.9% compared with 35.4% in the previous year, whilst the share of annuities and other life insurance rose from 51.7% to 53.2%.

Early withdrawals (surrender, conversion into paid-up policies and other early withdrawals) affected 3.6 million contracts, compared with 3.7 million during the previous year. The total underwritten amount of the contracts that were withdrawn early, at €110.2 billion, was on a par with the previous year. Early withdrawals accounted for 3.9% in terms of the number of policies and 3.6% in terms of the underwritten amount in the case of endowment policies, and for 5.4% in terms of number and 1.8% in terms of underwritten amount in the case of annuities and other insurance.

The total number of direct life insurance policies as at the end of 2006 was 94.3 million contracts (+0.2%), with a total underwritten amount of €2,336.7 billion (+2.7%). The share of mixed endowment insurance continued to fall, down from 55.5% to 52.8% in terms of the number of policies, or from 44.7% to 42.0% in terms of underwritten amount. Accounting for 15.0% in terms of policies and 20.6% in terms of underwritten amount, the share of term life insurance remained more or less unchanged. Annuities and other life insurance accounted for 32.2% compared with 29.5% in the previous year in terms of number of contracts, with the share of the underwritten amount lying at 37.5% compared with 35.0% in 2005.

Gross premiums written in direct insurance business rose by 2.7% to €73.7 billion. Mixed endowment insurance accounted for 49.0% compared with 45.4% in the previous year, whilst the share of annuities and other life insurance rose from 45.7% to 49.3%.

#### **Health insurers**

Gross premiums written in direct health insurance business increased by 4.2% to €28.5 billion in 2006, with the number of insured natural persons rising by 9.0% to reach €29.1 million.

#### **Property and casualty insurers**

In 2006, property and casualty insurance undertakings saw gross premiums written in direct insurance business fall slightly by 1.0% to €58.3 billion.

Gross expenditure for claims during the year under review fell by 3.4% (2005: +3.0%) to €19.1 billion, whilst gross expenditure for claims from prior years rose by 1.4% (2005: -6.7%) to €13.0 billion. Gross provisions relating to individual insurance claims from the year under review, at €14.1 billion, were higher than in the previous year, as were the gross provisions for individual claims from previous years, at €42.5 billion (rises of +2.3% and +3.3% respectively).

Motor vehicle insurance, with gross premiums totalling €21.0 billion, was the biggest area by far. This equates to a fall of 3.9% compared with -2.8% in 2005. Total gross payments for insurance claims for 2006 were 0.9% down, with 1.7% less being paid out for insurance claims from previous years. Gross provisions for individual claims from the year under review and for outstanding claims from previous years were at a similarly high level as in 2005, at €5.6 million and €23.7 million respectively.

In the area of general liability insurance, property and casualty insurance undertakings collected total premiums of €7.7 billion (+1.4%). The companies paid out 5.4% less for claims relating to the reporting year and 2.2% less for claims relating to prior years. Gross provisions for individual claims, which are particularly important in this insurance class, fell by 6.0% (previous year: -16.0%) with regard to outstanding claims from the reporting year

and by 8.6% (previous year: -7.8%) in relation to outstanding claims from earlier years.

In the area of fire insurance, insurance undertakings posted gross premiums of €1.9 billion (-4.2%). Gross expenditure for claims from 2006 fell by 2.8%, whilst gross provisions for individual claims from the year under review were up by 1.8%. With regard to insurance claims from previous years, the undertakings paid out 31.8% more (previous year: -15.9%), with provisions up by 2.6% (previous year: -15.7%).

Viewed together, comprehensive residential buildings insurance and comprehensive household insurance generated premiums of €6.6 billion (+1.5%). Expenditure for claims relating to the financial year rose by 2.1% year-on-year, with provisions up by 7.1%. Expenditure for claims from previous financial years was up by 8.2% on 2005, with provisions for such claims 4.0% higher than in 2005.

Premiums from general accident insurance totalled €6.3 billion (+4.7%). Gross expenditure for claims relating to the financial year rose by 3.1% year-on-year, with payments made for claims from previous years up by 1.0%. Provisions for individual claims outstanding from 2006 were up by 4.5% on the previous year, with provisions for claims outstanding from previous years up by 12.4% on the 2005 figure.

### **2.2.2 Investments**

Total investment by all German insurance companies increased in 2006, up 4.9% to €1,246.3 billion. (2005: €1,188.2 billion). The proportion of properties fell to 2.4% with a decline in the book value of property investments. The proportion of investments in fund units, at 21.3%, was more or less unchanged on the previous year. These were the biggest items alongside Pfandbriefe, municipal bonds and other bonds issued by credit institutions, accounting for some 19.0%, and investments with credit institutions, accounting for 15.7%. Overall, the breakdown of individual investments was similar to the situation in 2005. In terms of Pensionskassen, health insurance, property/casualty insurance and reinsurance undertakings, there was above-average growth in total investments. In contrast, growth in life insurance undertakings and death benefits funds was below average.

Tabelle 16  
Investments 2006

Investments of all Insurance Undertakings (IUs)	Balance as at 31/12/2006		Balance as at 31/12/2005		Change in 2006	
	in € million	in %	in € million	in %	in € million	in %
Real property and equivalent rights and shares in property companies	29,803	2.4	30,853	2.6	-1,050	-3.4
Shares in funds, public investment companies and investment companies	266,019	21.3	255,857	21.5	10,162	4.0
Loans secured by mortgages on property	62,979	5.1	63,953	5.4	-974	-1.5
Loans against securities and receivables secured against bonds	3,768	0.3	3,799	0.3	-32	-0.8
Loans to EEA states, their regional governments, regional corporations, international organisations	72,105	5.8	63,321	5.3	8,784	13.9
Corporate loans	8,010	0.6	9,583	0.8	-1,573	-16.4
ABS	815	0.1	697	0.1	118	17.0
Policy loans	5,215	0.4	5,358	0.5	-143	-2.7
Pfandbriefe, municipal bonds and other bonds from credit institutions	237,811	19.1	220,661	18.6	17,149	7.8
Listed bonds	113,864	9.1	112,879	9.5	985	0.9
Other bonds	6,472	0.5	4,191	0.4	2,281	54.4
Receivables from subordinated debt	22,829	1.8	21,716	1.8	1,114	5.1
Participation rights	14,202	1.1	13,358	1.1	843	6.3
Registered debts and liquidity papers	3,088	0.2	3,576	0.3	-488	-13.6
Listed shares	31,463	2.5	35,136	3.0	-3,673	-10.5
Unlisted shares and company holdings excl. shares in private equity	117,318	9.4	106,726	9.0	10,592	9.9
Shares in private equity	4,613	0.4	3,854	0.3	759	19.7
Investments at credit institutions	195,456	15.7	184,710	15.5	10,746	5.8
Investments in opening clause	15,042	1.2	15,160	1.3	-118	-0.8
Other investments	35,436	2.8	32,779	2.8	2,657	8.1
<b>Total investments*</b>	<b>1,246,313</b>	<b>100.0</b>	<b>1,188,171</b>	<b>100.0</b>	<b>58,142</b>	<b>4.9</b>
Life insurers	669,195	53.7	650,416	54.7	18,780	2.9
Pensionskasse	92,603	7.4	86,186	7.3	6,416	7.4
Death benefits funds	1,625	0.1	1,557	0.1	68	4.4
Health insurers	130,841	10.5	119,428	10.1	11,413	9.6
Property and casualty insurers	133,130	10.7	124,359	10.5	8,771	7.1
Reinsurers	218,919	17.6	206,227	17.4	12,692	6.2
<b>All IUs*</b>	<b>1,246,313</b>	<b>100.0</b>	<b>1,188,171</b>	<b>100.0</b>	<b>58,142</b>	<b>4.9</b>

\* Differences in the overall total are due to rounding differences.

## 2.3 Solvency

All branches of insurance showing good solvency.

On the whole, the primary insurers were already meeting the minimum capital requirements very well in 2005. Provisional estimates suggest that this was also the case in 2006.

In 2005, coverage in the life insurance sector rose by just under 13 percentage points to 190% compared with the previous year. This was due to the fact that the eligible capital rose more strongly than the required solvency margin. For some years, the coverage ratio has been relatively stable, lying at its long-term average.

Following evaluation of the scenario calculation as at 31 October 2006, the life insurance undertakings also clearly met the solvency requirements in 2006. Estimates put the coverage ratio for the end of 2006 at over 200%.

In the area of health insurance there was a marginal reduction in the coverage rate in 2005 from 219% to 214%. Based on forecasts made as at 31 December 2006, the coverage ratio for the solvency target is expected to be slightly up on the previous year's figure.

In the area of property and casualty insurance, the coverage rate in 2005 fell again, although less strongly than in the previous year. This was still due in part to the change in the supervisory regulations under Solvency I, which tended to result in higher solvency requirements. Given that the transitional regulations remained in force only until 1 March 2007, nearly all property and casualty insurers are now reporting in accordance with the new rules. Despite the fall, the coverage rate remains at a very high level and well in excess of the minimum capital requirements.

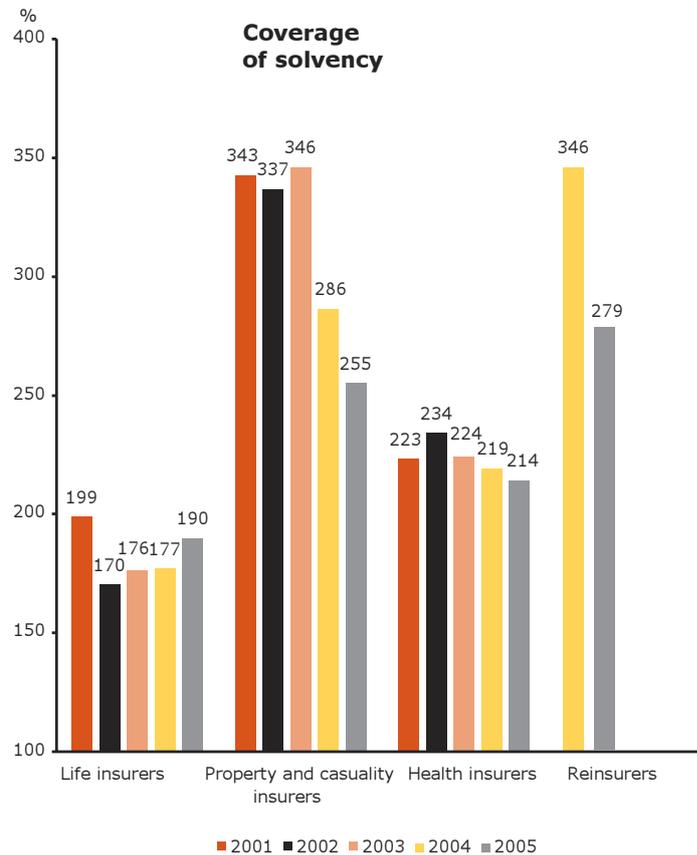
For 2004, following the entry into force of the statutory regulations on supervision of reinsurance business, the solvency of German reinsurance undertakings was also calculated for the first time in a comparable way to that of primary insurers. The coverage ratio of reinsurers supervised in Germany, at 346%, was very high. This figure is adjusted to take account of major reinsurers that also operate as holding companies. The coverage rate for 2005 was 279%.<sup>17</sup>

Five Pensionskassen covered the solvency margin with sufficient own funds as at 31 December 2005. Some companies remedied this shortfall during 2006. The other Pensionskassen were required to submit solvency plans, which are still being implemented. One company was prohibited by BaFin from taking on new business back in 2005, as it was unable to submit a convincing plan showing how a healthy financial situation would be restored.

In terms of the pension funds, the forecasts as at the cut-off date of 30 June 2006 revealed that all 24 funds held the necessary level of capital to cover the solvency margin.

<sup>17</sup> BaFin statistics for 2004/2005 – Reinsurers.

Figure 15  
**Development of solvency of German insurers and reinsurers**



## 2.4 Stress testing

### Stress testing as a quantitative element of risk management

Various forward-looking instruments are available to the supervisory authorities as early warning systems. One of these is stress testing, based on a possible negative capital market development. Stress testing is established as a quantitative element of investment risk management. It simulates crisis situations on the capital market with an impact on an insurer's balance sheet with the aim of ensuring that insurers introduce measures to increase their risk-bearing capacity in good time in the event of negative events.

The stress test reveals whether the insurance undertaking, when faced with the crisis scenario, can meet its contractual obligations without needing to take countermeasures. Insurers should also be well equipped to face potential capital market risks in the future.

- BaFin stress testing extended to include an additional scenario in 2006.

BaFin extended its stress testing during the reporting year to include a further scenario. To date, BaFin has considered only equity, interest rate and credit standing risks as part of its stress tests. Now, in order to simulate a negative development on the property markets too, the stress testing also encompasses a scenario whereby share prices fall by 20% and the market values of property fall by 8%. The supervisory authorities chose the relatively low value of 8% in light of the fact that property, unlike shares, is generally subject to longer-term movements.

As at the balance sheet date of 31 December 2005 the insurers were carrying out stress tests based on the following parameters:

Table 17

### Stress test scenarios

Stress test scenario	Asset class	Loss in market value
A 35	Equities	-35%
R 10	Bonds	-10%
RA 25	Equities	-20% and
	Bonds	-5%
AI 28	Equities	-20% and
	Property	-8%

BaFin stress testing in 2006 continued to take account of reserves on the assets side of the balance sheet and buffers on the liabilities side, such as free provisions for the reimbursement of premiums and final surplus funds. It was also necessary in 2006, however, to take account of the fact that the new Investment Act permitted greater use of derivatives in funds. Insurers use this option to portray asymmetrical risk profiles of the funds. Guarantee or total return concepts can be used to limit loss to ensure only partial participation in a potential loss. The stress test was therefore extended to ensure that hedging in this way can be taken into account under particular conditions.

BaFin will continue to react to changes in the statutory or economic basic parameters and adjust the stress test model accordingly. This is the only way in which to promote risk-adequate investment management by the undertakings.

### Stress test results

- Positive balances at all life insurers ...

The supervisory authority included 104 life insurers in its evaluation. Seven companies were exempt from stress testing due to the low risk of their investments. All of the life insurers recorded positive balances in the four scenarios. The results of the stress tests underscore the economically stable situation of the life insurance sector.

- ... and at all health insurers.

BaFin requested 45 health insurers to submit their stress test results. The remaining seven undertakings were exempt from submitting their results due to the low risk of their investments. As in the previous year, all the health insurers recorded positive values in the stress test. Even in the event of significant price falls or interest rate rises, it was sufficiently certain that enough assets

would have been in place, taking account of technical provisions and statutory capital adequacy requirements.

● Nine property and casualty insurers ...

180 property and casualty insurers submitted their stress test results to BaFin, with 39 undertakings exempt from this requirement. Of the 180 undertakings, 171 property and casualty insurers reported positive stress test results. Eight undertakings (4.4%) had negative results in all four scenarios, and one insurer (0.6%) had a negative result in one scenario. Sparked off by strong company growth and stricter solvency requirements, there was an above-average rise in the liabilities to be covered, particularly provisions for claims that had not yet been settled. Nevertheless, even in the case of the undertaking with a negative stress test result, it can be assumed that the risk-bearing capacity was sufficient. The high growth rates will fall further due to the ongoing pressure of competition. The insurers concerned have since introduced measures to increase their risk-bearing capacity, which in some cases have already been implemented in practice.

● ... and eleven Pensionskassen with negative results.

Of the 156 Pensionskassen supervised by BaFin at the beginning of the year, 31 were not required, on the basis of their 2005 financial statements, to submit stress test results due to their investments showing no or only little risk. Of the 125 Pensionskassen required to submit their result, 114 recorded positive results in all four scenarios. The level of the shortfall was generally low in the case of those Pensionskassen which recorded a negative result in one scenario (six undertakings) or several scenarios (five undertakings). These undertakings have since adopted measures to ensure that risk-bearing capacity is re-established. The Pensionskassen also showed a higher level of resistance to capital market risks.

● Insurers must inform BaFin of their risk asset ratio.

## 2.5 Composition of the risk asset ratio

All primary insurance undertakings reported on their investment portfolio in its entirety as at the 4th quarter of 2006. The undertakings were required to break down the different classes of investment on the basis of the schedule of investments given in section 1 (1) of the Investment Ordinance (AnIV) and on the basis of their particular risks.<sup>18</sup> The following evaluations are based on the data for life, health and property/casualty insurance undertakings and Pensionskassen as at the cut-off date of 31 December 2006. The book value of all of the investments of these areas of insurance was €1.03 trillion at this time.

Insurance undertakings may invest up to 35% of their restricted assets, in particular investments involving an elevated level of risk. These investments include, in addition to equity-based investments, participatory rights, claims from subordinated liabilities and hedge funds. The following table gives a breakdown of the risk asset ratio.

<sup>18</sup> Documentation 670.

Table 18  
Composition of the risk asset ratio

Form of investment in accordance with section 1 (1) no. ... AnIV, version dated 22 May 2005	Restricted Assets									
	Life insurers		Health insurers		Property and casualty insurers		Pensionskassen		Total for all four classes	
	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share
Total investments*	646,068	100.0%	128,878	100.0%	114,296	100.0%	91,710	100.0%	980,952	100.0%
Thereof:										
Loans against securities (No. 2), provided that shares (No. 12) are the object of the loan	57	0.0%	0	0.0%	0	0.0%	0	0.0%	57	0.0%
Receivables from subordinated debt (No. 9)	13,181	2.0%	3,944	3.1%	1,918	1.7%	1,890	2.1%	20,933	2.1%
Participation rights (No. 10)	9,204	1.4%	1,936	1.5%	1,38	1.2%	383	0.4%	12,903	1.3%
Fully paid-up shares which are included in a regulated market (No. 12)	9,198	1.4%	1,341	1.0%	1,358	1.2%	60	0.1%	11,957	1.2%
Non-listed fully paid-up shares, participating interests in a limited liability company, limited partnership and participating interests as silent partners within the meaning of the Commercial Code (No. 13)	8,572	1.3%	1,534	1.2%	2,304	2.0%	158	0.2%	12,568	1.3%
Units in funds (No. 15-17, incl. hedge funds), provided that they - include fully paid-up shares and participation rights which are included in a regulated market	44,896	6.9%	6,708	5.2%	13,405	11.7%	11,310	12.3%	76,319	7.8%
- cannot be definitively allocated to another form of investment; residual fund value and non-transparent funds	9,192	1.4%	1,532	1.2%	1,993	1.7%	1,386	1.5%	14,103	1.4%
Investments in high-yield bonds	3,336	0.5%	368	0.3%	702	0.6%	470	0.5%	4,876	0.5%
Increased market risk potential of funds**	2,805	0.4%	425	0.3%	944	0.8%	583	0.6%	4,757	0.5%
Investments linked to hedge funds (partly in categories other than the nos. of AnIV set out above)***	2,502	0.4%	490	0.4%	323	0.3%	233	0.3%	3,548	0.4%
Total investments subject to the 35% risk capital ratio	102,943	15.9%	18,278	14.2%	24,327	21.3%	16,473	18.0%	162,021	16.5%

\* Including cash at credit institutions, excluding liabilities from mortgages, land charges and capital annuity charges.

\*\* This is the MRP exceeding 100%, which must be added to section 2 (3) sentence 1 AnIV.

\*\*\* Approximate values.

Source: Sector totals as at 31 December 2006 for life, health and property/casualty insurers, as well as Pensionskassen, from the documentation 670, Circular 11/2005 (VA)

Equities accounted for between 9.0 and 10.4%.

The residual value, in the amount of 1.4% of the restricted assets for all classes, relates to all fund investments that could not be classified under other types of investment. Non-transparent funds were also allocated in full to this residual value. Consequently, equity-related investments accounted for between 9.0 and 10.4% of restricted assets. However, this level varies across the different insurance classes, at 6.2 to 7.4% for health insurers, and between 12.9 and 14.6% in the case of property/casualty insurers. Property/casualty insurance undertakings have the highest proportion of non-transparent funds.

Since the amendment to the Ordinance on the investment of restricted assets of insurance undertakings in August 2004, further classes of investment have been included in the risk asset ratio. These include investments in hedge funds or other direct or indirect investments linked to hedge funds. Direct investments in hedge funds are contained in the fund units investment class to a minimal extent. Most hedge fund investments, however, constitute note loans from suitable credit institutions or bonds whose yield and/or redemption value is determined by a hedge fund or hedge fund index. These are allocated to the schedule of investments in accordance with their cash instrument, but must be fully included in the risk asset ratio in accordance with section 2 (3) AnIV. These investments account for 0.4 percentage points of the risk asset ratio.

Subject to certain conditions, insurance undertakings may also invest up to 5% of their restricted assets in high-yield investments. These investments, which account for 0.5% of the restricted assets, are also included in the 35% ratio.

In accordance with the German Investment Act, a fund may, through the use of derivatives pursuant to section 51 (2) InvG or the corresponding provisions of another state, leverage potential market risk. This increased potential market risk of a fund is counted towards the risk asset ratio in accordance with section 2 (4) AnIV.

Table 19  
Proportion of total investments in selected asset classes

Form of investment	Total assets									
	Life insurers		Health insurers		Property and casualty insurers		Pensionskassen		Total for all four classes	
	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share
Total investments*	669,195	100.0%	130,841	100.0%	133,130	100.0%	92,603	100.0%	1,025,769	100.0%
Thereof:										
Investments in private equity holdings (in restricted assets according to section 1(1) no. 13 AnIV)	2,664	0.4%	447	0.3%	627	0.5%	114	0.1%	3,852	0.4%
Directly held asset backed securities and credit linked notes according to C 1/2001	5,815	0.9%	677	0.5%	533	0.4%	517	0.6%	7,542	0.7%
Asset backed securities and credit linked notes held in funds according to C 1/2002	5,084	0.8%	752	0.6%	1,754	1.3%	860	0.9%	8,450	0.8%
Investments in hedge funds and in investments tied to hedge funds (in restricted assets according to C 7/2004)	3,097	0.5%	554	0.4%	520	0.4%	488	0.5%	4,659	0.5%

\* Including cash at credit institutions, excluding liabilities from mortgages, land charges and capital annuity charges.

Source: Sector totals as at 31 December 2006 for life, health and property/casualty insurers, as well as Pensionskassen, from the documentation 670, Circular 11/2005 (VA)

Alternative investments continue to account for only a very small share of investments.

The table shows that the level of alternative investments as a proportion of total investments scarcely changed compared with the previous year. The share of investments in private equity rose from 0.3 to 0.4%, with investments in hedge funds up from 0.3 to 0.5%.

## 2.6 Trust activity and internal company guidelines for investment

Duties and powers of guarantee asset trustee.

The trustee must confirm under the balance sheet that the mathematical provisions have been properly created (section 73 VAG). A condition of such confirmation stipulates that suitability of the guarantee assets must be reviewed upon their allocation to the provisions. BaFin had noted that these reviews were not always being carried out on the record.

If an individual guarantee asset is not evidenced by certificate, an inhibition must be entered into the land register or corresponding registers to ensure the principle of dual control is followed. In many instances, this inhibition by the trustee was missing.

The supervisory authority noted that guarantee assets were not being secured immediately, i.e. no later than one week after the individual asset was registered in the list of assets. The trustee is responsible for checking that the assets are secured immediately.

Internal company guidelines for investment not always complete.

Insurance undertakings must draw up internal investment guidelines that flesh out the details of the undertaking's investment policy. There were many instances of the supervisory authority noting, when reviewing such guidelines, that account had not been taken of all of the requirements set out in Circular 15/2005 (VA). Examples of omissions included the criteria governing the use of innovative investment products, criteria for the selection of new counterparties and details of the qualifications and skills of employees working in investment management.

## 2.7 Life insurance

### Developments in life insurance

Rise in capital market interest rates and upbeat equity markets predominate.

The life insurers supervised by BaFin during the 2006 reporting year are expected to have recorded gross premiums in direct business of €73.7 billion.<sup>19</sup> This equates to a 2.7% rise on the previous year. The investment portfolio rose by approximately 2.9% to €669 billion.

The dominant factor regarding the economic situation of life insurers was bond market performance, with a clear rise in capital market interest rates experienced on the bond market from a

<sup>19</sup> The figures for 2006 are based on interim reporting as at 31 December 2006 and are therefore provisional figures.

relatively low starting point. As capital market interest rates rose during the year, the hidden reserves in life insurers' fixed-income investments fell. Because these investments are generally held until final maturity and then repaid at nominal value, the fall is only of limited significance, however. Crucial in assessing the long-term ability of insurers to meet their obligations, rather than the level of hidden reserves in fixed-income investments at a given point in time, is the level of capital market interest rates over the longer term. The moderate rise in capital market interest rates in 2006 should be assessed in a positive light, improving as it did companies' income situation.

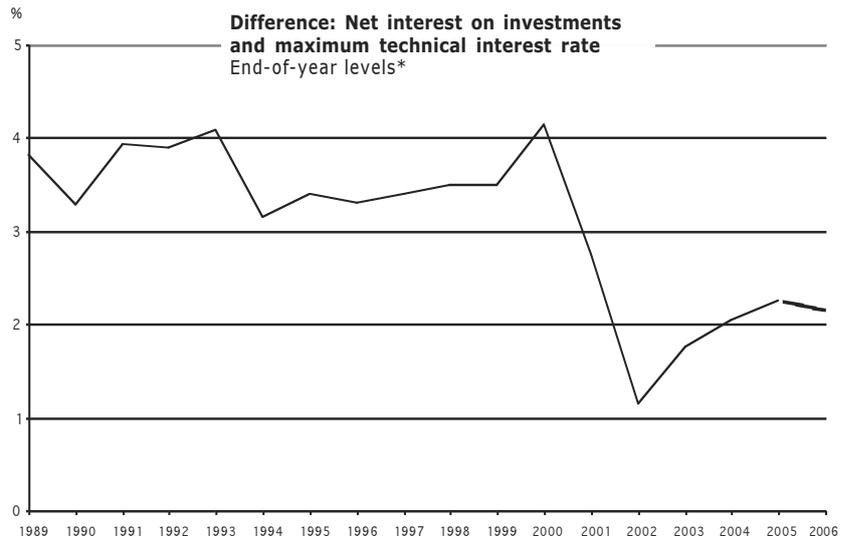
The upbeat development of the equity markets had a favourable impact on the life insurance undertakings' economic situation. The effect was limited, however, as the undertakings had a lower level of exposure to equities than in previous years.

● Net return for 2006 estimated at 5.0%.

The average net return on investments in 2006, based on provisional estimates, was 5.0% and thus slightly up on the previous year. There is a risk for life insurers that a sustained period of low interest rates could create a discrepancy between investment result and technical interest rate. The reduction in the maximum technical interest rate to 2.25% only reduces this risk for new business acquired with effect from 2007. The average technical interest rate in the contract portfolio of life insurers was around the 3.5% mark in 2006.

Figure 16

**Interest return of German life insurers**



\* 2006 figures are only provisional.

- Surplus declarations for 2007 mainly on a par with previous year.

In its scenario-based assessment as at 31 October 2006, BaFin also requested information on surplus bonuses for 2007. In this way, the supervisory authority gained an overview of whether the board decision corresponded to the proposal made by the responsible actuary and took appropriate account of the individual undertaking's economic situation. The surplus declarations provided by the life insurers were generally on a par with the previous year. The arithmetic average of total bonuses declared for endowment policies for 2007 was 4.2%, the same as in the previous year.

- All life insurers coped with stipulated BaFin scenario-based assessment.

As in previous years, BaFin conducted scenario-based assessments of the life insurers for the cut-off dates of 30 June and 31 October 2006. Alongside the stress testing process, the scenario-based assessments provide an additional risk-based supervisory instrument. They simulate the impact on commercial success of negative developments on the capital market. In 2006, the scenarios for equity prices moved within a range of up to 15% below the equity price at the given time. The scenario applied to interest rates involved a parallel increase in the yield curve of 25 basis points above the market situation on the cut-off date. All the life insurance undertakings would have been in a position to cope economically with the various different scenarios.

#### **Implementation of Federal Court of Justice rulings on invalid clauses**

- Undertakings reported on implementation of Federal Court rulings.

In October 2005, the German Federal Court of Justice ruled that the supposedly more transparent clauses used by insurance undertakings, with the trustee's consent, to replace invalid clauses without changing content were invalid.<sup>20</sup> The Court also declared the agreement on cancellation charges to be invalid.

Throughout 2006, BaFin monitored whether insurers were duly implementing the rulings and promptly discharging the justified claims. BaFin used various sources of information in this process of detecting cases of maladministration, above all consumer complaints.

For the purposes of obtaining a comprehensive picture of the industry, in autumn 2006 BaFin called upon all life insurers to provide information on completion of implementation. The supervisory authority analysed the responses and ascertained that the previous findings had been confirmed. The vast majority of life insurers had adhered to the requirements arising from the rulings. Only a few undertakings had not applied the Court's decisions to their insurance contracts. Whether the reasons stated for this failure to comply were convincing is currently being reviewed by the supervisory authority. There are now some Federal Court of Justice cases pending in this regard.

<sup>20</sup> BaFin 2005 Annual Report, p. 91.

### Protector protection scheme

BaFin supervises Protaktor Lebensversicherungs-AG in the latter's capacity as a life insurer and protection fund. The supervisory authority therefore counters any problems within the protection fund that could jeopardise proper fulfilment of the fund's role. BaFin may issue appropriate instructions necessary to eliminate or avoid any problems.

● Protaktor assigned new function by the state in 2006.

In May 2006, the Federal Finance Ministry entrusted Protaktor with the tasks and powers of the protection fund by means of legal ordinance.<sup>21</sup> This move coincided with the entry into force of the Protection Fund Financing Ordinance.<sup>22</sup> Pursuant to this ordinance, the member companies must pay contributions to the protection fund (ex ante financing). These contributions are based in the first instance on net technical provisions. Additionally, the individual financial and risk position of the member companies is also taken into account. By 2009, the protection fund should have reached a scale of approximately €600 million. The contributions for 2005 and 2006 were levied in November 2006 and amounted to around €246 million. Should the protection fund be required to rescue the insurance portfolio of an ailing life insurer, special contributions may be levied if the existing funds are insufficient. This is subject to an instruction being issued by BaFin to the effect that the insurance portfolio is to be transferred to the protection fund. In the event that the contributions are still not sufficient, BaFin will reduce the obligations from the contracts in question by up to 5% of the contractually guaranteed benefits.

### Statutory protection fund for life insurance

In 2004, the policymakers laid the foundation for a statutory protection fund for life insurance (sections 124 et seq VAG).

The fund guarantees the continuation of all affected insurance contracts in the event that a life insurer finds itself in difficulties. It protects all those who benefit under a life insurance contract. These primarily include policyholders, insured persons, beneficiaries, heirs and assignees.

All German life insurers and branches operated by life insurers from third states must be members of the protection fund. Branches and service providers from insurers from other EU or EEA states may not be members of the fund. In 2006, 106 life insurers were compulsory members of the fund. Additionally, 23 Pensionskassen had made use of the option of voluntarily joining the scheme.

<sup>21</sup> 2006 Federal Law Gazette I, p. 1170.

<sup>22</sup> 2006 Federal Law Gazette I, p. 1172.

## 2.8 Private health insurance

### Developments in private health insurance

- Stable income situation with volume of new business expected to be moderate.

The 52 private health insurers subject to supervision by BaFin are expected to have generated total premium income of approximately €28.5 billion in the 2006 financial year, a year-on-year increase of approximately 4.2%.<sup>23</sup> Due to the ongoing political debate on reform of the healthcare system, the development of new business, particularly in relation to full medical costs insurance, can however be expected to be moderate. Part of the growth in premiums can therefore also be attributed to the adjustment of premiums.

The investment portfolio rose by approximately 9.6% to €131 billion. Because 2006 was marked by a continued recovery on the equity markets, this had a positive impact on health insurers' economic position. Bond market interest rates, which did increase but nevertheless remained low relatively speaking, continued to have a detrimental effect on the interest income from new investments. Overall, the income situation is judged to have been stable in 2006.

- All health insurers coped with stipulated BaFin scenario-based assessment.

BaFin required 45 health insurers to carry out scenario-based assessments as at 30 June 2006 and to submit their results. Seven undertakings were exempt from the requirement to submit results due to the low-risk nature of their investments, or due to the fact that their insurance business was carried out in the same manner as property insurance. The supervisory authority had defined four different scenarios for 2006's scenario-based assessment based on market development. Two scenarios dealt exclusively with the influence of equity price risks on commercial success. The two other scenarios also incorporated interest rate risks into the forecast. All of the health insurers would have been in a position to cope economically with the various different scenarios. A rise in interest rates would, as expected, have resulted in a significant reduction in the hidden reserves for fixed-income investments. Even in the worst scenario the industry's hidden reserves still accounted for 1.4% of the investment portfolio.

At the end of 2006, the health insurers held balanced reserves of some €6 billion in their investments, which equates to some 4.6% of the investment portfolio. Hidden liabilities – due to the rise in capital market interest rates – are only present in fixed-income investments to a minor extent.

- Net interest earned in 2006 estimated at above 5.0%.

Based on the information from the scenario-based assessment, all of the health insurers would have been in a position to fulfil their guaranteed rate obligations. Some insurers, faced with the negative scenarios, would have had to make use of other surplus funds available on a sufficiently large scale, such as the safety loading.

<sup>23</sup> The figures for 2006 are based on interim reporting as at 31 December 2006 and are therefore provisional figures.

The negative scenarios used in the estimate did not materialise. BaFin therefore expects the companies in question to achieve a level of net interest earned of more than 5% as in the previous year.

### Technical interest rate for private health insurance

During the year under review, the German Actuarial Society (DAV), in cooperation with BaFin, developed the actuarial process used to determine a company-specific maximum technical interest rate, known as the actuarial corporate interest rate (ACIR) process.

BaFin received the estimated figures for the first phase from all of the supervised undertakings required to undergo the ACIR process. In the case of some insurers, the supervisory authority carried out company-specific reviews based on current versions of the second phase. There were no instances of health insurers being required to reduce their technical interest rate as a result.

● ACIR process developed further.

#### The ACIR process

The ACIR process is composed of two phases which are applied in consecutive years to health insurers that conduct their business in accordance with the technical principles of life insurance.

During the first phase, all undertakings that conduct their business in this way estimate, in April, their current investment income for both the current year and the following financial year on the basis of a flat rate.

Account is taken of the fact that a necessary reduction in the technical interest rate in the portfolio can only be performed if a premium adjustment has already been scheduled and that premium adjustments for the entire portfolio are not made each year but only every 1.76 years on average. The estimate is based on historical data with a confidence level of 95%.

If the calculations during the first phase produce values for some insurers that are not at least 5% above the current technical interest rate, a second phase is subsequently implemented at these insurers. The second phase involves taking a closer look of the specific situation of the company in order to make a more precise estimate. If the forecast level lies below the technical interest rate currently in use, the company must reduce this interest rate to the estimated value.

In August 2005, the DAV, during summary proceedings, adopted the first phase of the ACIR process as the provisional guideline for actuaries. The second phase of the ACIR process is currently the subject of summary proceedings. As part of the ordinary guideline process for the second phase, the DAV intends combining phase one and two in one joint guideline.

Medicator assigned new function by the state in 2006.

### Medicator protection scheme

Originally founded as a voluntary rescue company, Medicator AG was entrusted by the Federal Ministry of Finance in May 2006 with the tasks and powers of the protection fund for health insurers. Unlike the protection fund in place for life insurers, no financing ordinance exists for Medicator AG, as no provision is made under this scheme for ex ante financing. Rather, the member companies are required to pay contributions of up to 0.2% of the total of all net technical provisions (ex post financing) in the event of a protection case occurring and following the transfer of the ailing portfolio. Medicator AG is supervised by BaFin.

### Statutory protection fund for private life insurance

In 2004, the policymakers laid the foundation for a statutory protection fund in the area of substitutive health insurance. Health insurance is substitutive when it replaces statutory health insurance in part or in full e.g. in the case of full medical costs insurance or daily benefits insurance in the event of illness but not hospital per diem allowance insurance or additional rates paid alongside statutory health insurance.

The compulsory members of this fund include all health insurers that are authorised to operate substitutive health insurance business as well as the German branches of such insurers from third states. Branches of insurers from another EU or EEA state may not be members.

The fund provides protection for the claims of all those persons who benefit from an insurance agreement. The protection fund creates a system whereby the continuation of all affected insurance contracts is guaranteed in the event that a company operating substitutive health insurance business finds itself in difficulties.

## 2.9 Property/casualty insurance and reinsurance

### Developments in property and casualty insurance

Tough competition in motor vehicle insurance places burden on income.

The property and casualty insurance sector had a positive 2006 on the whole, although – as expected – the trend of the past few years where results have continuously improved was not maintained. Tough competition in motor vehicle insurance – the most important area of property and casualty insurance – intensified further and increased the financial pressure placed on undertakings in this sector.

There was a slight deterioration in the income situation of insurers during 2006. Provisional estimates indicate that gross premiums written in direct insurance business fell by 1.0% compared with the previous year to €58.3 billion.<sup>24</sup> Alongside the intensive price competition in the motor vehicle sector, further contributory factors were, above all, the soft industrial insurance market and the high level of market penetration in property and casualty insurance overall.

<sup>24</sup> The provisional figures are based on interim reporting.

At the same time, after three favourable financial years, there was a turnaround in terms of claims, with claim expenses up in most areas. There was a particularly clear rise in expenditure in property insurance. The hailstorms of June 2006 resulted in a rise in claim expenditure in the motor vehicle damage insurance segment. Otherwise, the sector was spared any major natural disasters during the year under review.

The combined ratio of claim costs rose according to provisional findings by some three percentage points to 92.5%. Although the insurers continued to generate a technical profit, there was an overall fall in the surplus recorded compared with the previous year.

### Developments in reinsurance

Reinsurers improved their capital situation again in 2006, given that the negative claim trend of 2005, sparked off by the serious natural disasters in the USA, did not continue into 2006. The recovery phase was supported by the positive environment on the financial markets, generating stable investment results.

The ongoing reorganisation – by means of selective and return-oriented subscription policy – helped ease the burden on actuarial practice and contributed to a stabilised income situation.

Based on provisional estimates for the 2006 financial year, gross premiums will be at around the same level as in 2005 (€45.4 billion). The capital of reinsurers is estimated at €55 billion (2005: €47.6 billion).

Overall, the current state of the national reinsurance market can be viewed as very stable.

### Finite reinsurance

Finite reinsurance is an area that has been increasingly focused on by the public and the supervisory authorities over recent years. This is a type of reinsurance where the transfer of the insurance risk from the primary insurer to the reinsurer plays only a subordinate role. Other functions, such as financing effects, are the main focus.

Finite reinsurance is a necessary and legitimate form of risk management within an insurance undertaking. Past experience has shown however, time and time again, that the risk of inappropriate use is particularly high in this area of reinsurance. Spectacular examples have been seen over the past few years in Australia and the USA. BaFin has reacted to this situation and is examining the spread of finite reinsurance within Germany's primary insurance and reinsurance industry. The supervisory authority is acutely aware of this issue and is striving to avoid any potential abuse of this form of reinsurance. This is why, for example, during on-site inspections of both primary insurers and reinsurers, particular attention is devoted to finite reinsurance relations.

Negative claim trend not maintained in 2006.

Legitimate component of risk management.

● Statutory regulation on finite reinsurance imminent.

Under German supervisory law, insurers must report separately on their use of finite reinsurance. Additionally, BaFin is authorised to demand a higher level of capital if a finite reinsurance contract does not transfer a sufficiently high risk. However, to date, there have been no regulations at either national or international level on the minimum amount of risk to be transferred or on other minimum requirements to be fulfilled by a (finite) reinsurance agreement. The European Reinsurance Directive contains further key points and, additionally, empowers national governments to adopt further, more specific rules through the introduction of ordinances. Following the entry into force of the 2006 VAG amendment, the German policymakers are expected to make use of this option before the end of 2007.

## 2.10 Pensionskassen and pension funds

### Developments with regard to Pensionskassen

● Competitive Pensionskassen expand their business.

There was only a slight rise in the area of occupational retirement provision in 2006. In terms of the classic Pensionskassen there was no major increase in premiums, with staff levels at many of the sponsoring companies stagnating or even falling. Competitive Pensionskassen, however, expanded their business activities further.

One of the reasons for the slower growth was that many of the more recent Pensionskassen had reached a significant premium volume and that the market is therefore becoming increasingly saturated. A further major reason is that companies are increasingly looking to direct insurance. The investments held by the 156 Pensionskassen supervised by BaFin rose by around 7.4% to €92.6 billion.

Increase in mathematical provisions leads to greater expenditure. In addition to the investment risks accounted for by stress testing, Pensionskassen also face what is known as longevity risk. This can mean that Pensionskassen are forced to adjust their bases of calculation and increase their mathematical provisions. The level of interest rates on the bond market, which are still low despite a slight increase, makes it increasingly difficult for companies to generate the surpluses needed to finance such adjustments, as only comparatively low-return investments are available as new investments.

● All Pensionskassen met their obligations.

BaFin made forecasts for 139 Pensionskassen as at 30 June 2006. 17 Pensionskassen were exempt from submitting calculations due to the low-risk structure of their investments. The companies were required to forecast the expected development over the 2006 financial year on the basis of four capital market scenarios. Using the submitted forecasts, BaFin recognised at an early stage that the Pensionskassen would be able to meet their obligations at the end of the financial year.

### Developments with regard to pension funds

#### ● Pension funds developed new products.

The young German pension fund sector was once again characterised by the building up of its business operations in 2006. Many pension funds developed new products enabling existing pension entitlement from employer schemes to be transferred to pension funds. Companies have been making use of the option available since late 2005 of taking on pension commitments with lower liquidity implication for the employer.

The number of future beneficiaries at the year-end rose to approximately 304,000 compared with 135,038 at the end of 2005. The number of pension recipients rose to approximately 164,000 (previous year: 28,633). The increase in the number of pension recipients is mainly down to the transfer of existing guarantees from employers. The success of the expanded range of pension-fund products will be of considerable importance for the development of the sector in Germany.

#### ● Provisional estimates show overall rise in investments of 680%.

Investments for the account and risk of the pension funds rose, according to provisional estimates, by 55% in 2006 to approximately €510 million. Investments made for the account and risk of employees and employers increased by 955% to approximately €7.8 billion. Overall, total investments rose by 680%.

The strong rise in investments for the account and risk of employees and employers can be attributed, above all, to a newly founded pension fund which took over the pension commitments of an industrial company in 2006. Because the first financial year of this pension fund does not end until the middle of 2007, the half-yearly data as at 31 December 2006 has been incorporated into the figures given here. Overall, the biggest share of the total investment related to specialty funds set up for that purpose.

#### ● Forecast statement gives no cause for concern.

BaFin prepared forecast statements for 24 pension funds as at 30 June 2006. The funds were required to portray the expected development over the 2006 financial year for various different capital market scenarios. All the companies concerned showed they would be able to cover their technical provisions in full and have the requisite own funds to cover the solvency margin even in the event of unfavourable developments on the capital market. Because pension funds have made the most of their investments for the account and risk of employees and employers, the fluctuations in value of the investments predominantly affect the employees and employers. A burden is placed on the pension funds only in those cases where the value falls below a minimum benefit level guaranteed by the pension fund.

## VI Supervision of banks and financial services institutions

### 1 Basis for supervision

Focus on implementation of Basel II.

Various legal foundations relevant to banking supervision were introduced or reformed during the year under review. The core aspect of this work was the transposition of Basel II and the corresponding European directives into German national law. With the act to implement the redefined European Banking Directive and redefined European Capital Adequacy Directive, the process of transposition into German law was completed at the end of 2006.<sup>25</sup> The new EU rules were mainly reflected in the new Solvency Ordinance (Solvabilitätsverordnung – SolvV), as well as in the Banking Act (Kreditwesengesetz – KWG) and the reformed Ordinance Governing Large Exposures and Loans (Großkredit- und Millionenkreditverordnung – GroMiKV).

#### 1.1 Amendment of the Banking Act

Exceptions for institutions belonging to groups (waiver rules).

Transposition of the new EU rules means that institutions will be supervised increasingly at group level, rather than just individually. An example of this approach is embodied in the new section 2a of KWG. The waiver rules allow companies belonging to a group, under certain circumstances, to dispense with the requirements relating to capital adequacy, the issuing of large loans and an internal control system at the level of the individual institution. These exceptions apply both to subordinate companies of a group of institutions or of a financial group holding, and to parent companies as defined in section 10a (1) to (3) of the KWG that are based in Germany. Any institution wishing to avail itself of this waiver must notify BaFin, without formality, of its intention and provide evidence of compliance with the appropriate preconditions. One such precondition, for example, is that there are no obstacles to the immediate transfer of own funds or repayment of liabilities. Furthermore, steps must be taken to ensure that the institution wishing to benefit from this waiver is included in the group-wide process of identifying, assessing, controlling, monitoring and communicating risks.



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Chief Executive Director  
of Banking Supervision

<sup>25</sup> 2006 Federal Law Gazette I, p. 2606.

- Option to calculate own funds at group level.

For the first time, groups of institutions and financial holding groups may now calculate own funds on the basis of their consolidated accounts. This move is the policymakers' response to a long-standing request of the banking sector, and means that the previous rules, which were based solely on the individual financial statements of institutions belonging to a group, have now been updated to comply with international standards. Moreover, the new rules also reflect the practice that dominates in the area of insurance supervision.

It applies to all groups that prepare their consolidated accounts according to the German Commercial Code (Handelsgesetzbuch – HGB) or the International Financial Reporting Standards (IFRS). In order to ensure that the quality and structure of regulatory capital are maintained, certain effects of IFRS are to be neutralised by a new legal ordinance. To this end, the BMF (Federal Ministry of Finance) issued the Ordinance Governing the Procedure for Calculating the Own Funds of Groups of Institutions and Financial Holding Groups when Using Consolidated or Interim Financial Statements at Group Level (Konzernabschlussüberleitungsverordnung – KonÜV), which was published in the Federal Law Gazette of 23 February 2007.<sup>26</sup>

- Zero weighting of intra-group receivables in standard approach.

According to the Banking Act, certain positions of the standardised approach to credit risk (SACR) can be zero-weighted if the loan is awarded to an institution within the same group of institutions or financial holding group. For the first time, this option now also applies to intra-group exposures to institutions that belong to the same institutional protection scheme (section 10c (2) KWG). Whereas the definition of intra-group exposures depends on the affected institutions being included in the same consolidated accounts and having their headquarters in Germany, the requirements for intra-group exposures to institutions that belong to the same institutional protection scheme are based primarily on that scheme. Such a scheme must have sufficient liquid funds to be able to meet its obligations in a crisis situation. Moreover, it must maintain systems that permit a complete overview of the risk situation of the individual members and of the entire protection scheme to be made. BaFin confirms whether the protection scheme meets these preconditions and checks that they remain in place on a regular basis. At least once a year, the protection scheme must disclose its financial situation and risks.

- Risk weighting for large exposures dependent on SACR risk weighting according to SolvV.

The large-exposure rules of the KWG and GroMiKV aim to limit the award of credit to a single borrower in order to minimise concentration risks. In order to ensure this aim is achieved effectively, the large-exposure rules adhere to the principle that any borrower can default, irrespective of his creditworthiness, for example due to insolvency. As a consequence, all loans must as a general rule count in their full amount towards the large exposure limits. Until now, only very few exceptions have been made to this rule. Exposures to the German state, a German federal state or a regional government of a state in the European Economic Area

<sup>26</sup> 2007 Federal Law Gazette I, p. 150.

(EEA) were allocated a flat-rate risk weighting of 50%, 20% or even a zero weighting. Only the risk-weighted value of the exposure then had to be set against the large-exposure limits. With the introduction of the EU Directives, other borrowers may now also benefit from a more favourable risk weighting. One innovation, for example, is that short-term loans to financial services institutions and other investment firms, central counterparties and stock exchanges, in addition to banks, can be treated more beneficially in relation to the large-exposure limits. Nevertheless, unsecured loans to such borrowers may only benefit from a reduced risk weighting if they are allocated an SACR risk pursuant to the SolvV that is equal to or better than the risk weighting calculated on the basis of the GroMiKV. For example, if an institution wishes to count only 50% of a loan to a regional government towards its large exposure limits, the corresponding SACR risk weighting according to SolvV must be 50% or lower.

● Revision of the trading book rules.

Transposition of the EU rules has also required some other amendments to existing legislation. For example, the trading book rules are now regulated in a single section, section 1a of the KWG. The existing rules have been expanded and explained in further detail. One innovation is the possibility of apportioning goods to the trading book. The KWG also stipulates explicitly how institutions should organise their trading book and control it by means of internal processes.

● Additional definition of financial instrument.

In addition to the legislative changes above, a second definition of financial instruments has been added to the KWG. The strict, narrow definition, as given in section 1 (11) of the KWG, is definitive in relation to determining the facts of authorisations according to section 1 of the KWG. All other areas of application are covered by the wider definition of financial instruments of the new section 1a (3) of the KWG. This two-way definition reflects the different requirements of the revised Capital Requirements Directive and the Markets in Financial Instruments Directive (MiFID).

● Disclosure of information by institutions.

Once each year, since the beginning of 2007, institutions must disclose qualitative and quantitative information on aspects such as their own funds, risks assumed and their risk management procedures (section 26a of the KWG in conjunction with section 321 of the SolvV). Institutions are free to decide for themselves through what medium this information is published. Non-significant, legally protected or confidential information need not be disclosed. However, in such cases institutions must disclose and publish their reason for not divulging such information.

● Defining the content of audits.

For the first time, BaFin is able to prescribe to an institution exactly what the auditor must take into consideration when auditing the annual accounts (section 30 of the KWG). In the medium term, this may lead to the number of special audits being reduced.

## 1.2 Solvency Ordinance

- SolvV as the central body of rules for minimum regulatory capital.

The revised SolvV replaces the previously applicable Principle I regarding institutions' own funds. It contains detailed provisions for appropriate capital adequacy for banks, groups of institutions and financial holding groups, thus defining in more precise terms the capital requirements of KWG. The new ordinance specifies how the minimum capital requirements for counterparty risks, market risks, and now for the first time, operational risks, should be calculated. The ordinance thus implemented the first pillar of Basel II in German legislation on time on 1 January 2007. Moreover, SolvV contains disclosure requirements with which institutions must comply according to the third pillar of Basel II.

- Alternative approaches to calculating counterparty risk.

SolvV has fundamentally revised the requirements of the previous Principle I which, for example, provided for only one uniform procedure for calculating the capital adequacy requirement for counterparty risks. In contrast, SolvV contains two alternative approaches, the so-called standardised approach to credit risk (SACR) and an approach based on internal ratings (IRBA), which has a foundation and an advanced approach. While institutions using the foundation approach have only to calculate the probability of default, the advanced approach also contains an estimate of the loss ratio in the case of default and the conversion factor. Institutions may be using the advanced approach with effect from 1 January 2008.

- Taking account of external credit ratings in SACR.

For the first time, institutions may now calculate the SACR risk weighting of counterparty risk positions on the basis of external credit ratings. The prerequisite is that these assessments have been published by rating agencies or export insurance agencies that are recognised by the supervisory authority. In addition, SACR continues to allow flat-rate risk weightings that only take account of the type of counterparty risk position to be applied.

- Creditworthiness and default probability of borrowers can be calculated internally.

In addition, IRBA provides institutions with a further, more risk-sensitive approach to the risk weighting of counterparty risk positions. With this approach, IRBA institutions can use their internal rating systems to calculate the minimum capital requirements for their counterparty risks. During this process they are permitted to allocate each borrower to a specific rating grade or risk pool on the basis of their own creditworthiness assessments. The resulting risk weighting also takes account of the probability of the borrower being unable to meet his payment obligations (in full). The default probability addressed in this way can be estimated by the institution for all borrowers on the same rating grade or in the same risk pool on the basis of historical data.

- Credit risk minimisation techniques can already be taken into account in SACR.

Institutions can reduce credit risk by means of financial collateral and guarantees. SolvV has totally revised the option for taking such credit securitisation techniques into consideration when calculating the risk weighting. The ordinance now contains a range of financial collateral that is much wider than that provided for

under Principle I. In addition, institutions already in the SACR regime have access to the more complex and comprehensive method in addition to the simple method of taking into account financial collateral. While the simple method only replaces the risk weighting with the weighting of the collateral, the more complex variant also takes account of the term of the securitising instrument as well as any possible fluctuations in value or forex rates. Institutions can apply their own models in this respect, too, in order to estimate value and exchange rate fluctuation factors.

IRBA institutions may estimate risk reduction themselves.

Institutions that use IRBA have an even wider range of possible financial collateral available to them than those using SACR. Irrespective of this range, IRBA institutions may even calculate risk minimisation themselves, using the advanced approach, provided they have suitable internal rating systems in place. For those involved in the retail business, use of own estimates within IRBA is already mandatory. From 2008, this will also be the case for those counterparty risk positions that do not form part of the retail business.

Introduction of capital requirements for operational risk.

Until now, the minimum capital requirements have applied only to counterparty and market risks. For the first time, SolvV now demands that explicit capital requirements be met for operational risk. The ordinance provides three alternatives for calculating the amount required for operational risk: the basic indicator approach, the standardised approach and the advanced measurement approach (AMA). The individual approaches are characterised by increasing levels of complexity, in the order listed above. While the amount for operational risk calculated using the standard approach is primarily determined using external factors, institutions that use the AMA may, from 2008, also calculate their capital requirement using internal risk measurement systems.

#### **BaFin collection of interpretations regarding SolvV**

Since mid-2006, BaFin has published a collection of interpretations regarding SolvV on its website.<sup>27</sup> These documents contain responses to interpretation issues that have arisen from the practical application of SolvV, based on BaFin's administrative practices. The flexibility of a collection of interpretations enables BaFin to discuss the actual needs of the banking sector, and document its supervisory practice in a clear format. At the same time, BaFin also uses its website to publish decisions in list format. This includes, for example, a list of rating agencies recognised for SACR, a list of central counterparties and a list of third states that have a substantively equivalent system of supervision. The ultimate aim is that the collection of interpretations will also link to explanatory information relating to SolvV, such as numerical examples of applications of individual rules, or additional notes on completing reports and forms.

There are two further sources of information on SolvV, in addition to the collection of interpretations. Firstly, there is the explanatory memorandum of the SolvV, which both creates the actual reference

<sup>27</sup> [www.bafin.de](http://www.bafin.de) » Aufsichtspraxis » Auslegungsgeschiedungen.

to the provisions of the Banking Directive and the Capital Requirements Directive, and explains the motives for exercising national discretions and formal specification. Secondly, the recommendations published by the specialist committees of the working group on implementation of Basel II remain valid in cases where no further or contrary specifications are laid down in SolvV or in more recent interpretative decisions issued by BaFin.

### 1.3 Ordinance governing large exposures and loans

GroMiKV revised in terms of form and content.

In Germany, legislators have implemented the large-exposure rules of the amended Banking Directive and the revised Capital Requirements directive in both the KWG and the GroMiKV. Whilst the KWG contains the basics of the large-exposure requirements, the detailed rules of GroMiKV deal with the specifics. The new GroMiKV completely replaces the previous regime governing large exposures, and provides institutions with greater room for manoeuvre. The old ordinance has not simply been revised in terms of content, but has also been restructured for greater clarity. In addition, GroMiKV contains forms, tables and reports in its annexes. With the exception of the reporting system, which does not come into effect until 1 January 2008, the new GroMiKV entered into force on 1 January 2007.

To ensure that capital requirements are as consistent as possible, GroMiKV refers to the specifications of SolvV wherever possible and justified in terms of content. The benefits are twofold: firstly, the various parts of the Banking Directive that contain identical specifications are implemented in an identical manner, and secondly, the reference technique also means that the GroMiKV is a much leaner piece of legislation.

Risk-sensitive determination of the borrower.

For the first time, institutions must record the identity of their large borrowers in the form of a risk-based assessment. The major component of this assessment relates to counterparty default risk, which refers to the risk that a borrower could be unable to meet its obligations towards the creditor. According to the new GroMiKV, the counterparty is the borrower who represents the counterparty default risk according to an internal risk assessment conducted by the institution. Previous rules, according to which in the case of receivables, for example, the debtor was always classified as the borrower, now only take the form of examples that the institution can refute in specific individual cases.

New provisions for reducing credit risk.

While GroMiKV previously defined only the types of collateral that could be taken into account, such as guarantees, bonds, cash balances or securities, it now also defines the minimum requirements that these types of collateral must meet and how they are to be valued. In the past, BaFin had used administrative practice to bridge this gap. Now, the expressly standardised

minimum requirements have been expanded significantly beyond these practices. For example, they also address the question of whether the collateralisation is valid in law, how the collateral agreement is drawn up or how the risks relating to transferred collaterals can be managed. For the first time, term and currency differences play a role in the valuation of collateral.

If the collateral meets the prerequisites for a reduction in credit risk according to GroMiKV, the amount of the exposure counted towards the large exposures limit is also reduced. Institutions using the advanced methods with regard to financial collateral as provided for in SolvV will also be able to use these methods, with BaFin's consent, for large exposure purposes.

● Award of loans within groups and joint liability schemes.

As in the case of the KWG, the revised GroMiKV now provides for easier treatment for institutions that belong to a group of institutions or a financial holding group. Loans that are awarded by an institution to another member of the same group do not have to be counted towards the large exposure limits. However, this provision does stipulate that both the lending institution and the borrower must be included in a full consolidation, in particular in a single consolidated financial statement. A similar privilege is accorded to institutions that are members of a joint liability scheme and award loans to companies in the same liability scheme.

● New large exposures and loans reporting system.

The reporting system applicable from 2008 pursuant to GroMiKV limits the reporting obligations of institutions to the minimum required for supervisory purposes. With the advent of this new regime, a number of reports, such as the quarterly highs for large exposures, have been scrapped, and the number of report copies to be submitted has been reduced. However, the EU Directives have also introduced new reporting requirements. For example, institutions must now tell the supervisor what approach they use for calculating the minimum capital requirements under SolvV (SACR, basic IRBA or advanced IRBA). Due to the euro credit register, reporting rules on large loans also require notification of loans awarded by foreign branches and subsidiaries of German banks.

#### **„Basel II Workshops“ with lenders**

At the end of 2006, BaFin joined forces with the Bundesbank to stage several workshops on the German implementation of Basel II. A total of five events were held for three different associations. At the workshops, representatives of the banking sector could gain an overview of how the various EU rules have been transposed into German law, especially with regard to KWG, SolvV and GroMiKV. Seven further workshops are planned for 2007.

In terms of content, the workshops were mostly concerned with the changes to legislation as a consequence of implementing Basel II. Furthermore, papers were presented explaining the key points in terms of minimum requirements for risk management (MaRisk),

and the Basel II supervisory review process (SRP). In addition to this basic level of knowledge, BaFin and the Bundesbank also staged more in-depth workshops on IRBA and SACR/credit risk minimisation (CRM), which were generally held as parallel sessions.

## 1.4 Liquidity Ordinance

At the same time as Principle I was replaced by SolvV, Principle II concerning the liquidity of financial institutions was replaced by the new Liquidity Ordinance (Liquiditätsverordnung – LiqV), as had been planned for some time. LiqV, which entered into force on 1 January 2007, now covers nearly all of the areas previously regulated by Principle II. The most significant innovation for financial institutions is an opening clause that, for the first time, allows them to use internal procedures for measuring and controlling risk in order to limit their liquidity risk. Therefore, the modernised liquidity rules in Germany now form a model for potential harmonisation at EU level.

Moreover, the range of payment types has also been expanded. In contrast to Principle II, LiqV does not talk about securities, but about assets, among which the European Central Bank also includes current account credits for the purposes of recognising collateral for the taking up of loans. The investment restrictions for e-money institutions are also new, as LiqV transposes the European requirements of the E-Money Directive. According to the latter, institutions must now ensure their liabilities relating to outstanding electronic money are backed by specific liquid assets.

## 1.5 Reports Ordinance

Through the Act implementing the revised Banking Directive and Capital Requirements Directive, German policymakers have also withdrawn or limited a number of reporting obligations. BaFin has taken on board this deregulatory approach of the new Reports Ordinance (Anzeigeverordnung – AnzV), which entered into force on 31 December 2006, and has further reduced its reporting requirements. For example, it has finally scrapped the obligation to submit nil returns and has consistently reduced the number of copies of each report to be submitted.

The new AnzV also provides for a considerably leaner reporting system regarding qualified participating interests. Only one report form need now be completed for each interest that must be reported. Duplicate and multiple reports are no longer required. In total, the number of sections in the new AnzV has been almost halved. Thus BaFin has achieved its aim of producing a lean and transparent rule book.

Liquidity Ordinance replaces Principle II.

Qualified participating interests reporting system slimmed down.

Circular and information sheet on the new qualified participating interests reporting system.

Moreover, BaFin has issued a circular containing the specific details of the redesigned qualified participating interest reporting system.<sup>28</sup> In this circular, BaFin once again limits the scope of the reporting obligations by waiving the requirement for additional participation reports. In addition, BaFin has published an information sheet on its website in a bid to ease transition to the revised AnzV for institutions.<sup>29</sup> Alongside general notes and a summary, the sheet also provides a special e-mail address via which institutions can put questions relating to the qualified participating interest reporting system directly to BaFin.

## 1.6 Further changes to supervisory law

New ordinances extend the Pfandbrief Act.

The Pfandbrief Act (Pfandbriefgesetz – PfandBG), which has been in force since 2005, requires that details of the mortgage lending value and the cover register each be regulated by a corresponding legal ordinance. In 2006, therefore, BaFin issued the Mortgage Lending Value Ordinance (Beleihungswertermittlungsverordnung – BelWertV) and the Cover Register Ordinance (Deckungsregisterverordnung – DeckRegV).

### Mortgage Lending Value Ordinance

BelWertV entered into force on 1 August 2006.<sup>30</sup> It set consistent and transparent requirements for all issuers of Pfandbriefe in relation to the methodology and form of the calculation of mortgage loan value, and the valuer's qualification. BelWertV carries forward the proven principles of calculating the mortgage loan value from the Mortgage Banks Act and the instructions for calculating values of the former mortgage banks. The new provisions on value calculation take account of the fact that the buildings to be valued serve as collateral for mortgage loans that should be incorporated into the cover assets for Pfandbriefe. According to BelWertV, therefore, a period-specific value of the property must be calculated – in other words the value that can be achieved for the entire duration of the loan with sufficient certainty. This should be distinguished from the fair value calculated at a specific point in time, which could be used, for example, by an owner or potential purchaser to calculate the current value of a property.

### Cover Register Ordinance

The DeckRegV entered into force on 1 September 2006.<sup>31</sup> According to PfandBG, the Pfandbrief banks must enter all cover assets used for covering issued Pfandbriefe in the Cover Register. A separate cover register must be maintained for each category of Pfandbrief: mortgage Pfandbriefe, public Pfandbriefe and ship

<sup>28</sup> Circular 1/2007 (BA).

<sup>29</sup> [www.bafin.de](http://www.bafin.de) » Aufsichtspraxis » Merkblätter & Formulare.

<sup>30</sup> 2006 Federal Law Gazette I, p. 1175.

<sup>31</sup> 2006 Federal Law Gazette I, p. 2074.

Pfandbriefe. For the first time, DeckRegV now regulates consistently the form and content of these cover registers. It also specifies the way in which entries should be made, communicated to BaFin and kept on record by BaFin. The Ordinance is based on the legal function of the cover register, which forms the basis for the legal securing of Pfandbrief creditors. Therefore, the individual requirements regarding the format and content of the register ensure all cover assets can be clearly and unambiguously identified should a Pfandbrief bank become insolvent.

### Refinancing Register Ordinance

A further legal ordinance issued by BaFin is the Refinancing Register Ordinance (Refinanzierungsregisterverordnung – RefiRegV), which entered into force on 23 December 2006.<sup>32</sup> RefiRegV also hangs more precise details on the legal framework created by the PfandBG by setting the specific requirements for the format of the refinancing register. Regulated in the KWG, the refinancing register should make it easy for institutions to evidence receivables by certificate and to transfer them. In addition to the format, RefiRegV also defines the way in which records are to be made in this register. The requirements stipulated in the ordinance serve primarily to ensure the registered items can be clearly identified should a refinancing company become insolvent.

### Draft Auditor's Report Ordinance

An important source of information for BaFin's supervisory work is the audit reports drawn up by the auditors of annual financial statements. In writing their reports, auditors must comply with certain requirements, including those specified by the Auditing Report Ordinance (Prüfungsberichtsverordnung – PrüfBV), in force since 1998. Due to the numerous modifications to the legislation on supervision and other developments in auditing, BaFin has discussed an initial draft discussion paper on a new PrüfBV with auditors' associations.

New PrüfBV focuses on risk-oriented and principle-oriented reporting.

The aim is for PrüfBV to focus more strongly on risk-oriented and principle-oriented reporting. More clearly than before, auditors of annual financial statements must now base their core areas of inspection and the scope and depth of their reporting on the risk position of the institution being audited. The draft ordinance also takes account of the changed demands on auditors, such as the trend for achieving "fast close", i.e. accelerated publication of the annual financial statements. In all, the new PrüfBV will be more flexible and less descriptive in its approach. The objective is to significantly trim down the ordinance.

Draft PrüfBV takes account of international requirements.

PrüfBV must also comply with the new supervision rules of Basel II and the IFRS international accounting standards. The new draft ordinance takes account of the requirements for the supervisory review process (SRP) defined by Basel II. The draft proposes that auditors should also evaluate the findings of special audits carried

<sup>32</sup> 2006 Federal Law Gazette I, p. 3241.

out during the appropriate reporting period. Changes also arise from the use of IFRS consolidated financial statements for banking supervisory purposes. Therefore, the report on the consolidated financial statements of IFRS companies must in future also refer to facts for which the use of IFRS has a significant impact on the consolidated equity.

## 1.7 Stress testing

Stress testing is a significant component of a bank's system for risk management and controlling. The findings obtained should provide information on such aspects as how the risks of a portfolio might develop under unfavourable market conditions. Stress testing, therefore, enables conclusions to be drawn regarding a bank's risk-bearing capacity. The findings of the stress testing conducted to date show that the German banking sector is basically equipped to deal with extreme financial market scenarios.

Greater importance attached to stress testing in Basel II.

With the implementation of Basel II, stress testing for banks is becoming even more important. In the Basel II provisions, stress testing plays an important role both for the minimum capital requirements of Pillar 1 and for the SRP banking supervisory review process of Pillar 2. For example, Pillar 1 stipulates that institutions wishing to calculate their capital requirement using internal risk assessment procedures (IRBA) must complement their forecast statements with appropriate stress testing. These institutions must produce, among other things, a map of the effects of a mild recession on the level of capital required for counterparty risks. In the area of operational risk, stress testing is also a method that must be applied as part of the advanced approach (AMA). BaFin has explained the stress testing procedures in greater detail in its minimum requirements for risk management (MaRisk). According to MaRisk, when analysing their risk-bearing capacity, banks must conduct appropriate scenario analyses for the relevant risks on a regular basis. The Committee of European Banking Supervisors (CEBS) has also published technical notes on stress testing within the context of SRP.

Stress testing survey of banks produces important findings.

In mid-2006, BaFin, working in collaboration with the Bundesbank, conducted a written survey of twelve system-relevant banks on the subject of stress testing, with the aim of gaining an overview of current practice in relation to stress testing. One important finding of the survey was that there is currently no generally applicable standard for appropriate programmes of stress testing among banks. In addition, the surveyed institutions also used different definitions of the terms stress and stress testing, although the majority aligned their investigations with the banking supervisory requirements of the SRP. The stress testing procedures implemented so far must, therefore, be analysed on a case-by-case basis according to the business structure of the institution and other risk management instruments. Almost all institutions have already developed stress testing procedures for market risk, credit risk and liquidity risk. In contrast, stress testing procedures

that take account of the mutual dependency of market, credit and liquidity risks are still in their infancy. Most of the institutions surveyed already conduct stress testing for operational risk, or are at least planning to do so for a future AMA model.

The survey forms a sound basis for a more in-depth analysis. BaFin plans to examine the subject in greater depth by means of individual supervisory discussions on risk management or within the context of SRP.

## 2 Ongoing solvency supervision

### 2.1 Authorised banks

As at the end of 2006, 2,110 banking institutions were under BaFin supervision. BaFin categorises the supervised banks into four large groups: lending banks, institutions belonging to the savings bank sector, institutions belonging to the cooperative bank sector and other institutions. The lending banks include, for instance, the major banks, private banks and branches of banks from outside the EEA. In addition to the public savings banks, the savings banks sector also includes the "free" savings banks and the Landesbanks. Allocation to the savings bank or cooperative banks sector depends primarily on the economic ties between the institutions. As a result, DZ Bank and WGZ Bank, for example, are assigned to the cooperative sector. The group of other institutions comprises the building societies, mortgage banks, securities trading banks and both the federal and state housing promotion banks (Förderbank).

Table 20

#### Number of banks by type of institution\*

Group of institution	2006	2005
Lending institutions	199	203
Institutions in the savings bank sector	469	475
Institutions in the cooperative sector	1,306	1,341
Other institutions	136	133
<b>Total</b>	<b>2,110</b>	<b>2,152</b>

\* As at 31 December. The numbers of banks assigned to each type differ slightly from those specified in the 2005 Annual Report due to internal changes.

● Licence applications from lending banks rare.

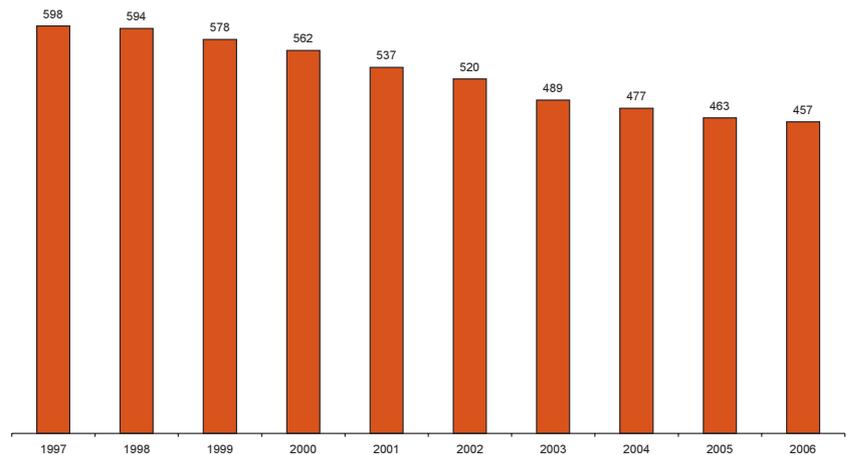
Despite the improved economic situation, only a few applications were submitted for licences to provide banking services. As at the year-end, only three licence applications had been submitted to BaFin. The trend is actually moving in a different direction. Instead of preparing and submitting a licence application, increasing numbers of investors are seeking to acquire their banking licence by purchasing an existing bank. They are seemingly under the erroneous impression that this path is less complex and involves less stringent requirements than the process of being granted a licence.

Fewer mergers among savings banks.

In 2006, the process of mergers among savings banks in evidence over recent years has experienced a marked slowdown. The number of savings banks fell slightly from 463 to 457 institutions. This figure equates to a drop of 1.3%.

Figure 17

#### Number of savings banks

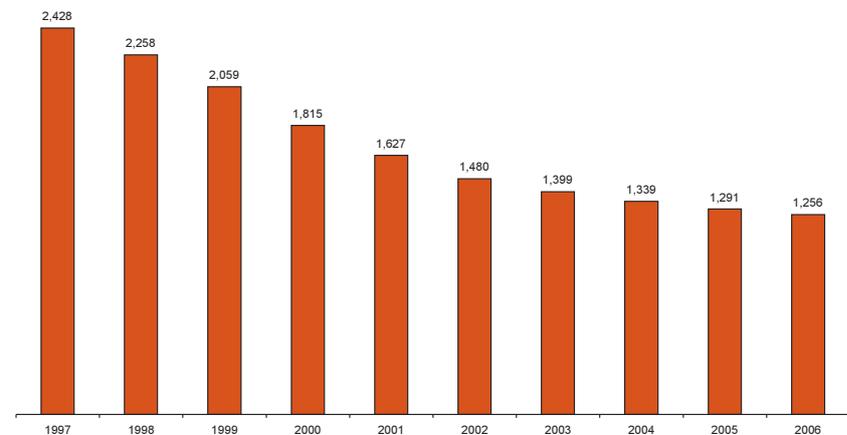


Development of the cooperative sector.

As at the end of 2006, BaFin's supervisory work in the cooperative banking sector covered a total of 1,256 primary institutions, two central banks, 10 institutions that are similar to central banks and 45 building cooperatives with savings schemes. The number of primary banks fell by 35 institutions, or 2.7%. Nevertheless, the pace of mergers in the cooperative banking sector slowed down compared with previous years.

Figure 18

#### Number of primary cooperative banks



The number of building societies under supervision remained unchanged in 2006. As in the previous year, BaFin supervised 15 private building societies and 11 that are under public ownership. In contrast, a large number of securities trading banks and stock exchange traders started up in the area of corporate finance, often

as investment companies or advisory companies acting in the area of issues. The background to this is the growing importance of the capital market as a source of financing for medium-sized companies. In light of the de facto deregulation of the German gas market, a company specialising in trading in gas-based derivatives also applied for a licence in 2006.

### Economic development

- High competitive pressure for private, regional and specialist banks.

The year under review witnessed a stabilisation in the income situation of the banking sector as a whole. This was particularly notable among the private, regional and specialist banks. However, these banks are subject to their own competitive pressure from domestic and foreign institutions. Particularly those institutions that had opted for a niche-based strategy have frequently failed to achieve their targeted results during the year under review. One cause is the increased competition for private customers, which has led to a marked weakening of income and alarming levels of concentration risk among a number of institutions.

- Positive development in the savings bank and cooperative sectors.

The rising economy has had an equally positive effect on savings banks and cooperative banks alike. The majority of savings banks recorded a slight increase in customer deposits over the past year and extended their lending business, while in some cases significantly increasing their prudential reserves. In addition, streamlined cost management and a risk-aware lending policy have contributed to the positive development of many cooperative banks. Nevertheless, the flat yield curve and sustained hard price competition in the banking market affected the institutions.

- Income situation of Landesbanks follows different patterns.

While some Landesbanks significantly improved their income situation compared with the previous year, the annual result of others remained at their 2005 levels. In some cases, results were even down, year on year. This development is primarily due to the difficult competitive situation in lending business (pressure on margins) and the subsequent weakness of the interest result. In contrast, the fact that interest rates remain relatively favourable only affected refinancing costs, and therefore the income situation, very slightly. In respect of risk provisioning in lending business, the favourable economic situation also helped ease tensions.

- Building societies suffer from low market interest rates.

Low lending rates are traditionally the strongest incentive for building society loans. However, in a time of low market rates, other property financiers can also offer loans at favourable conditions. As a consequence, building societies' loan business was sluggish. Loan waiver ratios were around 50% on average. There was, therefore, a further fall in building society loans as a proportion of building societies' total lending volume. However, there is some evidence that the bottom of the trough has now been reached. Firstly, interest rates seem to be stabilising, and secondly, building societies had adjusted their building savings rates to reflect the changed conditions. Ultimately, new business remained constant during the year under review, despite the abolition of the subsidy for the purchase of owner-occupied housing in 2005.

- Good year for securities trading banks and stock exchange brokers.

The radical technological and regulatory changes in the stock-exchange landscape continued to affect the business development of securities trading banks and stock brokers in 2006. The positive trend of the previous year persisted, while trading volumes rose once again during the year under review. Those institutions that had positioned their businesses to take advantage of promising niche areas were particularly well placed to profit from the sustained positive market environment. In particular, the availability of contracts for difference met with a particularly high level of appreciation among investors. However, there remains strong pressure for consolidation among those concentrating purely on stock brokering services, caused in part by such factors as the redistribution of trading books on German stock exchanges.

- Volatility in energy prices favours electricity futures trading.

2006 was characterised by heavily fluctuating energy prices which continued to tend upwards. Above all, this benefited electricity futures, as can be seen from the rising trading volumes on the German energy market, the EEX (European Energy Exchange). Energy companies are also increasingly interested in trading permits for energy-based derivatives again, particularly as the old legal framework is to be improved in 2007. With EU law regulating this sector of the market through MiFID, the European passport will apply to electricity trading for the first time. In addition, the new SolvV provides specialist electricity traders with transitional relief from some capital-intensive solvency requirements. The EEX also subjected itself to increased international competition during the year under review. As part of its strategy, it founded a legally independent clearing house that was licensed by BaFin upon application.

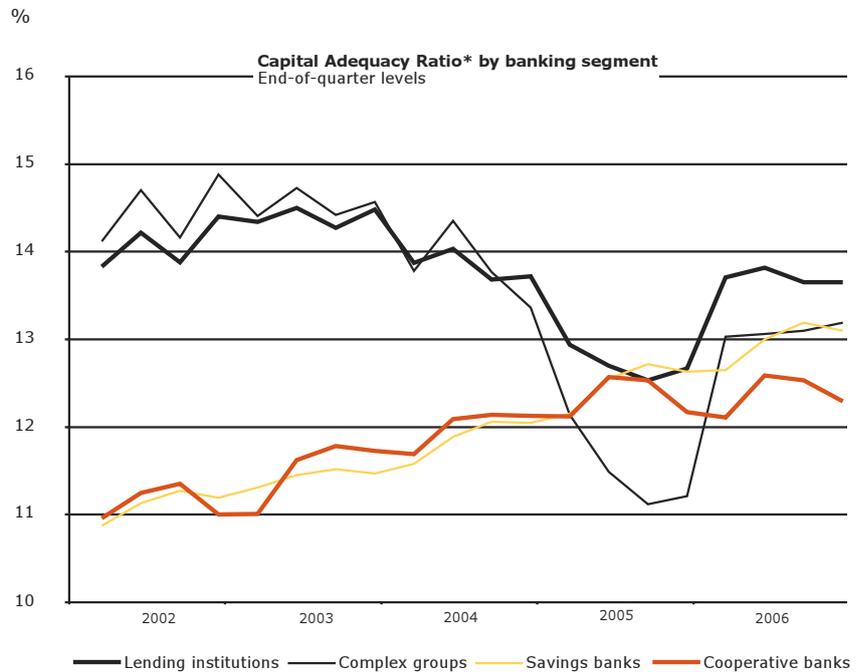


## 2.2 Solvency

- Significantly increased equity ratios among all groups of institutions.

Until the middle of 2005, the equity position in the German banking sector was still following a divergent trend. Equity ratios among lending banks, including the major banks, were falling; among the savings banks and cooperative banks they were rising. At the start of 2006, however, equity ratios rose significantly among all types of institution, especially among the major banks. They have stabilised at comfortable levels of well in excess of 12%. The weighted equity ratio climbed during the year under review from 13.1% at the start of the year to 13.3% at the end of 2006, and therefore well above the regulatory requirement of 8% applicable to every bank. The rise was caused mainly by the private major banks, whose ratios had fallen in 2005, as they used a risk-adjusted market valuation approach for the first time in their commercial business. The desire among institutions to create a certain equity buffer in order to achieve a better rating in a time of strong income also contributed to this development. The equity buffer of savings banks and cooperative banks also gradually increased, partly due to lower depreciation.

Figure 19  
**Solvency of German banks**



\* Liabe equity capital in relation to weighted risk assets; minimum ratio according to Principle I: 8%.

It can be seen that even the less well capitalised banks have made recognisable progress. For example, the 5% quartile rose over the past five years from 9.1% to 9.6% in 2006. This means that 95% of all institutions now have a regulatory equity capital ratio of at least 9.6%.

## 2.3 Supervisory actions

In its supervisory activities, BaFin takes particular care to ensure that banks cover internal mistakes and excessive risks and take steps to counter these quickly. For this reason, BaFin must continually keep up to date with the net assets, earnings and cash flow of financial institutions, as well as their risk situation and risk management. Special audits are just one of the instruments that the supervisory authority may use to obtain the necessary information. Auditors' reports on the annual financial statements are a further source of information, as are the reports and notifications submitted by the institutions themselves. To a greater extent than in the past, BaFin also relies on internal bank information, such as through evaluation of reports drawn up by the risk controlling or internal audit departments. In 2006, BaFin and the Bundesbank continued their proven strategy of conducting individual supervisory consultations with company managers. Supervisory consultations not only improve communications with the institutions, but also ensure that banking supervision is more closely geared towards current practices. The supervisory authority

uses this face-to-face meeting, usually once each year, to compare its assessment of the risk situation and risk management of an institution with the assessment of the institution's managers. A further key topic for discussion during the year under review was risk-oriented banking supervision in light of Basel II and the specific implementation of MaRisk by the institutions.

### **Management Information System for major banks**

In 2003, BaFin introduced a Management Information System (MIS) for the supervision of seven selected, system-relevant major banks. This system was then extended to 15 institutions at the end of 2005. The MIS is used by the selected institutions to provide BaFin with specific information on a quarterly basis. So far, the information has comprised a short-form income statement, including planned data, plus information on the risk situation such as the scope of hidden reserves and hidden liabilities. The reported data enables the banking supervisor to maintain an up-to-date view of the institutions' income, risk and assets situation. If any of these appear to worsen, the supervisory authority can inquire about the causes in a direct discussion with the reporting institution. Quick reactions are then possible.

Since all system-relevant banks will be obliged, as of the end of 2007, to prepare their consolidated financial statements according to IFRS, the supervisory authority has developed a new reporting format for the MIS. The structure of the income statement is now based on the Core Information of the CEBS Guidelines on Financial Reporting (FINREP) for IFRS financial statements.

Several shareholder assessments among lending banks.

During the year under review, BaFin once again conducted a number of shareholder assessments at a number of lending banks. It was the private, regional and specialist banks in particular that generally proved to have a very heterogeneous shareholder structure. A shareholder assessment is conducted if an investor wishes to acquire a key participating interest in an institution. In one case, BaFin prohibited an interested party from acquiring shares in a bank, as the party was proven to be unreliable. In addition there was concern that the sale of the bank would see it transferred to a group of companies with unclear structures and lack of economic transparency. In another process, negative facts only came to light after the end of the three-month period during which BaFin is entitled to forbid the purchase of shares. In this case, BaFin prohibited the party from exercising its voting rights and appointed a trustee in order to ensure the bank did not become involved in the non-transparent operations of the shareholder. During 2006, a number of foreign investors also showed interest in purchasing smaller German banks. The complexity and difficulty of the owner control processes vary considerably in these cases. For example, the acquisition of a domestic institution by a bank subject to supervision in another Member State of the European Union normally causes only a few problems. In contrast, the procedure is often extremely involved when the interested party belongs to a complex group of companies with links to countries outside the EEA.

Interest rate risk under closer examination.

Due to the sustained low level of interest rates, the supervisory authority has focused increasingly on interest rate risks. Its main area of concern has been the way in which supervised banks control and manage such risks. In the building-society sector, BaFin used standardised stress testing procedures to determine how various interest rate scenarios would affect the risks of individual building societies. As expected, the results varied greatly. Overall, it was established that should rates fall (again), many building societies would, in some cases, be subject to significant interest rate risks. In order to take into account the long-term nature of building society business, the supervisory authority will also be looking at comparable forecast calculations for early risk detection.

Deregulation of building society supervision.

The building society market is another area in which BaFin is pursuing the aim of deregulating supervision. In 2006, therefore, it relinquished the requirement whereby all building societies must have their own field staff. Instead, it now only demands that building societies consistently implement the statutory and supervisory requirements for the outsourcing of business units, in order to ensure that selling activity is implemented properly. The same applies to the concept of one-stop financing, in which various companies in a group or affiliation provide a borrower with loans at the same time. In future, the generally applicable outsourcing rules that govern all banks will also apply here.

According to the Building Societies Act (Bausparkassengesetz), building societies can only introduce new rates to the market once BaFin has approved the underlying contract conditions. Any subsequent rate modifications also require approval. During the year under review, BaFin approved a total of 13 building savings plan rates. This preventive rate control is intended to ensure that buildings savings plans can be fulfilled on a long-term basis. Here, again, BaFin is pursuing the objective of simplifying parts of the official approval process. For example, BaFin could, in future, waive the requirement that the contractual conditions be analysed from a legal perspective. This would allow it to concentrate more on the viability of the rates and, therefore, the long-term capability of contracts to be fulfilled. The core of future supervisory activities should be the controlling of specific risks faced by building societies based on analysis of their risk management. A milestone was achieved during the year under review with the first actual findings resulting from dialogue conducted by BaFin with the industry on ongoing collective monitoring. During these discussions, the individual building societies expressed their willingness to prepare a collective management report on a voluntary basis. From 2007, they will, for the first time, be using the report as a vehicle for providing standardised information on the situation of building society business.

Violations of supervisory law and sanctions imposed.

The supervisory authority obtains valuable findings from special audits and other sources of information that often reveal violations of supervisory law and result in the imposition of sanctions. During the year under review, findings of violation or sanctions imposed totalled 113 (previous year: 242). Individual audits often resulted

in several different reactions. Table 21 below provides a precise overview of the distribution of sanctions and violations, grouped by type of institution. For example, BaFin issued warnings to four managing directors in the savings bank sector in accordance with section 36 KWG in 2006. Further managing directors were dismissed by the boards of their savings banks after special audits revealed that they lacked the necessary specialist skills. In the cooperative bank sector, BaFin wrote to 35 cooperative banks, expressing findings of a serious nature. In the case of 10 institutions, it issued warnings to 13 managing directors or demanded their dismissal. In addition, BaFin instituted so-called measures in response to acute situations in the case of 11 cooperative banks. This instrument enables BaFin to instruct the management of an institution or to appoint supervisory personnel so that risks to the security of the deposits and assets entrusted to the institution can be countered at an early stage (section 46 KWG).

Table 21

#### Findings of supervisory law violations and sanctions imposed

Type of institutions	Serious findings	Measures against managing directors	Administrative fines	Measures in case of danger (section 46 KWG)
Lending institutions	14	0	0	0
Institutions in the savings bank sector	23	4	0	0
Institutions in the cooperative sector	35	13	0	11
Other institutions	13	0	0	0
<b>Total</b>	<b>85</b>	<b>17</b>	<b>0</b>	<b>11</b>

Compensation proceedings in the case of Phoenix Kapitaldienst GmbH.

In July 2006, in the Phoenix Kapitaldienst GmbH fraud case, Frankfurt Regional Court sentenced the former registered legal agent (Prokurist) with principal responsibility and the former managing director of the company to several years' imprisonment. The audit of the investors' claims as part of the insolvency proceedings has proven to be a difficult undertaking. The insolvency administrator must first calculate the actual change in value of each share in the Phoenix Managed Account, since the company had feigned fictitious profits over a period of many years on the basis of bogus transactions evidenced by forged accounting documents. While considering a separate legal case, the Compensatory Fund of Securities Trading Companies (Entschädigungseinrichtung der Wertpapierhandelsunternehmen – EdW) is also awaiting the results of this investigation. EdW can only calculate the value of any compensation when it knows the change in value of each share. Therefore, processing of the registered claims is being delayed, which is demanding a great deal of patience on the part of the affected investors. The insolvency administrator aims to initiate insolvency proceedings by means of an insolvency plan. However, this must first be accepted by the creditors. This would help avoid many years of legal battles that would prevent any payment in the amount provided for by the insolvency quota. Assuming that the creditors agree to the insolvency plan, an initial payment based on the insolvency quota could be made in the middle of 2007.

## 2.4 IRBA and AMA application procedures

15 authorisations foundation approach IRBA.

Since 1 January 2007, 15 institutions and groups of institutions have been permitted to calculate their regulatory capital requirements using an internal ratings based approach (IRBA). BaFin is the home-country supervisory authority in 14 of these cases and the host supervisory authority in only one case. In the event of the cross-border application of the IRBA, the supervisory authority works in close cooperation with the foreign regulator even during the authorisation process. The processes to date have involved supervisory authorities from, in particular, Luxembourg, the UK and Ireland, as well as Sweden, Belgium, Hungary and Poland. Overall, the supervisory authority has confirmed the suitability of some 100 different rating systems as part of authorisation processes, with further rating systems currently being reviewed. At the end of 2006, a further 23 applications for IRBA authorisation had been submitted to BaFin. Approximately one-third of the institutions and groups of institutions submitting applications are seeking authorisation to use the advanced approach, use of which is permitted under the Solvency Ordinance with effect from 1 January 2008. BaFin is the home-country supervisory authority in 20 of these cases and the host supervisory authority in three cases.

### IRBA authorisations at Landesbanks

To prepare for the use of the IRBA, the Landesbanks have entered into various different cooperation projects, both with each other and with the savings banks (Sparkassen). These mainly relate to data pooling, the development of rating methodology and maintaining rating processes. During the year under review, BaFin carried out 11 IRBA audits at Landesbanks together with the Bundesbank. These were carried out at the banks' request. As part of these audits, a total of 135 internal rating systems were assessed, most of which were developed as part of cooperation projects and were therefore in use at several Landesbanks. The supervisory authority began by auditing these rating systems at the institution acting as the pilot bank. This meant that it could then draw on its findings on the methodological structure of the systems when subsequently auditing the other banks involved in the cooperation project. As a result, there were significant synergistic benefits for the Landesbanks as well as for the banking supervisory authority.

The results of the audit showed that the German Landesbanks are, on the whole, well prepared for the introduction of Basel II. Consequently, all six Landesbanks that had applied to use an IRBA with effect from 1 January 2007 were granted authorisation with the suitability of the rating systems in use being confirmed. Further IRBA audits will be carried out in 2007. A particular focus will be placed on those Landesbanks that for commercial reasons, such as having selected the advanced approach, only applied for an authorisation with effect from 2008.

- Five applications for advanced measurement approach.

By the end of 2006, five institutions and institution groups had applied to use the advanced measurement approach to measure capital adequacy for their operational risks with effect from 1 January 2008. BaFin is the home-country supervisory authority in all of these cases. The audits to authorise the approaches have already begun, with some still in progress. BaFin expects to receive another five applications for authorisation in 2007, and these have been included in the planning of supervisory audits.

Institutions wishing to calculate the amount credited for operational risk using a standard approach must simply inform the supervisory authority accordingly in writing. Ten such notifications were received during the year under review. Of these, eight institutions have been using the standard approach since 1 January 2007. With the existing transitional regulations due to expire at the end of 2007, BaFin is expecting a significant increase in the number of notifications in this area in particular. At least one institution is planning to use the alternative standard approach as of 1 January 2008.

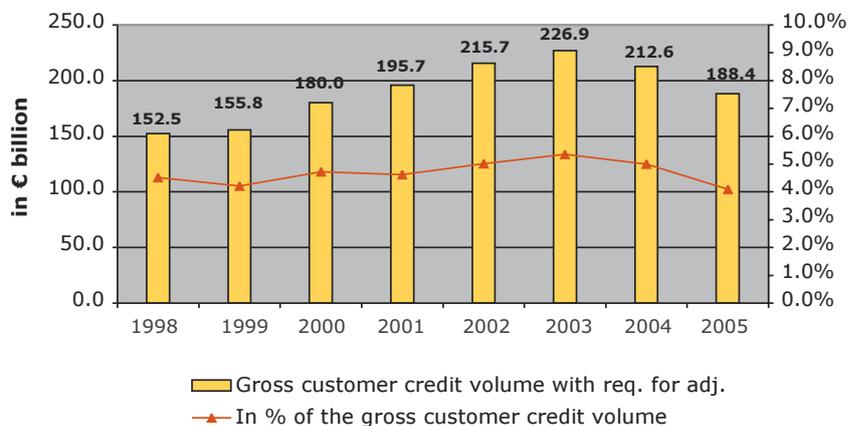
## 2.5 Non-performing loans

- Despite a fall, level of NPL remains high.

It is not possible to put a precise figure on the volume of non-performing loans (NPL) on the German market. However, the German Auditing Report Ordinance (Prüfberichtsverordnung – PrüfBV) makes provisions for obligatory reporting of loans requiring individual valuation allowance. Based on the aggregate gross client lending volume requiring specific allowances, BaFin has therefore used the audit reports relating to the annual accounts of the supervised banks to calculate an NPL volume of approximately €188 billion for 2005.<sup>33</sup> This is approximately 17% down on the highest level for non-performing loans, recorded in 2003. Due to a lack of uniform definitions, however, these figures can only be compared against data for other countries to a limited extent.

Figure 20

### NPL market potential



<sup>33</sup> The audit reports relating to the bank's financial statements for 2006 were not yet available to BaFin in full at the time of going to print.

NPL market has a varying impact.

One reason for the drop in NPL volume is to be found in the market for problem loans, which has been flourishing since 2003. This offers credit institutions the option of disposing of ailing loan portfolios. The NPL market can help make the financial sector more stable. NPL transactions open up new room for manoeuvre for the banks. They can get rid of "old burdens", relieve the strain on limited personnel resources and realign themselves strategically. Nevertheless, the potential "side effects" of the NPL market should also be borne in mind. NPL transactions – like all selling of receivables – shift elements of lending into unregulated territory. This has a negative impact on the transparency of the credit markets. A further problematic area is banking secrecy and data protection in general. Banks are obliged to treat the data on their borrowers confidentially. Conversely, however, the business model of NPL investors is based on precisely this detailed debtor information. In the interests of market integrity and to avoid operational risks, the market participants are responsible for finding viable solutions in this regard. Moreover, the low equity share of NPL investments offers only a small risk buffer in the event that the business model fails. Given that the main business focus, the work-out strategy and the time horizon of the business models often move closer to each other, the end result can be a concentration of risk.

#### **Investments in non-performing loans**

The business models of what are predominantly Anglo-Saxon investors are all very similar. The loans are often secured by property which is sold very quickly. The investment target is a return of 20 to 25%. To achieve this target, the investments are generally based on the same parameters. In other words, a significant yield element is the high level of borrowed capital used for financing the investment, in some cases up to 85% of the invested capital. German banks are among those providing this capital. Furthermore, a favourable purchase price is crucial to the investors. By international standards, however, the transaction prices achieved in Germany for NPL portfolios are very high. In some cases, they are well above 60% of the nominal loan amounts. This is due to the high proportion of loans secured by property and the fact that performing loans are included in the loan portfolio. With regard to the work-out, the investors also generally pursue the same strategies. The acquired NPL portfolios are processed using a strict approach and on the basis of stringent business plans. The current yield horizon is between three and a maximum of five years, achieved through short-term (debt-freeing) partial repayments by the debtor or the rapid realisation of the collateral. In contrast, loan commitments are only rescued in a few individual cases.

## 2.6 Financial services institutions

730 financial services institutions under BaFin supervision.

As at the end of 2006, 730 financial services institutions were under BaFin's supervision (previous year: 743). Of this total, 60 were domestic branches of foreign undertakings. There were also 3,358 freelancers (previous year: 3,403) acting as intermediaries for and distributing the financial instruments of 82 authorised institutions. The institutions are liable for these "tied agents", who do not require a licence of their own to provide these financial services. The tied agents are, however, indirectly supervised by BaFin as the supervised institutions bear full responsibility for them under supervisory law. If an intermediary's conduct is inappropriate, BaFin will approach the liable institution. In terms of civil law, the liability risk for these freelance intermediaries is covered by insurance taken out by the institutions. Individual financial services institutions make use of a large number of tied agents as intermediaries. This involves a high level of liability risk and should therefore be taken into account with regard to a company's risk profile. If an institution has assumed liability for numerous intermediaries, it runs the risk of ceasing to be aware of whether all the agents are operating as they should.

487 institutions providing portfolio management services.

In 2006, 148 financial services institutions provided investment and contract brokering services only (previous year: 159). A total of 487 undertakings were authorised to offer portfolio management services (previous year: 482). Four financial services providers were authorised to obtain ownership or possession of funds or securities from customers. This is subject to the prerequisite that the institution has capital resources totalling at least €125,000 and, additionally, has two managing directors. Thirty-one financial services institutions were permitted to trade in financial instruments for their own account. As in the case of securities trading banks, these institutions must have capital of €730,000.

The number of corporations rose slightly once again in 2006, with 57.4% of financial services institutions operating as limited liability companies (previous year: 56.2%). There was also a slight rise in the proportion of public limited companies, which accounted for 19.5% (previous year: 18.5%). Only 11.1% were registered as sole proprietorships (previous year: 12.6%).

Fifty applications for licences to provide financial services.

During the year under review, a total of 50 undertakings were authorised to offer financial services (previous year: 60). A further 14 financial services institutions applied for an extension of their licence (previous year: 8).

### Cooperation

Supervisory consultations with the Bundesbank.

The Bundesbank and BaFin met in November 2006 for their annual working group meeting. The participants use this meeting as an opportunity to discuss current practical issues that arise in relation to the supervision of securities trading banks and financial services institutions, and the prosecution of unlawful banking and financial services operations. For both sides, the working group is an

important forum for exchanging views and experience and fostering constructive working relationships between the two authorities.

Discussions with the Institute of Chartered Accountants and auditing associations.

Various discussions were held during the year under review with the German Institute of Chartered Accountants (Institut der Wirtschaftsprüfer – IDW) and the auditing associations dealing with specialist issues. The issues on the agenda included BaFin's experiences in auditing financial services institutions and investment companies during the past year and the auditors' experiences of the new Ordinance on Investment Services Audits (Wertpapierdienstleistungsprüfungsverordnung – WpDPV). The participants also discussed implementation of the Markets in Financial Instruments Directive (MiFID) and current investment supervision projects.

### Audits and measures

Numerous supervisory consultations and monitoring of audits.

During the year under review, BaFin carried out 156 supervisory consultations and monitored 114 audits. The monitoring of audits and supervisory consultations are important supervisory instruments that do not incur any costs for the institutions. Any questions on how business activities are designed can often be answered more quickly on site than by means of written correspondence, which can become drawn out. Additionally, direct talks can be held with the auditors to establish how they conduct their audit and set out their audit report. This personal contact contributes to the effectiveness of supervision. BaFin frequently carries out supervisory consultations and monitors audits together with the Bundesbank.

46 licences revoked.

During the year under review, 46 licences held by financial services institutions were revoked. There were 14 cases of institutions returning their licence. In other cases, the licence was revoked following a hearing.

A licence may be revoked in the event of circumstances indicating that the managing director of the institution is not reliable. In one case, a senior employee of an institution was arrested for professional fraud and bankruptcy. The managing directors of the institution concealed the arrest order from BaFin and justified the employee's long absence on the grounds of serious illness. In violation of its licence, the institution had also taken receipt of customer funds and used intermediaries that failed to meet the requirements for tied agents. The public prosecutor's office has since launched an investigation into one of the two managing directors of the former financial services institution.

Four special audits in accordance with section 44 KWG.

BaFin ordered four special audits in accordance with section 44 KWG in 2006.

One of these audits related to an undertaking based in Spain that was operating as a tied agent for a German institution. BaFin staff carried out the special audit both at the German institution as well as on the foreign agent's premises. According to information from

the local supervisory authority, the employees of the tied agent had repeatedly and seriously contravened supervisory regulations. Additionally, the foreign supervisory authority had received numerous complaints relating to the tied agent. These related to the employees' aggressive and intimidating behaviour, and also to the fact that the intermediaries had not upheld the investors' interests and failed to provide sufficient information on the relevant risks. The complaints were based on high investment losses and excessive charges. The special audit, which also involved representatives of the foreign supervisory authority, disclosed what were in some cases major breaches of the codes of conduct and of the organisational and reporting requirements. BaFin commenced proceedings against the German institution to prohibit it from cooperating with the tied agent. As a result, the financial services institution voluntarily ended its cooperation with the tied agent and wound up the related operations.

BaFin also conducted a special audit following an annual audit of an institution in accordance with the Securities Trading Act which revealed that financial services other than those covered by the institution's licence were being provided. BaFin found that the institution and its agents had also been engaging in cold calling and that they had been processing securities transactions incorrectly. Cold calling is prohibited in Germany as a form of improper conduct.

A further special audit was conducted by BaFin in the case of an institution that was licensed to provide portfolio management services but claimed not to perform any such investment services. This was the stated reason for the institution's failure to submit any audit reports. Nevertheless, the undertaking was not willing to give up its licence. The special audit revealed that, contrary to its claims, the institution was offering portfolio management services. There were also indications that the company was additionally engaging in deposit-taking business, which it was not permitted to do. The facts of the case are still being examined.

In autumn 2006, BaFin carried out a further special audit at an institution that had failed to submit audit reports and other documentation despite repeated requests for such information to be provided. There was also a suspicion of serious organisational shortcomings, particularly with regard to a GmbH acting as a tied agent. The special audit revealed that the institution was no longer carrying out commercial activities. The managing director informed BaFin that the company had transferred all its customer files to an interested buyer in Switzerland some time previously. On this basis, the company returned its licence in anticipation of it being revoked.

Seven managing directors of financial services institutions were issued with a warning from BaFin pursuant to KWG during the year under review. These warnings were primarily issued due to repeated breaches of reporting and notification obligations and of obligations in conjunction with annual audits. Sustained breaches of capital requirements also had a role to play.

Warnings.

## 3 Ongoing market supervision

### 3.1 Credit institutions and financial services institutions

#### Savings banks and cooperative banks

Compliance organisation a focus at savings banks and cooperative banks.

Once again during the reporting year, BaFin focused on compliance organisation in its supervision of savings banks and cooperative banks. Faced with greater supervisory requirements, credit institutions must set up individual implementation solutions, since the policymakers and supervisory authority have granted the banks ample room for manoeuvre in how they meet the requirements. Generally speaking, larger credit institutions have their own compliance departments, whilst smaller or medium-sized institutions frequently outsource compliance-related tasks. In some cases, several institutions will share one compliance officer, even though this set-up has practical difficulties. A further option is that an experienced compliance officer from one bank will make his expertise available to a less experienced colleague at another institution. This assistance compliance model should be limited to the induction phase or to exceptional situations, however.

Focus on advisory processes with regard to end customers.

The focus on the advisory process for end customers applied to audits of private and foreign banks in the previous year was applied by BaFin in its audits of savings banks and cooperative banks during the year under review. The Securities Trading Act demands that sufficient account be taken of the conflicts of interest that are inherent in advisory work. Suitable measures include work instructions, employee training and the type of employee remuneration, an appropriately designed cost and fee structure, the product selection itself and subsequent transaction controls. The random checks carried out related primarily to guarantee certificates and units in equity funds. BaFin found that the advice given was, generally, in the investor's interests.

#### Credit institutions

45 audit monitoring visits made to credit institutions.

BaFin carried out monitoring visits with regard to 45 audits of credit institutions' securities business. It also held three supervisory discussions on issues relating to market supervision with credit institutions.

One special audit in accordance with section 35 WpHG.

At the beginning of the reporting year, BaFin ordered a special audit for a specific reason at a credit institution with operations throughout Germany. An employee of the bank in question had previously informed BaFin that the local sales management had been encouraging staff to prevent customers from selling a particular security. During its special audit, BaFin questioned the local managers and individual investment advisors and assessed e-mails sent by the management and meeting notes of the investment advisors. Individual customer transactions in the security in question were examined in the form of spot checks.

It was not proved, however, that the sales management had prevented the investment advisors from giving appropriate advice to investors. It was also not necessary to introduce any measures under supervisory law as the bank independently introduced further organisational measures for protecting investors' interests during the provision of investment advice.

### Financial services institutions

Three special audits in accordance with section 35 WpHG.

BaFin carried out special audits in accordance with section 35 WpHG at three financial services institutions during 2006. All three audits were carried out together with special audits in accordance with the KWG. One audit related to cooperation with a foreign undertaking that was acting as the institution's tied agent. A second case related to suspected cold calling. In the third case, the undertaking returned its licence in anticipation of it being revoked following BaFin's discovery of serious organisational shortcomings during its special audit.

Threat of coercive payment due to continued cold calling.

The supervisory authority threatened one financial services institution with a coercive payment should it continue to engage in cold calling. Several complaints had been submitted to the supervisory authority. The institution returned its licence following a BaFin hearing on the revocation of the licence. The institution sold shares in small businesses on the US market that were not traded on stock exchanges. Given that the company also operated on a cross-border basis in the Netherlands, BaFin worked in close cooperation with its Dutch counterpart in supervising this institution.

BaFin prohibited cooperation with tied agents.

One institution informed BaFin that one of its former freelance agents had been unlawfully taking receipt of and appropriating customer funds. The freelance agent in question was by this time working for another institution. BaFin duly prohibited the latter from any cooperation with the tied agent until informed otherwise, and forwarded the facts of the case to the public prosecutor's office.

### Exemptions from audits

Fall in number of exemptions from compulsory annual audit.

BaFin granted 124 credit and financial services institutions exemption from the requirement to perform an annual audit in accordance with section 36 WpHG (previous year: 319). An exemption may be granted if an audit does not appear necessary in light of the type and scope of the business activity conducted by the institution concerned. Eighty-eight exemptions related to credit institutions, composed of 82 savings banks and cooperative banks and six private banks. There were 36 exemptions granted to financial services institutions. BaFin also granted 70 credit institutions exemption from the requirement to audit their safe custody business (previous year: 238).

As expected, there was a significant fall in the number of exemptions relating to audits of compliance with rules of conduct and audits of safe custody business during the year under review. Following BaFin's revision of the discretionary criteria in May 2004,

it was able to exempt more institutions, doing so for a period of between one and three years. It was also able to grant exemption on a long-term basis. The exempt institutions must have themselves audited every second, third or fourth financial year, depending on the nature and scope of their business. After the audit, however, they are not generally required to submit a new application for exemption.

Administrative offence proceedings due to cold calling and shortcomings in appointment of auditor.

During 2006, BaFin initiated new administrative offence proceedings against banks and financial services institutions in seven new cases. 15 cases were still pending from the previous year.

In four cases, BaFin imposed fines of up to €6,500. Eight cases were dropped, two of which were abandoned as they were not in the public interest. Ten cases were still pending as at the end of the reporting period. Most of the proceedings related to breaches of the ban on cold calling and failure to adopt an auditor or to do so in good time.

### 3.2 Rules of conduct with regard to financial analysis

Reporting obligations.

Persons responsible for preparing and communicating financial analyses in the course of their professional or business activities must adhere to particular rules of conduct and notify BaFin of their activities. The rules of conduct include strict provisions on the proper preparation and representation of financial analysis, on the disclosure of circumstances and relationships that could form the basis of a conflict of interests and on having an appropriate organisational structure with which to deal with such conflicts. Those subject to reporting obligations include, in particular, self-employed financial analysts or independent analysis companies who, unlike investment services providers, investment companies and public limited investment companies, are not already known to BaFin due to their carrying out activities subject to licensing requirements. Individual analysts employed by undertakings subject to reporting obligations are not covered by the reporting obligations. Similarly, journalists are also exempt provided they are subject to an equivalent form of self-regulation.

#### Credit and financial services institutions

450 institutions prepare or make use of analyses.

During the year under review, 450 credit and financial services institutions prepared their own analyses or used third-party analyses, which were made available to their customers or placed in the public domain. To determine whether the institutions adhere to the rules of conduct, BaFin primarily uses the annual report on the audit of investment services business. BaFin may also implement audits, even without cause. However, because such an audit involves significant costs for the companies concerned, BaFin will use other suitable but more cost-effective means in the first instance, such as supervisory consultations, etc. Serious

shortcomings with regard to compliance with competency and disclosure requirements generally do not arise. However, the supervisory authority discovered isolated cases of deficiencies with regard to the information required in the analyses. Having been informed of this situation, the institutions concerned remedied these deficiencies.

BaFin focused its monitoring on how credit institutions acting as syndicate banks in IPOs dealt with conflicts of interest. One of the tasks of syndicate banks, as well as valuing the company, involves preparing research aimed at potential investors. This means that syndicate banks must take suitable measures to guarantee impartial financial analysis, for example by creating areas of confidentiality and erecting Chinese walls to keep them apart, or by having an independent unit, such as the compliance department, monitor the flow of information required by various areas of confidentiality in individual cases.

### **Independent analysts**

In 2006, BaFin supervised 81 persons who had registered in accordance with section 34c WpHG. The authority predominantly used supervisory consultations in this area to place as small a financial burden on the supervised individuals as possible. As in the case of credit and financial services institutions, there were isolated cases of deficiencies in the information required in the analyses. Having been informed of the situation, the individuals concerned duly rectified the deficiencies. In one instance, BaFin initiated administrative offence proceedings, having found indications that a company had contravened the obligation to exercise due care and transparency obligations in publishing an investment recommendation. The supervisory authority has the power to impose fines of up to €200,000 in such instances.

### **Guidelines for supervisory practice**

#### **Cross-border distribution of analyses**

In monitoring the actions of financial analysts, BaFin bases its approach on the uniform European provisions of the Market Abuse Directive in order to achieve harmonized supervisory practice throughout the Member States of the European Union (EU). This is particularly important with regard to the cross-border preparation and use of financial analyses, for example if subsidiaries or branches of foreign groups publish an analysis in Germany that was prepared in another country. Financial analyses produced in another EU Member State and distributed in Germany directly from abroad or via a domestic third party (e.g. a domestic branch of a foreign credit institution) are not monitored by BaFin.<sup>34</sup> The authority assumes that the analysis has been produced in accordance with the provisions introduced to implement the Market

<sup>34</sup> Information from the associations on the change in administrative practice with regard to section 34b WpHG, foreign cases and indeterminate legal terms of 8 February 2006.

Abuse Directive in the Member State in question and monitored by the responsible supervisory authority in that state. To enable the law to be applied appropriately but flexibly, BaFin is increasing the level of responsibility held by the companies themselves. This relates in particular to such issues as which affiliated companies are incorporated into the investigation and disclosure of possible conflicts of interest or which other significant financial interests must be disclosed in a financial analysis, as well as the issue of how up to date the data contained in the analysis must be. Individual companies must take appropriate precautions based on their particular situation to ensure that the statutory requirements are met.

### Media

Journalists are exempt from supervision as detailed under section 34b WpHG if they are subject to an equivalent form of effective self-regulation, such as internal rules of conduct at a publishing house or the rules imposed by an overarching self-regulation body. This applies to financial analyses produced by journalists themselves, as well as to financial analyses produced by third parties that are then passed on by journalists, such as during reporting on the stock markets. BaFin may, however, verify the existence of a comparable form of self-regulation and determine that the existing controls do not comply with the statutory benchmarks.

During 2006, BaFin held numerous talks with media companies on the creation of a comparable form of self-regulation. The aim of these meetings was to ensure, within the framework of a form of self-regulation for journalists, that the requirements with regard to the proper presentation of financial analysis and the disclosure of conflicts of interest are observed.

Following on from these talks, the German Press Council (Deutsche Presserat) revised its Press Code in March 2006 to include a specific guideline on economic and financial market reporting for print media.<sup>35</sup> The guideline sets out basic rules of conduct for journalists who are preparing or distributing a financial analysis and are bound by the Press Code. The specific implementation of some principles, such as the setting up of further control mechanisms or potential sanctions, is the responsibility of the individual publishing house or journalist, depending on the requirements of the individual case. Additionally, provision also exists for complaints to be submitted to the German Press Council.

The German Association of Private Broadcasting and Telecommunications (Verband privater Rundfunk und Telekommunikation e.V.) has also drawn up guidelines for a comparable form of internal self-regulation for private broadcasters. The aim of these guidelines is to guarantee, in the interests of investor protection, transparency in respect of potential

● Comparable self-regulation in the media.

<sup>35</sup> Principles of conduct for journalists and recommendations of the German Press Council on economic and financial market reporting, available at [www.presserat.de](http://www.presserat.de).

conflicts of interest during the preparation or distribution of financial analyses, such transparency being a statutory requirement. At the same time, the guideline provides a common basis for the internal implementation of an effective form of self-regulation by private broadcasters.

### **Transparency in the distribution of financial analysis**

Section 34b WpHG also covers the distribution of third-party financial analysis. Irrespective of whether the financial analysis is distributed with or without amendments having been made either in summarised form or in full, clear details of the original authorship must also be included. The content of the financial analysis may not be passed on in a misleading manner. Any key changes must be clearly marked as such.

Generally, anyone distributing financial analyses must be sure that the company responsible for producing that analysis duly complied with its statutory obligations. This applies, in particular, in cases where the company responsible for producing the analysis is a domestic undertaking subject to supervision by BaFin. However, the party passing on the analysis bears responsibility for meeting its obligations arising from its distribution of the analysis, such as responsibility for passing on the content of the analysis in a way that is not misleading.

Anyone distributing a summarised version of a piece of financial analysis must indicate, in cases where the recipient can see potential conflicts of interest on the part of the author, the website or similar of the undertaking responsible for preparing the financial analysis. In the case of a distribution chain, an abstract reference to the website of the undertaking responsible for producing the analysis is sufficient. In general, it is not reasonable to expect a party passing on information to check in each individual case whether and where the author is making information publicly available in conjunction with conflicts of interest. This applies, in particular, to the forwarding of a large number of summaries of third-party financial analyses via the internet or through news agencies.



# VII Supervision of securities trading and investment business

## 1 Basis for supervision

### 1.1 Act implementing the MiFID



Georg Dreyling,  
Chief Executive Director  
of Securities Supervision

The draft legislation for the Implementation Law on Markets in Financial Instruments Directive (Finanzmarkttrichtlinie-Umsetzungsgesetz – FRUG)<sup>36</sup> proposes significant changes to the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) and the Stock Exchange Act (Börsengesetz – BörsG), as well as more minor modifications to the Banking Act (Kreditwesengesetz – KWG) and the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz – EAEG). With effect from 1 November 2007, FRUG will transpose the Market in Financial Instruments Directive (MiFID) into German law. Together with its two implementing measures, MiFID is Europe's most comprehensive legislative project in the area of securities trading.<sup>37</sup> The objective is to further harmonise and define in greater detail the rules, applicable throughout Europe, on the licensing of institutions and the provision of services relating to securities. The aim of greater competition between financial service providers and between trading centres is of equal benefit to investors, as are the expanded requirements for best practice and provision of information, thanks to factors such as expected lower execution costs. During the reporting year, BaFin cooperated on developing the wide-ranging new rules. In 2007, one of the major focuses will be on implementing these rules in supervisory practice.

Anyone offering investment advisory or operating a multilateral trading facility now requires a licence for this activity in accordance with KWG. In conjunction with the European Passport initiative, this licence allows service providers to operate on a cross-border basis. Consultancy and the brokerage of fund units remain exempt from licence requirements. Institutions that frequently and systematically deal on their own account, executing the orders placed by their customers to buy and sell shares, are classified as systematic internalisers and are now subject to specific rules such

<sup>36</sup> [www.bundesfinanzministerium.de](http://www.bundesfinanzministerium.de) »» Geld und Kredit.

<sup>37</sup> Directive 2004/39/EC; Implementing Directive 2006/73/EC; Implementing Regulation (EC) 1287/2006.

Expansion of catalogue of financial services subject to licensing requirements.

as an obligation to maintain quotes on a regular, continuous basis. These rules are intended to ensure the greatest level of transparency and to protect investors from being disadvantaged in internal order execution. The regular publication of buy and sell prices enables the investor to better assess the development of the price of a security.

● Best practice rules expanded.

The draft FRUG also extends and specifies the rules regarding record keeping, information and best practice in the case of securities services. In future, the costs of a number of securities services will need to be made even more transparent for investors. For this reason, FRUG contains various rules on the permissibility and publication of commission payments, and regulates the best execution requirement for client orders. With the end of the primacy of stock exchanges, competition between the exchanges and multilateral trading facilities is expected to intensify. Since multilateral trading facilities are comparable to what used to be termed facilities similar to exchanges, they are subject in many respects to the same requirements that apply to stock exchanges regarded as organised markets. This includes, in particular, the obligation for pre-trade and post-trade transparency. Moreover, securities services companies must, in future, immediately publish the details of their trading in equities conducted outside a stock exchange or a multilateral trading facility.

#### **Multilateral trading facilities**

A multilateral trading facility (MTF) is a trading platform that bears similarities with a stock exchange and that combines buy and sell orders for financial instruments according to defined and incontrovertible rules, thus generating a contractual relationship. In contrast to the situation regarding official, governed (or regulated, as they will be in future) markets of the stock exchange, there are fewer rules for MTFs in relation to the licensing of financial instruments. In addition, the integration of financial instruments into trading on a MTF does not entail any stock-exchange licensing obligations for the issuer such as the requirement to publish ad-hoc notices. An MTF may be operated by stock exchange companies and also as a new financial service by securities services companies. This provides the latter with the option to compete with the trading platforms of the regulated markets of the stock exchange and offer an alternative form of order execution.

MiFID reinforces the principle of home country supervision. In the case of cross-border securities services, the supervisory authority of the state in which the company is based is solely responsible in the majority of cases. This demands improved levels of cooperation and agreement among supervisory authorities, especially with regard to implementing branch inspections.

● Changes to reporting.

The principle of home country supervision also entails far-reaching modifications in terms of reporting. Until now, BaFin has received reports on all trades conducted on domestic stock exchanges. In future, a significant portion of these reports will no longer be

received directly. MiFID requires that transactions are reported initially to the home country supervisory authority, irrespective of the place of execution. The home country supervisor then forwards the reports to other supervisory authorities, particularly to the supervisory authority in the country in which the most liquid market for the financial instrument is located. Users of the XETRA trading facility that are based in other EU Member States (remote members) will, therefore, no longer report directly to BaFin. To ensure the fast and problem-free exchange of data, concerted efforts are underway in various working groups at national and European level to produce technical solutions.

## 1.2 Act implementing the Transparency Directive

The Transparency Directive Implementation Act (TUG), which came into force on 20 January 2007, transposes the Transparency Directive into German law.<sup>38</sup> Above all, TUG modifies the reporting obligations in the case of changes in voting rights and revises the publication requirements for important capital market information. Investors should gain access to reliable, complete and up-to-date information on the issuers of securities, as well as on the key participating interests of shareholders. This is intended to allow a sound assessment of the economic situation of a company to be made.

● Changes to reporting obligations on voting rights.

TUG introduces four new reporting thresholds for the notification of changes in voting rights. New thresholds at 3%, 15%, 20% and 30% are being added to the existing thresholds at 5%, 10%, 25%, 50% and 75%. The new entry-level reporting requirement at 3% means that interests below the previous level of 5% now become visible for all. The objective is to make the shareholder structure more transparent, and make unnoticed shareholder creep more difficult. In addition, TUG introduces the reporting requirement for specific financial instruments that assign the owner the right to purchase shares. It also shortens the reporting and disclosure deadlines so that changes in participating interests become visible more quickly.

● Publication and recording of capital market information.

The new disclosure system for important capital market information such as insider information, directors' dealings, voting right notification, financial reports and other information is geared towards EU-wide dissemination. Issuers must forward the capital market information for disclosure to various media channels. These must include channels that can actively disseminate the information as quickly and synchronously as possible throughout the EU/EEA. In case of financial reports, the size of the document in question means that an announcement of their publication will suffice. Furthermore, immediately after publication, the issuer must submit the information to the newly formed company register, and inform BaFin of the content and time of publication,

<sup>38</sup> 2007 Federal Law Gazette I, p. 10; Directive 2004/109/EC.

as well as of the media channels that have been used. The company register is the central repository in which all relevant company information is gathered and from which it can be retrieved at any time.<sup>39</sup>

● Financial reporting.

TUG revises the rules governing the content of and requirement to publish annual reports and half-yearly reports, as well as interim notices. In addition, the two-stage system of accounting controls has also included half-yearly financial reports since January 2007. Enforcement in this respect is limited, however, to case-based audits.

● Supervision based on home country principle.

The new rules are primarily based on the headquarters of a securities issuer being located in Germany, rather than on an issuer being listed on a German stock exchange, as was previously the case. This simplifies matters for companies, since they will now generally only have one legislative framework and one supervisory authority to deal with. The exception to this rule is the German issuer that is not listed on an exchange in Germany, but solely on an exchange in another EU Member State. In this event, the German disclosure rules do not apply, and such companies are subject to the rules of the host country. The opposite applies to companies based elsewhere in the EU whose securities are only listed on a stock exchange in Germany – they are subject to the German disclosure rules. As an exception, issuers of debt instruments with a denomination of at least €1,000 and issuers from non-EU Member States have the option to choose their jurisdiction.

### 1.3 REITs

In March 2007, the Bundestag passed an act allowing the creation of German real-estate joint-stock companies with shares listed on the stock exchange (REITs).<sup>40</sup> The aim behind this new law is to strengthen Germany's position as an economic location, inject greater professionalism into the real-estate market and achieve equal competition with European financial and real-estate centres.

A REIT is a real-estate company that invests capital in buildings and real estate, which it manages, whilst seeking to generate a return from rental income and increases in the value of the property.

The Act envisages REITs as listed joint-stock companies in which the profit at company level is not taxed, but where tax is levied on the dividend payments made to investors instead. The REIT status, and the associated exemption from corporation and trade tax, is only accorded to companies that meet complex requirements. In particular, they must distribute at least 90% of income as dividends, obtain at least 75% of their revenue from real estate and invest at least 75% of their assets in real estate. Equally, for

<sup>39</sup> [www.unternehmensregister.de](http://www.unternehmensregister.de).

<sup>40</sup> Enactment of the Bundestag of 23 March 2007 (BR-DRs. 191/07).

tax reasons, each shareholder is permitted to hold only a direct interest of less than 10% of the shares.

In order to ensure the tradability of the REIT shares, the legislation requires a minimum distribution of shares, which must always be upheld. At least 15% of the shares must be held by shareholders, each of whom must hold less than 3% of the voting rights in the company. In case of listed companies, at least 25% of the shares must be freefloat. BaFin will monitor compliance with these requirements when approving securities prospectuses for public offerings of REITs. The voting rights notification requirements of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) could be used for monitoring the minimum rate of distribution on an ongoing basis.

## 1.4 Act implementing the Takeover Directive

The Takeover Directive, which was transposed into German law in 2006, amends the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG) to take account of European takeover rules.<sup>41</sup> The objective is to create a common framework for company takeovers throughout Europe. The required legal amendments were not particularly complex, since German law already widely complied with the requirements of the Takeover Directive. The main aspects that have changed are specific requirements in terms of the content of offer documentation, and the responsibility of supervisory authorities in the case of cross-border takeovers. The regulations applicable for the acceptance of defence possibilities in the event of a takeover will be retained. Companies can however comply with the stricter guidelines of the Takeover Directive.

## 1.5 New investment regulations

● Revision of investment law planned for end of 2007.

The Federal Government is planning a major revision of the Investment Act (Investmentgesetz – InvG) for 2007. The objective of the draft legislation is deregulation. The reporting requirements of section 10 InvG will be scrapped and statutory deadlines introduced for the approval of funds. Rules intended primarily to protect private investors will be abolished in the specialty funds area, which is reserved for institutional investors. InvG will revert to the mandatory harmonisation requirements of the UCITS Directive. Investment companies will also forfeit their status as credit institutions in future. Infrastructure funds (“ÖPP” or private-public partnership funds) and other funds with flexible investment regulations are to be introduced in order to stimulate product innovation. The design of the open-ended investment company vehicle must be equivalent to a directive-compliant fund to allow cross-border selling of its shares, taking advantage of the relaxed

<sup>41</sup> Directive 2004/25/EC.

provisions of the UCITS Directive. Furthermore, restrictions under company law should be removed, making it possible to create a competitive counterpart to the Société d'investissement à capital variable (SICAV) investment instrument that is so widespread in Luxembourg. Finally, the corporate governance of investment companies should be improved. In April 2007, the cabinet agreed a draft for an amended investment act.<sup>42</sup>

## 2 Prospectuses

### 2.1 Securities prospectuses

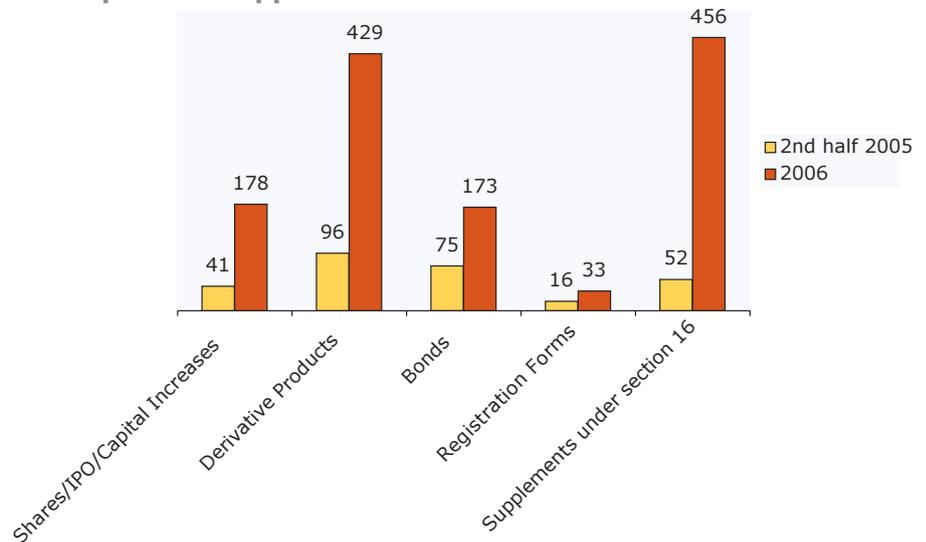
#### 2.1.1 Prospectus examination

More securities prospectuses in 2006.

In 2006, issuers of securities submitted a significantly higher number of prospectuses to BaFin for review. BaFin reviews all securities prospectuses to ensure they are complete, comprehensible and do not contain contradictory statements. The prospectus review process is based on the Securities Prospectus Act (Wertpapierprospektgesetz – WpPG). Only credit institutions which are permitted to continue using their old sales prospectuses are exempt from this process. During the reporting year, BaFin approved a total of 1,269 prospectuses, registration forms or supplements to prospectuses for securities that were to be offered for public sale or licensed for trade on an organised market. The supervisory authority provides a list of the approved securities prospectuses on its website.<sup>43</sup>

Figure 21

#### Prospectuses approved in 2006



<sup>42</sup> [www.bundesfinanzministerium.de](http://www.bundesfinanzministerium.de) » Geld und Kredit.

<sup>43</sup> [www.bafin.de](http://www.bafin.de) » Datenbanken » Hinterlegte Prospekte für Wertpapiere (since 1 July 2005).

429 prospectuses for derivative products.

Increase in share prospectuses for IPOs.

Total issue volume doubled.

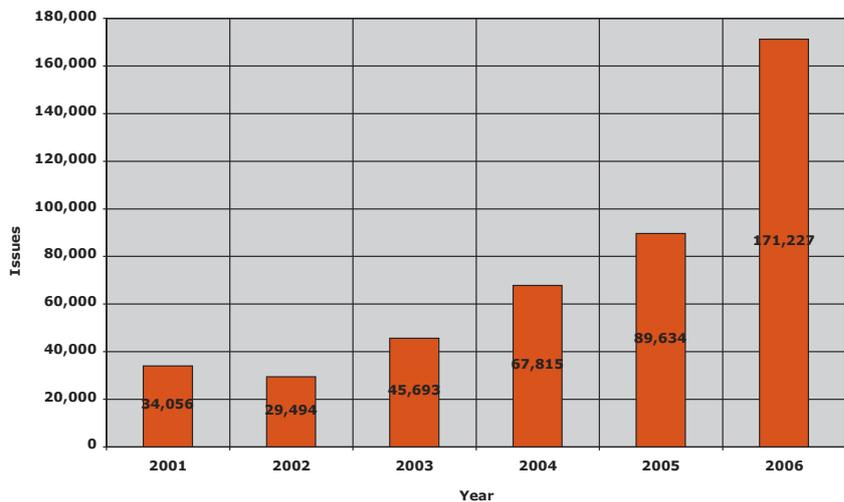
Compared to the strong second half of 2005 (280), securities issuers submitted a significantly higher number of prospectuses to BaFin in 2006. The primary reason was the positive development on the derivative market. BaFin approved 429 prospectuses for derivative products alone (previous year: 96).

The number of prospectuses for share issues also increased considerably, including those for IPOs. Securities issuers must always publish a securities prospectus in order to be licensed for an organised, official or regulated market. In 2006, there were 35 IPOs in the organised market.<sup>44</sup> In the OTC market, a prospectus is required only if the shares are offered for public sale as well. In the Entry Standard, the OTC segment of the Frankfurt stock exchange, 42 of 59 companies (more than 70%) published a prospectus that had been approved by BaFin. Debt instrument issuers submitted around the same number of prospectuses as in the previous year.

The total volume of securities issues almost doubled in 2006. BaFin reviewed a total of 1,402 prospectuses and base prospectuses. In addition, 97,841 final terms and conditions and 73,021 supplements were registered in accordance with the old law. In 130 cases, providers withdrew their application for approval. BaFin withheld its approval in three cases.

Figure 22

**Total issue volume\***



\* (Full) prospectuses, final provisions and supplements in accordance with the old law.

After the initial uncertainty on the market on how to cope with the new rules, the quality of the prospectuses that were submitted increased markedly during the reporting year. This improvement enabled BaFin to speed up the average time taken to approve a prospectus. In the case of institutions that issue securities on a frequent basis, such as the major banks, the review process from initial submission to approval now often takes less than two weeks.

<sup>44</sup> www.deutsche-boerse.com »» Cash Market »» Monthly Statistics »» December 2006.

- BaFin provided notification of 791 prospectuses.

In 2006, securities issuers took greater advantage of the opportunities provided by the European Passport, which enables them to publicly offer a security that has an approved prospectus in its home country to investors in other EEA states. While there were more prospectuses coming into Germany in 2005 than going out to other EU countries (187 in comparison with 104), this trend reversed in 2006. BaFin provided notifications for 791 of the prospectuses that it had approved to other EU/EEA states. These comprised 288 notifications to Austria, 169 to Luxembourg, 66 to the Netherlands, 54 to Sweden, 51 to Italy, 35 to France, 22 each to the United Kingdom and Belgium, 18 to Spain, 17 to Ireland, 15 to Norway, ten each to Finland and Portugal, seven to Denmark, five to Poland and one each to Greece and the Czech Republic. In comparison, 726 issuers had their prospectuses approved by foreign supervisory authorities, who then provided notification of these to Germany: 387 from Luxembourg, 119 from the United Kingdom, 95 from the Netherlands, 52 from Ireland, 48 from Austria, 18 from France, six from Belgium and one from Norway. This development indicates that Germany has become more attractive as a supervision location.

- Consolidated financial statements in accordance with IFRS.

### 2.1.2 Financial information in securities prospectuses

The EU Prospectus Regulation requires issuers to provide audited historical financial information for the past three financial years in their prospectuses for share issues. Companies must prepare this information either according to the International Financial Reporting Standards (IFRS) or according to the national accounting standards of a Member State. The share prospectuses reviewed by BaFin in 2006 contained mainly IFRS consolidated financial statements.

- Pro forma financial data for major current transactions.

If there is a significant gross change in values in the most recent or current reporting period because, for example, the issuer bought or sold a subsidiary, the issuer must present pro forma financial information in the prospectus.<sup>45</sup> Pro forma financial information depicts a hypothetical situation. It shows how a transaction would have affected the financial statements had the company existed in the modified structure for the entire duration of the reporting period. This can be done, for instance, by means of a pro forma income statement or a pro forma balance sheet. The German Institute of Chartered Accountants (Institut der Wirtschaftsprüfer – IDW) has issued an accounting and auditing practice statement for preparing and auditing pro forma financial information.<sup>46</sup>

- Complex financial histories.

If the issuer has existed only as a legal entity for less than three years, or if major restructuring has been implemented in the

<sup>45</sup> Annex I, 20.2 in conjunction with Annex II of Regulation (EC) 809/2004.

<sup>46</sup> IDW RH HFA 1.0004 and IDW PH 9.960.1, WPg 2006, Vol No. 3/2006, p. 133 and 141 et seq.

issuer's group, the financial data of the issuer alone is usually not sufficient for investors. Historical financial information relating to other companies in the group may then be meaningful, for example if the issuer is continuing the operational business of another company. In order to deal with such complex financial histories, the European Commission issued a Regulation on 27 February 2007 amending the EU Prospectus Regulation.<sup>47</sup> According to this amendment, financial information relating to a company other than the legal issuer may need to be included in the prospectus to ensure that investors have adequate information.

- Supervisor demands independent value assessment for property companies.

In 2006, issues by property companies were one of the main focuses of prospectus review. Some of these companies wished to float on the stock market in order to retain the option of being recognised as a REIT in future. If the company constitutes a property company in accordance with the recommendations of CESR, BaFin may make specific requirements in terms of prospectus content. This is the case if a company mainly holds or renovates buildings for rental or as an investment for its own portfolio, or acquires buildings as an investment for its own portfolio. In such a case, BaFin will demand that the issuer include an expert valuation in the prospectus, prepared by an independent expert valuer. Condensed value reports are also possible. The CESR recommendations form an important and detailed guide to the content and layout of the expert valuation.<sup>48</sup>

- Annual information document.

Each year, issuers must publish a document containing all information that has been announced during the previous twelve months. In 2006, BaFin compiled a list of frequently asked questions and appropriate responses and published them on its website.<sup>49</sup>

## 2.2 Non-securities investment prospectuses

- Consolidation of closed-end funds.

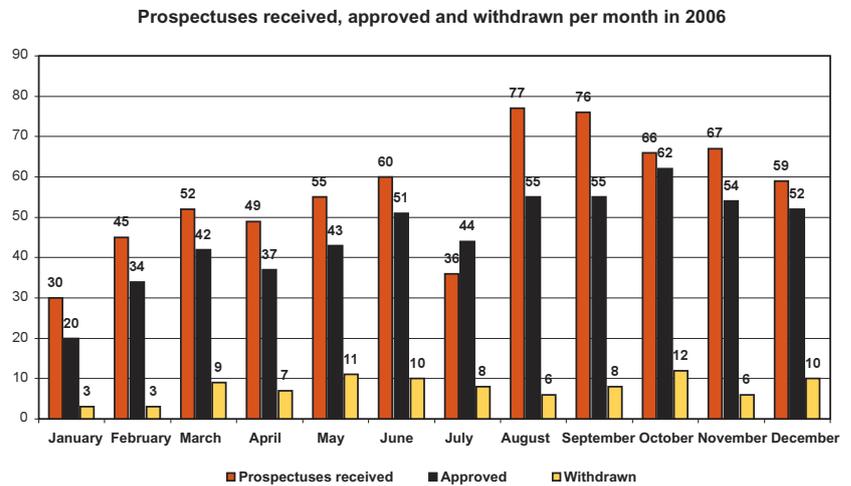
The number of prospectuses submitted for this category fell in 2006. One of the reasons is the cessation of tax benefits for closed-end funds. In total, BaFin received 672 prospectuses (second half of 2005: 739) for investments such as partnership shares in a KG (German limited partnership), GmbH (German private limited company) or GbR (civil law partnership) and for registered bonds. Of these, BaFin approved 549 (second half of 2005: 617) for publication. In five cases, BaFin prohibited publication since the prospectus did not meet minimum requirements in terms of content. 93 prospectuses were withdrawn by their provider.

<sup>47</sup> Regulation (EC) No. 211/2007.

<sup>48</sup> CESR's recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses (809/2004; Ref. CESR/05-054 b).

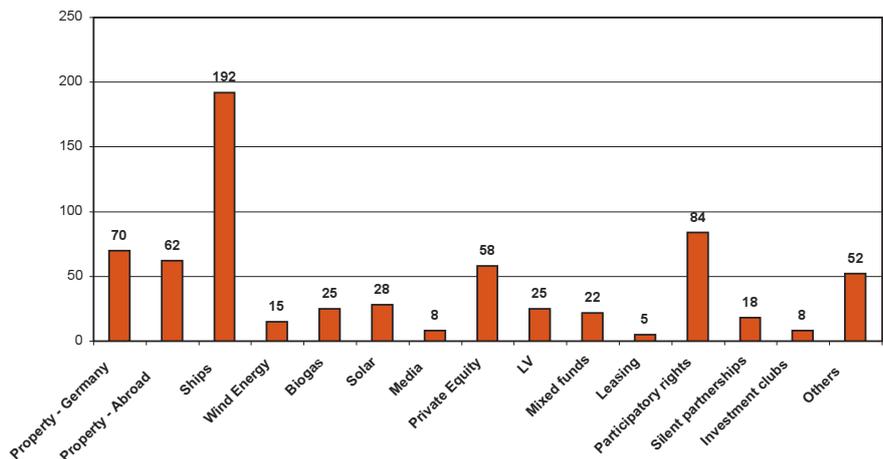
<sup>49</sup> www.bafin.de »» English Version »» For Providers »» Stock Exchange listed Companies »» FAQ - Annual Document, § 10 WpPG.

Figure 23  
Prospectuses received, approved and withdrawn in 2006



The most common subject of prospectuses involved ship funds, following by real estate funds, profit participation rights and private equity funds. In total, providers who submitted a prospectus in 2006 aimed to achieve an issue volume of around €16 billion.

Figure 24  
Prospectuses by type of fund in 2006



BaFin has published an overview of the approved publications of sales prospectuses on its website.<sup>50</sup>

● Frequent errors in prospectuses.

Providers and issuers frequently made errors during the year under review while preparing the risk section of their prospectuses. All risks must be presented in a separate section that contains only this information. Nevertheless, companies often use the risk

<sup>50</sup> www.bafin.de »» Datenbanken »» Hinterlegte Vermögensanlagen-Verkaufsprospekte (since 1 July 2005).

section to present measures that can be used to minimise risks, and to state opportunities. In addition, providers often furnish insufficient information on the costs associated with acquiring the investment. Other errors include planned figures and balance sheets that are not expressly identified as forecasts. If a prospectus contains errors and is not modified, BaFin is unable to approve it for publication.

● Dialogue with market participants.

As in the previous year, BaFin held a workshop in 2006 with issuers, providers, lawyers and auditors to discuss questions relating to prospectus legislation. Topics up for discussion included, in particular, the most frequent shortcomings of prospectuses and the requirement to provide additional information in the case of significant changes. Moreover, BaFin briefed participants on which banking transactions and financial services require a licence according to KWG. Sometimes providers submit prospectuses to BaFin that give rise to suspicion that unlawful transactions are being conducted. BaFin investigates such cases. It also issues regular reminders that approval of publication of a prospectus is not an indication of whether the planned transactions require permission according to KWG, or whether a provider has already obtained such permission.

## 3 Supervision of investment business

### 3.1 Investment companies

As at the end of 2006, the 77 (previous year: 79) German investment companies were managing 1,517 (previous year: 1,421) retail funds with assets totalling €354 billion (previous year: €353 billion) and 4,367 (previous year: 4,882) specialty funds with assets totalling €672 billion (previous year: €624 billion). Over the course of the year, BaFin approved 154 new retail funds. 40 retail funds were dissolved.

● Approval process for retail funds quicker.

To overcome competitive disadvantages for German investment companies, BaFin overhauled its procedure for approving retail funds in 2006. Whereas the process used to take an average of two to three months, BaFin has reduced the average approval period to two to three weeks. A significant factor in this reduction was the revision of the sample contractual conditions and sample prospectuses. Germany is now in second place in Europe, ahead of Luxembourg, for the approval of retail funds.<sup>51</sup>

<sup>51</sup> White Paper on Enhancing the Single Market Framework for Investment Funds, p. 42 ([http://ec.europa.eu/internal\\_market/securities/ucits/index\\_en.htm](http://ec.europa.eu/internal_market/securities/ucits/index_en.htm)).

- Capital adequacy for minimum payment guarantees.

### Guarantee funds

It has been possible to issue guarantee funds in Germany since the end of 2005. These are investment funds in which investors receive a minimum specified percentage of the issue value when they redeem their units, irrespective of how the fund has performed. The investment company that manages the fund provides a minimum payment guarantee. Guarantee funds may take the form of a fund with a limited term, the units of which can be acquired only during a limited issue period. Guarantees then only take effect at the fund's maturity date. If the guaranteed minimum redemption value is identical to the issue value, the guarantee is a capital maintenance guarantee. If the guaranteed minimum redemption value is lower than the issue value, the guarantee takes the form of a maximum loss guarantee. If it is higher than the issue value, the guarantee is referred to as a fund performance guarantee. Guarantee funds are also available with an unlimited term. In such cases, the guarantees usually apply to definable, regularly recurring time points. In all cases, the units can also be redeemed at any other time. However, since the guarantees do not apply to this time point, the investor only receives the current redemption value, which could be lower than the minimum redemption price at that time.

The licensing of guarantee funds significantly improves the competitive situation for German funds compared with funds domiciled abroad. During the year under review, BaFin consulted on a circular that regulates the capital adequacy requirement for investment companies' minimum payment guarantees and the handling of guarantees within the Large Exposures Ordinance (Großkredit- und Millionenkreditverordnung – GroMiKV) in order to complete the supervisory framework for guarantee funds. The circular specifies that the investment companies do not always have to match their guaranteed payments with equity capital. Rather, this is only a requirement in cases where the value of the fund's assets – taking account of a security deduction – no longer covers the value of the payment guarantee (a system of conditional effective capital cover). In relation to GroMiKV, the circular stipulates how the guarantees are to be taken into account in terms of the upper limits for individual risk positions defined in KWG. GroMiKV specifies how credit institutions and financial services institutions must record, measure and weight large exposures and loans.

The risk-sensitive system makes it additionally attractive for investment companies to ensure, by means of corresponding risk management techniques such as hedging with zero coupon bonds, that the unit value does not fall below the guaranteed minimum value. The circular also brings the treatment of other forms of minimum payment guarantee up to date, for example in the case of Riester pension plans offered by credit institutions and financial services institutions. BaFin published this circular in February 2007.<sup>52</sup>

<sup>52</sup> Circular 2/2007 (BA).

## 3.2 Real estate funds

● Real estate fund situation significantly calmer.

The situation regarding open-ended real estate funds calmed down considerably in 2006 after the decision to suspend the redemption of fund units was made by the grundbesitz-invest real estate fund of DB Real Estate in late 2005, and then also by the grundinvest and US-grundinvest real estate funds of KanAm in early 2006. Within a period of three months, both investment companies lifted their ban on unit redemptions. Since March and April 2006, it has been possible to redeem units in full from both funds. In addition, the inflow of investment into real estate retail funds has largely returned to normal since the second quarter of 2006.

● Restructuring off to successful start.

German real estate fund companies used the significant net outflow of funds in 2005 and 2006 as an opportunity to move away from their older properties in increasing numbers. They also reduced the proportion of German properties in their real estate portfolios. In realigning their property stocks, German investment companies benefited primarily from the keen interest of foreign investors in German real estate. Many foreign investors felt that German commercial and domestic properties represented good value in international comparison during the year under review. Consequently, some companies offered their real estate portfolios preferentially to international financial investors as means of accelerating their fund restructuring plans. According to the assessment of the selling companies, such package sales offer the advantage that fund properties representing different types of usage, location criteria and revenue prospects can be offered for sale at more favourable conditions overall. For example, in December 2006, DB Real Estate sold property from its grundbesitz-invest fund amounting to over €2 billion to a subsidiary of Fortress. DB Real Estate valued the additional proceeds from the sale at around €200 million. In order to ensure the profit benefited only the investors who had already committed themselves to the fund, the company temporarily ceased issuing new units between mid-December 2006 and mid-March 2007, until the sale agreement had been completed in full. Units could, nevertheless, be redeemed at any time.

### General development of open-ended real estate funds

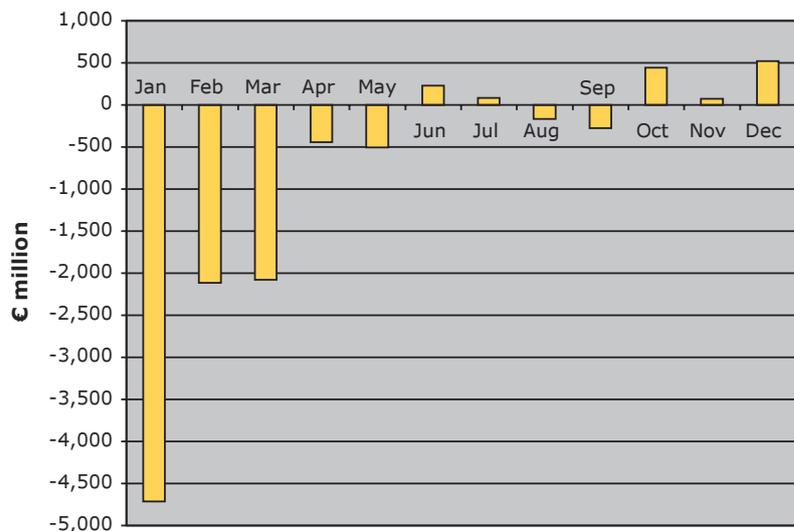
As at the end of 2006, German investment companies were managing a total of 41 (previous year: 38) real estate retail funds with a volume of €77.8 billion (previous year: €86.7 billion) and 108 (previous year: 100) real estate special funds with a volume of €19.6 billion (previous year: €16.7 billion). Providers mostly comprise private major banks, the associations of the cooperative and savings bank organisations and insurance groups, in addition to smaller investment companies. Despite the falling market volume, BaFin received two new applications for a licence to operate a real estate fund business in 2006. The companies requesting the licences focus on issuing funds for institutional investors. Market participants, especially institutional investors, are increasingly interested in open-ended real estate retail funds due

to the favourable accounting requirements and for tax reasons.

Investment levels among open-ended real estate retail funds were not uniform during the reporting year. Although the sector recorded significant net investment outflows of €8.9 billion in the first quarter, primarily due to the temporary suspension of the redemption of units imposed by individual real estate retail funds, these outflows were reduced considerably in April and May. In June and July, investment started to return to the sector. Following further net outflows in August and September, the sector once again achieved inflows in the fourth quarter of 2006. The temporary suspension of the redemption of units does not appear to have impaired the result achieved by the real estate funds in the long term.

Figure 25

#### Net inflow of funds for open-ended real estate funds in 2006



Sources: BaFin, Bundesbank

● Yields remain positive.

In 2006, performance of the open-ended real estate retail funds registered a year-on-year improvement, measured according to the BVI method (comparison of redemption values), of some 1% to around 4%. The rise in average performance is primarily due to the increased orientation of property portfolios to foreign markets and the restructuring measures undertaken by some funds during the year under review. The majority of funds that perform particularly well, achieving growth of over 7% in some cases, are relatively young products with a high proportion of foreign properties.

● BaFin observed restructuring measures.

BaFin was regularly briefed on the situation at those companies whose funds were experiencing significant capital outflows. Various solutions to halt the movement and restructuring concepts were discussed with these funds. The supervisor is particularly careful to

ensure that properties are only sold when the sale price is not below, or is only just below, the value calculated by the expert committee. If the company sells its entire portfolio, BaFin believes that the total price should be taken into account. The sale prices of the individual properties are no longer relevant in such an event. The real estate fund companies still provide BaFin with regular updates on the inflow and outflow of investment. This gives the supervisor a quasi-real time overview of the movement of capital with regard to real estate retail funds.

### 3.3 Market supervision

● Focus: Violations of investment limits, total cost transparency.

In 2006, BaFin focused on how investment companies act should investment limits be violated. It also paid increased attention to the total cost transparency of funds and the eligibility of structured products, such as credit derivatives, asset backed securities and certificates for acquisition by investment funds. For example, BaFin required disclosure of which structured products the companies used, whether the companies adhered to the statutory and contractual investment limits and whether they had made the necessary organisational arrangements to ensure risks could be monitored appropriately. Another topic for supervisory visits was the extent to which the companies had implemented the rules of conduct of the Federal Investment and Asset Management Association (BVI) and how these could be incorporated into the audit of the annual financial statements.

BaFin evaluated audit reports and annual reports of around 1,450 retail funds. Once again it was evident that many companies are taking advantage of the recently expanded range of investment sources for investment funds. With the increase of the market risk potential to 200%, investment funds can now flexibly deploy derivative instruments and structured products for their portfolios. However, increased levels of transparency are required to ensure the ensuing risks are subject to suitable monitoring. During its audits and supervisory visits, BaFin will be concentrating more on how these funds have implemented the processes necessary to record potential risk.

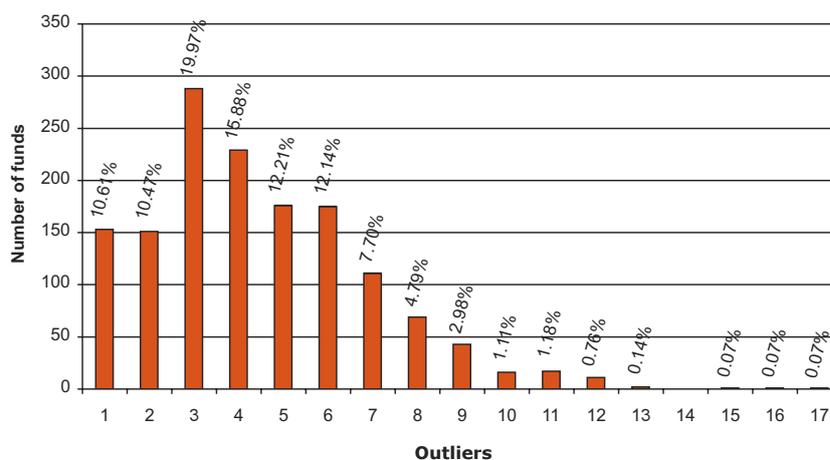
● Many anomaly reports due to fluctuations on equity markets.

In 2006, the supervisor also focused on evaluating notifications made under the Ordinance on Derivative Financial Instruments (Derivateordnung – DerivateV). The Ordinance requires all investment companies to calculate the potential loss risk per fund and to inform BaFin if the actual loss incurred on a given day is greater than the previously calculated loss risk. Investment companies can use a form specially developed by BaFin for their quarterly reports.

Evaluation of the notifications has shown that, in the second quarter of 2006 in particular, there were significant losses, causing a number of anomaly reports. The underlying causes were the strong fluctuations on the international capital markets and on the equity markets in particular.

The chart below indicating the numbers of reports in the second quarter of 2006 demonstrates how often the daily loss of a fund exceeded the calculated potential loss risk in the twelve months before the report was submitted. For example, as at 30 June 2006, around 19.97% of funds (288) reported three such instances for the previous twelve months.

Figure 26  
**Loss risk reports\***



\* As at 30 June 2006.

The use of derivatives may not increase the market risk potential of an investment fund by more than twice. Increased risks demand corresponding suitable risk management systems for funds and investment companies. Anomaly reports are an important initial method for assessing and checking risk models and risk management systems. In 2006, BaFin used this tool as a basis for conducting its initial supervisory discussions.

Increased investment limit violations among real estate special funds.

BaFin has increasingly detected cases of investment limits being violated by open-ended real estate special funds. These violations on the part of companies that are otherwise seldom affected can be attributed to the problems experienced on the German office building markets during the reporting year. If an investment company still breaches the investment limits after the end of the four-year grace period following formation of the real estate fund, BaFin will intervene. In recognition of the difficult market conditions facing the investment companies, BaFin has worked closely with the companies concerned and has agreed to extend the grace period by a maximum of twelve months. This has avoided any fund dissolution which would have placed an additional strain on the real estate market with further sale offers.

### 3.4 Hedge funds

Hedge fund activities in the public eye.

Hedge funds have been at the centre of public and political discussions on the question of financial stability. For example, the German government used its presidency of G8 to initiate an

international debate on the requirements for transparency in hedge funds. With non-regulated funds, systemic risks may arise due, for instance, to the large amount of leverage among banks should hedge fund collapses encroach on the entire financial sector. A need for action is particularly evident among the non-transparent international funds, and less so with regard to the regulated German funds.

● Capital inflows to German hedge funds uneven.

In 2006, BaFin licensed eight single hedge funds, including two public limited investment companies, and four funds of hedge funds. In total, as at the end of the reporting year, 25 single hedge funds and 15 funds of hedge funds, plus eight foreign funds of hedge funds, were licensed. According to reports from the industry association, approximately €2.78 billion is invested in domestically licensed hedge funds.<sup>53</sup> Of this amount, €1.35 billion is invested in single hedge funds and €1.43 billion in funds of hedge funds. The assets of the funds have, however, developed very differently. For example, one hedge fund suspended the issuing of units for a period in 2006, since the strategy was no longer profitable due to the high investment volume. In contrast, two public limited investment companies returned their licences and three funds were closed.

● Growth nevertheless positive on the whole.

Despite this situation, the sector continues to grow overall, both in terms of investment volume and the number of funds. This trend will probably persist in the future. This assertion is backed by the increasing interest of institutional investors and the growing amount of experience gathered both in the investment industry and by the supervisor. BaFin will continue to keep approval periods to a minimum.

● Eleven supervisory visits.

During the year under review, BaFin conducted eleven supervisory visits and held numerous meetings. A supervisory visit may be triggered, for example, by evidence gathered in the scope of the audit of the annual report. Such questions can frequently be clarified more quickly in face-to-face meetings and contribute to a more informed evaluation of the supervised company.

BaFin still conducts regular supervisory inspections in advance of awarding an operating licence for a hedge fund. Such inspections enable an initial assessment to be made regarding whether the investment company and the fund satisfy the statutory and contractual requirements.

Regular contact, independent of the specific visits, should also help foster an improved exchange of information between the supervisor and supervised company so that the situation of the companies can be evaluated more accurately. For example, discussions with potential portfolio managers allow to clarify options and limits relating to the issuing of a hedge fund according to InvG more quickly and more effectively. BaFin intends to further expand its regular contact with supervised companies, especially through annual meetings.

<sup>53</sup> Source: BAI (Bundesverband Alternative Investments).

Four special audits of hedge funds to date.

Since 2004, BaFin has conducted four special audits in accordance with section 44 (1) KWG, in order to obtain a direct insight into the situation of the hedge funds. On each occasion the audits were expressly identified as not being carried out for a specific reason. The aim is to recognise developments within the sector that are of relevance for the supervisor at an early stage, and to ensure that any problems can be avoided. In all four cases, BaFin conducted the audits itself on site.

In terms of content, BaFin deliberately chooses a wide scope, focusing on the investment process, internal control procedures and risk controlling and also compliance. Within the investment process, it is interested in back- and middle-office activities. In relation to risk controlling, BaFin verifies its suitability and independence from portfolio management in order to ensure a clear division of functions. The compliance audit is primarily concerned with verifying compliance with sales and investment rules.

While the audits are solely concerned with the hedge fund sector, they can also provide an important source of information for the other investment supervisory activities.

### 3.5 Foreign investment funds

New record: 6,292 EU UCITS investment funds licensed for distribution.

In 2006, BaFin dealt with 1,395 (previous year: 1,015) distribution notices for foreign EU directive-compliant investment funds (UCITS funds). The number of new notifications once again reached a new all-time high. In total, the number of foreign UCITS funds with a licence for distribution increased despite numerous mergers and liquidations in their home countries to the new record level of 6,292 (previous year: 5,380). In five cases, BaFin prohibited companies from offering fund units to the public in Germany in future. In addition, the supervisor answered numerous queries relating to the prerequisites for public sale, and investigated investors' complaints to the extent permitted by its responsibilities as host state supervisor. These were concerned, for example, with whether the investment companies were meeting their disclosure obligations or whether there were problems with advertising.

Adjustments to management companies.

In dealing with the distribution notices of EU UCITS investment funds, BaFin must pay particular attention to implementing the guidelines published by CESR on the transitional rules of the UCITS Amending Directives. The area of concern here was compliance by management companies with the directive. The CESR Guidelines specify that, with effect from 30 April 2006, UCITS III funds must have a management company that meets the infrastructure criteria laid down in Directive 2001/107/EC amending the UCITS Directive.<sup>54</sup> Therefore, from 30 April 2006, BaFin was unable to

<sup>54</sup> CESR's guidelines for supervisors regarding the transitional provisions of the amending UCITS Directives (Ref.: CESR/04-434b). UCITS III funds are investment funds that comply with the UCITS Directive as amended by directives 2001/107/EC and 2001/108/EC.

accept further distribution notices from UCITS III funds whose management companies had not been restructured in respect of the amended UCITS Directive. These rules also apply to investment companies set up in the form of a company. If these investment companies are self-managing and have not appointed a separate management company, they must therefore comply with the rules of the amending directives. BaFin also referred to the change in the legal situation in its information sheet on the submission of distribution notices.<sup>55</sup>

● Notification procedure to be simplified.

The guidelines published by CESR in June 2006 on the simplification of the notification procedure for foreign EU UCITS investment funds will, where necessary, be implemented with the planned revision of InvG in 2007 and an amendment to the information sheet on the submission of distribution notices.<sup>56</sup> The guidelines stipulate, for example, that foreign companies, including those in an umbrella structure, no longer have to include all subfunds that have been approved in the home country as part of the notification procedure. A further aim is to allow foreign companies to use, in some areas, standard-format notification letters for the whole of Europe.

● Conversion of non-UCITS investment funds continues.

In 2006, BaFin continued the process of converting to InvG those investment funds that were not compliant with the directive and that had submitted an amendment notification. BaFin verifies whether the prescribed conversion to InvG of all non-UCITS investment funds that are authorised for public sale in Germany has been conducted correctly. The conversion process is scheduled for completion in 2007. A further priority was the processing of new notifications of non-UCITS investment funds and the concerted provision of consultancy to companies in advance of a planned notification. Moreover, the supervisor responded to queries from market participants about whether non-permitted public sales had been conducted, and investigated complaints lodged by investors.

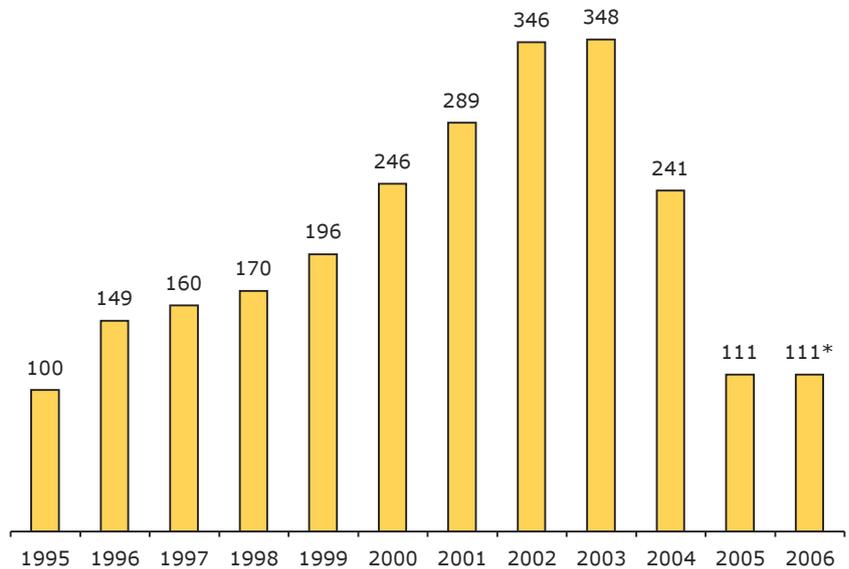
● Development of foreign investment funds licensed for distribution.

Since 1990, the number of individual funds licensed for distribution has increased significantly. As in previous years, the majority of these comes from Luxembourg and Ireland. The number of foreign EU UCITS investment funds licensed for distribution rose by almost 17% in 2006. The reasons include the constantly expanding opportunities for investment opened up by the UCITS Amending Directives. The number of non-UCITS funds licensed for distribution fell slightly year on year.

<sup>55</sup> [www.bafin.de](http://www.bafin.de) » » Für Anbieter » » Investmentfonds » » Ausländische Investmentfonds.

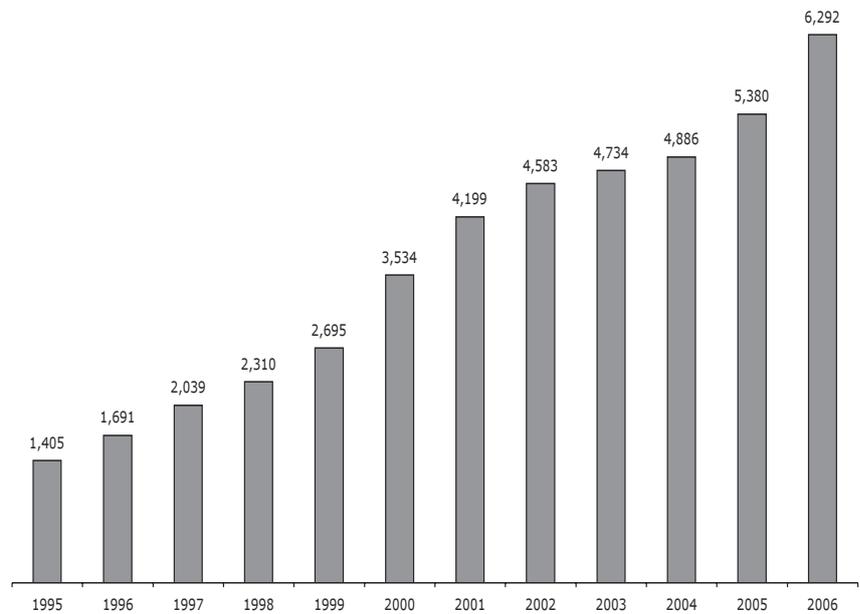
<sup>56</sup> CESR's guidelines to simplify the notification procedure of UCITS, June 2006, Ref.: CESR/06-120b.

Figure 27  
**Individual non-UCITS funds**



\* As of 2006, these statistics also include foreign funds of hedge funds licensed for distribution (8).

Figure 28  
**Individual UCITS funds**



## 4 Monitoring of market transparency and integrity

### 4.1 Market analysis

BaFin analyses 1,250 cases.

BaFin conducts routine analysis of transactions in order to monitor the bans on insider trading and market manipulation. In 2006, the authority conducted 1,250 analyses.

Focus on particularly insider-relevant backgrounds.

The slight fall in comparison with the previous year (1,450) is down to factors such as the approach adopted by the supervisor in its insider analysis, which is more heavily risk-oriented than before, focusing on particularly insider-relevant backgrounds. The number of ad hoc disclosures, on the basis of which BaFin conducts a number of analyses of possible insider actions and market manipulation, also fell slightly.

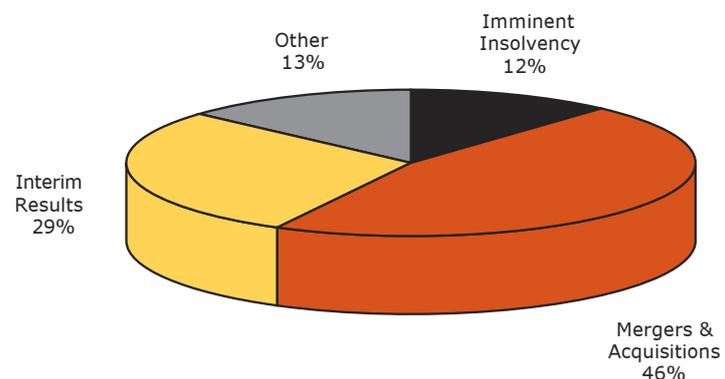
Reports submitted by investors, in contrast, almost doubled. Most reports concerned the raw materials and solar power sectors. They related primarily to low-liquidity financial instruments traded in the OTC market.

84 positive analyses.

In 84 cases, the analysis revealed evidence pointing to insider trading (52 cases) or market manipulation (32). In these cases, BaFin initiated formal investigations. Despite the fall in the overall number of cases, the number of positive analyses was almost the same as during the previous year.

Figure 29

#### Background of positive insider analyses

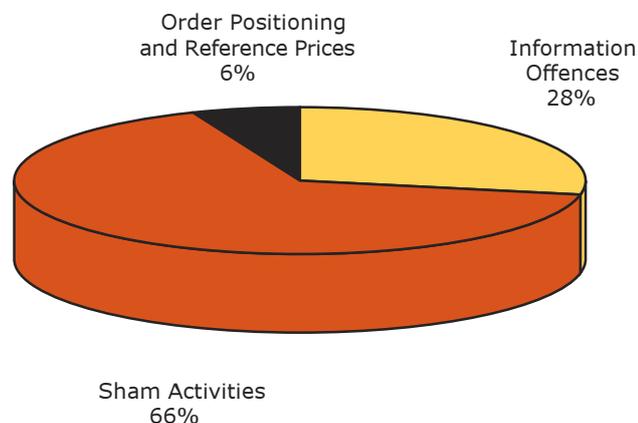


Increasing number of insider actions in relation to mergers.

The vast proportion of positive insider analyses (87%) related, as in previous years, to insolvencies, interim results and, above all, M&A activity (46%).

Most insider analyses in 2006 were once again conducted in the official market (17) and the regulated market (21). The proportion of analyses of OTC transactions increased strongly, however, now amounting to almost 27% (14).

Figure 30

**Background of positive market manipulation analyses**

- Market manipulation by means of sham activities.

Positive market manipulation analyses related mainly to instances of sham trading (66%). These occur when parties to a trade agree the transaction in advance or the financial instruments do not even change hands (pre-arranged trades and “wash sales”). They also include transactions in which stock exchange prices are driven up or down (bull raid or bear raid) in order to close an existing position at a profit.

- Almost half of market manipulation analyses involve OTC instruments.

The proportion of positive cases of market manipulation involving financial instruments that are traded solely in the OTC market amounted to 53% (17). Four market manipulation analyses related to the official market and nine to the regulated market.

- Closer monitoring of the bond and derivative markets.

With regard to insider trading and market manipulation, BaFin’s analyses concentrate largely on trading in shares, share options and warrants. Since the commodity and energy future markets are increasing in importance, alongside the pension markets, BaFin conducted a risk analysis of these areas. This analysis revealed that these areas posed a high potential risk to the integrity of the market, causing BaFin to realign its market analysis efforts. In future, it will observe the markets for bonds and their derivatives, commodity and energy derivatives and for structured products more intensively than before.

- Increasing evidence of misdealing in options, warrants and leverage certificates.

During the reporting year, BaFin observed that, before the disclosure of insider information, potential insiders were dealing in shares as well as in Eurex options or warrants and in leverage certificates of the issuers concerned. For example, in the case of one takeover offer, the supervisor discovered suspicious transactions in many warrants and leverage certificates that are mainly the subject of OTC trading. Some market participants had achieved significantly higher profits with these derivative financial instruments than with share transactions. BaFin also queried transactions of providers of contracts for difference, identifying suspicious activities in these instruments, too. Other European supervisory authorities found indicators of insider trading in this case as well. The mechanism used featured spread bets that were traded on the target company.

### Contracts for difference and spread bets

Contracts for difference are transactions that take advantage of the difference between the purchase price and the sale price of a financial instrument. They are used for speculating on price changes – of shares, raw materials, indices or currencies, for example – without actually owning these instruments. Contracts of difference allow speculators to go long (speculating on price gains) or short (price losses). Spread bets are bets on the future price development of financial instruments or indices. With low initial capital and a high leverage effect, speculators bet on changes in the difference (the spread) between the underlying value (the share of the target company) and a suitable index.

- Banks and financial services providers reported 707 million transactions.

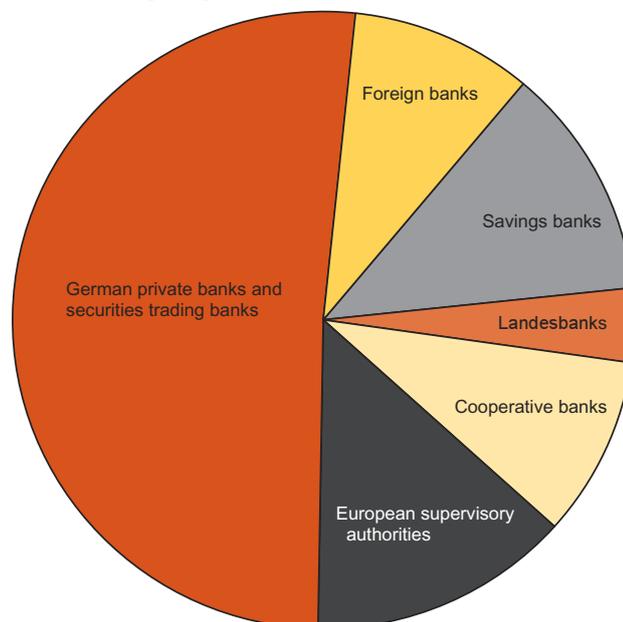
When investigating insider trading and market manipulation, BaFin accesses the transaction reports of the credit and financial services institutions. According to section 9 WpHG, these institutions must report all their transactions involving financial instruments. In 2006, the supervisor received around 707 million such reports (previous year: 560 million). That corresponds to an average of some 2.8 million data records per day (previous year: 2.2 million). The increasing number of reports reflects the high vitality of the markets during the year under review.

- BaFin received 74 notifications of suspicion from market participants.

BaFin received 74 suspicious activity reports from securities services companies, credit institutions and operators of OTC markets. These groups must submit reports if they suspect that trades they encounter breach the rules on insider trading or market manipulation. Seven reports were supplied by mutual banks, twelve by savings banks and ten were forwarded to BaFin from other European supervisory authorities. The remaining suspicious activity reports were generated by private credit institutions, of which ten were foreign institutions. A total of 62 reports related to shares, eleven to warrants and one to an interest rate product. Of these, 27 suspicious activity reports resulted in investigations, 17 due to suspicion of insider trading and ten due to suspected market manipulation. In relation to one case of insider trading, reports were submitted by a number of institutions and the British Financial Services Authority (FSA). No further investigations were carried out in the case of 27 reports.



Figure 31  
Suspicious activity reports



## 4.2 Insider trading

Table 22  
Insider trading investigations

Period	New investigations	Results of investigation			Pending investigations
		Dis-continued	Referred to public prosecutor's office		
	Insider	Insider	Cases	Persons	Total
2004	57	37	23	71	88
2005	54	17	23	95	102
2006	51	23	24	106	106

● 51 new insider investigations.

In 2006, BaFin opened 51 new investigations relating to suspected insider trading. It referred 24 cases to the public prosecutor and filed complaints against a total of 106 individuals. BaFin discontinued investigations in 23 cases of suspicion. As at the end of the reporting year, 106 investigations were still pending.

Table 23  
Prosecutors' reports on closed insider proceedings

Period	Total	Discontinued	Discontinued after out-of-court settlement	Final court decisions			
				Decisions by the court	Convictions following summary proceedings	Convictions following full trial	Acquittals
2004	199	163	29	0	2	5	0
2005	99	69	19	0	4	5	2
2006	71	42	17	0	6	5	1

● Eleven convictions for insider trading.

The cases reported by BaFin resulted in eleven convictions in 2006, five following a full trial and six after summary proceedings. State prosecutors dropped 59 cases of which 17 were discontinued in exchange for an out-of-court settlement.

Foreign supervisory authorities referred 21 cases to BaFin, a rise on the previous year (14). Particularly frequent were enquiries from France, Finland, the UK and the USA. BaFin requested information from foreign supervisory authorities, such as Austria, Luxembourg, Switzerland and the UK, with regard to 56 cases of insider trading.

Some of the cases concluded in 2006 are described below.

### **GeneScan Europe AG**

On 17 February 2003, GeneScan Europe AG disclosed that its Executive Board had agreed to a takeover by Eurofins Scientific S.A. A price of €1.10 per share would be offered. As a result of this announcement, the stock exchange price of GeneScan Europe AG rose from €0.74 to €1.09.

The accused, a lawyer at a large chamber who was working for Eurofins Scientific S.A. during the takeover process, had previously participated in a number of negotiations between the two companies. Despite her duty to remain silent, she had told her partner, the co-accused, about the impending takeover. Up to 14 February 2003, he invested a total of €18,820 in shares of GeneScan Europe AG, earning a profit of €11,430 when he subsequently sold this holding.

Mannheim Local Court convicted the lawyer in August 2006, imposing a fine payable in 90 daily instalments of €100. The woman's partner also received a fine of 90 daily instalments of €160 each.

### **Dyckerhoff AG**

On 5 June 2003, the Italian company Buzzi Unichem SpA made a voluntary public offer to purchase the preferred shares of Dyckerhoff AG. It offered 2.4 Buzzi preferred shares for each share in Dyckerhoff. As a result, the listed price of the Dyckerhoff preferred shares rose by 28%.

Previously, a bank employee who had been involved in preparing the takeover had acquired 30,500 shares in Dyckerhoff AG for two securities accounts belonging to his mother. He sold 500 shares before the announcement, and the remaining 30,000 directly afterwards. His price gains totalled €95,000.

A senior employee of the Dyckerhoff Group also purchased 4,000 preferred shares a few hours before Buzzi Unichem SpA disclosed its plans. When the takeover bid was accepted on 30 September 2003, he made a profit of €10,500.

Frankfurt Local Court issued the bank employee with a warning and imposed a suspended fine following summary proceedings in the amount of 150 daily instalments of €170 each. As a condition of the suspended fine, the court ordered the accused to pay €50,000 to charitable organisations. The case against the mother was dropped, as was the case against the Dyckerhoff employee, on the basis that a payment of €10,000 would be made to charitable organisations.

### **Winkler + Dünnebier AG**

On 26 August 2004, Körber AG announced that it would be making a voluntary public takeover offer to the shareholders of Winkler + Dünnebier AG at a price of €9.75. On the previous day, shares in Winkler + Dünnebier AG had closed at €3.55. The offer therefore represented a premium of 175% on the most recent price and of 161% on the minimum price (€3.73) required by takeover legislation.

Previously, an employee with a managerial role at Winkler + Dünnebier AG who knew about the planned takeover bid had provided a friend who was a doctor with €40,000. The doctor used this money to purchase a total of 14,164 shares during July and August 2004. This corresponded to almost 50% of the total number of shares in Winkler + Dünnebier AG traded on the Frankfurt stock exchange during this period. The resulting profit of €89,525 was shared between the employee (€59,683.33) and the doctor (€29,841.67) at the end of 2004.

Koblenz Local Court issued the employee with a warning and imposed a suspended fine following summary proceedings in the amount of 180 daily instalments of €200 each. As a condition of the suspended fine, the court ordered the accused to pay €60,000 to a charitable organisation. The Public Prosecutor's Office in Koblenz dropped the case against the doctor in accordance with section 153 of the Code of Criminal Procedure.

### **Nordwest Handel AG**

Nordwest Handel AG announced on 13 June 2003 that its Chief Executive was to be dismissed with immediate effect. On 5 June 2006, the Chairman of the Supervisory Board of the company had already written to around 1,500 industrial partners and 900 connected businesses to inform them that the Chief Executive had been suspended with effect from 5 June 2003 due to differences of opinion in relation to strategic direction and a lack of ability to integrate with customers, suppliers, banks and staff.

In response to the letter, three employees of partner companies had sold their entire holdings in Nordwest Handel AG.

Hagen Regional Court imposed criminal fines of between €1,500 and €3,500. The Court imposed a criminal fine of €3,000 against the Chairman of the Supervisory Board for the unauthorised disclosure of insider information.

### **DayStar Technologies Inc.**

At 16.10 on 9 June 2005, DayStar Technologies Inc. published a press release announcing it had agreed a sale contract for solar cells with a German company. The press release stated that, on the basis of the contract, the company expected sales revenues of up to US-\$ 60 million through to 2008.

The accused, an employee with a managerial role at the German company, purchased 20,000 DayStar shares on 3 and 9 June 2006 up until 15.19 at a total price of €149,688.50. Once his orders had been executed, the accused asked his personal banker about a press release he had been expecting. He admitted to being an employee of the German business partner. Directly after the press release was published, he started to sell his shares.

The bank employee informed her Compliance department of the suspicious transactions, with which the accused had made a profit of €89,339.44. The bank then reported its suspicion to BaFin, in accordance with section 10 WpHG.

In the course of its investigations, BaFin located six further individuals who had made suspicious trades via several credit institutions prior to publication of the press release.

Würzburg Local Court convicted the employee of the German company on eight counts of insider trading and four counts of unauthorised disclosure of insider information, imposing a one-year prison sentence. The sentence was suspended. The court also imposed a criminal fine of €21,960 and ordered the forfeiture of the profit. Three further accused were sentenced after summary proceedings, with the Court imposing criminal fines of between €1,050 and €2,000, also ordering the forfeiture of their profits, amounting to up to €3,047.50. The court dropped the case against one accused in return for an out-of-court settlement.

Rheinberg Local Court dropped proceedings against two further accused in return for administrative fines of €2,000 and €4,000.

### **Micrologica AG**

On 28 February 2001, Micrologica AG issued an ad hoc disclosure on its impending insolvency. The statement asserted that a private investor, with whom a credit line of €2 million had previously been agreed, now planned to terminate this facility for a good cause.

The accused, Head of Finance and Accounting and a registered legal agent (Prokurist) at Micrologica AG, who already possessed this information, had sold all the Micrologica shares he held, a total of 3,500, for €10,500 on 21 February 2001. Through this timely sale, he avoided a loss of around €6,680.

Tostedt Local Court found the accused guilty of insider trading and issued him with a warning. The court also imposed a suspended fine of 50 daily instalments of €60 each.

### National Discount Brokers Group Inc.

On 10 October 2000, a major German bank announced its intention to buy US-based brokerage National Discount Brokers Group Inc. The bank stated that it would pay US-\$ 49 per share.

In September 2002, BaFin was contacted by a private individual. The witness informed the supervisor that in October 2000 he had received DM 80,000 from a married couple with whom he was acquainted followed by an express bank transfer of DM 120,000. The couple had asked him as a friend to use the money to buy shares in National Discount Brokers Group Inc on the floor of the exchange and to resell these afterwards. Accordingly, at the beginning of October 2000, the witness purchased a total of 3,255 NDB shares for DM 207,419.83. When the takeover was announced, he sold the shares for a total price of DM 346,189.67. Only later did the witness learn that his friend, a senior employee at the bank, had been involved in the takeover negotiations.

In March 2006, Duisburg Regional Court dropped the proceedings against the bank employee and his wife following a full trial in return for out-of-court settlements of €20,000 and €5,000. The couple were permitted to retain the profit of DM 138,769.84.

## 4.3 Market manipulation

Table 24

### Market manipulation investigations

Period	New investigations	Results of investigation						Pending investigations	
		Discontinued	Referred to public prosecutor's office or BaFin administrative fines section				Total (Cases)		Total
			Prosecutor		Admin. fines section				
			Cases	Persons	Cases	Persons			
2004	52	13	15	35	1	1	16	65	
2005	53	13	11	20	1	1	12	93	
2006	60	30	15	38	5	6	20	103	

- BaFin opened 60 new investigations into market manipulation.

In 2006, BaFin opened 60 new investigations on suspicion of market manipulation, and dropped 30 cases. In 15 cases, the supervisor found evidence of criminal market manipulation, in some cases in conjunction with insider trading. It reported 38 individuals to the appropriate public prosecutors. Some suspicions recurred in several cases of manipulation. As at the end of the year, 103 investigations were still pending.

Table 25

**Prosecutorial and court reports, and reports by the internal administrative fines section concerning closed price manipulation proceedings**

Period	Total	Decisions of public prosecutors		Final court decisions in criminal proceedings				Decisions in administrative offence proceedings	
		Discontinued	Discontinued after settlement out of court	Decisions by the court	Convictions following summary proceedings	Convictions following full proceedings	Acquittals	Discontinued	Final administrative fines
2004	14	7	0	0	1	1	0	1	4
2005	17	8	3	0	0	3	0	2	1
2006	15	6	4	0	3	1	0	0	1

During the reporting period, one conviction was obtained following a full public trial. Cases referred by BaFin resulted in three summary judgments, including one for breach of trust, after the court had limited prosecution to this offence. Public prosecutors dropped cases against ten suspects; four cases were discontinued in exchange for an out-of-court settlement.

In 2006, BaFin opened six administrative offence proceedings on suspicion of attempted market manipulation, while another case was pending from the previous year. BaFin concluded one case in court, imposing a fine of €3,750. As at the end of the year, six cases were still pending.

Foreign supervisory authorities requested support from BaFin for investigations of market manipulation cases on 28 occasions. BaFin issued requests to foreign authorities in respect of 19 cases.

Below are descriptions of selected cases concluded in 2006 and investigated by BaFin with regard to market manipulation.

#### **Hedge fund manager**

In 2002, a fund manager published a study into a listed company. In this study he portrayed the financial situation of the company in a negative light, stated a target share price that was well below the listed price and issued a "strong sell – high risk" recommendation for the share. As a result, the share lost around one-fifth of its listed value. At the same time, the fund manager had responsibility for managing a hedge fund that had a strategy of short selling on falling prices of the share in the company, and therefore had a significant economic interest in that specific share price falling. The study made no reference to this fact, however. Once the price had collapsed, the fund manager issued a further study two weeks later, revising the negative statements of the first study and issuing a buy recommendation.

BaFin reported the fund manager to the appropriate public prosecutor. Frankfurt am Main Local Court issued the fund manager with a warning on 21 December 2005 for market manipulation

according to section 59 of the German Criminal Code (Strafgesetzbuch – StGB). A suspended fine of €90,000 (180 daily instalments of €500) was imposed, subject to the condition that the fund manager pay €50,000. The decision became non-appealable on 20 January 2006. In a comparable case which had, however, not progressed beyond an attempt to manipulate the market, BaFin had already imposed an administrative fine on the same fund manager in 2004.<sup>57</sup>

### **Beta Systems AG**

A fund manager concluded transactions with himself on the stock exchange that were systematically disadvantageous to various funds he managed. On each occasion, he issued an order for his own private securities account to be executed on the Xetra stock exchange trading system, which he then followed with a precisely matched sell order for the account of the fund. On the basis of the arranged orders he influenced the stock exchange prices. The manager then sold the shares he had acquired cheaply through his private securities account at a more expensive sale price on Xetra. He also conducted private sales of shares to the fund at inflated prices. In total, he conducted 65 share trades for his private account to the detriment of the funds he was managing.

Munich Local Court convicted the accused after summary proceedings of particularly grave breach of trust and market manipulation. It imposed a criminal fine of €24,000 (240 daily instalments of €100 each).

### **Ponaxis AG**

Between July and September 2003, the two accused used two corporate securities accounts to make over 100 bogus stock exchange trades involving shares in Ponaxis. The transactions involved moving shares from one corporate securities account to another. Their market share of the stock exchange turnover was between 60% and 100%. By means of numerous matched orders, they forced the price of the share on the Frankfurt stock exchange, which had been between €0.60 and €0.80, up to €1.04. This nearly matched the issue price for new shares from a rights issue due to be placed on the market at €1.00, making this offer now appear attractive. Moreover, the accused sold large numbers of shares at the increased price for the companies they controlled. The accused also manipulated the listed prices of shares in Unylon AG and Ponachem AG in a similar fashion.

BaFin reported this case of market manipulation by means of pre-arranged trades to Frankfurt am Main public prosecutor's office. The public prosecutor opened investigative proceedings, but later discontinued these for legal reasons, in accordance with section 170 (2) StPO. The bogus transactions constituted prohibited manipulation according to the legislation applicable at the time of the action and according to the legal situation in 2006. As the

● Manipulating the market with misleading information.

<sup>57</sup> BaFin 2004 Annual Report, p. 196.

investigations began, the WpHG had however been amended by the Market Abuse Directive in October 2004, newly incorporating the ban on misleading information. Moreover, the specifying ordinance (Marktmanipulations-Konkretisierungsverordnung – MakonV) was not passed by the Federal Ministry of Finance until March 2005. This meant that between October 2004 and March 2005 there was no basis for prosecuting this type of manipulation. BaFin was of the opinion, however, that until MakonV came into force, the actions of the accused could be prosecuted as an “other deceptive act”. According to the supervisor, implementation of the Market Abuse Directive simply repositioned the existing prohibition. Since then, misleading information has no longer been covered by the prohibition of other deceptive acts, but is now prohibited as a fully distinct alternative form of market manipulation.

### **Augusta Technologie AG (Stop order fishing)**

#### **Stop orders**

Users of the Xetra trading system use stop orders to make the placement of orders in the electronic order book dependent on a certain price threshold being reached. Stop orders are used to limit losses if the price level of a share falls. There are stop market orders and stop limit orders. When the stop limit is reached, stop market orders are automatically placed in the order book in the form of unlimited orders, whereas stop limit orders are placed as limited orders.

From the middle of 2002, an experienced private investor repeatedly issued matched buy and sell orders that were executed against each other in the Xetra stock exchange trading system. Using these bogus transactions, he reduced the stock exchange price of various shares down to a specific target price limit at which he believed other market participants were holding stop market orders. These orders, which did exist at this price, were then triggered and could be traded automatically in the form of unlimited sale orders. In order to acquire the shares as planned, the accused had already issued matching high-volume buy orders – mostly in the form of iceberg orders. He used this method to trigger 34 stop orders of other participants and acquired a total of 7,117 shares at an artificially reduced listed price.

Frankfurt am Main Local Court decided that the bogus transactions constituted deceptive acts and convicted the accused in September 2006 of market manipulation, imposing a criminal fine of €6,000. In contrast to the Ponaxis case, Frankfurt am Main public prosecutors did not believe that the lack of a specifying ordinance on the prohibition of manipulation prevented prosecution.

### **Solarworld AG**

On 16 February 2005, a trader acting for two different securities trading firms arranged twelve trades through the accounts of the two firms in order to create corresponding bogus demand on the

market and attract other buyers (pre-arranged trades). In this way, the trader acquired a short sell position of some 14,000 shares for one of the companies. In order to close the short sell position on the following day and return a profit, he manipulated the opening price on the Frankfurt securities exchange downwards. He did this by issuing buy orders with low limits at variance with the last reported trade to cover his short position in Xetra before the opening auction started. During the opening auction, he then placed numerous low-limit sell orders for the securities account of the other company that were disadvantageous to this company. When the opening price was established, these orders caused the opening price to be around 5% lower than the closing price of the previous day. These trades constituted around 96% of the trading volume in the opening auction. Thanks to his manipulation, the accused closed the short sell positions with a financial advantage of around €33,000, to the detriment of the other securities account he was managing.

BaFin reported the case to the Frankfurt am Main public prosecutor's office on account of market manipulation and breach of trust. The prosecutor commenced legal proceedings for breach of trust, but dropped the action for the equally realised act of market manipulation in accordance with sections 154 and 154a StPO.

In another case, involving more than 100 such pre-arranged trades in ten different shares, the Frankfurt am Main public prosecutor also dropped the case in accordance with section 153a StPO in return for an out-of-court settlement of €5,000.

#### **MWB Wertpapierhandelshaus AG**

Using a pseudonym, an employee of a credit institution submitted a forged ad hoc disclosure to the Wallstreet Online Internet board to the effect that MWB AG would be taken over by Baader Wertpapierhandelsbank AG.

Following a report from BaFin, the Cologne public prosecutor discovered the real name of the individual behind the pseudonym. The accused had submitted the disclosure to the Internet from his workplace computer and had also actually traded in shares in MWB AG, although not directly before or after the disclosure. The false report did not cause any reaction in the stock exchange price of the affected shares. The actions of the accused were therefore contrary to regulations, but not liable to prosecution, since they did not extend beyond an attempt to manipulate the stock exchange price. The public prosecutor subsequently referred the case back to BaFin for the opening of administrative offence proceedings. These were concluded in May 2006 with the imposition of an administrative fine of €3,750.

#### **Artnet.com AG**

On 9 May 2001, a Leipzig-based GmbH (private limited company) disclosed that it wished to take over a majority interest in

artnet.com AG. It made the shareholders of artnet.com AG an individual offer of €6.75 to €8.75 per share. As a result, the share price rose by up to 300% from €1.13 to as high as €4.

The accused, who had been responsible for initiating the report on the impending takeover, purchased 145,000 shares in artnet.com AG before publication. After the announcement, he sold this entire holding by 4 July 2001, generating a profit of €136,288.56. No takeover was ever intended, at any time. Moreover, the GmbH would never have been in a financial position to enter into such a transaction.

Leipzig Local Court convicted the accused after a full trial for price fraud in accordance with section 88 of the old form of the Stock Exchanges Act (Börsengesetz – BörsG), imposing a suspended prison sentence of one year and four months. The Court dropped the charge of insider trading. In 2003, the Federal High Court (Bundesgerichtshof – BGH) issued a decision in relation to scalping, to the effect that the exploitation of a self-created insider fact did not constitute the exploitation of an actual insider fact. Such an action should be considered in legal terms as market manipulation, the Court decided.

The criminal proceedings against an employee of the GmbH who had aided the main accused were dropped by the court in accordance with section 153a (2) StPO in return for an out-of-court settlement of €2,500.

## 4.4 Ad hoc disclosure and directors' dealings

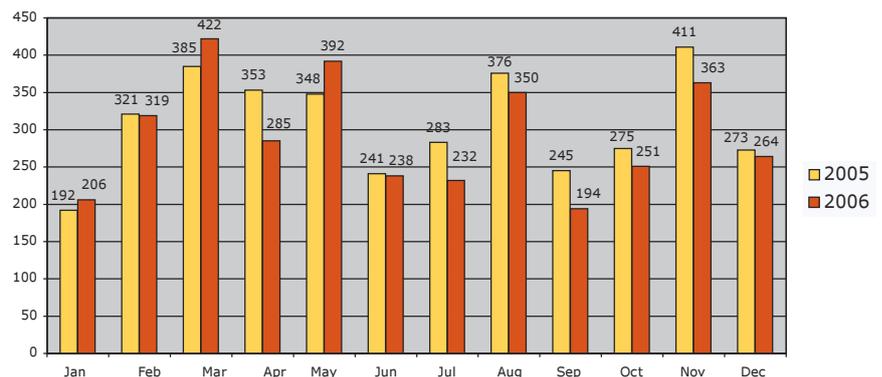
### Ad hoc disclosure

- Listed companies published 3,516 ad hoc disclosures.

Listed companies published 3,516 ad hoc disclosures in 2006 (previous year: 3,704). Companies must make an immediate report in the event that new circumstances, unknown to the public, occur in their business area that could influence the price of the financial instrument and directly affect the issuer. 3,051 (previous

Figure 32

### Ad hoc disclosures in 2005 and 2006



year: 3,204) disclosures were issued by domestic companies and 465 (previous year: 500) by foreign companies. In comparison with the previous year, therefore, the number of ad hoc disclosures fell slightly. Firstly, issuers are increasingly aware of their statutory obligations, and therefore issue fewer unnecessary disclosures. Secondly, many have made the transition to IFRS for the preparation of their accounts. This transition generated more reports in 2005, since the different accounting standards caused variant business figures.

Changes introduced by AnSVG remain an important topic.

Once again, in 2006, BaFin responded to a number of questions on the information requirements and obligations that had changed significantly with the introduction of the Act on Improvement of Investor Protection (Anlegerschutzverbesserungsgesetz – AnSVG). In 2005, BaFin was primarily concerned with clarifying basic questions and providing issuers with help in dealing with the new rules. During the year under review, however, greater emphasis was placed on the in-depth discussion of specialist issues. This situation showed that the issuer guidelines published by BaFin in 2005 had been used intensively by companies in their day-to-day work.

The demand for information was particularly high in the case of company takeovers. In these cases, an ad hoc disclosure must be submitted as soon as the significant points of the transaction, especially the approximate purchase price, have been established. Another frequent problem is the lack of details on purchase or sale prices in these disclosures. Companies must specify at least a range for the purchase price, or alternatively state the balance-sheet effects of the takeover. If this information is not provided, the ad hoc statement is deemed incomplete. In some circumstances, companies can exempt themselves from their disclosure obligations. Practice has shown, however, that companies rarely make use of this exemption option.

Changes also introduced by TUG.

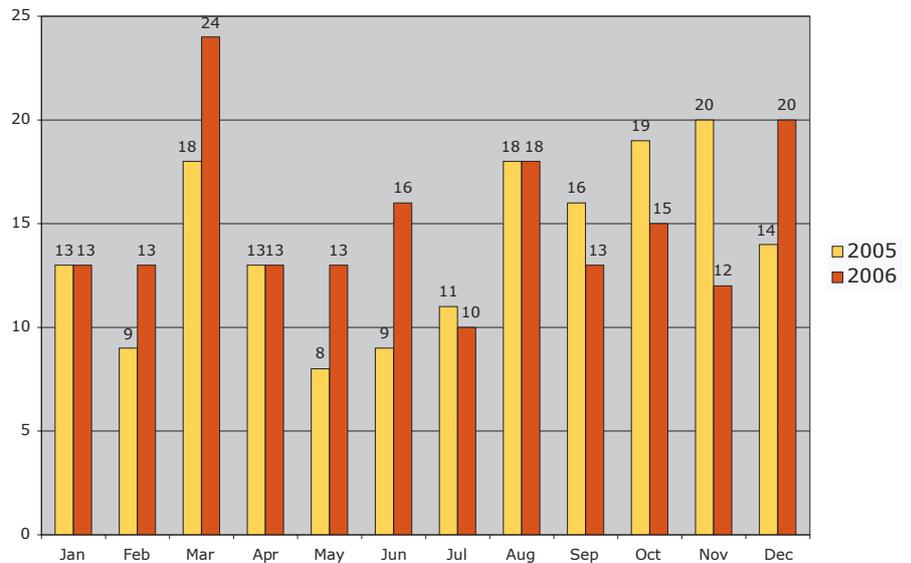
Following the transposition of the Transparency Directive into German law, listed companies are now subject to only the information obligations of the capital market legislation of their home country, provided this is within the EU. BaFin expects, therefore, that a large number of companies from other EU Member States will no longer be subject to German ad hoc disclosure requirements. Only in exceptional cases will foreign issuers remain bound by German ad hoc obligations.

Issuers may exempt themselves from their ad hoc requirements.

In 2006, there were 180 cases of listed companies exempting themselves from their obligation to disclose insider information. That corresponds to an average of 15 exemptions per month. After each exemption, BaFin verifies that the requirements for exemption are actually in place. Companies are permitted to exempt themselves from their ad hoc obligations as long as this is done to protect their own justified interests or to guarantee the confidentiality of the information, and if there is no fear that the general public will be misled. The usual case for such a postponement of the disclosure is, for example, a multi-stage decision-making process. For example, the management board has

made a decision that could potentially have a significant influence on the company's price, but the supervisory board has not yet given its consent. As before, companies have sometimes appeared uncertain in relation to exemptions, approaching the supervisor with questions.

Figure 33  
**Exemptions in 2005 and 2006**



- BaFin imposed nine administrative fines for breaches of ad hoc disclosure obligations.

In 2006, BaFin imposed nine administrative fines of up to €80,000 for failure to disclose insider information, failure to disclose insider information on time or incomplete disclosure of insider information. In two instances it referred the cases to the public prosecutor, since there were already investigative proceedings pending against those responsible for these companies relating to fraud, the delaying of insolvency proceedings and market manipulation. BaFin dropped 31 cases, of which 28 were discontinued due to a lack of public interest. As at the end of the year, 66 investigations were still pending.

In total, BaFin opened 30 new investigations, while 78 cases were pending from the previous year.

#### Directors' dealings

- Directors' dealings significantly down again.

In 2006, managers of listed companies reported 4,687 (previous year: 5,118) dealings to BaFin. The number of directors' dealings reports therefore fell again following a strong rise in 2005. The first reason is that many questions have now been resolved, and reports are now only submitted where actually required. Secondly, notifying parties can now submit just one notification for all dealings conducted on a single day.

- Administrative offences.

BaFin imposed eight administrative fines of up to €5,000 during 2006 for breaches of the reporting obligations of company insiders.

In one case from 2005, Frankfurt am Main Local Court confirmed a decision of BaFin to impose an administrative fine totalling €18,000. A legal challenge to this is currently pending with the responsible Higher Regional Court (Oberlandesgericht – OLG). The supervisor dropped 71 cases, of which 69 were discontinued due to a lack of public interest. As at the end of the year, 24 investigations were still pending. In 2006, BaFin initiated eleven new proceedings, while 92 administrative offence proceedings remained open from the previous year.

Directors' dealings database forms important source of information.

The database containing the published dealings in accordance with section 15a WpHG on the BaFin website<sup>58</sup> was useful for investors as an important source of information. In addition, the database is being used as an analysis tool by market participants and the press to develop investment strategies on the basis of the reporting patterns of company insiders.

#### 4.5 Voting rights

Preparing for TUG.

The significant changes to the voting rights reporting system brought about by TUG formed a core area of activity in 2006.

As of January 2007, changes to voting rights must be announced more quickly. The deadlines for announcements are now based on trading days, rather than calendar days as before. Trading days are considered to be all calendar days with the exception of Saturdays, Sundays and public holidays that are legally recognised as such in at least one German state (Land). BaFin has created a trading day calendar, available on its website, to simplify calculation of the reporting deadlines.

The supervisor has informed those with notification and disclosure obligations of the latest changes to the law by means of an information letter. It has also published a Frequently Asked Questions list on this topic. The BaFin standardised notification form should also be of assistance.<sup>59</sup>

In order to help companies, investors, lawyers and service providers prepare in good time for the new rules, BaFin organised two information events in December 2006, during which it introduced the impending changes, and gave delegates the opportunity to ask questions. BaFin plans to continue this dialogue with practitioners.

BaFin received over 4,000 voting rights reports.

In 2006, BaFin received 4,178 reports of changes in voting rights at German listed companies (official and regulated market). There is a requirement to report all changes in the voting rights of a shareholder that cross the 5%, 10%, 25%, 50% or 75% thresholds. From January 2007, these thresholds are supplemented by those at 3%, 15%, 20% and 30%.

<sup>58</sup> www.bafin.de »» Datenbanken »» Meldungen nach § 15a WpHG (Directors' Dealings).

<sup>59</sup> www.bafin.de »» English Version »» For Providers »» Stock Exchange listed Companies »» Major holding of voting rights, section 21 et seq. WpHG.

The renewed increase in the volume of reports in 2006 is largely due to the fact that the shareholder structure of listed companies has changed more markedly than in the past. During the year under review, 505 (previous year: 448) companies were authorised for the official market on a German stock exchange. 514 (previous year: 479) were authorised for the regulated market.

#### Attribution of voting rights

The calculation of voting right proportions takes account of the voting rights arising from shares owned by the notifying party. Shareholders are also attributed those voting rights, the exercising of which they are in a position to influence. For example, voting rights from shares held by a trustee for the account of the notifying party are also attributed. In May 2006, Frankfurt Administrative Court confirmed BaFin's opinion that section 22 WpHG contains abstract facts relating to attribution. Therefore, the requirement for attribution is not that the notifying party has a secured claim to the third party actually following his instructions. The voting rights are also attributed when the trustor's right of instruction is expressly excluded by contractual means.

● BaFin imposed administrative fines in 91 cases.

BaFin may impose an administrative fine in the case of missing, delayed, incorrect or incomplete notifications or disclosure of significant voting right proportions. In 2006, it initiated 24 proceedings and imposed 91 fines of up to €20,000. 415 cases were still pending from previous years. BaFin dropped 311 cases, of which 172 were discontinued due to a lack of public interest. 37 cases were pending as at the end of 2006.

● Voting rights database.

The disclosed voting rights notifications are processed by BaFin, and placed in a database in a summary form available to all from the supervisor's website.<sup>60</sup>

Users may search by the name of a listed company, or alternatively for a notifying shareholder. The database holds information on the number of voting rights held by a notifying party, directly, indirectly (i.e. via attribution) and in total.

<sup>60</sup> [www.bafin.de](http://www.bafin.de) » English Version » Databases » Major Holdings of Voting Rights in Officially Listed Companies.

Figure 34  
Voting rights database

The screenshot shows the BaFin website interface. At the top, there is a search bar with the text 'Suche:' and buttons for 'Start' and 'Hilfe'. Below the search bar, the page title is 'Aktiengesellschaft: MAX MUSTERMANN HOLDING AG (Musterdorf)'. The main content area displays a table with the following data:

BaFin-ID:	Meldepflichtiger	Wohnsitz oder Ort	Stimmrechtsanteil		
			Direkt gehalten (Prozent)	Zurechnung (Prozent)	Gesamt (Prozent)
40006322	MAX MUSTERMANN GmbH	Musterdorf	5,0001		5,0001
61001556	Mustermann, Max	Deutschland		5,0001	5,0001

On the left side of the interface, there are search filters for 'Aktiengesellschaft' and 'Meldepflichtiger'. The 'Aktiengesellschaft' filter includes a search bar, radio buttons for 'von links' and 'mittig', a 'Suche AG' button, and an alphabetical index (A-Z, Sonstige). The 'Meldepflichtiger' filter includes a search bar, radio buttons for 'von links' and 'mittig', a 'Suche MP' button, and an alphabetical index (A-Z, Sonstige). At the bottom of the left sidebar, there is a 'Download Ergebnis' button and a 'Zur Startseite' link. The footer of the page contains the text '© Bundesanstalt für Finanzdienstleistungsaufsicht'.

Voting rights are often taken into account several times, i.e. for several notifying parties. For example, if a GmbH has a direct interest in a listed company, its voting right proportion also appears in the database under the name of the GmbH's majority shareholder as an attributed share. Voting rights that can be exercised exist only once, however. The direct voting rights proportion of the GmbH and the attributed interest of the majority shareholder may not, therefore, be added together. The voting right proportions specified in the database may differ from the actual shareholder structure. For example, if the voting rights proportion of a shareholder changes between two notification thresholds, e.g. within the 50% to 75% band, the change does not appear in the database. The database will be updated only when a threshold is affected and a notification has to be submitted.

Historical notifications cannot be obtained via the database. However, these will be available via the company register in future.<sup>61</sup>

<sup>61</sup> [www.unternehmensregister.de](http://www.unternehmensregister.de).

## 5 Corporate takeovers

In 2006, the increasing number of hostile and competitive takeover bids, such as the takeover of Schering AG by Bayer AG, was a focus of attention of the supervisor and the general public alike. In total, 39 bids were submitted to BaFin. The proportion of foreign bidders rose slightly. In addition to verifying sufficient levels of transparency in corporate takeovers, BaFin ensures the bidding process is concluded quickly and all shareholders are treated equally.

A further important topic for the supervisor was the implementation of the Takeover Directive, and the associated amendments to WpÜG.

### 5.1 Offer procedures

● BaFin approved 37 offer documents.

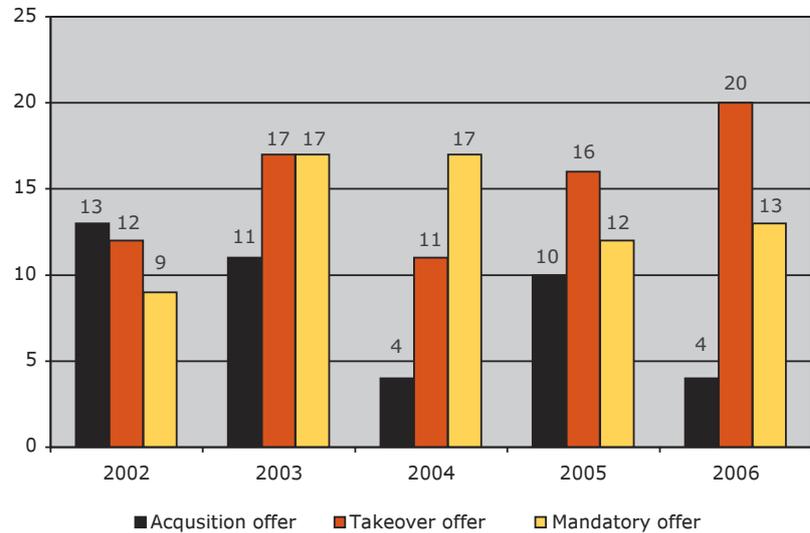
During the year under review, BaFin inspected 39 offers and approved the publication of 37 offer documents (previous year: 38). It prohibited the offer in two cases.

13 were mandatory offers that the bidder is obliged to make when acquiring 30% or more of the voting rights in the target company and thereby gaining control. A further 20 cases involved takeover bids, by which bidders who do not have control of a company attempt to take over. Four bids comprised simple acquisition offers. These are offers where the bidder either wishes to simply acquire shares in the target company, or where the bidder already has control of the company and simply wishes to increase its interest.

The published offer documents can be viewed on the BaFin website.<sup>62</sup>

<sup>62</sup> [www.bafin.de](http://www.bafin.de) »» Datenbanken »» Veröffentlichte Angebote nach § 14 WpÜG (German only).

Figure 35  
**Number of offer procedures**



Share buy-backs no longer a case for WpÜG.

Transaction volumes.

"White knight" competing bidder.

In July 2006, BaFin amended its previous practice and no longer demanded an offer procedure to be performed in accordance with WpÜG in the case of companies buying back their own shares. Whereas there were three public offers to acquire own shares in 2005, no such purchase offers were conducted in 2006.

As in previous years, the transaction volume<sup>63</sup> of most offers was below €100 million. With a volume of €17 billion, the takeover offer made by Bayer AG to the shareholders of Schering AG was the largest ever transaction volume seen since the entry into force of WpÜG. The lowest volume (€1.137 million) was the offer made by VIB Vermögen AG to the shareholders of Bürgerliches Brauhaus Ingolstadt AG.

#### **Takeover offer from Bayer AG to the shareholders of Schering AG**

The general public and the press followed the takeover offer made by Bayer AG (Bayer) to the shareholders of Schering AG (Schering) in April 2006 with particular interest.

Previously, a subsidiary of Merck KGaA (Merck) had announced in March that it wished to make the shareholders of Schering a takeover offer of €77 per share. Schering rejected this offer and found a white knight in Bayer. In general, WpÜG prohibits all actions that may prevent an offer from succeeding. Nevertheless, companies may search for competitive bids to act as a white knight.

<sup>63</sup> The transaction volume is calculated by multiplying the number of shares to be acquired by the bidder with the price per share that the bidder offers as part of the offer procedure. The ancillary transaction costs are then added to this amount.

● Bidder unable to withdraw unilaterally.

Once Bayer had announced it would buy the shares at €86 each, Merck decided not to increase its offer and wished to withdraw from the impending bidding war. However, once a bidder has officially announced a takeover, it must carry through the offer procedure to the end. The procedure can be ended only by BaFin approving or prohibiting the offer document. BaFin thus prohibited the Merck offer on 29 March 2006.

● Agreement between supervisory authorities.

Bayer conducted the offer procedure as a dual offer in accordance with both German and US law, since American Deposit Receipts (ADR), which evidence American Depositary Shares (ADS), were being traded on the New York Stock Exchange. One Schering ADS corresponds to one Schering share. Since the offer had to meet two different legal systems, close cooperation was required between the bidder and the supervisory authorities and between the supervisory authorities.

In cases where an offer has to satisfy the requirements of different legal systems, WpÜG provides bidders with the option to exclude securities holders from a specific country. Exclusion of the US-based Schering shareholders would, however, not be considered by Bayer, since those shareholders owned a significant proportion of the Schering shares (15% to 20%), and Bayer would barely have been able to reach the intended 75% threshold without those holdings.

● Approval in terms of anti-trust law and withdrawal rights.

Problems in taking account of the requirements of the two legal systems arose in particular because the offer was subject to the condition precedent of approval by the anti-trust authorities. Since the offer in US law remained open until approval was issued by the German anti-trust authorities, Bayer would have had to offer US-based shareholders an unconditional right of withdrawal for the duration of the interim period. This would then mean that Bayer would have had to offer all Schering's shareholders the opportunity to withdraw, due to the equality of treatment principle of the WpÜG. Had Schering's shareholders taken advantage of this opportunity, the proportion of Bayer's holding in Schering on expiry of the acceptance period would possibly have fallen below the minimum acceptance threshold of 75%. Under German takeover law, the defining point for the entry into force or expiry of conditions is the end of the acceptance period. Since the minimum acceptance threshold had been met at this point, Bayer would not have been able to cite the non-achievement of the minimum acceptance threshold, had the actual acceptance rate been lower due to subsequent withdrawals of acceptance. For example, the acceptance rate could have fallen below 50%, which would have meant that the economic targets pursued by Bayer in its offer could no longer be achieved. In agreement with BaFin, the SEC (US Securities and Exchange Commission) agreed to release Bayer from the obligation of ceding the right of withdrawal to the shareholders due to the outstanding approval of the offer by the anti-trust authorities. This was the only way Bayer could carry through its offer as planned.

● Takeover offer not for ADS.

A further point of investigation for BaFin was the extent to which the takeover offer had to extend to the ADS in addition to Schering's own shares. Since ADR are traded only in the USA and not in Germany, BaFin could not have verified the price offered for the ADS and could not have approved an offer document that had stated a specific offer price for the ADS. Therefore, in agreement with BaFin, Bayer conducted the takeover offer for all Schering shares including those represented by the ADS, but not for the ADS themselves.

● Increase in competitive and hostile offers.

Following the wrestling match for Schering, a bidding war broke out at the end of 2006 for Techem AG. The corporate bodies of Techem AG rejected an offer published in November 2006 by the Australian Macquarie Group to purchase the company's shares at a price of €44 per share, and found a bidder for a competitive offer in the fund company BC Partners. In a similar fashion to Bayer during the Schering takeover, BA Partners assumed the role of the white knight and offered €52 per share. In response, Macquarie increased its offer to €55 per share. This was the first time a bidder perceived as hostile had prevailed against a white knight. However, the two competitors subsequently joined forces to bid jointly for the Techem shares. Neither of the offers reached the required acceptance threshold and, as a result, failed.

● Defensive measures of the management board (opt out).

German public limited companies have various ways of defending themselves against unwanted attention from bidders.

Even if the target company has not limited its defensive options, it may not, once the decision to submit an offer has been published, undertake any actions without the agreement of a shareholders' meeting to prevent the success of the offer (section 33 WpÜG). Certain defensive measures remain open to the management board, however. In particular, these include the search for a competing bidder to act as a white knight. Moreover, defensive measures agreed with the supervisory board of the target company, or defensive measures for which the shareholders' meeting has given its consent within the past 18 months, may also be undertaken. Furthermore, the management board may undertake all actions that a proper and conscientious managing director of a company unaffected by a takeover offer may undertake.

● Waiver of defensive measures possible with reservations.

If a company's articles of association subject the company to the stricter regime for defensive measures (opt in), the management board and supervisory board of the target company may only undertake actions outside the usual operating sphere of the company if the corresponding decision has already been made and partially implemented before publication of the bidder's decision to submit an offer. In addition, only the shareholders' meeting of the company can empower the management board or supervisory board to undertake defensive measures. The supervisory board no longer has this authority. However, a search for a competing offer is still permitted. In order to ensure the bidder and target company

are equally equipped, the target company may, by resolution of the shareholders' meeting, declare as inapplicable the provisions in the articles that would simplify the takeover if the bidder has corresponding instruments to prevent a takeover (Reservation of Reciprocity, section 33c WpÜG). So far, no target company has availed itself of the opt-in form, and voluntarily restricted its defensive options.

## 5.2 Exemption procedures

● BaFin received over 663 exemption applications.

BaFin received 663 applications for exemption from obligations under section 35 WpÜG, the duty to publish and make a bid to existing shareholders for control of the target company (also sections 36 and 37 WpÜG). In 365 of those cases, holders of voting rights applied for their voting rights not to be taken into account in accordance with section 36 WpÜG. 298 exemption applications were received in accordance with section 37 WpÜG, of which 246 were for a temporary modification of the standard attribution procedure of section 30 (1) sentence 1 no. 1 WpÜG.

76 applications were approved and four were rejected. In 25 cases, applicants withdrew the applications. As at the end of 2006, 558 applications were still pending.

● Internal group restructuring still a major area of activity.

As in previous years, most applications submitted in accordance with section 36 WpÜG (355) related to the acquisition of control due to internal group restructuring. Of these, 322 were for a temporary modification of the standard attribution procedure. Nine applications were related to inheritance and/or family law issues, while one was concerned with a change in legal form.

● Numerous applications for modified attribution.

In total, BaFin received 568 applications relating to the temporarily modified standard attribution procedure in conjunction with the Act implementing the Takeover Directive. According to the wording of this act, voting rights of a subsidiary company would have to be attributed upwards (to the parent company), sideways (to affiliated companies) and downwards (to subsidiaries of the parent or subsidiary company). This would require group-wide attribution of controlling positions, even if no material changes had occurred in holdings or interests, justifying a mandatory offer. In order to meet the formal requirements and avoid committing a breach of the act, many company groups lodged exemption applications. TUG restored the wording of section 30 (1) sentence 1 no. 1 WpÜG to what had been applicable before the introduction of the Act implementing the Takeover Directive. As was the case previously, only subsidiary companies' voting rights are therefore attributed to parent companies. This also applies to cases dating from before the entry into force of the TUG in which BaFin has a restricted interpretation of the attribution procedure in accordance with section 30 (1) sentence 1 no. 1 WpÜG. BaFin anticipates, therefore, that many applications will be withdrawn in 2007.

### ● Exemption of company groups.

In a company group, every company to which voting rights are attributed must submit its own exemption application. The time frame for submitting applications for exemption to section 37 WpÜG is limited, in contrast to submitting those for section 36 WpÜG. Bidders must submit their exemption application before their bid for control or within seven days from this time. The application period starts as soon as the bidder is aware, or should have been aware, according to the circumstances that it had attained control. In the case of exemption applications submitted after the deadline by individual companies in a group, BaFin will not, however, deny this exemption provided at least one company in the group has submitted a justified application on time, thus meeting the deadline for all. Otherwise, denial would mean that companies that had submitted their application for exemption on time, would have to be treated as though they had breached the provisions of the Act. Nevertheless, an application received within the deadline from one company only ensures that the deadline is met by all others in the group provided those other companies are able to demonstrate that the same justification for exemption applies. In such a case, the timely application of one company ensures the deadline is met for all.

## 5.3 Legal decisions on acting in concert

In its judgment of 18 September 2006 in the WMF AG case, the BGH gave its first opinion on acting in concert.<sup>64</sup> Control of a public limited company is not solely held by the shareholder who holds at least 30% of the voting rights directly as owner of the shares. WpÜG also allows voting rights from shares belonging to a third party to be attributed to the bidder. The prerequisite is that the bidder has agreed its behaviour in relation to the target company with the third party – referred to as acting in concert (section 30 (2) WpÜG).

A previous major shareholder of WMF AG had claimed for interest due to an alleged failure to make a mandatory offer (section 38 WpÜG). The BGH suspended the decision of Munich Higher Regional Court, which had affirmed the obligation to make an offer on the basis of acting in concert. According to the BGH, acting in concert applies only if the parties agreed in advance on the exercise of voting rights resulting from shares in the target company. Therefore, the BGH has expressly restricted acting in concert to agreements on the exercise of voting rights arranged in the shareholders' meeting. In the case of arrangements agreed solely within the supervisory board, the BGH ruled that it cannot be assumed that shareholders agree in relation to the target company in accordance with section 30 (2) WpÜG. BaFin, too, has so far never presumed that acting in concert applies solely on the basis of an arrangement within the supervisory board and BaFin takes account of the opinions of the BGH in relation to acting in concert in its administrative practice.

<sup>64</sup> BGH, Judgment of 18 September 2006 (II ZR 137/05), BGHZ 169, pp. 98 – 109.

## 5.4 Fine procedures

- Administrative fines of up to €75,000 imposed.

In 2006, BaFin initiated eight administrative offence proceedings due to potential breaches of WpÜG. 43 cases were still pending from previous years. In eight cases BaFin imposed administrative fines of up to €75,000. In total, 25 cases were dropped, of which 21 were discontinued due to a lack of public interest. 18 cases were still pending as at the end of the reporting period.

- Fine for incorrect disclosure.

In one case, a bidder was too late in submitting notification of its takeover of control of a target company. In addition, the notification had not been disclosed correctly. Previously, the bidder had subscribed to new shares in another listed company, which it sought to transfer before the capital increase was entered into the Commercial Register (Handelsregister). Since the transfer of new shares is not permitted before registration (section 191 of the German Stock Corporation Act – Aktiengesetz), the transfer agreement was ineffective. Consequently, the interest of the bidding company rose to 43.1% in total following the registration of the capital increase on 24 January 2003. Had the transfer been effective, it would have retained only 29.92%, therefore failing to gain control of the target company. BaFin informed the affected company of the invalidity of the transfer agreement, and the resulting acquisition of control on 24 January 2003. Nevertheless, the company disclosed in September 2003 that it had only held the new shares since 27 August 2003, and had therefore gained control of the target company on this date. The bidding company lodged an appeal against the fine imposed by BaFin. Frankfurt Higher Regional Court (Oberlandesgericht – OLG) upheld BaFin's decision for the most part, however, and set the fine for wilfully incorrect disclosure at €75,000.<sup>65</sup> A legal complaint lodged against the decision of the OLG was rejected by the BGH at the request of the Public Prosecutor General in a decision of 31 May 2006.<sup>66</sup>

- Comments of management board and supervisory board within two weeks.

In another case, Frankfurt Higher Regional Court detailed the requirements for comments of the management board and the supervisory board of the target company (section 27 (3) WpÜG).<sup>67</sup> Usually, comments must be issued within a period of two weeks, which must not be exceeded. In simple cases, or cases that are particularly urgent, a shorter time frame would be considered. According to the decision, publication of comments later than two weeks after transmission of the offer document could no longer be described as immediate, and was only justifiable in the case of quite exceptional circumstances and difficulties.

<sup>65</sup> OLG Frankfurt, decision of 30 November 2005 (WpÜG-OWi-1/04), BB 2006, p. 2266.

<sup>66</sup> BGH, decision of 31 May 2006 (2 ARs 78/06), wistra 2006, p. 391.

<sup>67</sup> OLG Frankfurt, decision of 8 December 2006 (WpÜG-OWi-1/05), AG 2006, p. 207.

## 6 Balance sheet control/enforcement

- 1,102 companies subject to balance sheet control.

In a two-tier enforcement procedure, the German Financial Reporting Enforcement Panel (FREP) and BaFin examine the financial statements of companies whose securities are approved for trading in Germany on the official or regulated market. As at the end of 2006, a total of 1,102 companies from 25 countries were subject to balance sheet control. Of these, 867 were German, 170 European (123 from EU Member States) and 65 companies from eight non-European countries. The accounting standards to be examined range from German HGB through IFRS and US GAAP to other national standards.

- Examination of foreign companies.

While examining foreign companies whose securities are approved for trading in Germany, BaFin coordinates its efforts with the responsible enforcement panel of the home country. In 2006, it did so with Austria, Ireland, Jersey, the Netherlands, Switzerland and the United Kingdom. Moreover, bilateral meetings were held with the responsible supervisors from the Netherlands and Switzerland.

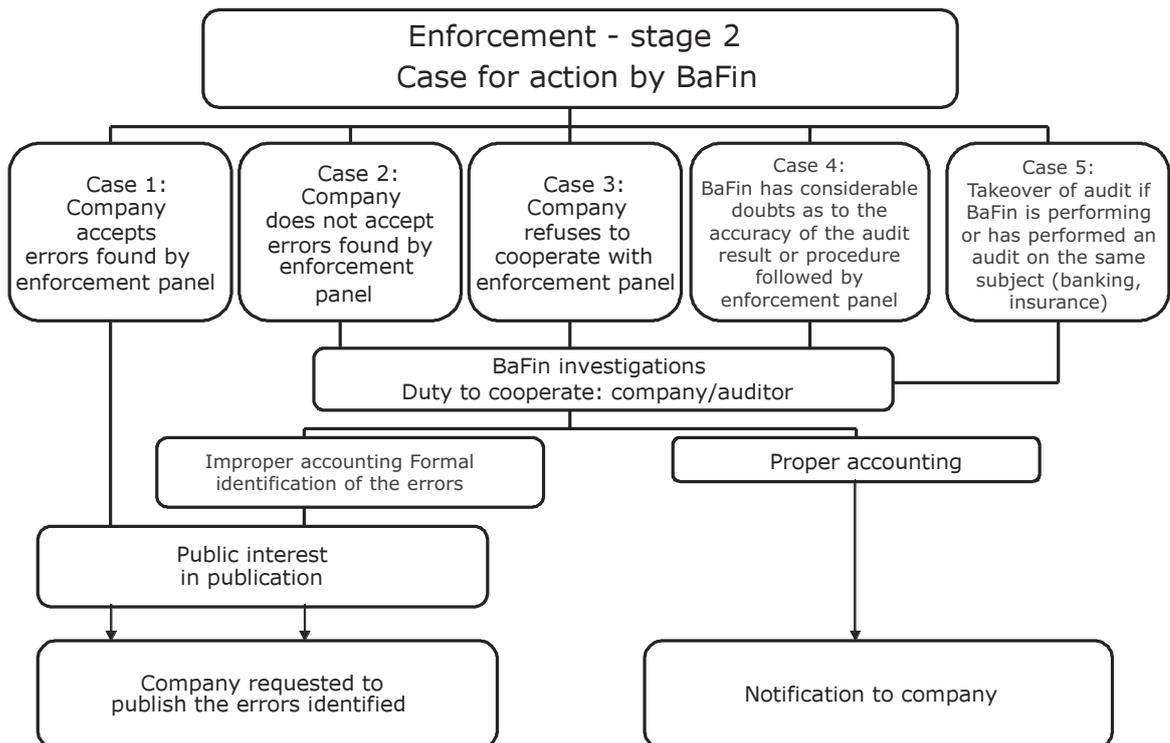
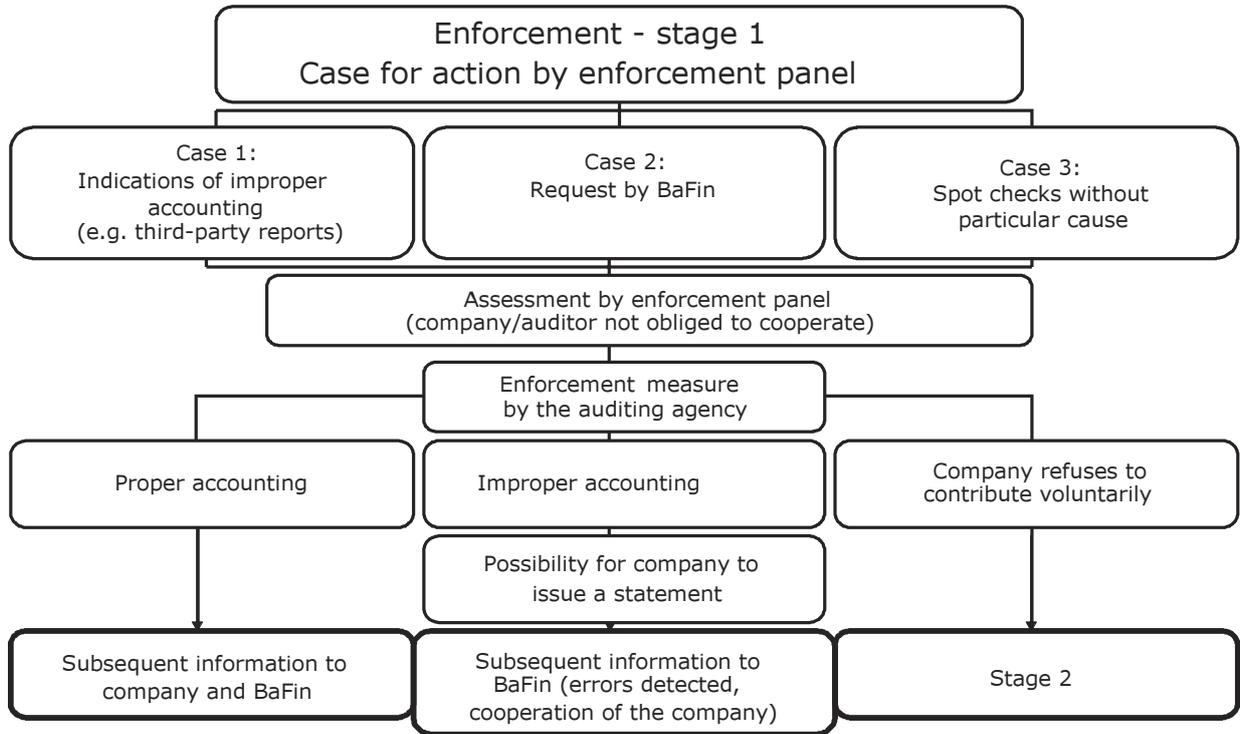
BaFin has published a list of the companies subject to enforcement on its website.<sup>68</sup>

Table 26  
**Enforcement by country**

Germany	867
Netherlands	49
United States of America	35
Jersey	29
Austria	23
United Kingdom	16
Switzerland	13
Japan	10
France	9
Luxembourg	9
Israel	8
Ireland	6
Canada	4
Cayman Islands	4
Italy	4
Spain	4
Brazil	2
Finland	2
Norway	2
Australia	1
Gibraltar	1
Guernsey	1
Iceland	1
Latvia	1
South Africa	1
<b>Total</b>	<b>1,102</b>

<sup>68</sup> www.bafin.de » English Version » Databases » List of companies to be inspected in accordance with the enforcement process.

Figure 36  
Enforcement process



158 examinations initiated in 2006.

The DPR initiated 21 extraordinary examinations, of which two were carried out at BaFin's request. It also began a further 137 random examinations. Eleven extraordinary examinations and 98 random audits were completed.<sup>69</sup>

DPR found errors in 19 cases. Of these, 15 cases were referred to BaFin during the reporting year. The remaining cases were handed over at the start of 2007. Nine of the affected companies have accepted the errors detected. In relation to these, BaFin ordered that five cases be disclosed in the reporting year and four cases disclose their errors at the start of 2007. Six issuers expressed their disagreement with the errors found. In these cases, BaFin commissioned a second-stage balance sheet examination of the disputed points. One of the six cases where companies disputed the errors found has been concluded. The affected company disclosed the error that was also found in the second-stage examination at the start of 2007. In one case, an affected company appealed to Frankfurt Higher Regional Court in relation to the order from BaFin to disclose the error, and applied for provisional legal protection.

Companies must disclose errors found.

The errors found often involved the reporting of equity capital, information in the notes and management reports and the accounting for deferred taxes and goodwill.

When DPR or BaFin detect an error, the affected company must inform the capital market immediately. Along with the error, the company must also disclose the reason for its discovery. BaFin does not order disclosure of an error if there is no public interest in the information. It may also exempt a company from its disclosure requirement on request, if announcement of the error could damage the justified interests of the company. For instance, if the company is in the middle of ongoing restructuring negotiations, disclosure may be postponed until the negotiations have been completed. In such cases, BaFin must weigh up the interests of the company in secrecy against the interests of the capital market for information. If the company's interests are more important, BaFin will exempt the company from its disclosure obligation. This occurred once during the reporting year.

Accounting errors also material for share price.

In addition to disclosure in accordance with section 37q (2) WpHG, errors discovered in the accounting can also oblige the affected company to publish an ad hoc disclosure. This is the case when the error discovered may have a material effect on the company's listed price. The first ordered disclosures have demonstrated that companies are still unsure as to how to deal with the two disclosure obligations. While the ad hoc disclosure is restricted to purely insider information, the disclosure made in relation to enforcement must also contain information on the accounting standard breached and the material parts of the reason for the error being discovered.

<sup>69</sup> Source: DPR.

 Fines.

In 2006, one company was too late in disclosing the discovery of an error. In this case, BaFin initiated administrative offence proceedings. Late error disclosures may be penalised with a fine of up to €50,000.





## VIII Cross-sectoral responsibilities

### 1 Combating money laundering

#### 1.1 International anti-money laundering measures

During the year under review, BaFin worked on the practical implementation of standards to prevent money laundering and the financing of terrorist activities, as updated and revised by the Financial Action Task Force on Money Laundering (FATF) and the EU in 2005.



● Typology report on new payment methods.

In 2006, FATF, with BaFin's involvement, prepared a typology report on new payment methods. The report provides an overview of the individual payment categories and an explanation on how they work and the risks they represent in terms of money laundering. A common feature of the new payment methods is their use of the latest technological advances. For example, there has been a massive rise in the past few years in the numbers of payments being made via the Internet, using chip cards and with mobile telephones. These new forms of payment have now been established around the world. Investigative agencies have discovered they are increasingly being used for money laundering.

● BaFin intensifies country evaluations.

BaFin stepped up its involvement in the mutual evaluation reports conducted by FATF on individual countries. BaFin sent one investigator each to work as a financial expert on the mutual evaluations of China and Portugal. These evaluations force the countries concerned to comply with international standards and to work continuously on improving their prevention systems.

● New rules on politically exposed persons and simplified know-your-customer requirements.

In the middle of 2006, the first implementing directive of the EU Money Laundering Directive entered into force.<sup>70</sup> It contains important interpretative tools for dealing with politically exposed persons and the simplified know-your-customer obligations, especially in the banking sector. The Money Laundering Directive specifies organisational measures and know-your-customer obligations, which credit institutions, financial service providers and certain forms of insurer in particular have to meet and uphold in taking into account risk-oriented principles, in order to prevent money laundering and the financing of terrorist activities.

● National implementation of the Third Money Laundering Directive.

The consequence of the imminent implementation of the EU Money Laundering Directive and the first implementing directive will be a complete overhaul of money laundering legislation in Germany and the money-laundering provisions of KWG and VAG. BaFin is

<sup>70</sup> BaFin 2005 Annual Report, p. 181.

cooperating closely on the current implementation efforts. The objective is to transpose the directive consistently into German law on a 1:1 basis, while making maximum use of the options provided for in the directive in order to simplify the requirements for the financial sector wherever possible. In the run-up to implementation, BaFin has intensified its efforts at external events in order to inform the financial sector of the rules with which it can be expected to comply in order to prepare it in the best way possible for the future requirements resulting from the directives.

● EU payments regulation adopted.

At the end of 2006, the EU adopted the Regulation on information on the payer accompanying transfers of funds. The regulation sets the requirements for identification, verification and forwarding of payer information for cross-border money transfers. The purpose of the regulation is to ensure money transfers are wholly traceable. It implements a special recommendation of FATF in the Member States of the EU. Section 25b KWG will be expanded to include additional rules, particularly in relation to responsibilities.

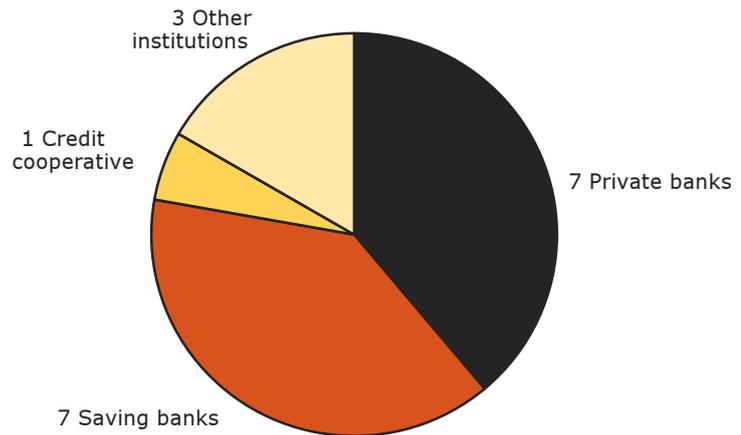
● EU committees formed task force.

The EU committees CEBS, CESR and CEIOPS joined forces in 2006 to create the Anti-Money Laundering Task Force (AMLTF). The Task Force is concerned with practical issues relating to the application of EU money-laundering rules by supervisory authorities. Particularly as all responsibilities relating to the fight against money laundering lie with the supervisory authority, BaFin will be able to provide comprehensive support in this form.

## 1.2 Anti-money laundering measures at banks, insurance companies and financial services institutions

During the year under review, BaFin conducted 18 special audits (previous year: 23) to investigate whether credit institutions were complying with the rules on preventing money laundering. As in previous cases, the audits revealed the need for improvement in analysing risks, as well as in fine-tuning IT-supported anti-money laundering systems and group-wide implementation of money laundering rules. Overall, the institutions experienced difficulties in implementing anti-money laundering measures in a way that reflected the level of risk involved. BaFin issued two Chief Executives with a warning for serious breaches in relation to the prevention of money laundering.

Figure 37

**Distribution of special audits in 2006 by groups of institutions**

BaFin conducted six supervisory visits and one special audit of financial services providers. Above all, the supervisory visits of institutions in their first year of existence have proven an effective tool in counteracting deficits in money-laundering prevention procedures at the earliest possible stage. BaFin conducted on-site investigations of two life insurers.

● Optimisation of IT research systems.

It is gratifying to note that IT-based systems used for combating money laundering and the financing of terrorist activities are gradually gaining almost blanket coverage in the credit sector. The systems must be updated constantly in order to keep pace with the latest developments. The focus in the year under review was on fine-tuning and adjusting the systems to focus the search on truly unusual and suspicious cases. In practical usage, the systems have demonstrated deficiencies, resulting primarily from risk analysis. Where companies do not accurately record their business activities and customer structures, and do not evaluate this information according to risk, the findings of the IT-based research are frequently inadequate.

● Prosecuting underground banking.

In the year under review, BaFin launched 141 new proceedings due to unauthorised financial transfers, foreign currency and credit card transactions.

The fall from the previous year's figure of 215 was significant, since BaFin decided not to start new administrative proceedings against known financial agents. Financial agents are recruited by fraudsters using computers. The agents make their accounts available for fraudulent transfers and use wire transfers to forward the money they receive.<sup>71</sup> The financial agents are usually

<sup>71</sup> BaFin 2005 Annual Report, p. 185.

identified immediately by the investigating authorities as tools of the hidden fraudsters who work via the Internet. Financial agents usually cease all further transactions immediately, given the claims raised against them and the criminal investigative proceedings. There is, therefore, no need for BaFin to initiate a ban on further transactions.

Despite widespread warnings on the Internet, many naive people are still succumbing to the mass advertising conducted by fraudsters via spam e-mail. Around 1,000 cases were reported to BaFin in 2006. Financial agents transferred over €2.5 million to countries of the former CIS. In handing down convictions for money laundering and the unauthorised operation of financial services, the criminal courts have not allowed financial agents to use naivety as a defence. It must be clear to those acting as a financial agent that any transaction involving such a disproportionate ratio of work to revenue is highly dubious and that money transfer operations clearly may not be operated by one and all.

## 2 Account access procedure

Account access procedure secures the integrity of Germany as a financial centre.

The automated access to account information in accordance with section 24c KWG has proved an effective tool in securing the integrity of Germany as a financial centre.<sup>72</sup> Investigators use the procedure above all to uncover serious criminal acts such as fraud, money laundering, offences under the Drug Law (Betäubungsmittelgesetz – BtMG), tax offences and corruption. Moreover, the accounts of persons accused by the Public Prosecutor of involvement in the failed suitcase bomb attacks on regional trains in Dortmund and Koblenz were investigated. On receipt of the information, BaFin blocked access to the accounts in accordance with section 6a (1) KWG. Moreover, BaFin also accessed data, particularly in conjunction with the prosecution of unauthorised banking or financial services transactions.

Section 24c KWG allows BaFin to use central research facilities to combat the financing of terrorist acts, money laundering and the unauthorised operation of banking and financial services more effectively. Credit institutions must store the account/securities account number, date it was opened and closed, name and date of birth of the account holders and any other persons authorised to dispose of the account, and the names and addresses of the beneficial owners. Account balances and transactions are not recorded. BaFin primarily provides information from these files to criminal investigation authorities.

BaFin processed 81,000 requests.

In 2006, BaFin processed approximately 81,000 requests for information (previous year: around 62,000) and provided

<sup>72</sup> BaFin 2005 Annual Report, p. 185

information on approximately 665,000 accounts (previous year: around 485,000). As in the previous year, most of the requests were made by the various criminal prosecuting authorities: public prosecutor's offices, the audit bureaus of the tax authorities, the customs investigation offices and the police. The police alone directed some 48,000 requests to BaFin (previous year: 39,000). BaFin submitted around 1,000 requests in the year under review (previous year: around 600).

Table 27

**Authorised agencies in 2006**

Authorised agency	2006		2005	
	absolute	in %	absolute	in %
BaFin	972	1.2	632	1.0
Police authorities	47,805	58.9	38,675	62.0
Tax authorities*	11,838	14.6	10,008	16.0
Prosecution authorities	12,861	15.8	7,494	12.0
Custom authorities*	7,202	8.9	5,160	8.3
Others	478	0.6	441	0.7
Total	81,156	100	62,410	100.0

\* The tax and customs authorities are only authorised to have BaFin perform account enquiries in accordance with section 24c KWG with respect to criminal proceedings.

Positive response from investigating agencies.

During the year under review, BaFin conducted a survey of the agencies authorised to access account information. In total, 95% of those who responded judged the quality of the account information they received to be good or better. According to information from the investigating agencies, the account access procedure enabled them to secure assets amounting to around €68.5 million, and in many cases provided evidence for further investigations, in 2005.

### 3 Licensing requirements and prosecution of unauthorised transactions

Nowadays, investors can select from a range of products with which, it is claimed, they can prepare for old age, build their assets or save tax. Often, these products are supplied by companies that are not supervised by BaFin. The contracts, which are marketed via websites, the print media and sales personnel, are usually difficult for investors to understand. BaFin verifies these investment offers and their status in regard to whether they require authorisation according to KWG and VAG, in order to protect consumers and the position of Germany as a financial centre.

### 3.1 Assessment of authorisation requirements

BaFin offers providers the opportunity to have their projects assessed for possible authorisation requirements, even before they begin to operate. This enables providers to be sure their intended activity complies with supervisory legislation. If there is a requirement for authorisation, those responsible cannot start their business operations until they have received written authorisation from BaFin. Providers who start trading without gaining authorisation will be subject to supervisory proceedings, but also to criminal proceedings, since unauthorised banking, insurance and financial services operations are a punishable offence according to KWG and VAG.

In the past year, BaFin inspected 443 inquiries about authorisation requirements for planned business projects (previous year: 371). Of these, 421 inquiries related to KWG (previous year: 325) while 22 were concerned with VAG (previous year: 46).

● Internet platforms to find private lenders.

A number of authorisation requests are currently with BaFin regarding planned business activities in which loans are arranged via an Internet platform, between non-licensed money lenders and people looking for capital. The models for these so-called peer-to-peer lending models (P2P lending) are Internet platforms that have been in operation for some years in the UK and the USA.

While no banking permit is normally required simply for arranging loans, the operators of the platform must ensure it is not used for operating unauthorised banking transactions. Therefore, BaFin must verify whether the users of the platform would be subject to any banking supervisory authorisation requirement in terms of their commitment. This would be the case if the users were operating a commercial banking business, or dealing at a level that requires a commercial structure. Possible banking transactions in this instance comprise, in particular, the lending business on the side of the lender and the deposits business on the side of the borrower.

● Deposits business in relation to three-party relationships.

BaFin has recently become aware of investment offerings in which investors can acquire an apparent profit-and-loss-dependent interest in a company – the investment company. A legal entity independent of the investment company acts as a guarantor, promising unconditional repayment of the money accepted by the investment company. The de facto effect of this structure is to exclude the investor's putative loss share in relation to the capital paid in. However, it could be assumed, in the individual case, that this is a single capital investment offering, provided the guarantor's promise to make unconditional repayment is to be attributed to the investment company. In such a case, the investment company would be operating a form of deposit business requiring authorisation, by dint of accepting the invested money.

● Arrangement of financial spread bets requires authorisation.

For some time, the market has been offering a new product in financial betting. The product type enables investors to profit from price fluctuations in shares. An especially common form of betting

on the financial markets is the financial spread bet. The bookmaker first defines a spread, for example 136-137. The higher value applies when purchasing a bet, the lower upon sale. If the spread is based on a share price, the investor making the bet must speculate as to whether the price of the share will rise or fall. If the share price rises, the bookmaker's spread price will also rise, for example to 156-157. Those placing bets can limit their loss risk by setting stop-loss marks that trigger an automatic buy or sell order as soon as the value exceeds or falls below the spread.

BaFin's investigations showed that the arrangement of such financial spread bets is subject to authorisation as investment broking according to KWG. The definition of investment broking requires that financial instruments are brokered. A financial spread bet is a futures transaction, the price of which is linked directly (in the case of share price bets) or indirectly (in the case of index bets) to the stock-exchange or market price of a security. Futures transactions are derivatives, and are therefore considered financial instruments for the purposes of KWG. This finding is also supported by the new Markets in Financial Instruments Directive (MiFID). The directive also defines financial transactions that take advantage of price differences as financial instruments.

#### **Authorisation requirement for referral brokers**

Anyone who makes a recommendation to an investor to buy specific financial instruments and nominates a seller is exercising a form of investment broking known as referral broking. According to KWG, this is a financial service that may only be provided commercially with the corresponding authorisation issued by BaFin. However, BaFin will only issue such authorisation to persons it considers technically and personally suitable and, moreover, that it will subject to continuing supervision. In this way, BaFin can counteract the risk of investors being directed by means of unprofessional methods to purchase certain, possibly extremely risky or overpriced financial instruments.

In 2006, Hesse Administrative High Court (VGH Hessen) found in two provisional legal protection cases that the definition of referral broking as a form of investment broking was in contravention of EU law, and declared that this rule may not be applied by either BaFin or German courts.<sup>73</sup> According to the opinion of VGH Hessen, notification broking is not covered by the Investment Service Directive, during the transposition of which the provision was added to KWG. According to the court, while German policymakers were entitled to go beyond the provisions of the Directive, case law established by the European Court of Justice (ECJ) demands that such a measure must be expressly clarified. If the legal opinion of VGH Hessen were to prevail, the initial consequence would be that anyone would be able to act as a broker of financial instruments without requiring authorisation from BaFin.

In BaFin's opinion, the clarification obligations that VGH Hessen has assumed in its decisions cannot be found in either European

<sup>73</sup> Ref.: 6 TG 985/05 and 6 TG 2789/05.

law or in the case law of the ECJ. This is all the more valid in this instance, as the Directive does not specify unambiguously how it is to be transposed. BaFin is striving to clarify these legal points in various principal proceedings that are currently underway. Until the issues are decided, it remains steadfast in its opinion that the ruling of KWG conforms to European law, and that notification brokering services provided in relation to financial instruments represent a financial service subject to authorisation requirements.

### 3.2 Exemptions

● Exemption from supervision.

BaFin may exempt a company from specific provisions, above all from the authorisation requirement, if the supervisor is of the opinion that the company's form of business does not require supervision (section 2 (4) KWG). Typically, these are the types of business that a company operates as an ancillary line or sideline, or that are associated by necessity with a business activity that is in itself exempt from authorisation. In 2006, BaFin issued exemptions to 20 companies (previous year: 38); 12 further applications had been submitted to the supervisor as at the end of the year. This means that as at the end of 2006, a total of 263 institutions were exempted from the authorisation requirement.

In 2006, there was also an increase in the number of exempted foreign providers who provide cross-border services in Germany. Companies from third countries outside the EU may request exemption from the authorisation requirement if they are subject to an equivalent level of supervision in their home country. During the past year, BaFin exempted a total of nine institutions from Switzerland, the USA, Canada and Australia.

BaFin is also entitled to exempt companies that exclusively operate an e-money business (section 2 (5) KWG). As at the end of 2006, four companies were exempted on this basis, and one other application had been submitted to BaFin.

### 3.3 Black capital market

Consistent action to combat the black capital market helps to uphold the integrity of Germany's position as a finance centre. The phrase black capital market covers banking, insurance and financial services transactions conducted without the required authorisation according to KWG or VAG. Together with the Bundesbank, BaFin pursues a strategy of combating this business. BaFin has a range of far-reaching powers of investigation and intervention at its disposal. It can inspect suspicious companies on site, search their offices and seize documents. If the suspicion of unauthorised activity is proven, BaFin can prohibit business operations and order them to be wound up. This situation enables BaFin to protect investors, too, who ultimately must bear the direct consequences of unauthorised trading.

### Supervisory and investigative measures

During 2006, BaFin started 622 new investigative proceedings (previous year: 662). Most of these related to unauthorised banking and financial services operations. In the insurance sector, BaFin investigated just 43 cases of unauthorised insurance operations (previous year: 24). The focus here was rather on assessing authorisation requirements. In the year under review, BaFin made approaches to suspicious companies in relation to 87 cases with a formal request for information and presentation of documents (previous year: 100), and imposed 30 penalty fines (previous year: 41). It carried out 26 on-site inspections and searches (previous year: 12).

Formal measures the last resort.

In many cases, providers cease unauthorised operations on a voluntary basis once BaFin has informed them of the authorisation requirement. BaFin intervenes formally against the provider only in cases where this does not happen. During the reporting year, the supervisor intervened with 24 prohibition orders (previous year: 22) while winding-up orders, at 22, remained at the same level as the previous year. In 15 cases, the supervisor appointed a liquidator. BaFin may also take proceedings against companies and individuals party to the intention to conclude or process unauthorised transactions. These do not only include companies that willingly participate in the unauthorised investment plans, for example in the role of money collection point. BaFin may also enforce measures against companies that are unwittingly involved in unauthorised business, for instance taking recourse to their regular services. During the year under review, BaFin issued instructions to two involved companies.

Legal redress against the measures imposed by BaFin.

Individuals or companies against which BaFin had imposed formal sanctions or measures appealed in 84 cases during the year under review (previous year: 146). In the same period, BaFin concluded 133 appeal procedures, 37 of which were handled by means of a ruling on the objection. In 34 cases, BaFin rejected the appeal in full, while 3 appeals were only partially repudiated.

Often those affected by measures imposed by BaFin also took legal action. Out of 122 disputes that came before the courts (previous year: 152), a decision was reached in 52 cases in 2006, of which 47 were settled in favour of BaFin. In five cases, the courts upheld the legal redress of the affected parties.

One further case had been pending since 2004, since Frankfurt am Main Administrative Court (VG Frankfurt) had submitted questions of European law to the ECJ for a preliminary ruling. The submission was particularly concerned with the question of whether a company based outside the EU may have recourse to the right to free movement of capital for the purposes of the commercial award of loans to residents of an EU Member State, or whether such financial services are subject solely to the freedom to provide services. The freedom of capital movement is the only basic freedom to which companies from third countries outside the EU also have recourse. In its decision, the ECJ clarified, however, that

banking supervisory authorisation requirements and location requirements for such a company relate primarily to the freedom to provide services.<sup>74</sup> The ECJ decided, therefore, that the national provisions of KWG, as specified by BaFin, do not contravene European law. This decision strengthens BaFin's position in the case which is now continuing before Frankfurt Administrative Court, and on which a decision has still to be reached.

## 4 Consumer complaints

● Number of complaints from consumers rose slightly to 22,520.

In total, 22,520 customers of insurers, credit and financial services institutions complained to BaFin in 2006. This figure is around 1.6% above the previous year's total of 22,165.

The supervisor investigates each complaint and verifies whether a company has breached its codes of conduct and whether measures should be taken under supervisory legislation. It helps individual consumers as far as possible, for example by persuading the company to rectify a fault, or explaining the legal situation in layman's language. However, BaFin operates solely in the public interest. It cannot act in the private legal interests of individual complainants.

To protect themselves against fraud, unprofessional products or the total loss of their capital, investors should closely analyse the professionalism and economic plausibility of the offerings in which they are interested. There is, unfortunately, no secure protection against insolvency and criminal acts.

### Consumer helpdesk

Since March 2006, BaFin has been providing a new service, the BaFin Consumer Helpdesk. By calling 01805 122 346 between 8 a.m. and 6 p.m., Monday to Friday, consumers can have their questions answered by trained staff. The helpdesk staff provide information on the supervisor, the complaints procedure and the status of ongoing complaints. They also supply information on company authorisations.

As at the end of 2006, the BaFin Consumer Helpdesk had received around 22,300 calls. More than half of all calls related to the insurance sector, while the banking and savings bank sectors contributed around 25%. Ten per cent of calls related to investment supervision.

The BaFin Consumer Helpdesk is prepared for sudden floods of calls. For example, in the first eight days following the closure of Privatbank Reithinger in August 2006, between 80 and 130 consumers called BaFin each day solely to ask for advice on this topic. Each caller received information promptly.

<sup>74</sup> ECJ, C – 452/04.

The initial statistical assessments show that, as awareness of the Consumer Helpdesk grows, an increasing number of citizens are using the new service. More than 90% of callers are satisfied with the new service provided by BaFin.

#### 4.1 Complaints relating to credit institutions and financial services institutions

3,451 citizens complained to BaFin about credit and financial services institutions in 2006. In addition, BaFin submitted official positions on 48 complaints made to the Petition Committee of the German Bundestag, and members of the public also made 451 general non-complaint enquiries. A total of 573 complaints, eight of which were part of a petition, were successful; while 295 complaints, including three petitions, were partially successful.

##### Selected cases

● Sale of loans basically permitted.

During the year under review, BaFin received significantly more complaints and inquiries relating to the sale of loans by credit institutions. In assigning the loan, the loan receivable and all claims therein against the customer are transferred to another credit institution or company, which does not have a banking permit. Many citizens have queried whether such sales of receivables without the agreement of the borrower are legally permissible, and what the effect of the assignment of the loan receivable is on the individual loan agreement. At the start of 2007, BGH decided that the assignment of a loan receivable by a credit institution was effective.<sup>75</sup> Neither banking secrecy nor the Federal Data Protection Act prevents effective assignment, according to the Court. Breach of these rules could, however, lead to claims for damages by the customers against the bank. As it turned out, none of the complaints involved actual disadvantages suffered by a customer. BaFin has published information on the sale of loans on its website.

● Old savings books – what are they worth?

A common query made by citizens to BaFin relates to old savings books found during house moves or in the inherited belongings of relatives. If the deposit is denominated in deutschmarks, there may be a case for a claim for withdrawal against the bank or its legal successor. There is no basis for a claim on savings books denominated in reichsmarks or old East German marks. The deadlines by which such deposits could be converted have now expired.

● Information on investment decisions.

Citizens often ask whether they can entrust their savings to a specific company. BaFin is able to provide information on whether a company has corresponding authorisation, what deposit guarantee schemes it belongs to and the extent to which deposits are protected according to the scheme's articles of association. BaFin cannot make any statement relating to the reputation of a supervised company.

<sup>75</sup> Ref.: XI ZR 195/05.

● Credit institutions have taken account for everyone recommendations on board.

During the reporting year, significantly fewer citizens complained about credit institutions that had terminated a private individual's current account or refused to open an account. The complaints procedure has shown that the credit institutions are largely following the recommendations of the Central Credit Committee in relation to the account for everyone concept (Konto für Jedermann). With a number of complaints, BaFin managed to persuade the credit institution to keep the account open, or to open a new account if it emerged there were no grounds for mandatory termination or account refusal.

● Phishing risks in online banking.

The number of reports relating to phishing also fell notably. Phishing is the extraction of secret account information using forged e-mail messages. No bank customers claimed to have suffered actual damage from phishing messages. There were no complaints received about other forms of electronic attack, such as pharming.

Despite all their security measures, credit institutions cannot avoid every conceivable form of trickery or fraud on the Internet. It is, therefore, even more important for customers to take note of security information. Bank customers can find such information on the banks' own webpages, and on the websites of banking associations, the Federal Office for Information Security and BaFin.

● Bank transfers processed speedily.

Complaints about the amount of time it took to effect a bank transfer were unfounded, almost without exception. The instructions were carried out by the credit institutions within the statutory deadlines. Investigation of the complaints also demonstrated that institutions did not delay bank transfers and did not select methods that automatically entailed longer transfer periods. For the first time in several years, however, a complaint about the time taken for a transfer was upheld. The bank had processed the instructions incorrectly, and the transfer took four working days instead of three.

## 4.2 Complaints relating to insurance undertakings

Most complaints handled by BaFin in 2006 once again involved the insurance sector. A total of 17,675 complaints were submitted, compared with 17,531 in 2005. These comprised 15,225 (previous year: 15,716) complaints, 846 (previous year: 773) general inquiries not based on a complaint and 102 (previous year: 114) petitions received by BaFin via the Bundestag or the BMF. In addition, there were 1,502 inquiries in which BaFin was not the competent authority.

Overall, 23.9% of proceedings had a favourable outcome for the complainant (previous year: 25.2%). 67.6% of complaints were unfounded, and in 8.5% of cases BaFin was not the competent authority.

Table 28

**Complaints received by insurance class**

Year	Life	Motor vehicle	Health	Accident	Liability	Legal expenses	Building Household	Other classes**	Other complaints**
2006	6,243	1,923	2,201	1,119	1,251	1,280	1,535	621*	1,502*
2005	5,858	1,896	2,604	1,242	1,268	1,437	1,408	359*	1,459*
2004	8,119	2,518	4,162	1,413	1,577	1,474	1,824	518*	1,504*
2003	5,548	2,758	3,408	1,416	1,565	1,300	1,948	467*	1,368*
2002	5,504	3,151	2,765	1,770	1,671	1,499	1,600		

\* No comparative figures available for prior year due to statistical changeover.

\*\* Incorrect address, brokers, etc.

The largest proportion of complaints (31.2% as against 29.8% in 2005) related to the handling of insurance policies. This was followed by complaints about claims settlement in life and non-life insurance at 29.1% (previous year: 29.6%), contract termination at 17.4% (previous year: 18.2%) and business conduct when negotiating contracts at 9.2% (previous year: 10.9%). In addition, 12.6% fell into the other category (previous year: 11.5%). Specific provisions of the law relating to proof of age contributed to 0.6% of the complaints.

The main grounds for complaint are shown in the following table.

Table 29

**Grounds for complaint**

Grounds	Number
Amount of insurance payment	1,702
Coverage issues	1,544
Surplus bonus/ profit credit	1,473
Advertising/advice/ application processing	1,257
Manner of claims processing/delays	1,218
Change to contract, extension	1,169
Proper termination	1,053
Improper termination	1,051
Acquisition costs, life insurance	910
Other (contract handling)	873

**Selected cases**

During the year under review, BaFin once again received a number of complaints with regard to surrender values and bonuses in the life insurance sector. A significant portion of these were related to the question of whether the insurance undertakings have to comply with BGH case law regarding non-transparent terms and conditions of insurance. BGH was of the opinion that termination and waiver of premium with regard to capital-forming life insurance infringed the rights of customers.<sup>76</sup>

The BGH case law in this instance applies only to policies taken out between the end of July 1994 and the middle of 2001. BaFin is unable to help with policies taken out before this period. The same applies if the insurer invokes a time-related limitation of liability. Since the question of such a time limit has not yet been clarified in the highest court, companies can currently invoke this principle without being accused of causing a nuisance.

<sup>76</sup> BaFin 2005 Annual Report, p. 91.

 BaFin monitored settlement behaviour of life insurers.

The complaints procedure has shown that the majority of life insurers are adhering to the BGH decisions. In contrast, some mutual societies (Versicherungsverein auf Gegenseitigkeit – VvaG) are rejecting this application on the basis of their legal form, and are of the opinion that mutual societies are not affected by these judgements. They are currently in the process of having the BGH clarify whether or not this opinion is correct.

● Publication of actuarial calculations.

Some insurance policyholders have also invoked BGH case law in demanding that life insurers publish their actuarial calculations. The judgements of the courts have, however, not changed the applicable legal position. These calculation bases are still classified as confidential internal company secrets. Therefore, BaFin's statutory obligation of confidentiality means that it may not provide customers with these documents without the agreement of the insurer.

● No unauthorised unequal treatment in relation to surplus bonuses.

Another frequent complaint from policyholders is in relation to unequal treatment in the declaration of surplus bonuses. One policyholder complained, for example, that the insurer did not plan to pay surplus bonuses on his pension insurance contract in 2006. However, the insurer had declared a bonus of 0.5% on newly agreed contracts. After investigating the complaint it was found that there was no inequality in treatment. The new contracts were based on a different tariff with up-to-date mortality tables, which proposed a lower guaranteed pension.

● BaFin ensures insurers comply with contractual obligations.

Customers frequently complained that insurers did not comply with their contractual obligations, or did not meet these sufficiently. For example, in one case the policy documents provided by the insurer to the customer gave the customer the option of requesting a life-long life annuity or a widow(er)'s pension instead of the insurance sum. When the customer exercised this option, the insurer offered a pension calculated on the basis of the data applicable in 2005 (interest and mortality tables). That did not, however, comply with the provisions of the policy. These stipulated that the calculation base applicable at the time of taking out the policy (1965) should be used. BaFin insisted that the insurer should also apply its own contractual rules. As a result, the customer now receives a significantly higher monthly pension.

● No double insurance in relation to private and statutory obligatory nursing insurance.

During the year under review, an insurance policyholder contacted BaFin since her private health insurer had refused to retroactively cancel a case of duplicate insurance. The customer had only just realised that since the introduction of obligatory nursing insurance she had been insured in both the statutory and private obligatory nursing insurance schemes. A statement from the insurer proved that it had become aware of the policyholder's membership of the statutory health insurance scheme on the occasion of a change in her collective wage agreement. Once it was proven to the insurer that the membership of the statutory health insurance was already in place at the time of introduction of the obligatory nursing insurance in 1995, the insurer cancelled the private obligatory nursing insurance policy retroactively from the beginning and repaid premiums with interest.

Companies must verify whether nursing requirements have changed objectively.

A customer complained because an insurer refused to pay a grant from the private obligatory nursing insurance scheme for his 13-year old disabled daughter who was in need of care. The father had applied for a grant for the installation of an external lifting platform adjacent to the door into the house. The company's reason for the rejection was that it had already paid a subsidy for measures to improve the child's living space seven years ago. At that time, it was apparently already obvious that a stairlift would be necessary when the child was larger and heavier. A subsidy would be considered for a new measure only if the care situation had changed objectively. After reconsidering the case, the insurer admitted that seven years ago the child's change in health and future care requirements could not be forecast, and paid the subsidy at the agreed rate.

No noteworthy events in property and casualty insurance.

The complaints in the area of property and casualty insurance did not raise any notable cases during the reporting year. Insurers who rejected the claims of their customers were the main cause of complaint.

The following is an example case from the world of private liability insurance: While leaving her tax advisor's offices, a client walked into a glass door separating the reception area from the main corridor. She suffered concussion, and her spectacles were damaged. The client lodged a claim for damages against her tax advisor. She claimed that the door bore no markings of any sort and could not be seen, and thus represented a source of danger. Moreover, the door had otherwise always remained open. The tax advisor's private liability insurer rejected the claim for damages. It argued that the client must have known about the presence of the glass door from her previous visits. Moreover, the glass was tinted and therefore easy to see. To clarify its position, the insurer submitted photographs. However, on the photographs the door could only be recognised on close inspection by the door handle. Despite the tinted glass, the door was not obviously visible against the light paint that had been used in the corridor beyond. When BaFin informed the insurer of this situation, it offered the client a damages settlement of €2,000, which she accepted.

### 4.3 Complaints relating to securities business

With each complaint it receives, BaFin verifies whether measures should be taken under supervisory legislation. During the year under review, 669 written customer complaints about credit institutions and financial services institutions were received in relation to investment operations (previous year: 589). This represented an increase in the number of complaints in comparison with the previous year. In addition to numerous telephone calls, BaFin also answered 226 written inquiries on securities trading.

#### Selected cases

More frequently than in previous years, customers complained about what they felt was the excessive amount of time taken to

Duration of securities account transfers too long.

effect securities account transfers. This usually related to foreign investment units or shares that were not held by the institution in Germany, but were held by intermediate custodians abroad. BaFin verified whether the institution or its securities handling agent had issued the instructions required for the securities account transfer without delay and had monitored execution of the transfer. In the case of some institutions, the supervisor found that the orders had accumulated due to an unexpectedly high number of securities account transfers, and these had been processed only gradually. In other cases, the institution had deliberately held the order back in order to discuss further conduct of the business relationship with the customer.

- Insufficient monitoring and a lack of communication the cause of delays.

The cause of delays in some cases, however, was insufficient monitoring of the order execution process or a lack of communication between the offices involved. In one case, for example, the security concerned had not been transferred even after a period of months, despite numerous e-mail messages between the investment services agent and the foreign custodian. In another case, an investor waited for over a month for shares he had purchased in a capital increase measure to be posted to his account. According to information provided on the telephone to BaFin by the institution managing the account or its investment management company, the shares were still to be delivered. BaFin therefore immediately contacted the main payment office responsible for handling the capital increase. It transpired that all subscription notes had already been delivered in full weeks previously. After renewed contact with the institution managing the account, it was determined that the securities had been delivered to its investment management company a long time ago. An internal communication fault, however, had prevented the items from being allocated to the customer concerned.

- Complainants often insufficiently aware of market rules.

Insufficient awareness of the rules of the stock exchange, market mechanisms and products on the part of complainants, rather than misdeeds committed by investment services companies in relation to supervisory law, lay behind many complaints. In such cases, BaFin attempts to pass on corresponding information. For example, BaFin explained the occurrence of partial executions in the XETRA electronic trading system, or the difference between profit opportunities and profit guarantees. Another topic was the particular nature of the flat listing of bonds. The price of these securities includes any interest accrued since the last interest payment date.

A number of questions related to the specifics of trading on the stock exchange, such as the cancellation of orders already executed or tax-related questions, such as documentation of the beginning of a speculation period in the case of securities account transfers. BaFin is not the competent authority in such matters, and the complainants must be referred to the trading surveillance offices of the stock exchanges and to the tax authorities.

## 5 Freedom of Information Act

The Federal Freedom of Information Act (Informationsfreiheitsgesetz – IFG) entered into force at the start of 2006. This legislation provides all citizens with the right to demand access to official information from the authorities of the Federation. The IFG mainly serves as a means to ensure control and acceptance of the actions of the state. With the entry into force of the IFG, Germany is adopting international standards.

Table 29

### Inquiries made in line with the Freedom of Information Act

Supervisory section	Number	Application withdraw	Access to information granted	Access to information granted in part	Access to information rejected	pending	of which appeals submitted	of which court action taken
Banking	14		1	4	8	1	6	3
Insurance	5			1	4		2	
Investment	41	1	9	6	25		11	1
Others	12		1	5	6		4	
Total	72	1	11	16	43	1	23	4

BaFin received a total of 72 inquiries on the basis of IFG during the year under review. These focused primarily (41 inquiries) on the supervision of investment activities. Fourteen inquiries related to the banking supervisor, and five to the insurance supervisor. Twelve inquiries were cross sectoral.

The interests of those making requests under IFG were primarily concerned with the results of investigations in relation to breaches of ad hoc disclosure requirements and insider trading rules such as share price and market price manipulation. Furthermore, inquiries mainly demanded access to files on credit and financial services institutions, and insurance undertakings. Mostly, access to this information is used in preparation and execution of compensation cases against supervised companies or third parties.

BaFin had to reject most of the applications. The reasons included jeopardising the control and supervisory actions of BaFin, protection of operational and business secrets and of the personal data of third parties. 23 applicants appealed against the rejection issued by BaFin. Most of these appeals were rejected. Four appellants have lodged a claim against the rejection of their appeal with VG Frankfurt am Main. The first judgement is expected in 2007.



**Confidentiality obligations**

The IFG contains a large number of exceptional circumstances that limit or exclude the right of access to information. In particular, IFG protects the operational and business secrets of companies, and the personal data of third parties. In addition, there are other special statutory confidentiality obligations related to the provisions of EU law.

In section 3 no. 1d of IFG, the legislation protects the confidence of supervised companies in the discretion of the supervisory authority, thus preventing competitors or other third parties from exploiting the information advantage of BaFin at the expense of effective supervision of the financial markets. The information advantage of BaFin relates primarily to all statutory notification and reporting obligations. In addition, the voluntary exchange of information ensures supervisory activities are appropriate and up to date. This situation demands the unconditional confidentiality of the information provided.

The policymakers further restrict the right of access to information in cases where the information is subject to a specific official secret (section 3 no. 4 IFG). Such an official secret is enshrined in section 11 of the Financial Services Supervision Act (Finanzdienstleistungsaufsichtsgesetz – FinDAG). This provision refers to the pertinent provisions of supervisory law, such as section 9 KWG, section 84 VAG and section 8 WpHG, and forms the basis for a special statutory confidentiality obligation placed on BaFin and its attendants.

IFG also contains provisions on the protection of operational and business secrets, and personal data. In this respect, personal data may be published only if the applicant's information interest outweighs that of the third party for protection (section 5 IFG).

## IX About BaFin

### 1 Organisational structure and personnel

Internal auditing reoriented.

#### Changes to organisation and strategic controlling

As a consequence of the case of corruption within the IT Group, BaFin restructured its Internal Audit section in 2006. Internal Audit is now directly subordinate to the President, to whom it reports directly. This ensures the department's independence. Internal Audit has also been allocated additional staff, and will relinquish non-auditing tasks to other departments and realign its audit planning along even more risk-oriented lines.

Organisational development concept produced.



BaFin attaches great importance to the continual refinement of its structures and processes. This means it is ready to face the challenges of the future and represents value for money. In 2006, it expanded the remit of its Organisational Systems and Development section, restructuring its organisation and staff. Taking account of its strategic goals, the supervisory authority has prepared an Organisational Development Proposal that aims to optimise BaFin's internal structures, design technical and administrative processes efficiently and ensure resources are deployed economically. To this end, it has compiled an Organisation Manual that defines the framework for systematic, effective organisational restructuring, and sets out standards for future organisational studies, methods and techniques.

Structure of insurance supervisor optimised.

In 2006, BaFin concentrated on overhauling the structure of its insurance supervision division. It tightened its departmental and section structures, creating an important organisational framework for expanding supervision of international groups. In the banking supervision division the supervision of the Landesbanks was split into two sections, according to geographic areas.

Methods-Time Management assessment of staff in PRO Group and Human Resources.

In order to enable BaFin to make its technical and administrative processes more effective in other areas, it initiated organisational measures and projects, such as in the Prospectuses (PRO) Group and Human Resources (Z 5). Staff members were assessed and their performance measured using MTM (Methods-Time Measurement) systems and a multi-moment work sampling study.

Internal control system refined and expanded.

During the year under review, BaFin began building up its internal control system. The objective was to create a uniform control system, founded on an analytical approach and based on generally

accepted standards of control. To achieve this aim, BaFin conducted a risk analysis and evaluation of its entire organisation in 2006, laying the groundwork for the implementation of comprehensive control measures. By the end of 2007, all risk-relevant core processes, procedures and rules will have been determined, procedures improved and binding organisational mechanisms for security and control introduced.

BaFin operates with two management systems – the control system that is currently under construction and its strategic management. Strategic management includes both the strategy and KPI system and the strategic reporting system. For its management and control system, BaFin has adapted management systems with proven records in industry to reflect the processes, structures and requirements of a public financial supervisory authority, and has interlinked these with the existing control elements.

The main focus of the control system is the BaFin mission statement and the aims and strategies derived therefrom. The aims are based on the statutory purpose of BaFin and mainly involve upholding and promoting the stability and integrity of the German financial system. With its medium- to long-term strategies for supervisory practice, BaFin is defining how to best meet its statutory obligations. In an annual planning cycle, BaFin managers produce specific measures aimed at implementing the supervisor's strategies in its daily work. Management monitors this implementation by means of controlling indicators. In the medium term, targets agreed by staff and their line managers will complement the control system. This will provide all staff members with an overview of the major tasks and targets each financial year, enabling them to deploy their personal resources more effectively according to importance and urgency.

In July of the year under review, the Real Estate Funds section moved to Frankfurt, following in the footsteps of the General section, the Supervisor of foreign investment funds compliant with the directive and the Securities Funds section. This move completed the merging of the investment and securities supervisors.

### Staff

As at 31 December 2006, BaFin employed 1,679 people (previous year: 1,631), of whom around 65% were civil servants (1,098, previous year: 1,005).

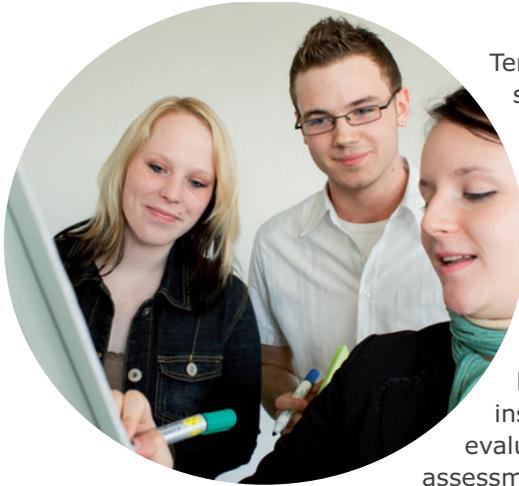
Table 31

#### Staff as at 31 December 2006

Career path	Employed			Civil servants	Regular employees
	Total	Women	Men	Total	Total
Senior level	619	224	395	566	53
Upper level	583	274	309	467	116
Middle/ lower level	477	309	168	65	412

Investment supervisor's move to Frankfurt complete.

1,679 employees.



Ten members of staff are on long-term secondment to European and international institutions and supervisory authorities.

At the beginning of the year under review, BaFin had 33 vacancies among senior posts and 29 among upper-level posts. During 2006, it recruited 91 new staff (including civil service candidates, trainees and temporary staff), mainly fully qualified lawyers and graduates of higher education institutions. In total, 3,000 applications were evaluated, 377 interviews conducted and 33 assessment centre sessions held.

Table 32  
**Recruitment in 2006**

Career path	Qualifications						
	Total	Women	Men	Lawyers	Economic scientists	Mathematicians	Others
<b>Senior level</b>	29	9	20	22	6	-	1
				Polytechnic graduates	IT	Actuarial staff	Others
<b>Upper level</b>	39	19	20	20	3		16
<b>Middle level</b>	15	8	7				
<b>Trainees</b>	8	3	5				

● Training at BaFin.

In 2006, 20 new trainees started their traineeships or career training at BaFin. As at the end of the year under review, there were 70 trainees and trainee civil servants working for the supervisor. BaFin provides training for the following careers: administrative clerk (5), IT specialist (3), office communication specialist (32) and media and information services specialist (1). Together with the Bundesbank, it also offers civil service trainees aiming at upper-level posts the option to prepare for their future work by combining a course of study at an institute of higher education with practical work experience (29).

● BaFin values good training and professional development.

BaFin offers good training and professional development opportunities for its staff. During the year under review, BaFin implemented a new training concept developed in close cooperation with all of the authority's specialist areas. The programme involves specialist qualifications, and aims to help staff develop at a personal level. In 2006, 1,066 employees took part in 500 training and professional development workshops, such as those devoted to MaRisk.

## 2 Budget

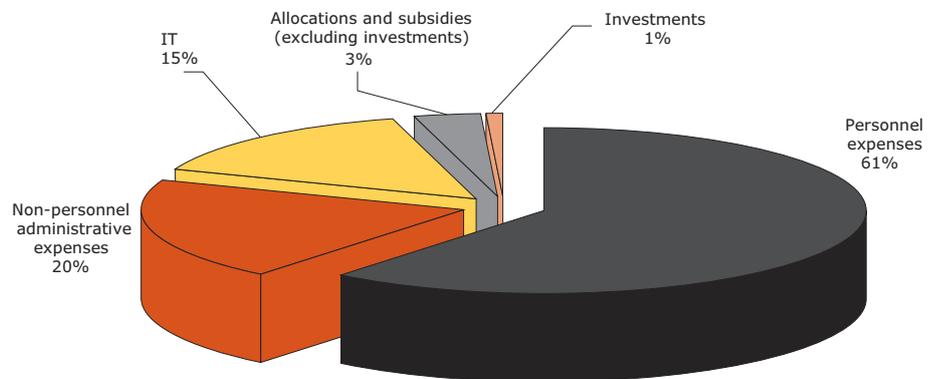
● 2006 budget: €126.8 million.



BaFin’s budgetary plans, as laid out by its Administrative Council and approved by the Federal Ministry of Finance, provided for expenditures and revenues of around €126.8 million for the year under review (previous year: €126.5 million). Personnel costs amounted to around 61% of the proposed expenditures, at €77 million (previous year: €75.6 million), while non-personnel costs accounted for approximately 20%, at €25.3 million (previous year: €25.7 million).

The special section of the budget plan containing expenditures and revenues relating to enforcement amounted to around €6.5 million (previous year: €4 million) in 2006. Of this amount, approximately €5 million was allotted to the German Financial Reporting Enforcement Panel (FREP).

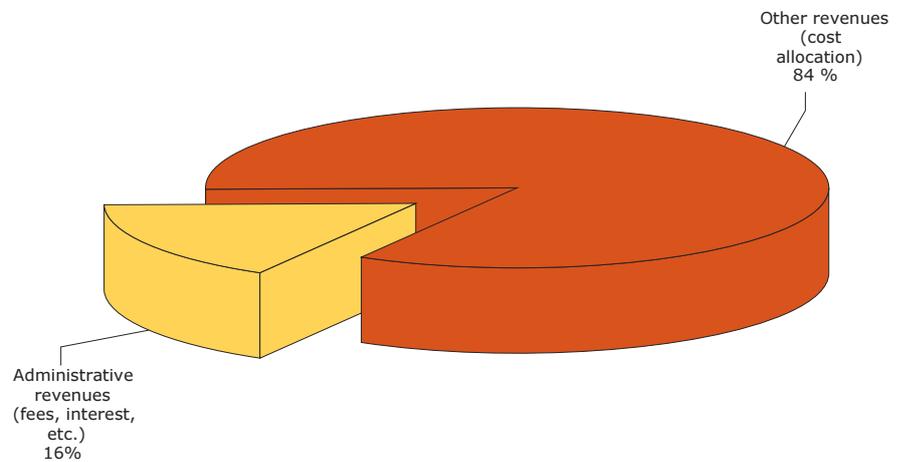
Figure 38  
**Expenditures (2006 budget)**



● €106 million from cost allocation, €18.9 million in fees.

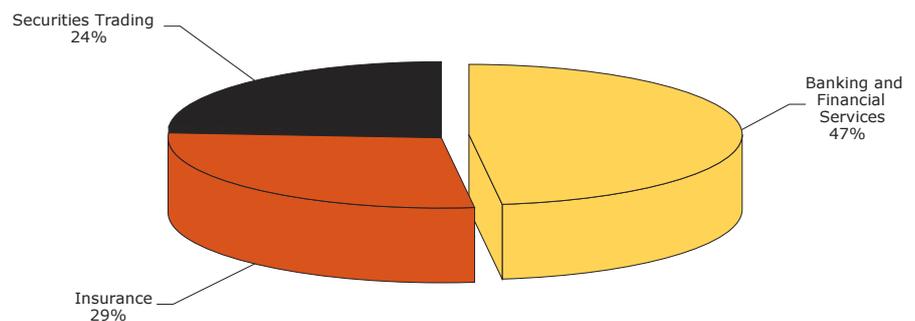
BaFin does not receive any funding from the federal budget. It is financed by cost allocation payments (2006 estimate: €106 million, previous year: €110.3 million) and fees including separate reimbursements (2006 estimate: €18.9 million, previous year: €14.7 million) from the companies subject to supervision.

Figure 39  
**Revenues (2006 budget)**



The largest source of finance is cost allocation. By applying a system of cost and performance accounting, all expenses incurred by BaFin are systematically allocated directly to the source. According to final calculations for 2005, the banking sector contributed 47%, the insurance sector 29% and the securities trading sector 24% to the overall total of approximately €91 million.

Figure 40  
**Cost allocations by supervisory area 2005**



BaFin has also based the calculation of prepayments for 2007 on this proportional distribution. The final cost distribution for 2006 will be calculated during 2007.

● Expenditure of €112.3 million.

According to the 2006 annual accounts which have not yet been adopted by the Administrative Council, spending by BaFin totalled approximately €112.3 million (previous year: €109.7 million). The supervisor generated revenues of around €132.9 million (previous year: €130.2 million). In the area of enforcement, expenses of €5.7 million were incurred against revenues of €15.8 million (surpluses, prepayments for 2005, 2006 and 2007). The surpluses from repayments for 2005 and 2006 will be repaid by BaFin to the supervised undertakings and institutions in 2007.

### **BaFin financing model is lawful**

In November 2006, the Frankfurt am Main Administrative Court ruled that BaFin's cost allocation method was lawful and permitted under constitutional law as a special levy for financing purposes. One cooperative bank (Volksbank) and two financial services institutions had commenced proceedings against cost allocation decisions issued by BaFin. Each claimant had been called upon to pay minimum-level amounts. Their case focused on questioning the legitimacy, under financial constitutional law, of the principle of financing by means of cost allocation. They also claimed that the minimum amount system contravened the principle of equal treatment enshrined in the Basic Law, since the minimum amounts placed a disproportionately high burden on institutions with a low level of total assets. According to the decision issued by the aforementioned court, the use of cost allocations served a specific purpose above and beyond a simple procurement of funds, since they served to finance a specific task – namely the supervision of financial services. The court further stated that the cost allocations were collected from a homogeneous group that had a particular factual relationship with the task to be financed. The court therefore held that the levy was, in the main, in the interests of those being required to pay it. While the purpose of the supervisory authority was to serve the general public, financial service providers gained the most from the supervisory authority, since the latter boosted confidence in the sector. The court approved, in particular, of the minimum amounts for the banking and financial services sectors, and for securities trading. It stated that the minimum amount should not have to be scaled according to the actual expense incurred by the supervisor. The court was of the opinion that policymakers were authorised to make rules of a generalising nature, and in this respect demand the same minimum amount from companies that cause high expenditure as from those that cause low expenditure.

In September 2006, the Federal Administrative Court (Bundesverwaltungsgericht – BVerwG) had already confirmed the legitimacy in law of the cost allocation of the former Federal Banking Supervisory Office (Bundesaufsichtsamt für das Kreditwesen – BAKred) for 1999 and 2000 and, correspondingly, also the cost distribution. In February 2007, the Administrative High Court (Verwaltungsgerichtshof – VGH) in Kassel also ruled that the BAKred cost allocation was legitimate.

## 3 Public relations

 BaFin in the public interest.

During the year under review, BaFin answered thousands of written and oral questions from journalists, consumers, investors, students, companies, etc. The questions related to subjects such as information on the increasing number of hostile and competitive takeovers. There were also many inquiries relating to the insolvency and closure of Privatbank Reithinger. The Federal Court of Justice's (Bundesgerichtshof – BGH) previous rulings on surrender values in

relation to life insurance policies continued to command widespread attention. A large number of the inquiries involved individual regulatory measures, as well as the case of corruption within BaFin.

3. Practical Forum on White-Collar Crime and the Capital Market.

In September 2006, over 300 public prosecutors, judges and police officers accepted BaFin's invitation to attend its third Forum on White-Collar Crime and the Capital Market. The event, now well established in the calendar, dealt with such issues as how to uncover pre-arranged trades, a form of market manipulation. In addition, BaFin presented financial instruments such as credit derivatives, and held discussions with participants on new online methods of payment, how they work and the related money-laundering risks. To make the event as practical as possible, public prosecutors, representatives of trading surveillance offices (Handelsüberwachungsstellen – HÜSt), listed companies and for the first time policemen joined BaFin staff in presenting papers.

IAM Düsseldorf, INVEST Stuttgart and stock market open days.

In 2006, BaFin participated as an exhibitor in the INVEST and IAM investor fairs and in open days at the Dresden, Hamburg and Frankfurt stock exchanges. A number of inquiries related to the respectability and value of certain money investments. BaFin explained the scope of its regulatory activities, and provided guidance on where to obtain more information. Investors frequently asked whether a specific provider was permitted to trade, or if a prospectus had been submitted for an investment. In response, BaFin stated that it was not permitted to provide advice on investment decisions. Particular interest was expressed with as to whether specific business models, such as investment clubs, require permission. BaFin uses these events to give consumers and investors, as well as market participants, the opportunity to talk to a supervisor in a face-to-face meeting.

Visitor groups.

Many groups again participated in visits to learn more about BaFin. Particularly frequent visitors were students and schoolchildren who had learned about the work of the financial regulator in lectures and in class, and wished to learn more about the practical aspects of BaFin's work.

BaFinJournal.

Since the start of 2007, BaFin has been publishing its new Journal as a monthly newsletter. BaFinJournal provides the players on the financial markets with up-to-date, concise information on major supervisory issues. It is the central informative publication and replaces the previous BaFin Publications (Veröffentlichungen der BaFin – VerBaFin). In contrast to VerBaFin, however, it no longer contains only the regulator's official announcements. BaFinJournal can be viewed on the BaFin website, and can also be obtained from the Infomail service. BaFin Infomail provides regular information on all new publications that are available through the website. It contains links to new circulars, press releases and publications. An English-language counterpart BaFinQuarterly is published every three months, and deals with the subjects covered by BaFinJournal that may also be of interest outside Germany. The website was restructured during the year under review, and BaFin plans to give it a complete facelift in 2007.



Dr. Sabine Reimer,  
Head of Press and  
Public Relations

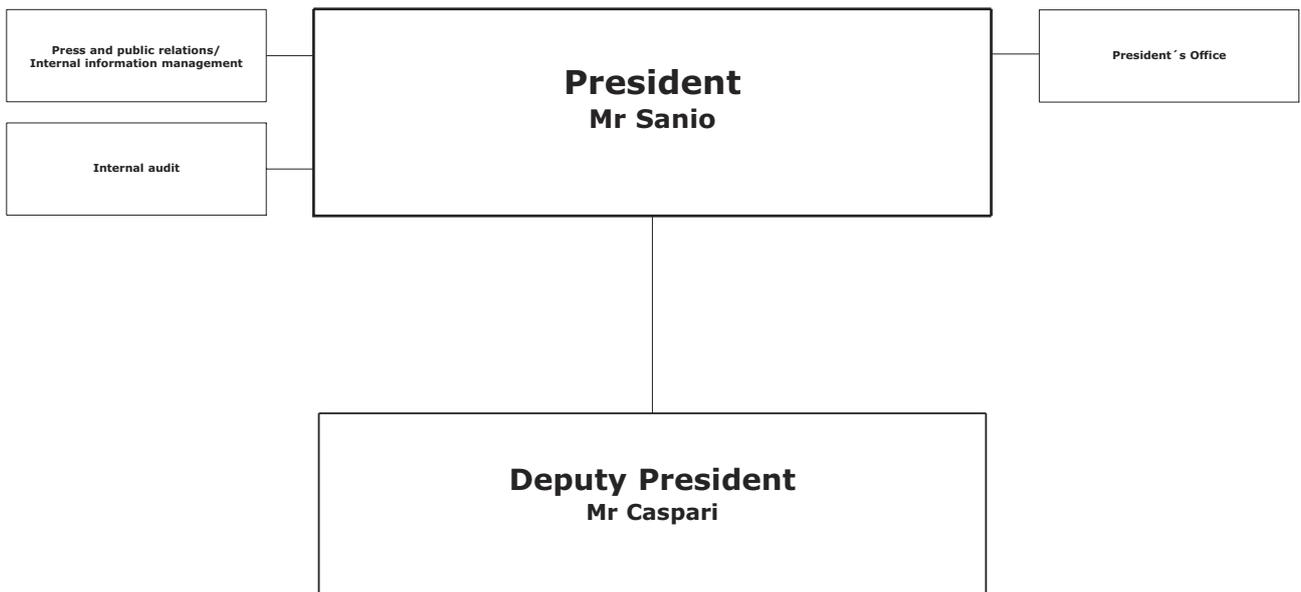


# Appendix

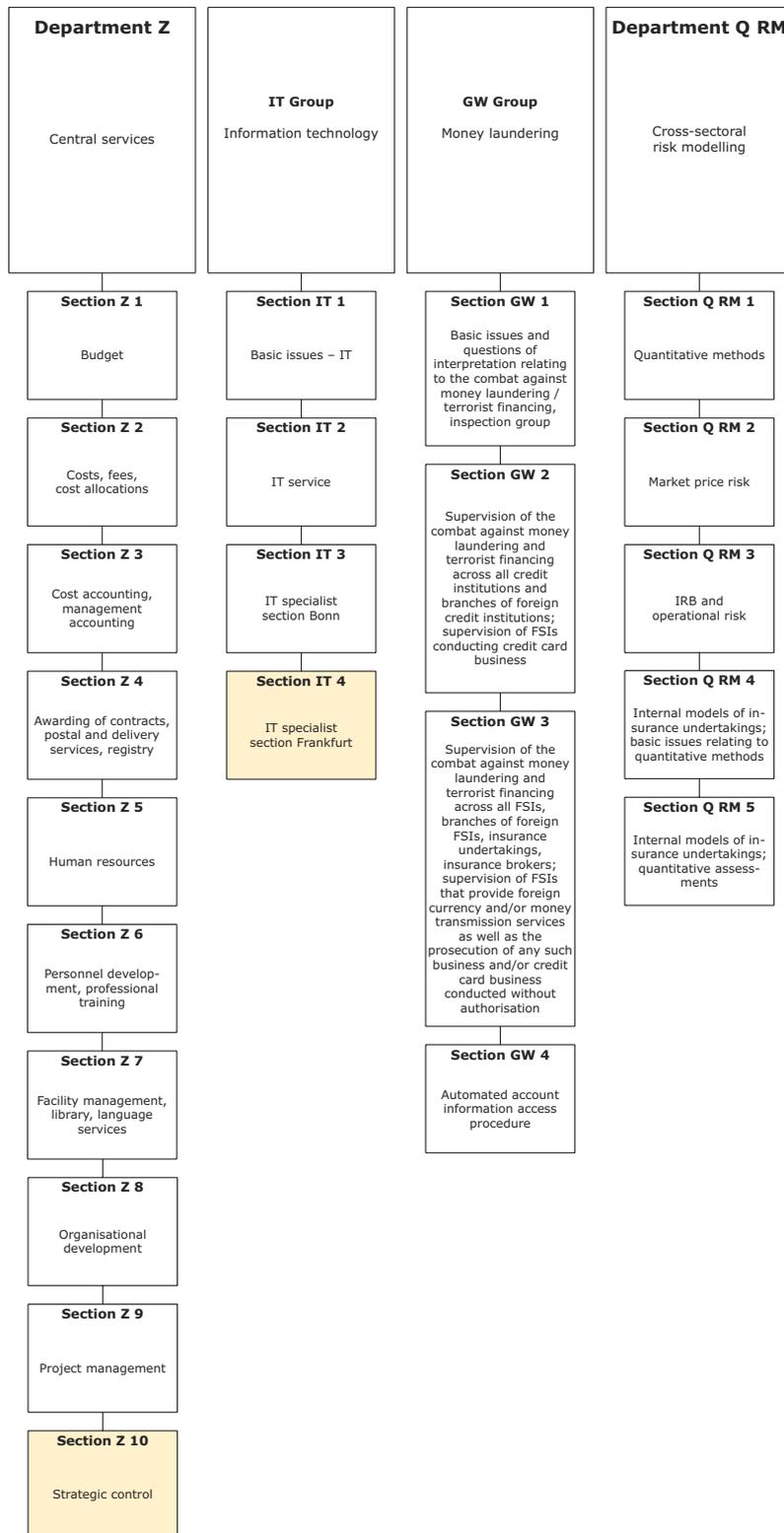




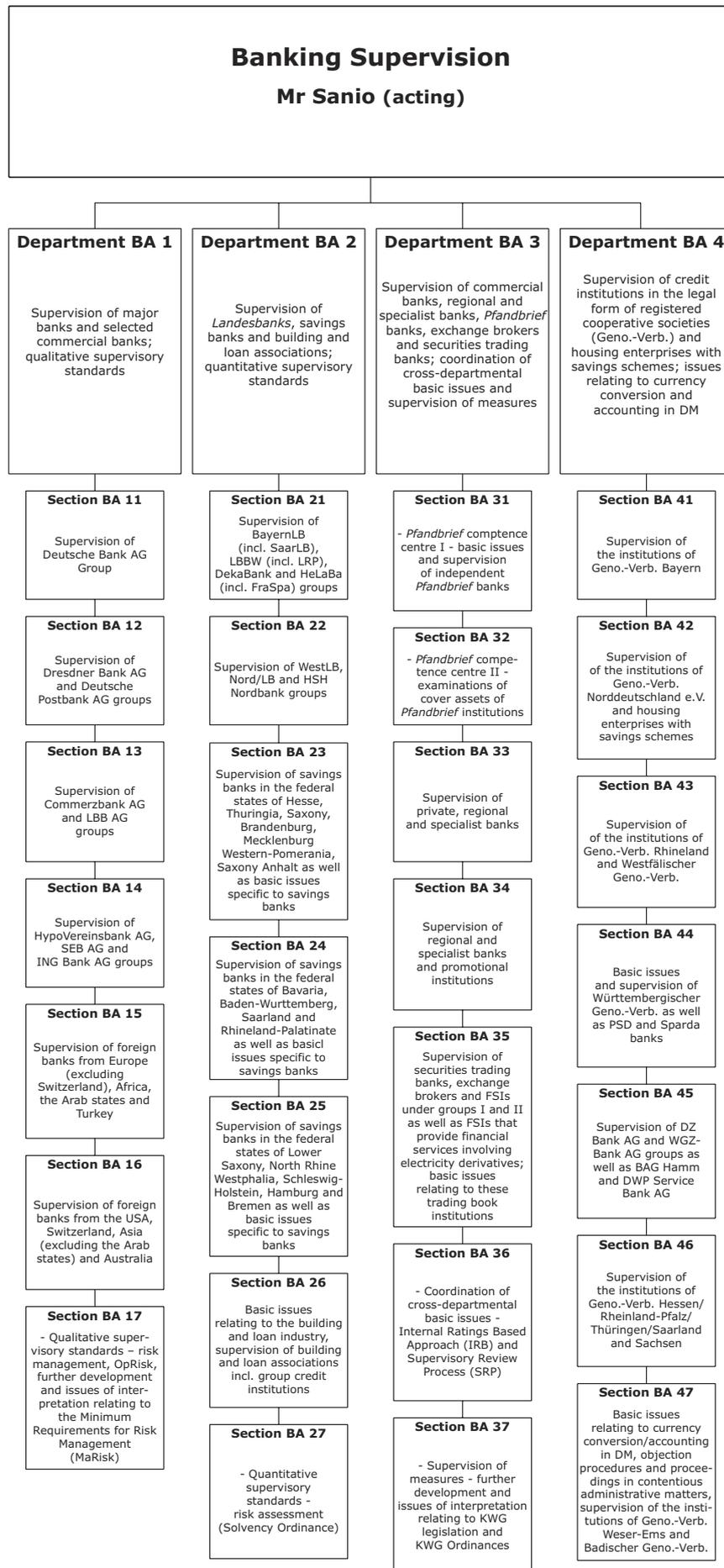
## Organisational overview

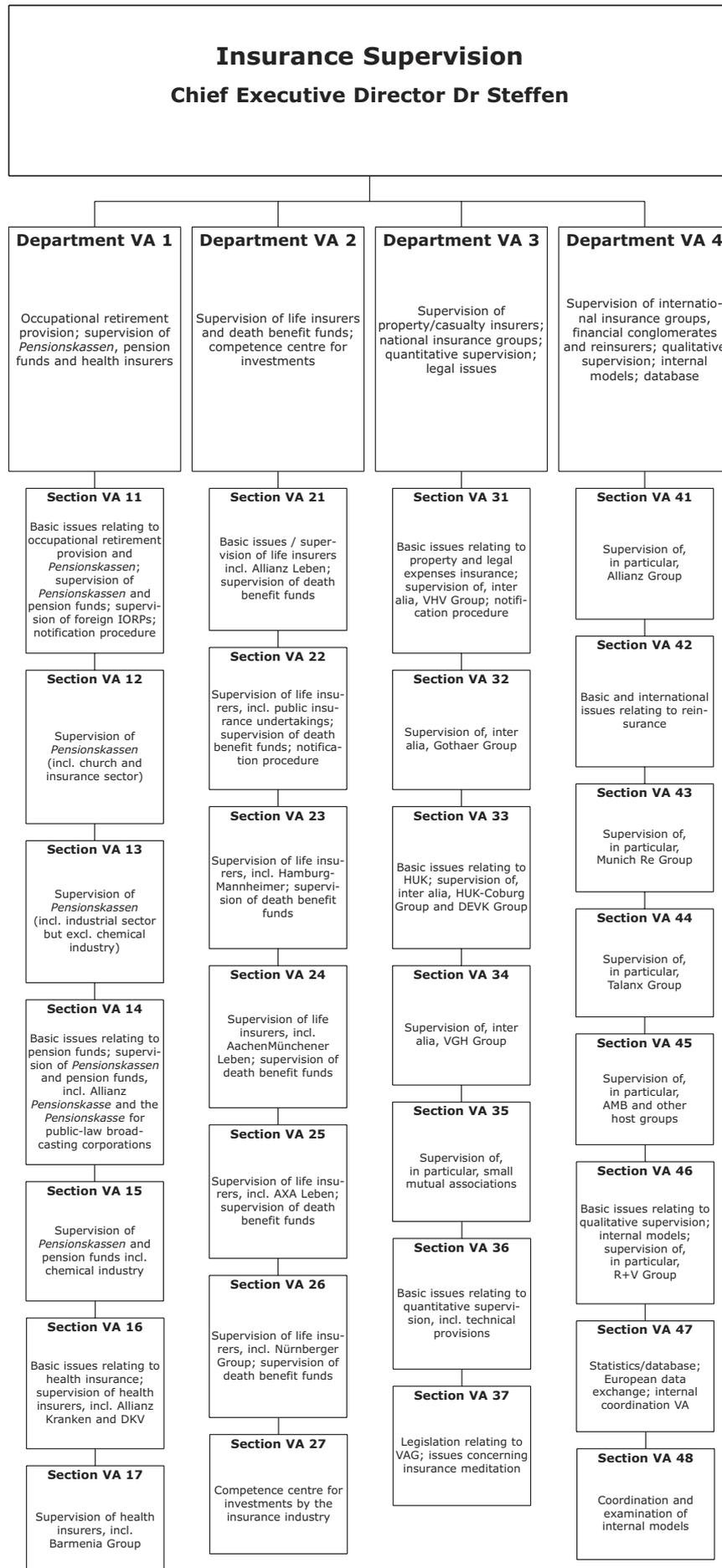


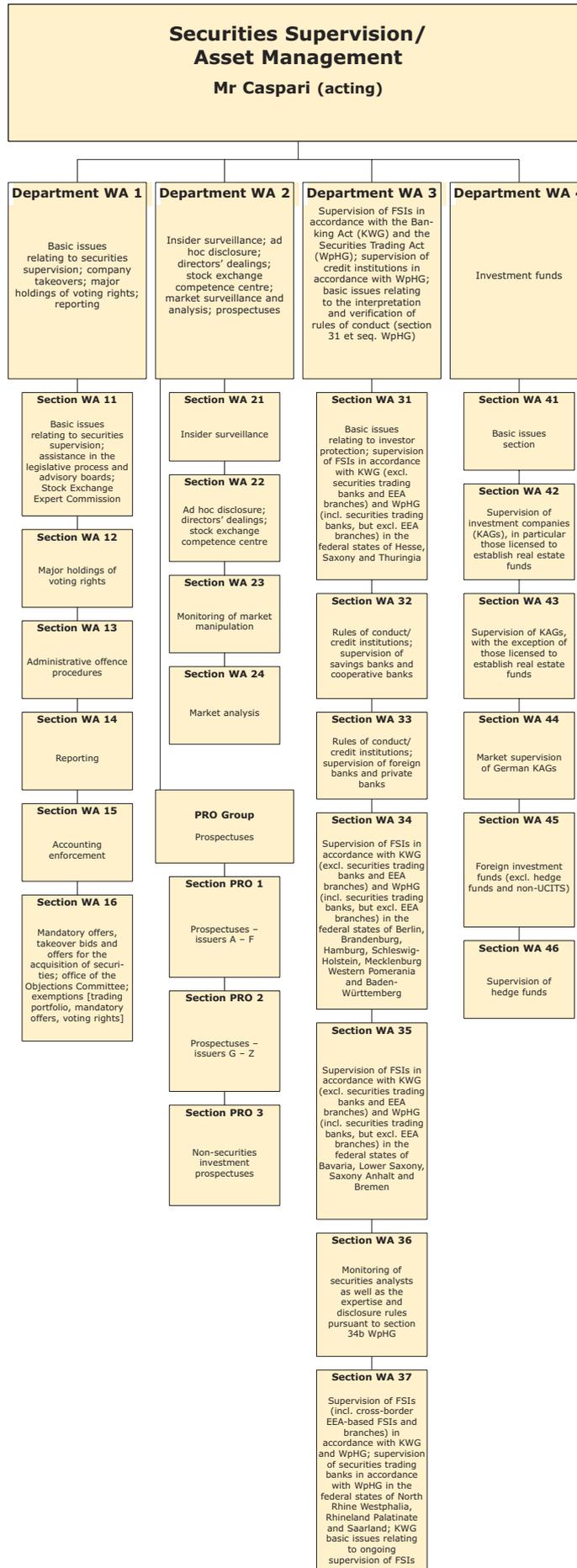
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- Frankfurt office

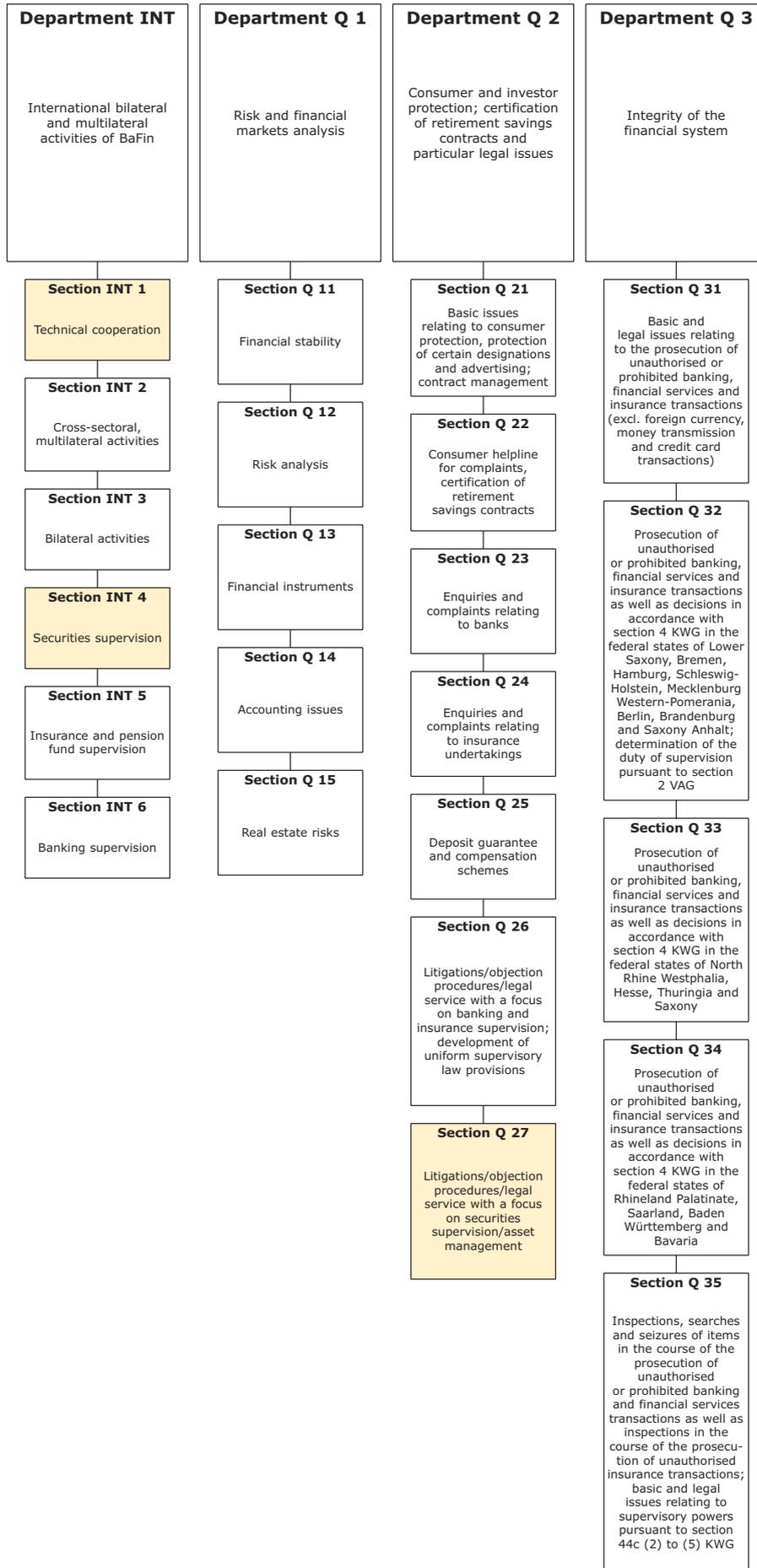


Bonn office  
 Frankfurt office









Bonn office  
 Frankfurt office

# BaFin Bodies

## 2.1 Members of the Administrative Council

### **Representatives of the ministries**

Dr. Mirow, Thomas (BMF - Chairman)  
Asmussen, Jörg (BMF - Deputy Chairman)  
Schröder, Uwe (BMF)  
Conert, Jens (BMF)  
Dr. Hardieck, Thomas (BMW)  
Schaefer, Erich (BMJ)

### **Representatives of the German Bundestag (Lower House of Parliament)**

Kalb, Bartholomäus (MdB)  
Bernhardt, Otto (MdB)  
Spiller, Jörg-Otto (MdB)  
Hauer, Nina (MdB)  
Thiele, Carl-Ludwig (MdB)

### **Representatives of credit institutions**

Dr. Pleister, Christopher  
Müller, Klaus-Peter  
Haasis, Heinrich  
Rasche, Henning  
Dr. Fischer, Thomas R.

### **Representatives of insurance undertakings**

Hoenen, Rolf-Peter  
Dr. von Fürstenwerth, Jörg  
Dr. Meyer, Lothar  
Dr. Caspers, Friedrich

### **Representative of investment companies**

Dr. Mansfeld, Wolfgang

As at: March 2007

## 2.2 Members of the Advisory Board

### **Representatives of credit institutions**

Dr. Massenbergh, Hans-Joachim  
Dr. Schackmann-Fallis, Karl-Peter  
Lehnhoff, Jochen  
Tolckmitt, Jens  
Boos, Karl-Heinz  
Zehnder, Andreas J.

### **Representatives of insurance undertakings**

Dr. Schareck, Bernhard (Chairman)  
Dr. Rupprecht, Gerhard  
Dr. von Bomhard, Nikolaus  
Dr. Winkler, Heiko

### **Representative of investment companies**

Päsler, Rüdiger H.

### **Representative of the Bundesbank**

Hofmann, Gerhard

### **Representative of the Association of Private Health Insurers**

Schulte, Reinhold

### **Representatives of academic groups**

Prof. Dr. Dr. h.c. Baums, Theodor  
Prof. Dr. Wagner, Fred  
Prof. Dr. Dr. Achleitner, Ann-Kristin (Deputy Chairperson)

### **Representative of the Task Force for Occupational Retirement Provision – aba –**

Schwind, Joachim

### **Representatives of consumer protection organisations**

Kühnlentz, Stephan (Stiftung Warentest)  
Prof. Römer, Wolfgang (Ombudsman for insurance undertakings)  
Dr. Balzer, Christian (Arbitrator for the Customer Complaints department of RSGV)

### **Representative of the legal and business professions**

Wüstenbecker, Jens (AfW)

### **Representative of SME associations**

Loistl, Ulrike (DVFA)

### **Representative of the trade unions**

Foullong, Uwe (ver.di)

### **Representative of industry**

Härter, Holger P. (Porsche AG)

As at: March 2007

## 2.3 Members of the Insurance Advisory Council

Prof. Dr. Christian Armbrüster	Freie Universität Berlin Faculty of Law
Prof. Dr. Martin Balleer	Former Executive Board Member of Deutsche Aktuarvereinigung (DAV) e.V.
Prof. Dr. Dr. h.c. Jürgen Basedow	Max Planck Institute for Foreign and International Private Law, Hamburg
Beate-Kathrin Bextermöller	Stiftung Warentest Financial Services Department
Dr. Leberecht Funk	President of the Verband Deutscher Versicherungsmakler e.V. (VDVM) Funk Gruppe GmbH
Prof. Dr. Gerd Geib	Member of the Executive Board of KPMG Deutsche Treuhand- Gesellschaft AG Chairman of the Insurance Committee of the Institut der Wirtschaftsprüfer in Deutschland e.V.
Michael H. Heinz	President of the Bundesverband Deutscher Versicherungskaufleute e.V.
Andrea Hoffmann	Head of Financial Services Department Verbraucherzentrale Sachsen e.V.
Prof. Dr. Gottfried Koch	Universität Leipzig Institute for Insurance Studies
Dr. Lothar Meyer	Chairman of the Executive Board of ERGO Versicherungsgruppe AG
Dieter Philipp	President of Aachen Chamber of Trades (Handwerkskammer)
Dr. Gerhard Rupprecht	Chairman of the Executive Board of Allianz Deutschland AG

Dr. Bernhard Schareck	Member of the Executive Board of Wüstenrot & Württembergische AG Chairman of the Supervisory Board of Karlsruher HK AG Member of the Supervisory Board of Karlsruher Lebensversicherung AG President of the Gesamtverband der Deutschen Versicherungswirtschaft e.V.
Hauptrecht Freiherr Schenck zu Schweinsberg	Chairman of the Insurance Committee of the Bundesverband der Deutschen Industrie e.V. (BDI), Cologne Managing Director of Thyssen Krupp Versicherungsdienst GmbH, Industrieversicherungsvermittlung
Dr. Hans-Jürgen Schinzler	Chairman of the Supervisory Board of Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in Munich
Prof. Dr. Wolfgang Schönemann	Universität Dortmund Chair for Private Law
Reinhold Schulte	Chairman of the Executive Board of the SIGNAL IDUNA Group Chairman of the Verband der privaten Krankenversicherung e.V.
Joachim Schwind	Attorney at law Division Head of Hoechst AG CEO of Pensionskasse der Mitarbeiter der Hoechst-Gruppe VVaG and Höchster Pensionskasse VVaG
Prof. Dr. Hans-Peter Schwintowski	Humboldt-Universität Berlin Faculty of Law Chairman of the Academic Advisory Committee of the Bund der Versicherten e.V.
Richard Sommer	ver.di-Bundesverwaltung Vereinte Dienstleistungsgewerkschaft Financial Services

Elke Weidenbach	Specialist insurance consultant Verbraucherzentrale NRW e.V. Financial Services Group
Prof. Dr. Wolfram Wrabetz	Main authorised agent and Chairman of the Executive Boards of HELVETIA Versicherungen in Germany Member of the Management Team of HELVETIA PATRIA Gruppe Schweiz Representative agent of Hesse Regional Government in insurance matters
Prof. Dr. Jochen Zimmermann	Universität Bremen Economics Department tba

As at: March 2007

## Complaint statistics for individual undertakings

- 3.1 About these statistics
- 3.2 Life insurance
- 3.3 Health insurance
- 3.4 Motor insurance
- 3.5 General liability insurance
- 3.6 Accident insurance
- 3.7 Household insurance
- 3.8 Residential buildings insurance
- 3.9 Legal expenses insurance
- 3.10 Insurers based in the EEA

### 3.1 About these statistics

BaFin has been publishing complaint statistics broken down by insurance company and class in its annual report for some years. Its predecessor, the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV), was ordered to include this information by the Berlin Higher Administrative Court in its ruling of 25 July 1995 (Case No.: OVG 8 B 16/94).

In order to provide an indicator as to the quality and volume of insurance business, the number of complaints fully processed by BaFin during 2006 is compared against the number of contracts in the respective insurance class as at 31 December 2005. Figures on existing business are reported by the insurance undertakings. The information on existing business puts those insurance undertakings going through a phase of strong expansion, which frequently include newly founded companies, at a disadvantage, because the new business generated during the year, on the basis of which complaints are made, is not accounted for in the complaint statistics. The informational value of these statistics is, therefore, limited with regard to the quality of individual undertakings.

In the case of collective insurance with regard to the existing business figure for life insurers, the figure specified relates to the number of insurance contracts. In health insurance, existing business is based on the number of natural persons who hold health insurance, rather than on the number of insured parties under each policy, which is usually higher. This indicator is still not entirely reliable.

The figures reported for the property and casualty sector related to insured risks. If undertakings have concluded group policies with many insured persons, this will increase the figure for existing business. Owing to limited disclosure requirements (section 51 (4) no. 1 sentence 4 of the Ordinance on Insurance Accounting – RechVersV), the existing business figures can only be included for insurers whose gross premiums earned in 2005 exceeded €10

million in the respective insurance classes or types. With companies that did not meet this threshold in individual insurance classes, no information on existing business is given in the table (n.a).

The statistics do not, however, include undertakings operating within one of the classes listed, but were not the subject of any complaints during the year under review.

No data is provided for companies from the European Economic Area, given that they are not accountable to BaFin. In order to present a more complete overview, the figures for the number of complaints have, however, been included.

## 3.2 Life insurance

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of life insurance policies as at 31/12/2005</b>	<b>Complaints</b>
1001	AACHENMÜNCHENER LEB.	5,237,886	222
1006	ALLIANZ LEBEN	10,299,461	433
1007	ALTE LEIPZIGER LEBEN	964,888	56
1035	ARAG LEBEN	391,151	33
1181	ASPECTA LEBEN	716,582	79
1303	ASSTEL LEBEN	382,790	61
1020	AXA LEBEN	2,142,983	173
1011	BARMENIA LEBEN	243,318	18
1012	BASLER LEBEN	107,024	9
1013	BAYER. BEAMTEN LEBEN	424,277	26
1015	BAYERN-VERS.	1,645,029	90
1145	BHW LEBEN	999,455	23
1132	CIV LEBEN	1,988,302	61
1122	CONCORDIA LEBEN	141,559	4
1021	CONDOR LEBEN	218,043	13
1078	CONTINENTALE LEBEN	628,304	26
1022	COSMOS LEBEN	1,207,045	49
1146	DBV-WINTERTHUR LEBEN	2,345,652	150
1023	DEBEKA LEBEN	3,058,415	56
1167	DELTA DIREKT LEBEN	66,165	1
1017	DELTA LLOYD LEBEN	828,680	53
1136	DEVK ALLG. LEBEN	595,516	21
1025	DEVK DT. EISENBAHN LV	855,409	10
1113	DIALOG LEBEN	199,986	3
1110	DIREKTE LEBEN	132,091	6
1180	DT. ÄRZTEVERSICHERUNG	214,044	29
1148	DT. LEBENSVERS.	244,881	1
1028	DT. RING LEBEN	910,385	67
1107	EUROPA LEBEN	413,902	13
1310	FAMILIENFÜRSORGE LV	304,470	8
1175	FAMILIENSCHUTZ LEBEN	185,765	10
1063	GENERALI LV	1,252,618	104
1108	GOTHAER LEBEN AG	1,272,859	115
1162	GUTINGIA LEBEN	31,374	1
1040	HAMB. LEBEN	25,277	5
1184	HAMB. MANNHEIMER LV	6,659,961	407
1312	HANNOVERSCHE LV AG	778,970	47
1114	HANSEMERKUR LEBEN	182,756	24
1142	HDI LEBENSVERS.	118,716	11
1033	HDI-GERLING LEBEN	1,934,676	149
1158	HEIDELBERGER LV	458,147	25
1137	HELVETIA LEBEN	119,650	5
1055	HUK-COBURG LEBEN	726,249	27
1047	IDEAL LEBEN	487,120	16
1048	IDUNA VEREINIGTE LV	2,361,890	82
1097	INTER LEBEN	210,948	19
1119	INTERRISK LEBENSVERS.	82,236	1
1128	ITZEHOER LEBEN	57,379	1

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of life insurance policies as at 31/12/2005</b>	<b>Complaints</b>
1045	KARLSRUHER HK AG	130,642	5
1050	KARLSRUHER LEBEN	1,244,619	60
1130	KARSTADTQUELLE LV AG	1,213,965	52
1054	LANDESLEBENSHILFE	25,162	1
1062	LEBENSVERS. VON 1871	735,767	29
1112	LVM LEBEN	709,239	31
1109	MECKLENBURG. LEBEN	157,554	8
1173	MONEYMAXX LEBENSV.-AG	132,553	16
1064	MÜNCHEN. VEREIN LEBEN	146,661	12
1193	NECKERMANN LEBEN	60,877	3
1164	NEUE LEBEN LEBENSVERS	672,895	26
1147	NÜRNBERG. LEBEN	2,973,617	192
1056	OEFF. LEBEN BERLIN	133,680	6
1115	ONTOS LEBEN	38,699	2
1159	PAX LEBEN	27,369	1
1194	PB LEBENSVERSICHERUNG	295,103	13
1123	PLUS LEBEN	40,696	1
1309	PROTEKTOR LV AG	235,817	78
1081	PROV. LEBEN HANNOVER	794,242	26
1083	PROV.NORDWEST LEBEN	1,804,398	52
1082	PROV.RHEINLAND LEBEN	1,282,969	98
1141	R+V LEBENSVERS. AG	4,391,616	167
1018	RHEINLAND LEBEN	366,872	3
1150	SAARLAND LEBEN	111,427	2
1090	SCHWEIZERISCHE LEBEN	1,248,799	66
1034	SECURITAS GILDE LEBEN	88,457	3
1157	SKANDIA LEBEN	323,518	17
1153	SPARK.-VERS.SACHS.LEB	346,069	9
1104	STUTTGARTER LEBEN	483,220	59
1091	SV SPARKASSENVERS.	1,571,441	97
1092	UNIVERSA LEBEN	240,077	11
1093	VER.POSTVERS.	n.a.	1
1140	VICTORIA LEBEN	2,683,484	463
1139	VOLKSFÜRSORGE DT. LV	4,249,920	206
1099	VOLKSWOHL-BUND LEBEN	1,040,339	73
1151	VORSORGE LEBEN	69,775	20
1160	VPV LEBEN	1,306,202	66
1149	WGV-SCHWÄBISCHE LEBEN	47,779	1
1005	WÜRTT. LEBEN	1,821,812	49
1103	WWK LEBEN	994.124	149
1138	ZÜRICH DTSCH. HEROLD	2,862,394	210
1096	ZÜRICH LEBEN	250,643	1
1196	ZÜRICH LV AG	698,349	63

### 3.3 Health insurance

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured persons as at 31/12/2005</b>	<b>Complaints</b>
4034	ALLIANZ PRIV.KV AG	2,393,968	253
4010	ALTE OLDENBG. KRANKEN	100,064	5
4112	ARAG KRANKEN	227,343	16
4138	ASSTEL KRANKENV.AG	9,294	2
4095	AXA KRANKEN	492,390	120
4042	BARMENIA KRANKEN	884,462	34
4134	BAYERISCHE BEAMTEN K	805,331	74
4004	CENTRAL KRANKEN	1,566,647	124
4118	CONCORDIA KRANKEN	71,591	2
4001	CONTINENTALE KRANKEN	1,155,935	64
4101	DBV-WINTERTHUR KRANK.	856,159	74
4028	DEBEKA KRANKEN	3,188,860	83
4131	DEVK KRANKENVERS.-AG	130,471	4
4044	DKV AG	2,970,159	288
4013	DT. RING KRANKEN	584,509	35
4115	DÜSSELDORFER VERS.KR.	6,656	30
4121	ENVIVAS KRANKEN	49,880	6
4089	EUROPA KRANKEN	207,819	12
4128	GLOBALE KRANKEN	72,966	2
4119	GOTHAER KV AG	457,063	31
4043	HALLESCHE KRANKEN	520,280	64
4018	HANSEMERKUR KRANKEN	570,578	36
4122	HANSEMERKUR S.KRANKEN	1,110,851	6
4117	HUK-COBURG KRANKEN	503,704	62
4031	INTER KRANKEN	386,749	69
4126	KARSTADTQUELLE KV AG	466,009	24
4011	LANDESKRANKENHILFE	425,483	29
4109	LVM KRANKEN	223,611	8
4123	MANNHEIMER KRANKEN	81,757	9
4037	MÜNCHEN.VEREIN KV	222,950	26
4125	NÜRNBG. KRANKEN	151,095	8
4143	PAX-FAMILIENF.KV AG	118,758	3
4116	R+V KRANKEN	306,400	10
4002	SIGNAL KRANKEN	1,949,741	116
4039	SÜDDEUTSCHE KRANKEN	449,892	20
4108	UNION KRANKENVERS.	843,442	32
4045	UNIVERSA KRANKEN	341,928	25
4105	VICTORIA KRANKEN	1,024,927	80
4139	WÜRTT. KRANKEN	79,187	2

## 3.4 Motor insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31/12/2005	Complaints
5342	AACHENMÜNCHENER VERS.	2,015,435	34
5498	ADAC-SCHUTZBRIEF VERS	n.a.	6
5581	ADLER VERSICHERUNG AG	n.a.	1
5312	ALLIANZ VERS.	15,123,338	195
5405	ALTE LEIPZIGER VERS.	337,900	1
5455	ARAG ALLG. VERS.	n.a.	6
5397	ASSTEL SACH	n.a.	14
5515	AXA VERS.	3,702,555	92
5593	BAD. ALLG. VERS.	115,987	3
5316	BAD. GEMEINDE-VERS.	500,996	3
5317	BARMENIA ALLG. VERS.	306,225	2
5633	BASLER SECURITAS	517,692	16
5310	BAYER. BEAMTEN VERS.	188,268	16
5324	BAYER.VERS.VERB.AG	1,642,668	5
5098	BRUDERHILFE SACH.AG	395,476	19
5338	CONCORDIA VERS.	1,385,069	21
5339	CONDOR ALLG. VERS.	91,949	2
5340	CONTINENTALE SACHVERS	294,495	11
5552	COSMOS VERS.	432,041	32
5529	D.A.S. VERS.	466,347	44
5343	DA DEUTSCHE ALLG.VER.	1,387,512	51
5311	DBV AG	289,148	11
5854	DBV-WINSELECT	n.a.	2
5037	DBV-WINTERTHUR	758,117	24
5549	DEBEKA ALLGEMEINE	588,550	6
5513	DEVK ALLG. VERS.	2,718,035	50
5344	DEVK DT. EISENB. SACH	957,991	9
5055	DIRECT LINE	430,578	47
5347	DT. HEROLD ALLG.VERS.	991,873	27
5084	DTSCH. INTERNET	n.a.	3
5354	ERSTE ALLGEMEINE VERS	n.a.	1
5038	EURO-AVIATION	n.a.	1
5541	EUROP ASSISTANCE	n.a.	2
5508	EUROPA SACHVERS.	392,023	19
5470	FAHRLEHRERVERS.	310,986	4
5024	FEUERSOZIETÄT	137,233	5
5505	GARANTA VERS.	1,096,598	18
5456	GENERALI VERS. AG	1,435,522	43
5368	GERLING-K. ALLGEMEINE	1,211,969	25
5531	GOTHAER ALLG.VERS.AG	1,335,324	52
5469	GVV-KOMMUNALVERS.	140,165	1
5585	GVV-PRIVATVERSICH.	229,231	1
5420	HAMB. MANNHEIMER SACH	579,144	18
5501	HANSEMERKUR ALLG.	n.a.	3
5096	HDI INDUSTRIE VERS.	576,658	4
5085	HDI PRIVAT	2,971,620	103
5044	HDNA VVAG	n.a.	3
5384	HELVETIA VERS.	261,793	6

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31/12/2005</b>	<b>Complaints</b>
5086	HUK24 AG	711,513	23
5375	HUK-COBURG	7,121,415	132
5521	HUK-COBURG ALLG. VERS	5,203,311	107
5401	ITZEHOER VERSICHERUNG	775,796	12
5078	JANITOS VERSICHERUNG	n.a.	11
5570	KARLSRUHER BEAMTEN	n.a.	3
5509	KARLSRUHER VERS.	424,983	5
5562	KARSTADTQUELLE VERS.	n.a.	3
5058	KRAVAG-ALLGEMEINE	923,452	23
5080	KRAVAG-LOGISTIC	673,501	24
5399	KRAVAG-SACH	n.a.	2
5402	LVM SACH	4,436,052	33
5061	MANNHEIMER VERS.	175,942	2
5412	MECKLENBURG. VERS.	714,991	9
5414	MÜNCHEN. VEREIN ALLG.	n.a.	4
5390	NOVA ALLG.VERS.	616,058	26
5426	NÜRNBG. ALLG.	284,027	3
5686	NÜRNBG. BEAMTEN ALLG.	329,616	7
5543	OEVA ALLG.VERS.MANNH.	n.a.	1
5791	ONTOS VERS.	180,946	7
5519	OPTIMA VERS.	n.a.	4
5787	OVAG - OSTDT. VERS.	n.a.	3
5432	PATRIA VERS.	136,049	2
5446	PROV.NORD BRANDKASSE	768,309	7
5095	PROV.RHEINLAND VERS.	1,241,333	12
5438	R+V ALLGEMEINE VERS.	3,404,831	28
5798	RHEINLAND VERS. AG	211,616	4
5051	S DIREKT VERSICHERUNG	n.a.	5
5451	SIGNAL UNFALL	360,264	7
5781	SPARK.-VERS.SACHS.ALL	137,972	5
5036	SV SPARK.VERSICHER.	898,172	9
5458	TRANSATLANT.ALLG.VERS	n.a.	1
5463	UNIVERSA ALLG. VERS.	n.a.	1
5441	VEREINTE SPEZIAL VERS	352,347	9
5042	VERSICHERUNGSK.BAYERN	135,148	3
5400	VGH LAND.BRAND.HAN.	1,772,324	9
5862	VHV ALLGEMEINE VERS.	3,634,103	69
5598	VHV AUTOVERSICHERUNG	n.a.	2
5472	VICTORIA VERS.	1,615,938	28
5473	VOLKSFÜRSORGE DT.SACH	1,165,505	27
5484	VOLKSWOHL-BUND SACH	n.a.	10
5093	WESTF.PROV.VERS.AG	1,363,409	9
5525	WGV-SCHWÄBISCHE ALLG.	749,987	22
5479	WÜRTT. GEMEINDE-VERS.	942,059	7
5480	WÜRTT. U. BADISCHE	n.a.	3
5783	WÜRTT. VERS.	1,976,963	33
5476	WWK ALLGEMEINE VERS.	n.a.	3
5050	ZURICH VERS. AG	1,769,530	36

## 3.5 General liability insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31/12/2005	Complaints
5342	AACHENMÜNCHENER VERS.	1,246,090	49
5581	ADLER VERSICHERUNG AG	n.a.	2
5312	ALLIANZ VERS.	5,142,539	147
5405	ALTE LEIPZIGER VERS.	231,539	12
5800	ARAG ALLG. RS	n.a.	1
5455	ARAG ALLG. VERS.	20,934,653	45
5512	ASPECTA VERSICHERUNG	n.a.	2
5397	ASSTEL SACH	n.a.	3
5515	AXA VERS.	1,783,853	47
5593	BAD. ALLG. VERS.	n.a.	2
5316	BAD. GEMEINDE-VERS.	125,260	3
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SECURITAS	279,897	8
5310	BAYER. BEAMTEN VERS.	n.a.	6
5319	BAYER. HAUSBESITZER	n.a.	1
5324	BAYER.VERS.VERB.AG	946,233	12
5098	BRUDERHILFE SACH.AG	264,392	3
5338	CONCORDIA VERS.	363,880	13
5339	CONDOR ALLG. VERS.	37,333	4
5340	CONTINENTALE SACHVERS	265,502	5
5552	COSMOS VERS.	n.a.	3
5529	D.A.S. VERS.	231,303	30
5343	DA DEUTSCHE ALLG.VER.	n.a.	1
5771	DARAG DT. VERS.U.RÜCK	69,747	3
5311	DBV AG	569,858	9
5037	DBV-WINTERTHUR	1,010,204	19
5549	DEBEKA ALLGEMEINE	1,016,285	9
5513	DEVK ALLG. VERS.	966,898	11
5344	DEVK DT. EISENB. SACH	617,909	4
5347	DT. HEROLD ALLG.VERS.	349,562	5
5350	DT. RING SACHVERS.	150,596	7
5508	EUROPA SACHVERS.	n.a.	1
5516	FAMILIENSCHUTZ VERS.	n.a.	5
5024	FEUERSOZIETÄT	123,076	9
5505	GARANTA VERS.	n.a.	2
5365	GEGENSEITIGKEIT VERS.	n.a.	2
5456	GENERALI VERS. AG	936,945	38
5368	GERLING-K. ALLGEMEINE	902,091	53
5531	GOTHAER ALLG.VERS.AG	1,408,716	75
5485	GRUNDEIGENTÜMER-VERS.	n.a.	2
5469	GVV-KOMMUNALVERS.	2,761	2
5585	GVV-PRIVATVERSICH.	n.a.	1
5374	HAFTPFLICHTK.DARMST.	625,169	8
5032	HAMB. FEUERKASSE	n.a.	1
5420	HAMB. MANNHEIMER SACH	609,713	42
5501	HANSEMERKUR ALLG.	n.a.	4
5096	HDI INDUSTRIE VERS.	21,085	5
5085	HDI PRIVAT	505,897	9

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31/12/2005</b>	<b>Complaints</b>
5384	HELVETIA VERS.	381,141	9
5375	HUK-COBURG	1,787,664	16
5521	HUK-COBURG ALLG. VERS	829,303	5
5546	INTER ALLG. VERS.	n.a.	11
5780	INTERRISK VERS.	n.a.	1
5401	ITZEHOER VERSICHERUNG	173,446	2
5078	JANITOS VERSICHERUNG	n.a.	5
5570	KARLSRUHER BEAMTEN	n.a.	1
5509	KARLSRUHER VERS.	200,635	4
5058	KRAVAG-ALLGEMEINE	n.a.	1
5080	KRAVAG-LOGISTIC	n.a.	3
5402	LVM SACH	1,074,482	26
5061	MANNHEIMER VERS.	139,406	6
5412	MECKLENBURG. VERS.	256,202	17
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5390	NOVA ALLG.VERS.	363,984	20
5426	NÜRNBG. ALLG.	294,639	9
5686	NÜRNBG. BEAMTEN ALLG.	n.a.	1
5015	NV-VERSICHERUNGEN	n.a.	3
5017	OSTANGLER BRANDGILDE	n.a.	1
5432	PATRIA VERS.	n.a.	1
5446	PROV.NORD BRANDKASSE	380,669	9
5095	PROV.RHEINLAND VERS.	835,172	22
5583	PVAG POLIZEIVERS.	n.a.	2
5438	R+V ALLGEMEINE VERS.	1,521,040	34
5798	RHEINLAND VERS. AG	148,419	8
5773	SAARLAND FEUERVERS.	n.a.	1
5690	SCHWARZMEER U. OSTSEE	n.a.	3
5448	SCHWEIZER NATION.VERS	n.a.	1
5451	SIGNAL UNFALL	239,992	1
5781	SPARK.-VERS.SACHS.ALL	n.a.	2
5586	STUTTGARTER VERS.	n.a.	1
5036	SV SPARK.VERSICHER.	677,808	12
5459	UELZENER ALLG. VERS.	131,840	4
5463	UNIVERSA ALLG. VERS.	n.a.	2
5042	VERSICHERUNGSK.BAYERN	17,260	3
5400	VGH LAND.BRAND.HAN.	692,360	9
5464	VHV	n.a.	8
5862	VHV ALLGEMEINE VERS.	787,051	20
5472	VICTORIA VERS.	1,136,376	49
5473	VOLKSFÜRSORGE DT.SACH	972,806	35
5461	VPV ALLGEMEINE VERS.	n.a.	2
5093	WESTF.PROV.VERS.AG	801,571	9
5525	WGV-SCHWÄBISCHE ALLG.	285,555	4
5479	WÜRTT. GEMEINDE-VERS.	255,254	2
5480	WÜRTT. U. BADISCHE	100,143	1
5783	WÜRTT. VERS.	1,012,881	29
5590	WÜRZBURGER VERSICHER.	n.a.	3
5476	WWK ALLGEMEINE VERS.	n.a.	5
5050	ZURICH VERS. AG	572,910	37

## 3.6 Accident insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31/12/2005	Complaints
5342	AACHENMÜNCHENER VERS.	1,847,845	44
5498	ADAC-SCHUTZBRIEF VERS	1,058,443	2
5581	ADLER VERSICHERUNG AG	219,903	2
5312	ALLIANZ VERS.	5,811,235	123
5405	ALTE LEIPZIGER VERS.	91,495	2
5455	ARAG ALLG. VERS.	20,925,710	20
5512	ASPECTA VERSICHERUNG	208,541	42
5515	AXA VERS.	893,048	19
5593	BAD. ALLG. VERS.	6,153	1
5792	BADEN-BADENER VERS.	294,475	23
5317	BARMENIA ALLG. VERS.	125,592	4
5633	BASLER SECURITAS	147,400	3
5310	BAYER. BEAMTEN VERS.	96,253	6
5324	BAYER.VERS.VERB.AG	587,147	5
5326	BERGISCHE BRANDVERS.	n.a.	1
5040	CIC DEUTSCHLAND	n.a.	6
5790	CIV VERS.	200,526	12
5338	CONCORDIA VERS.	301,508	3
5339	CONDOR ALLG. VERS.	45,247	1
5340	CONTINENTALE SACHVERS	740,154	16
5552	COSMOS VERS.	191,475	4
5529	D.A.S. VERS.	273,934	19
5311	DBV AG	215,057	3
5037	DBV-WINTERTHUR	305,200	10
5549	DEBEKA ALLGEMEINE	1,626,253	9
5513	DEVK ALLG. VERS.	631,647	6
5344	DEVK DT. EISENB. SACH	279,561	1
5347	DT. HEROLD ALLG.VERS.	1,280,809	5
5350	DT. RING SACHVERS.	424,520	32
5508	EUROPA SACHVERS.	56,269	1
5516	FAMILIENSCHUTZ VERS.	307,712	21
5456	GENERALI VERS. AG	1,455,358	22
5368	GERLING-K. ALLGEMEINE	2,681,318	16
5531	GOTHAER ALLG.VERS.AG	755,873	31
5372	GOTHAER VERS.BANK	3,213,607	2
5585	GVV-PRIVATVERSICH.	17,121	1
5374	HAFTPFLICHTK.DARMST.	118,400	3
5012	HAMB. LEHRER-FEUERK.	n.a.	1
5420	HAMB. MANNHEIMER SACH	2,253,640	122
5501	HANSEMURKUR ALLG.	85,602	2
5085	HDI PRIVAT	139,012	4
5384	HELVETIA VERS.	136,006	8
5375	HUK-COBURG	1,089,496	5
5573	IDEAL VERS.	11,306	1
5546	INTER ALLG. VERS.	78,886	7
5057	INTERLLOYD (D)	45,391	3
5780	INTERRISK VERS.	388,874	7
5509	KARLSRUHER VERS.	141,605	2
5562	KARSTADTQUELLE VERS.	343,749	4

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31/12/2005</b>	<b>Complaints</b>
5402	LVM SACH	846,955	8
5412	MECKLENBURG. VERS.	147,405	12
5334	MEDIENVERS. KARLSRUHE	852	2
5390	NOVA ALLG.VERS.	705,400	16
5426	NÜRNBG. ALLG.	563,039	64
5686	NÜRNBG. BEAMTEN ALLG.	108,291	3
5015	NV-VERSICHERUNGEN	25,964	3
5787	OVAG - OSTDT. VERS.	4,615	1
5074	PB VERSICHERUNG	88,135	2
5446	PROV.NORD BRANDKASSE	351,821	1
5095	PROV.RHEINLAND VERS.	1,298,379	7
5583	PVAG POLIZEIVERS.	313,661	1
5438	R+V ALLGEMEINE VERS.	1,423,433	20
5798	RHEINLAND VERS. AG	100,829	2
5690	SCHWARZMEER U. OSTSEE	98,414	6
5451	SIGNAL UNFALL	734,706	24
5586	STUTTGARTER VERS.	254,428	24
5036	SV SPARK.VERSICHER.	328,568	5
5463	UNIVERSA ALLG. VERS.	97,222	3
5511	VER. VERS.GES.DTSCHL.	150,962	7
5400	VGH LAND.BRAND.HAN.	5,699,297	1
5464	VHV	n.a.	1
5862	VHV ALLGEMEINE VERS.	248,789	2
5472	VICTORIA VERS.	1,017,692	69
5473	VOLKSFÜRSORGE DT.SACH	673,177	16
5484	VOLKSWOHL-BUND SACH	172,890	4
5461	VPV ALLGEMEINE VERS.	143,354	2
5093	WESTF.PROV.VERS.AG	1,020,831	3
5525	WGV-SCHWÄBISCHE ALLG.	69,547	1
5480	WÜRTT. U. BADISCHE	187,409	3
5783	WÜRTT. VERS.	636,521	15
5590	WÜRZBURGER VERSICHER.	57,940	4
5476	WWK ALLGEMEINE VERS.	166,540	6
5050	ZURICH VERS. AG	1,180,001	8

## 3.7 Household insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31/12/2005	Complaints
5342	AACHENMÜNCHENER VERS.	856,059	32
5581	ADLER VERSICHERUNG AG	n.a.	1
5312	ALLIANZ VERS.	3,124,921	99
5405	ALTE LEIPZIGER VERS.	162,629	3
5068	AMMERLÄNDER VERS.	n.a.	2
5455	ARAG ALLG. VERS.	232,414	44
5512	ASPECTA VERSICHERUNG	n.a.	3
5397	ASSTEL SACH	n.a.	2
5515	AXA VERS.	996,359	19
5357	BAD. BEAMTENBANK	n.a.	1
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SECURITAS	241,699	1
5310	BAYER. BEAMTEN VERS.	n.a.	4
5324	BAYER.VERS.VERB.AG	531,815	5
5098	BRUDERHILFE SACH.AG	201,721	2
5338	CONCORDIA VERS.	223,813	3
5340	CONTINENTALE SACHVERS	129,508	2
5552	COSMOS VERS.	n.a.	2
5529	D.A.S. VERS.	145,019	18
5343	DA DEUTSCHE ALLG.VER.	n.a.	1
5311	DBV AG	200,577	3
5037	DBV-WINTERTHUR	309,329	5
5549	DEBEKA ALLGEMEINE	627,782	10
5513	DEVK ALLG. VERS.	798,560	11
5344	DEVK DT. EISENB. SACH	458,004	2
5328	DOCURA VVAG	n.a.	1
5347	DT. HEROLD ALLG.VERS.	286,659	5
5350	DT. RING SACHVERS.	208,107	4
5508	EUROPA SACHVERS.	n.a.	1
5470	FAHRLEHRERVERS.	n.a.	2
5516	FAMILIENSCHUTZ VERS.	n.a.	4
5024	FEUERSOZIETÄT	n.a.	2
5456	GENERALI VERS. AG	589,095	25
5368	GERLING-K. ALLGEMEINE	466,682	13
5531	GOTHAER ALLG.VERS.AG	836,541	39
5372	GOTHAER VERS.BANK	n.a.	1
5585	GVV-PRIVATVERSICH.	n.a.	1
5032	HAMB. FEUERKASSE	n.a.	1
5420	HAMB. MANNHEIMER SACH	442,337	22
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI PRIVAT	235,219	5
5384	HELVETIA VERS.	293,457	2
5086	HUK24 AG	n.a.	1
5375	HUK-COBURG	1,216,095	20
5521	HUK-COBURG ALLG. VERS	491,784	6
5780	INTERRISK VERS.	n.a.	2
5078	JANITOS VERSICHERUNG	n.a.	3
5570	KARLSRUHER BEAMTEN	n.a.	1

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31/12/2005</b>	<b>Complaints</b>
5509	KARLSRUHER VERS.	110,535	3
5404	LBN	n.a.	1
5013	LEHRER-FEUER SCHL.-H.	n.a.	2
5402	LVM SACH	623,859	19
5061	MANNHEIMER VERS.	97,003	1
5412	MECKLENBURG. VERS.	159,961	8
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5390	NOVA ALLG.VERS.	266,013	8
5426	NÜRNBG. ALLG.	164,152	5
5686	NÜRNBG. BEAMTEN ALLG.	n.a.	1
5015	NV-VERSICHERUNGEN	n.a.	5
5017	OSTANGLER BRANDGILDE	n.a.	1
5432	PATRIA VERS.	n.a.	1
5446	PROV.NORD BRANDKASSE	302,546	3
5095	PROV.RHEINLAND VERS.	559,145	16
5583	PVAG POLIZEIVERS.	n.a.	4
5438	R+V ALLGEMEINE VERS.	733,152	2
5798	RHEINLAND VERS. AG	107,723	9
5451	SIGNAL UNFALL	n.a.	1
5781	SPARK.-VERS.SACHS.ALL	n.a.	3
5586	STUTTGARTER VERS.	n.a.	1
5036	SV SPARK.VERSICHER.	384,999	7
5463	UNIVERSA ALLG. VERS.	n.a.	2
5400	VGH LAND.BRAND.HAN.	482,692	2
5862	VHV ALLGEMEINE VERS.	245,462	2
5472	VICTORIA VERS.	730,688	32
5473	VOLKSFÜRSORGE DT.SACH	885,401	15
5484	VOLKSWOHL-BUND SACH	n.a.	1
5461	VPV ALLGEMEINE VERS.	185,075	6
5093	WESTF.PROV.VERS.AG	2,433,680	10
5525	WGV-SCHWÄBISCHE ALLG.	n.a.	1
5479	WÜRTT. GEMEINDE-VERS.	n.a.	1
5783	WÜRTT. VERS.	703,811	15
5590	WÜRZBURGER VERSICHER.	n.a.	1
5476	WWK ALLGEMEINE VERS.	n.a.	8
5050	ZURICH VERS. AG	370,522	7

## 3.8 Residential buildings insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31/12/2005	Complaints
5342	AACHENMÜNCHENER VERS.	333,496	15
5312	ALLIANZ VERS.	2,059,261	58
5405	ALTE LEIPZIGER VERS.	140,926	4
5455	ARAG ALLG. VERS.	n.a.	7
5397	ASSTEL SACH	n.a.	1
5515	AXA VERS.	539,404	21
5633	BASLER SECURITAS	153,262	2
5319	BAYER. HAUSBESITZER	n.a.	3
5043	BAYER.L-BRAND.VERS.AG	2,593,329	15
5324	BAYER.VERS.VERB.AG	482,152	7
5098	BRUDERHILFE SACH.AG	n.a.	1
5040	CIC DEUTSCHLAND	n.a.	2
5338	CONCORDIA VERS.	175,910	3
5340	CONTINENTALE SACHVERS	60,543	2
5552	COSMOS VERS.	n.a.	2
5529	D.A.S. VERS.	58,964	8
5771	DARAG DT. VERS.U.RÜCK	n.a.	2
5311	DBV AG	93,431	1
5037	DBV-WINTERTHUR	113,711	8
5549	DEBEKA ALLGEMEINE	193,926	5
5513	DEVK ALLG. VERS.	285,413	3
5344	DEVK DT. EISENB. SACH	160,076	1
5347	DT. HEROLD ALLG.VERS.	112,858	3
5350	DT. RING SACHVERS.	49,735	1
5470	FAHRLEHRERVERS.	n.a.	1
5024	FEUERSOZIETÄT	87,489	7
5456	GENERALI VERS. AG	317,153	17
5368	GERLING-K. ALLGEMEINE	181,421	11
5531	GOTHAER ALLG.VERS.AG	292,844	39
5372	GOTHAER VERS.BANK	n.a.	2
5485	GRUNDEIGENTÜMER-VERS.	53,902	2
5032	HAMB. FEUERKASSE	164,672	3
5420	HAMB. MANNHEIMER SACH	127,688	10
5085	HDI PRIVAT	89,046	5
5384	HELVETIA VERS.	165,436	4
5375	HUK-COBURG	495,015	5
5521	HUK-COBURG ALLG. VERS	137,052	2
5546	INTER ALLG. VERS.	n.a.	2
5780	INTERRISK VERS.	n.a.	1
5509	KARLSRUHER VERS.	70,135	3
5402	LVM SACH	389,433	8
5061	MANNHEIMER VERS.	50,380	2
5412	MECKLENBURG. VERS.	89,953	7
5334	MEDIENVERS. KARLSRUHE	n.a.	2
5014	NEUENDORFER BRAND-BAU	n.a.	1
5390	NOVA ALLG.VERS.	100,539	10
5426	NÜRNBG. ALLG.	70,728	6
5446	PROV.NORD BRANDKASSE	328,541	11
5095	PROV.RHEINLAND VERS.	657,905	34

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of insured risks as at 31/12/2005</b>	<b>Complaints</b>
5438	R+V ALLGEMEINE VERS.	679,410	18
5798	RHEINLAND VERS. AG	75,191	7
5491	SCHLESWIGER VERS.V.	n.a.	2
5451	SIGNAL UNFALL	n.a.	2
5036	SV SPARK.VERSICHER.	2,721,361	42
5463	UNIVERSA ALLG. VERS.	n.a.	2
5400	VGH LAND.BRAND.HAN.	490,708	7
5472	VICTORIA VERS.	352,930	22
5473	VOLKSFÜRSORGE DT.SACH	193,071	10
5484	VOLKSWOHL-BUND SACH	n.a.	1
5461	VPV ALLGEMEINE VERS.	n.a.	9
5093	WESTF.PROV.VERS.AG	2,048,254	11
5525	WGV-SCHWÄBISCHE ALLG.	n.a.	4
5479	WÜRTT. GEMEINDE-VERS.	n.a.	2
5480	WÜRTT. U. BADISCHE	19,450	1
5783	WÜRTT. VERS.	377,518	13
5476	WWK ALLGEMEINE VERS.	n.a.	2
5050	ZURICH VERS. AG	241,457	7

## 3.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	No. of insured risks as at 31/12/2005	Complaints
5826	ADAC-RECHTSSCHUTZ	2,807,921	5
5809	ADVO CARD RS	1,530,849	111
5312	ALLIANZ VERS.	2,690,352	91
5825	ALLRECHT RECHTSSCHUTZ	245,435	34
5800	ARAG ALLG. RS	1,748,614	146
5801	AUXILIA RS	523,015	23
5515	AXA VERS.	n.a.	1
5838	BADISCHE RECHTSSCHUTZ	126,677	11
5310	BAYER. BEAMTEN VERS.	n.a.	8
5098	BRUDERHILFE SACH.AG	154,324	7
5831	CONCORDIA RS	371,057	27
5338	CONCORDIA VERS.	n.a.	2
5802	D.A.S. ALLG. RS	2,906,544	133
5529	D.A.S. VERS.	n.a.	3
5343	DA DEUTSCHE ALLG.VER.	n.a.	8
5311	DBV AG	n.a.	2
5037	DBV-WINTERTHUR	169,646	13
5549	DEBEKA ALLGEMEINE	310,064	10
5803	DEURAG DT. RS	583,421	43
5829	DEVK RECHTSSCHUTZ	975,675	24
5834	DMB RECHTSSCHUTZ	621,396	8
5347	DT. HEROLD ALLG.VERS.	144,994	15
5365	GEGENSEITIGKEIT VERS.	n.a.	1
5368	GERLING-K. ALLGEMEINE	217,173	22
5531	GOTHAER ALLG.VERS.AG	n.a.	5
5372	GOTHAER VERS.BANK	n.a.	1
5828	HAMB. MANNHEIMER RS	461,843	25
5827	HDI RECHTSSCHUTZ	279,546	13
5818	HUK-COBURG RS	1,549,915	74
5401	ITZEHOER VERSICHERUNG	n.a.	4
5812	JURPARTNER RECHTSSCH.	n.a.	2
5823	KARLSRUHER RS	100,684	8
5815	LVM RECHTSSCHUTZ	661,267	12
5412	MECKLENBURG. VERS.	128,046	11
5805	NEUE RECHTSSCHUTZ	444,020	39
5426	NÜRNBG. ALLG.	n.a.	1
5813	OERAG RECHTSSCHUTZ	1,172,196	51
5836	R+V RECHTSSCHUTZ	555,228	6
5806	RECHTSSCHUTZ UNION	403,651	45
5807	ROLAND RECHTSSCHUTZ	1,122,977	82
5459	UELZENER ALLG. VERS.	n.a.	1
5400	VGH LAND.BRAND.HAN.	168,143	2
5525	WGV-SCHWÄBISCHE ALLG.	368,071	21
5479	WÜRTT. GEMEINDEK.A.VERS.	n.a.	1
5480	WÜRTT. U. BADISCHE	n.a.	1
5783	WÜRTT. VERS.	548,313	15
5050	ZURICH VERS. AG	310,547	19

### 3.10 Insurers based in the EEA

Reg. no.	Name of insurance undertaking	Complaints
5902	ACE EUROPEAN (GB)	14
5595	AIG EUROPE S.A. (F)	10
1306	AIG LIFE NIEDER.(IRL)	8
5029	AIOI MOTOR (GB)	2
7644	ALLIANZ WORLDW. (IRL)	1
7323	ASPIS PRONIA (GR)	1
5545	ASSITALIA VERS. (I)	1
7203	ATLANTICLUX (L)	46
5064	ATRADIUS KREDIT (NL)	1
5090	AXA CORPORATE S. (F)	9
1300	CANADA LIFE (IRL)	27
7539	CAPITALLEBEN VERS.(FL)	4
1182	CARDIF LEBEN (F)	5
5056	CARDIF VERS. (F)	10
1189	CIGNA LIFE INS. (B)	2
7453	CLERICAL MED.INV.(GB)	38
7724	CREDIT LIFE INT. (NL)	11
7985	CSS VERSICHERUNG (FL)	1
5048	DOMESTIC AND GEN.(GB)	4
7309	DONAU ALLGEMEINE (A)	3
7310	DT. KRANKENV (L)	1
1161	EQUITABLE LIFE (GB)	5
7477	ERIKA FöRSÄKRING.(S)	1
7813	FINANCE LIFE (A)	2
5053	FINANCIAL INSUR.(GB)	4
7811	FINAREF LIFE (IRL)	4
7155	FONDIARIA (I)	1
7353	FÖRSÄKR.VIATOR (S)	1
7646	FORTIS CORPORATE (NL)	1
7481	FORTUNA LEBEN (FL)	2
5030	GOUDA VERS.-AG (NL)	1
7270	HANSARD EUROPE (IRL)	1
5079	HISCOX INS. (GB)	1
7611	IHRE ZUKUNFT N.V. (NL)	1
1304	INORA LIFE NL (IRL)	1
7747	INT.HEALTH INS. (DK)	1
7525	INT.INS.HANNOVER (GB)	1
5788	INTER PARTNER ASS. (B)	2
7685	LANDMARK INS. (GB)	1
7031	LEGAL/GENERAL ASS (GB)	2
7734	LIBERTY EUR. (IRL/E)	21
7007	LLOYD'S OF LONDON (GB)	1
5592	LLOYD'S VERS. (GB)	1
5054	LONDON GENERAL I. (GB)	2
7237	MUTUELLE DES ARCH. (F)	1
7579	NEMIAN LIFE & P. (L)	8
7806	NEW TECHNOLOGY (IRL)	48
7459	NORWICH U. LIFE (GB)	1
7723	PRISMALIFE AG (FL)	19

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>
1317	R+V LUXEMB. LV (L)	2
7415	R+V LUXEMBOURG L (L)	7
7761	RELIANCE MUTUAL (GB)	1
7730	RIMAXX (NL)	12
5069	SBAI S.A. (B)	1
7763	STONEBRIDGE (GB)	3
7518	SUN LIFE ASS.SOC. (GB)	1
7691	THE HULLBERRY (NL)	1
7754	UPS INT.INS.LTD. (IRL)	3
1311	VDV LEBEN INT. (GR)	17
7643	VIENNA-LIFE (FL)	1
7483	VORSORGE LUXEMB. (L)	16
5088	XL INSURANCE (GB)	2

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## Abbreviations

<b>A</b>	<b>ABS</b>	Asset-backed securities
	<b>AfS</b>	Available for sale
	<b>AG</b>	Aktiengesellschaft (German public limited company) / Amtsgericht (local court)
	<b>AG OpR</b>	Working Group – Operational Risk
	<b>AHBR</b>	Allgemeine Hypothekenbank Rheinboden
	<b>AIG</b>	Accord Implementation Group
	<b>AIRBA</b>	Advanced internal rating based approach
	<b>AktG</b>	Aktiengesetz (Stock Corporation Act)
	<b>ALM</b>	Asset liability management
	<b>AltZertG</b>	Altersvorsorgeverträge-Zertifizierungsgesetz (Act governing the certification of contracts for private old-age provision)
	<b>AMA</b>	Advances measurement approaches
	<b>AnIV</b>	Anlageverordnung (Investment Ordinance)
	<b>AnSVG</b>	Anlegerschutzverbesserungsgesetz (Act on the improvement of investor protection)
	<b>AntKIV</b>	Anteilklassenverordnung (Unit Class Ordinance)
	<b>AnzV</b>	Anzeigenverordnung (Reports Ordinance)
	<b>AO</b>	Abgabenordnung (Tax Code)
	<b>AP</b>	Assessment process
	<b>AS-Fonds</b>	Altersvorsorge-Sondervermögen (Retirement funds)
	<b>ATF</b>	Accounting Task Force
	<b>ATS</b>	Alternative trading system
<b>AuslInvestmG</b>	Auslandinvestment-Gesetz (Foreign Investment Act)	
<b>AVB</b>	Allgemeine Versicherungsbedingungen (general terms and conditions of insurance)	
<b>AVmG</b>	Altersvermögensgesetz (Retirement Savings Act)	
<b>B</b>	<b>BA</b>	Bankenaufsicht (banking supervision)
	<b>BAC</b>	Banking Advisory Committee
	<b>BaFin</b>	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
	<b>BAG</b>	Bundesarbeitsgericht (Federal Labour Court)
	<b>BAKred</b>	Bundesaufsichtsamt für das Kreditwesen (former Federal Banking Supervisory Office)

<b>BAV</b>	Bundesaufsichtsamt für das Versicherungswesen (former Federal Insurance Supervisory Office)
<b>BAWe</b>	Bundesaufsichtsamt für den Wertpapierhandel (former Federal Securities Supervisory Office)
<b>BCBS</b>	Basel Committee on Banking Supervision
<b>BCP</b>	Basel Core Principles for Effective Banking Supervision
<b>BerPensV</b>	Verordnung zur Berichterstattung von Pensionsfonds (Ordinance on reporting by pension funds)
<b>BerVersV</b>	Verordnung über die Berichterstattung von Versicherungsunternehmen (Ordinance on reporting by insurance undertakings)
<b>BetrAVG</b>	Gesetz zur Verbesserung der betrieblichen Altersversorgung (Act to improve occupational retirement provision)
<b>BGB</b>	Bürgerliches Gesetzbuch (Civil Code)
<b>BGBL.</b>	Bundesgesetzblatt (Federal Law Gazette)
<b>BGH</b>	Bundesgerichtshof (German Federal Court of Justice)
<b>BIA</b>	Basisindikatoransatz (basis indicator approach)
<b>BilKoG</b>	Bilanzkontrollgesetz (Accounting Enforcement Act)
<b>BIS</b>	Bank für Internationalen Zahlungsausgleich (Bank for International Settlements)
<b>BkRL</b>	Bankenrichtlinie (Banking Directive)
<b>BMF</b>	Bundesministerium der Finanzen (Federal Ministry of Finance)
<b>bn</b>	Billion(s)
<b>BörsG</b>	Börsengesetz (Exchange Act)
<b>BSC</b>	Banking Supervision Committee
<b>BSpkV</b>	Bausparkassenverordnung (Building Societies Ordinance)
<b>BVB</b>	Besondere Vertragsbedingungen (special fund rules)
<b>BVerfG</b>	Bundesverfassungsgericht (Federal Constitutional Court)
<b>BVI</b>	Bundesverband Investment und Asset Management e.V. (Federal Investment and Asset Management Association)
<b>BVR</b>	Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (Central organisation of the German cooperative banking groups)
<b>C</b>	
<b>CCP</b>	Central counterparty
<b>CDO</b>	Collateralised debt obligation

	<b>CDS</b>	Credit default swap
	<b>CEBS</b>	Committee of European Banking Supervisors
	<b>CEIOPS</b>	Committee of European Insurance and Occupational Pensions Supervisors
	<b>CESR</b>	Committee of European Securities Regulators
	<b>CFTC</b>	Commodities Future Trading Commission
	<b>CLN</b>	Credit linked notes
	<b>COREP</b>	Common reporting
	<b>CP 3</b>	3 <sup>rd</sup> Basel Consultation Paper
	<b>CPLG</b>	Core Principles Liaison Group
	<b>CPSA</b>	Conference of Pension Supervisory Authorities
	<b>CPSS</b>	Committee on Payment and Settlement Systems
	<b>CRD</b>	Capital Requirements Directive
	<b>CTF</b>	Capital Task Force
	<b>CRT</b>	Credit risk transfer
<b>D</b>	<b>D</b>	Directive
	<b>DAV</b>	Deutsche Aktuarvereinigung (German Actuarial Society)
	<b>DAX</b>	Deutscher Aktienindex (blue chip index listing the 30 major German companies)
	<b>DeckRV</b>	Deckungsrückstellungsverordnung (Mathematical Provisions Ordinance)
	<b>DGAP</b>	Deutsche Gesellschaft für Ad-hoc-Publizität mbH (corporate news dispatch service)
	<b>DerivateV</b>	Derivateverordnung (Derivatives Ordinance)
	<b>DMBilG</b>	D-Mark-Bilanzgesetz (D-Mark Accounting Act; relates to companies with a registered office in the Former German Democratic Republic as at 1 July 1990)
	<b>DSGV</b>	Deutscher Sparkassen- und Giroverband (German Savings Bank Association)
<b>E</b>	<b>EBC</b>	European Banking Committee
	<b>EBK</b>	Eidgenössische Bankkommission (Swiss Federal Banking Commission)
	<b>EC</b>	European Community
	<b>EcoFIN</b>	Economic and Financial Council
	<b>EdB</b>	Entschädigungseinrichtung deutscher Banken GmbH (Compensatory Fund of German Banks)
	<b>EdW</b>	Entschädigungseinrichtung der Wertpapierhandelsunternehmen (Compensatory Fund of Securities Trading Companies)

<b>EECS</b>	European Enforcer Coordination Session
<b>EEX</b>	European Energy Exchange
<b>EFC</b>	Economic and Financial Committee
<b>EFCC</b>	Economic and Financial Crimes Commission
<b>EFR</b>	European Financial Services Round Table
<b>EFRAG</b>	European Financial Reporting Advisory Group
<b>EFSSAC</b>	Effective Financial Services Supervision in Accession Countries
<b>EIOPC</b>	European Insurance and Occupational Pensions Committee
<b>EG</b>	Einführungsgesetz (introductory act)
<b>ESAEG</b>	Einlagensicherungs- und Anlegerentschädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
<b>ESC</b>	European Securities Committee
<b>ESCB</b>	European System of Central Banks
<b>ESTG</b>	Einkommenssteuergesetz (Income Tax Act)
<b>ECJ</b>	European Court of Justice
<b>e.V.</b>	eingetragener Verein (registered society)
<b>EEC</b>	European Economic Community
<b>EEA</b>	European Economic Area
<b>EEU</b>	European Economic Union
<b>F</b>	
<b>FATF</b>	Financial Action Task Force on Money Laundering
<b>FEDNY</b>	Federal Reserve Bank of New York
<b>FESCO</b>	Forum of European Securities Commissions
<b>FinAV</b>	Finanzanalyseverordnung (Ordinance on the analysis of financial instruments)
<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 Finanzdienstleistungsaufsichtsgesetz (Ordinance on the imposition of fees and allocation of costs pursuant to the FinDAG)
<b>FINREP</b>	Financial Reporting Framework
<b>FIRBA</b>	Foundation Internal Ratings Based Approach
<b>FMA</b>	Finanzmarktaufsicht Österreich (Austrian Financial Markets Authority)

	<b>FMFG</b>	Finanzmarktförderungsgesetz (Financial Market Promotion Act)
	<b>FREP</b>	Financial Reporting Enforcement Panel
	<b>FSAP</b>	Financial Services Action Plan / Financial Sector Assessment Program
	<b>FSC</b>	Financial Services Committee
	<b>FSF</b>	Financial Stability Forum
	<b>FSI</b>	Financial Stability Institute / Financial services institution
	<b>FSS</b>	Financial Supervisory Service
	<b>FSSAP</b>	Financial System Stability Assessment Program
	<b>FST</b>	Financial stability task
	<b>GAAP</b>	Generally accepted accounting principles
<b>G</b>	<b>GB BAV</b>	Geschäftsbericht des Bundesaufsichtsamtes für das Versicherungswesen (annual report of the former Federal Insurance Supervisory Office)
	<b>GbR</b>	Gesellschaft bürgerlichen Rechts (civil-law partnership)
	<b>GdC</b>	Groupe de Contact
	<b>GDV</b>	Gesamtverband der deutschen Versicherungswirtschaft e.V. (German Insurance Association)
	<b>FY</b>	Financial year
	<b>GMG</b>	Gesetz zur Modernisierung der gesetzlichen Krankenversicherung (Statutory Health Insurance Modernisation Act)
	<b>GmbH</b>	Gesellschaft mit beschränkter Haftung (German private limited company)
	<b>GP</b>	Gross premiums
	<b>GroMiKV</b>	Großkredit- und Millionenkreditverordnung (Ordinance governing large exposures and loans)
	<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>HMG</b>	Heilmittelwerbegesetz (Law on advertising in the healthcare system)
	<b>HUK</b>	Haftpflicht-Unfall-Kraftfahrtversicherung (Thirdparty/accident/motor vehicle insurance)
<b>I</b>	<b>IADI</b>	International Association of Deposit Insurers

<b>IAIS</b>	International Association of Insurance Supervisors
<b>IAS</b>	International accounting standards
<b>IASB</b>	International Accounting Standards Board
<b>IASC</b>	International Accounting Standards Committee
<b>IASCF</b>	International Accounting Standards Committee Foundation
<b>ICAAP</b>	Internal capital adequacy assessment process
<b>IdW</b>	Institut der Wirtschaftsprüfer (Institute of German Certified Public Accountants)
<b>IFRS</b>	International financial reporting standards
<b>IFSC</b>	Integrated Financial Supervisors Conference
<b>IM</b>	Intelligent miner
<b>InsO</b>	Insolvenzordnung (Insolvency Code)
<b>InvAG</b>	Investment-Aktiengesellschaft (public limited investment company)
<b>InvG</b>	Investmentgesetz (Investment Act)
<b>InvMV</b>	Verordnung des Bundesministeriums der Finanzen über die Meldepflicht nach § 10 Abs. 1 und 2 des Investmentgesetzes, Investmentverordnung (Ordinance of the Federal Ministry of Finance concerning the notification obligation according to section 10 (1) and (2) of the Investment Act)
<b>IOPS</b>	International Organization of Pension Supervisors
<b>IOSCO</b>	International Organization of Securities Commissions
<b>IRBA</b>	Internal ratings based approach
<b>ISD</b>	Investment Services Directive; Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field
<b>ISDA</b>	International Swaps and Derivates Association
<b>IT</b>	Information technology
<b>IMF</b>	International Monetary Fund, IMF
<b>IU</b>	Insurance undertaking
<b>J</b>	
<b>JGS</b>	Jahresgemeinschaftsstatistik über den Schadenverlauf in der Kraftfahrzeug-Haftpflichtversicherung (Overall annual statistic concerning the claims experience in motor third party liability insurance)
<b>JF</b>	Joint forum
<b>IP</b>	Investment portfolio

<b>K</b>	<b>KAG</b>	Kapitalanlagegesellschaft (investment company)
	<b>KAGG</b>	Gesetz über Kapitalanlagegesellschaften (Investment Companies Act)
	<b>KaIV</b>	Kalkulationsverordnung (Calculation Ordinance)
	<b>KfW</b>	Kreditanstalt für Wiederaufbau (Reconstruction Loan Corporation)
	<b>KG</b>	Kommanditgesellschaft (German limited partnership)
	<b>KH-Versicherung</b>	Kraftfahrzeug-Haftpflichtversicherung (motor third party liability insurance)
	<b>KLR</b>	Kosten- und Leistungsrechnung (cost and results accounts)
	<b>KonTraG</b>	Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (Act concerning the control and transparency of companies)
	<b>KuMaKV</b>	Verordnung des Bundesministeriums der Finanzen zur Konkretisierung des Verbotes der Kurs- und Marktpreismanipulation vom 18. November 2003 (Ordinance detailing stock exchange and market price manipulation)
	<b>KWG</b>	Gesetz über das Kreditwesen (Banking Act)
<b>L</b>	<b>LG</b>	Landgericht (Regional Court)
<b>M</b>	<b>M &amp; A</b>	Mergers & acquisitions
	<b>m</b>	Million(s)
	<b>MaH</b>	Mindestanforderungen an das Betreiben von Handelsgeschäften (Minimum requirements for the trading activities of credit institutions)
	<b>MaIR</b>	Mindestanforderungen an die Ausgestaltung der Internen Revision (Minimum requirements for the internal audit function of credit institutions)
	<b>MaK</b>	Mindestanforderungen an das Kreditgeschäft (Minimum requirements for the credit business of credit institutions)
<b>MaKonV</b>	Verordnung des Bundesministeriums der Finanzen zur Konkretisierung des Verbotes der Marktmanipulation vom 1. März 2005, Marktmanipulations-Konkretisierungsverordnung (Ordinance of the Federal Ministry of Finance specifying the prohibition of market manipulation)	

	<b>MaRisk</b>	Mindestanforderung an das Risikomanagement (Minimum requirements for risk management)
	<b>MCR</b>	Minimum capital requirement
	<b>MD&amp;A</b>	Management discussion and analysis
	<b>MFP</b>	IMF Code of Good Practices on Transparency in Monetary and Financial Policies
	<b>MiFID</b>	Markets in Financial Instruments Directive
	<b>MIS</b>	Management information system
	<b>MoU</b>	Memorandum of understanding
	<b>MMoU</b>	Multilateral memorandum of understanding
<b>N</b>	<b>NCCT</b>	Non-cooperative countries and territories
<b>O</b>	<b>OCC</b>	Office of the Controller of the Currency
	<b>OECD</b>	Organisation for Economic Cooperation and Development
	<b>OFC</b>	Offshore financial centre
	<b>OJ</b>	Official Journal
	<b>OLG</b>	Oberlandesgericht (Higher Regional Court)
	<b>ÖPG</b>	Gesetz über die Pfandbriefe und verwandten Schuldverschreibungen öffentlich-rechtlicher Kreditanstalten (Act on Pfandbriefe and similar bonds of credit institutions under public law)
	<b>OTC</b>	Over-the-counter
	<b>OVG</b>	Oberverwaltungsgericht (Higher Administrative Court)
	<b>OWiG</b>	Gesetz über Ordnungswidrigkeiten (Act on administrative offences)
<b>P</b>	<b>P&amp;L</b>	Profit and loss account
	<b>PBoC</b>	Peoples Bank of China
	<b>PfandbrG</b>	Pfandbriefgesetz (Pfandbrief Act)
	<b>PFE</b>	Potential future exposure
	<b>PFKAustV</b>	Verordnung über die Kapitalausstattung von Pensionsfonds (Pension Funds Capital Resources Ordinance)
	<b>PfIVG</b>	Pflichtversicherungsgesetz (Compulsory Insurance Act)
	<b>PIOB</b>	Public Interest Oversight Board
	<b>PKV</b>	Private Krankenversicherung (private health insurance)
	<b>PPV</b>	Pflegepflichtversicherung (compulsory long-term care insurance)
	<b>PrüfbV</b>	Prüfungsberichtsverordnung (Audit Report Ordinance)

<b>Q</b>	<b>Q RM</b>	Querschnitt Risikomodellierung (cross-sectoral risk modelling)
	<b>QIS</b>	Quantitative impact studies
<b>R</b>	<b>RAS</b>	Risk assessment system
	<b>RdV</b>	Rückstellung für drohende Verluste (provision for impending losses)
	<b>RechVersV</b>	Verordnung über die Rechnungslegung von Versicherungsunternehmen (Ordinance on insurance accounting)
	<b>RfB</b>	Rückstellung für Beitragsrückerstattung (provisions for bonuses and rebates)
<b>S</b>	<b>SchBkG</b>	Gesetz über Schiffspfandbriefbanken (Act on ship pfandbrief banks)
	<b>SCR</b>	Solvency capital requirement
	<b>SEC</b>	Securities and Exchange Commission
	<b>SEP</b>	Supervisory evaluation process
	<b>SGB</b>	Sozialgesetzbuch (Social Code)
	<b>SPV</b>	Special purpose vehicle
	<b>SRP</b>	Supervisory review process
	<b>IBNR reserve</b>	Reserve for claims incurred but not reported
	<b>STA</b>	Standardansatz (standard approach)
	<b>StPO</b>	Strafprozessordnung (Code of Criminal Procedure)
	<b>SWAP</b>	Securities watch applications
<b>T</b>	<b>Task Force Re</b>	Task Force on Enhancing Transparency & Disclosure in the Reinsurance Sector
	<b>tba</b>	To be announced
	<b>TCI</b>	The Children's Investment Fund Management
	<b>UCITS</b>	Undertakings for the collective investment of transferable securities
<b>U</b>	<b>US-GAAP</b>	US Generally Accepted Accounting Principles
	<b>UStG</b>	Umsatzsteuergesetz (VAT Act)
<b>V</b>	<b>VAG</b>	Versicherungsaufsichtsgesetz (Insurance Supervision Act)
	<b>VerBAV</b>	Veröffentlichungen des Bundesaufsichtsamtes für das Versicherungswesen (publications of the Federal Insurance Supervisory Office)
	<b>VerBaFin</b>	Veröffentlichungen der Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin publications)
	<b>VerkprospG</b>	Verkaufprospektgesetz (Prospectus Act)
	<b>VG</b>	Verwaltungsgericht (Administrative Court)

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	<b>VGH</b>	Verwaltungsgerichtshof (Administrative High Court)
	<b>VVaG</b>	Versicherungsverein auf Gegenseitigkeit (mutual society)
	<b>VVG</b>	Versicherungsvertragsgesetz (Insurance Contract Act)
<b>W</b>	<b>WpDPV</b>	Wertpapierdienstleistungs-Prüfungsverordnung (Investment Services Enterprises Examination Ordinance)
	<b>WpHG</b>	Wertpapierhandelsgesetz (Securities Trading Act)
	<b>WpPG</b>	Wertpapier-Verkaufsprospektgesetz (Securities Prospectus Act)
	<b>WpÜG</b>	Wertpapiererwerbs- und Übernahmegesetz (Securities Acquisition and Takeover Act)





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