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**Annual Report**  
**Federal Financial Supervisory Authority**  
**(Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)**





## President's Statement



An integrated financial supervisory authority like BaFin is truly faced with quite a few challenges in the course of one year, including some unpleasant surprises. However, the sub-prime crisis, which struck in the middle of 2007, eclipsed all previous crises. Clever financial engineers used the gaps in national and international supervisory regulations, they circumvented Basel I, the body of rules and regulations for banks, and they staged a wide-scale regulation arbitrage, from which the financial markets are still suffering serious consequences. Banks were able to load up with risks unchecked since they did not have to back this with equity. The profit machinery kept revving ever more until it completely overheated and almost brought the international financial system to a standstill.

Bavarian comedian Karl Valentin once said, "Hopefully it won't be as bad as it is," as if he divined today's discussion on the valuation of burning structured papers.

Here, experiences of financial supervisors are clear: of the fears we have due to our profession, the worst case scenario almost always comes to pass. However, since the future has too many unknowns, we are almost never able to predict what that worst case will be the next time. Sherlock Holmes' successful business model of knowing what others do not is beyond the means of financial supervisors.

We did not know about the dangerous goings-on that were happening across the Atlantic over the past years. Specifically, this involved US mortgage financiers, who were more or less unsupervised, granting more and more loans to individuals unworthy of credit. The extremely great risk resulting from that situation was then mostly passed on, using complex securitisation transactions, to other financial actors who, when purchasing the securities, relied on the ratings given by the rating agencies.

The banks, which had taken on too many of these papers, were in dire straits, and major efforts were needed to save them. In such situations, it is the supervisor's duty to help organise emergency efforts and that has always worked, especially in Germany. Now the lessons need to be learned from this serious financial crisis and the international supervisory regime needs to be rebuilt; this is certainly no small feat. However, financial supervisors are a tough breed and one of their characteristics is the belief that problems can be solved. We know that serious work needs to be done to make the global financial system more stable.

In this regard, the Financial Stability Forum's Draghi Report, which received broad political support, put forth convincing, extensive blue prints. No one should disparage it as being an ill-conceived overregulation.

The Draghi Report's recommendations must be implemented in the coming months, and that will require an enormous effort. The international community of supervisors is highly motivated to report success as swiftly as possible. Because even though supervisors have nerves of steel, one thing is clear: we do not want to face this kind of crisis again.

Bonn and Frankfurt am Main | April 2008

A handwritten signature in black ink, reading "Jochen Sanio". The signature is written in a cursive, flowing style with a large initial 'J' and a long, sweeping tail.

Jochen Sanio  
President

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# I Highlights



## Sub-prime crisis

Severe turbulence developed on the global financial markets in 2007, which posed a serious threat to financial stability. The international financial crisis also gripped Germany, and kept BaFin in suspense. Two German credit institutions fell into serious difficulties and could only be stabilised by a concerted effort with the active participation of BaFin. Moreover, the entire German financial sector suffered from the consequences of this crisis, which demonstrated the fully developed networking of the global financial system in the way it emerged and then spread.

● Defaults in second-class U.S. mortgage loans trigger shockwaves.

This financial crisis originated in the United States. The market there indulged in unsustainable excesses in the granting of mortgage loans to private households with a poor credit rating (sub-prime mortgages). As the short-term interest rates climbed in the course of monetary streamlining and house prices fell at the same time, the number of loan defaults in the bloated sub-prime segment became more and more frequent, triggering a shockwave that flowed around the globe and gripped the financial systems almost all over the world. The crisis was able to spread so quickly because the individual credit risks were bundled and passed on to the international capital markets through mass securitisation in the form of innovative, structured financial products. Although this credit risk transfer distributed the risks more widely, it also promoted damaging incentive mechanisms, which ultimately led to loans not being checked and monitored with the necessary level of care by the banks. In a climate of low interest rates, this unleashed a storm of demand for this type of relatively high-risk securities, which then required a constant supply of individual loans.

● Sub-prime crisis encroaches on to credit markets.

In the summer, the ever worsening news from the U.S. housing market and the increasing number of defaults of mortgage loans fed the general misgivings about the lasting value of the complex and often unclearly structured products, so that the sub-prime crisis overlapped on to the general credit markets. The risk tolerance suddenly fell, and the risk premiums climbed rapidly. In many market segments, the liquidity dried up. At that time, a particular hotbed came to the fore: several banks had created special-purpose companies with a business model whereby earnings are generated from maturity transformation through interest arbitrage off the balance sheet, and so with little burden on the equity capital. These vehicles purchased high-yield, long-term assets such as asset-backed securities (ABS) and collateralised debt obligations (CDO) – often in relation to U.S. sub-prime loans – and refinanced themselves in the short term by issuing commercial papers. The initiating banks provided liquidity pledges or acted as “sponsors” in order to gain an excellent rating for the money-market programmes supporting the refinancing. German banks were extremely active in

this business area. As the follow-up financing began to falter because of the dubious quality of the assets, which were often linked to U.S. sub-prime loans, the banks had to fulfil their pledges or intervene to protect their reputations. Some institutions clearly underestimated the liquidity risks. However, it was possible to correct certain precarious situations within the German banking system.

● Loss of trust between banks.

The uncertainty about the actual risk content in the individual bank balance sheets and about the proper valuation of structured products in phases of lacking market liquidity triggered a serious loss of trust between the banks. Refinancing became much more difficult. The banks began to stockpile liquidity. As a result, there were massive disruptions on the inter-bank market. The leading central banks had to intervene and to administer liquidity injections in high doses to the market in several, at times concerted campaigns. Complete transparency about the actual risks of the individual institutions will be a prerequisite for restoring the lost trust between banks. Easily comprehensible, unified standards for evaluating structured financial products will be indispensable. BaFin is monitoring the international efforts in this area extremely intensively.

● Sub-prime crisis is putting regulations to the test.

The consequences of the sub-prime crisis have also made it clear that the regulations governing banking supervision need to be reviewed, both internationally – in Basle and at EU level – and here in Germany. From the point of view of BaFin, this begs the question of whether certain exemptions from banking supervisory requirements can still be justified: for instance, the preferential conversion factors that apply to qualified securitisation liquidity facilities. Another example is that the ordinance governing Large Exposures and Loans (Großkredit- und Millionen-Kreditverordnung – GroMiKV) makes it easier to extend loan commitments: any loan commitments that have not yet been exercised and with an original term of up to one year must thereby only be considered (as yet) up to 50% (section 27 (3) GroMiKV).

Moreover, the supervisory authorities are considering which lessons can be learned from the sub-prime crisis for the further development of banking supervision standards and guidelines. They are paying particular attention to the future requirements for stress tests for the institutions and the disclosure obligations regarding the transfer of risk and the characteristics of complex products. Another area under discussion is the issue of how to handle concentration risks, the work of the rating agencies and the question of how to evaluate illiquid and complex products.

● New regulations involve more risk-sensitive equity requirements.

At the beginning of 2007, the Basle equity regulations (Basle II) and the related EU specifications were implemented in German law; this was the most significant change in bank-supervision law since the 1980s. The new regulations are characterised primarily by more risk-sensitive equity requirements and a set of regulations for risk management that are more oriented towards quality. Their new, principle-based approach to supervision will at the same

time create a valid foundation for risk-oriented practice in terms of supervision and auditing. For instance, the Solvency Ordinance (Solvabilitätsverordnung – SolvV) contains specific requirements for taking securitisation risks into account – including risks arising from securitisation liquidity facilities. As BaFin will now be taking the internal risk-measurement procedures of the various institutions more stringently into account, it will also create the incentive for the institutions to enhance their risk-management systems.

External credit-rating assessments by recognised rating agencies may also be integrated into the calculation of the minimum equity requirements as a further risk-differentiating element. The new regulations have already taken into account that the credit rating for securitisation tranches should be assessed differently than for government or corporate bonds. The minimum requirements for risk management (MaRisk) have also established qualitative requirements for liquidity risk management for the first time.

- New regulations have been binding only since the beginning of 2008.

However, most institutions used transitional regulations for the year 2007; they have therefore only been applying the new rules since January 1, 2008. This also applies insofar as the new equity regulations affect the stipulations concerning large exposures and million loans. It is therefore scarcely possible to answer the question whether the new regulations have proven effective in the sub-prime crisis. However, the experiences of the year 2007 emphasise the fact that the previous regulations were not suitable for restricting risks effectively. One point was particularly damaging: namely, that credit lines with an original term of less than one year and that were not exercised did not have to be supported by equity.

- Insurance sector is hardly suffering at all from the sub-prime crisis.

Not even insurers as significant institutional investors have been able to escape entirely from the market turbulences of the sub-prime crisis. However, it turned out that the financial effects of the sub-prime crisis were limited for German insurers and reinsurers as of the end of the reporting year.

This assessment is based on an intensive audit of the capital-asset risks and on several surveys of primary insurers and reinsurers since summer 2007. Insurers that have invested more than 3% of their capital assets in credit-risk transfer products also had to submit their internal stress tests, which they have to carry out every quarter, to BaFin in October 2007. All the insurers passed the test.

The probable reasons for the limited effects on the insurance sector are primarily the restricted business purpose of the insurers and also the supervisory ban on carrying out certain transactions. For instance, the insurers are not allowed to supply liquidity lines for structured investment vehicles (SIVs) or special refinancing structures such as conduits. In Germany, there are also strict requirements in terms of supervisory law for the capital investments of restricted assets: for instance, insurers may only invest a maximum of 7.5% of the entire financial assets in credit-risk transfer products. Moreover, the insurers were far from exploiting

this quota in full. In 2007, the average quota was 1.6% of the total capital assets of the industry.

### **Credit brokerage via the internet**

In 2007, credit-brokerage platforms on the internet enjoyed increasing popularity. These platforms, which were familiar above all in the Anglo-American region, are now also offering to broker loans from private investors to private persons or companies here in Germany. Most of the recently set-up platforms followed the principle of bringing borrowers and lenders together without involving a credit institution. Although no banking authorisation is required for the exclusive brokerage of loans – and so the credit-brokerage platforms basically do not come under the auspices of BaFin – BaFin does check in individual cases whether the operators or the users of the credit-brokerage platform do in fact base their investment on an obligation to hold an authorisation in terms of banking supervision law. Anyone who runs banking operations such as credit or deposit transactions for commercial purposes or to the extent of being a business requires an authorisation from BaFin.

BaFin has been and is in contact with several potential operators of online credit-brokerage platforms. In this area, BaFin sets particularly great store by the fact that the operators must take contractual and technical measures to exclude the running of illicit banking transactions via their platform. If there is a lack of convincing measures, BaFin is entitled according to the German Banking Act (Kreditwesengesetz – KWG) to determine itself whether the users or suppliers of the platform are running or are involved in transactions that require an authorisation. Should this be the case, BaFin may bar illicitly operated transactions and decree that they are settled immediately.

### **New legislation 2007**

On November 1, 2007, the Act Implementing the Markets in Financial Instruments Directive (Finanzmarktrichtlinie-Umsetzungsgesetz – FRUG) came into force. It transposes the EU Financial Markets Directive – “MiFID” for short – and parts of the related Implementing Directive into German law. The MiFID is the most significant directive in capital-market law of recent times and is also referred to as the “new basic European law for securities trading”. The new regulations are correspondingly extensive – the national implementation act FRUG covered 60 pages in the Federal Law Gazette: the changes primarily affect the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) and the Stock Exchange Act (Börsengesetz – BörsG), and to a lesser extent the Banking Act (Kreditwesengesetz – KWG). The FRUG is primarily extending the catalogue of financial services that require an authorisation and the rules of conduct for investment services enterprises. Moreover, it implements the regulations for the authorisation and operation of trading platforms which were specified by the MiFID. Two newly passed statutory ordinances and changes to existing statutory ordinances in accordance with the WpHG define the legal

● New trend: loans from private parties to private parties.

● FRUG and InvÄndG.

specifications of the FRUG in greater detail. The same also applies to the EU MiFID Implementing Regulation, which can be applied directly without being transposed into national law.

The Act Amending the German Investment Act (Investmentänderungsgesetz – InvÄndG), which came into force on December 28, 2007, modernises and simplifies the regulations that German asset management companies have to comply with when setting up funds in Germany. The objective of the law is to increase the international competitiveness of the German fund industry, without neglecting investor protection. The InvÄndG will help to reduce the bureaucracy in the financial sector: the complexity of the regulations will be cut back to the European harmonisation provisions, and some disclosure obligations will be suspended or simplified. Moreover, two new asset classes will be created and the general conditions for open-ended real-estate funds will also be improved. In addition, the InvÄndG will further enhance investor protection and corporate governance.



## II Economic environment

### 1 Financial system in severe endurance test

#### ● Crisis escalates.

After several quiet years with favourable financial markets and steady growth of the world economy, dark clouds built up over the international financial system in 2007, emanating from the US mortgage market, which developed into a hurricane-like storm during the rest of the year. The constantly growing tensions posed a serious test for global financial stability. There was no comprehensive improvement by the end of the year. The after-shocks will therefore still be clearly felt in 2008. There is even a risk that the financial crisis may even break through to the real economy in an even more acute form and more severely than first expected. In this scenario, there would be a fear of additional negative feedback effects reaching the financial system via the general economy.

#### ● Origins in the uncontrolled growth of the US sub-prime market.

The distortions originated in the uncontrolled award of residential real-estate loans to low-income private persons in the United States. This "sub-prime" segment was still virtually insignificant just a few years ago. In 2001, just 2.6% of all outstanding US residential building loans were allocated to borrowers with a poor credit rating. Yet, after that, an extraordinarily dynamic growth phase began to build up momentum. The weighting had already increased to 14% by 2007. Two long-term developments stimulated the financing of residential properties through mortgage loans, which often featured variable interest rates. On the one hand, the short-term interest rates were extremely low for a relatively long period due to an expansive financial policy and, on the other hand, there was a consistent increase in housing prices over several years. However, the decisive driver was the securitisation business.

#### ● Detrimental incentives in the securitisation process at banks ...

Securitisation allowed the mortgage financiers to pass the credit risks quickly on to the capital market. Investment banks collected the individual loans, bundled them and sold them as bond-like, structured financial products such as Residential Mortgage Backed Securities (RMBS) or newly packaged as Collateralised Debt Obligations (CDO) to investors all over the world. As the risks disappeared very quickly from the banks' balance sheets, the credit institutions no longer had any incentive to place strict requirements on the credit rating of their customers when granting loans or to consistently monitor the loans through to maturity. On the contrary, in order to satisfy the continually growing demand from investment banks for material that could be securitised, they opened up new customer groups and granted mortgage loans to persons whose credit-worthiness would generally have been deemed insufficient in the past. In the heat of intense competition, many institutions ignored the usual standards for the prudent



granting of loans. In order to acquire new business, the mortgage financiers created more and more exotic credit variants such as "interest-only mortgages" with a payment-free grace period or "payment option loans" with negative amortisation, which attracted customers with low initial monthly instalments but were difficult to understand because of their complexity. Moreover, loans were often granted without any proof of income. Borrowers who lacked equity were often able to close the gap easily with an additional, subordinate loan. Not even the investment banks were urgently concerned about a high credit quality, because their business model is aimed at passing on the credit risks and generating the majority of their earnings from commission income for structuring innovative financial products. They therefore abetted the lax lending practice of the mortgage banks.

● ... and rating agencies.

A good rating was a prerequisite for the smooth sale of the securities, because many investors were bound to special investment regulations in order to avoid concentrations of risk. In actual fact, the majority of the structured products possessed a good to excellent rating, although most of the tranches possessed an appreciable proportion of second-class sub-prime loans. The rating agencies were confronted with the problem that they could not build their models on sufficiently reliable data from the past, because mass securitisation is still a recent phenomenon. In addition, they were exposed to serious conflicts of interest. As they are paid for rating structured products not by the investors but by the investment banks, they have an incentive to supply rating structures desired by the customer that will allow a quick sale of the securities on the market.

● Carefree investors on the hunt for good returns.

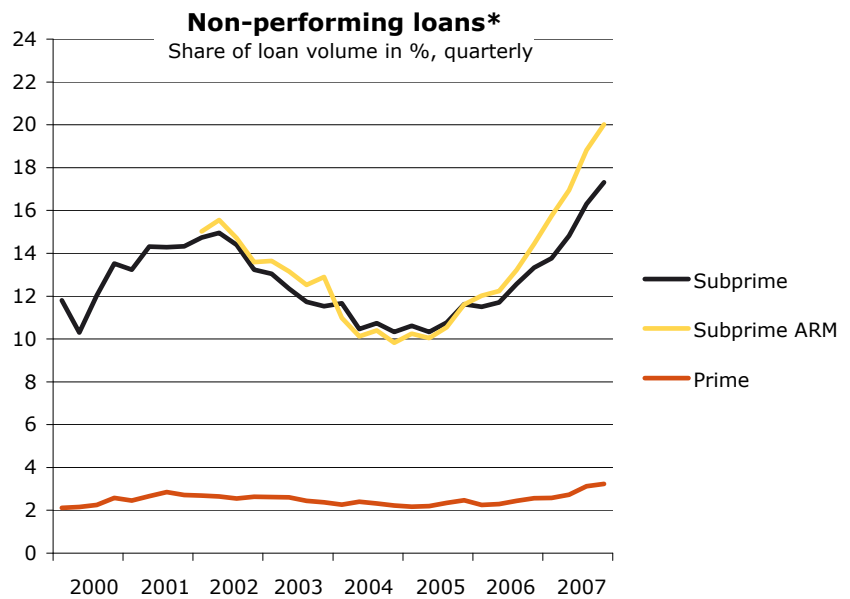
In an environment of unusually low interest rates in historical terms, investors spurred on the securitisation activities in the search for extra returns. Secure government bonds no longer offered sufficient interest to satisfy the demanding income expectations of the market participants. It was only possible to keep the securitisation machine running at such high speed for so long by increasing the demand for investments with a striking yield mark-up. In view of the essentially favourable macro-economic conditions, the investors became negligent and often blindly trusted the judgment of the rating agencies and did not carry out sufficient self-assessments of the basic quality of the structured securities.

● Increasing short-term interest rates and slow-down on the US housing market as triggers of the crisis.

The roots for the escalation of the crisis had therefore already developed. When the short-term interest rates increased considerably during the course of the tightening of the monetary policy in the USA since 2004 and the fundamental constitution of the housing market deteriorated significantly, the weak points in the securitisation system were brought to light. The financial position of the US borrowers was therefore trapped in a pincer-like grip from two sides at once: firstly, low-income borrowers without any relatively large reserves in particular were no longer able to pay their mortgages and had to give up their houses. The payment default rates in the sub-prime segment increased dramatically

and at the end of the year in 2007 even clearly surpassed the last record high just after the recession year of 2001. At the same time, adjustable rate mortgages (sub-prime ARMs) were affected particularly severely by this push because of the striking interest adjustment shock. The number of foreclosures also leaped upwards at a dramatic rate during 2007.

Figure 1  
**Payment default rates in US residential real-estate loans**



\* With at least 30 days' payment arrears.

Sources: Mortgage Bankers Association, Bloomberg

● Sub-prime crisis spreads to credit markets.

At first, it was primarily US mortgage banks that suffered from the increasing number of loan defaults in the sub-prime area, as they had to take struggling loans back from the investment banks due to contractual agreements and the actually rejected risks therefore landed back on their own books. Many were not able to cope with this situation, became insolvent and ceased trading or were taken over by other banks. As the terrible news from the US residential real-estate market built up in the summer and the credit quality became worse and worse, doubts about the lasting value of structured products became more widespread – especially any products relating to US sub-prime mortgage loans. The turbulence that had previously been restricted to the US mortgage market reached over to the credit markets and so entered an entirely new dimension.

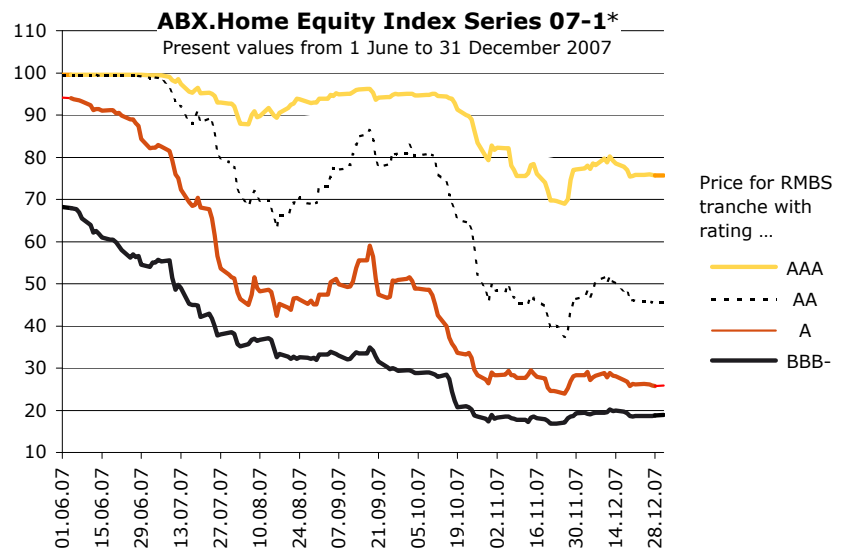
● Price collapse on the securitisation market.

A first wave of sales started on the securitisation market in July. Initially, this only affected the relatively poorly advised tranches, but the price losses subsequently extended like a cascade to the other tranches of the RMBS structures. Following an interim stabilisation, the persistently negative reports from the US housing market triggered another price slide. The ABX.Home Equity index

as a benchmark for the structured products based on underlying US sub-prime loans collapsed dramatically again and fell to new lows in November that had not even been considered possible in the past.

Figure 2

### Sell-outs on the securitisation market



\* Benchmark for structured products based on underlying US sub-prime mortgages.  
Source: Markit Group

● Abrupt swing in the risk tendency.

As the US sub-prime problems overlapped on to the credit markets, the risk premiums shot upwards. Opaque structured products were suddenly no longer in demand, because the experts realized that it was not possible to assess the risks reliably. Entire market segments dried up, so it became almost impossible to determine meaningful prices for this type of financial products. High-risk, leveraged financing such as leveraged buy-outs (LBO) started to falter and could not be passed on to the capital market as easily as before. The investment banks operating in this sector found themselves exposed to so-called "warehouse" risks because they had to retain the financing plans in their own books much longer than planned. A whole series of LBO transactions were deferred, restructured at new rates less favourable for the banks or even abandoned entirely.

● Rating agencies heighten the nervousness of the market participants.

The rating agencies helped to intensify the crisis with their initially hesitant behaviour. Although the number of defaults in sub-prime loans was building up, they clung for a long time to their originally awarded high ratings. Over the course of time, it became clearer and clearer that the applied rating models were not able to accurately depict the default probabilities of the sub-prime mortgage loans. These methodological flaws fuelled long-term doubts in the reliability of the rating judgments for structured financial products. It was only when the public pressure

became stronger that the agencies performed an about-turn and downgraded securities with notable sub-prime components on a broader and, in some cases, radical basis. Some RMBS tranches even fell in a single step from the highest quality grade (AAA) to categories below the investment-grade range. This response by the rating agencies, which was more aggressive than ever before, only served to irritate the market participants even more.

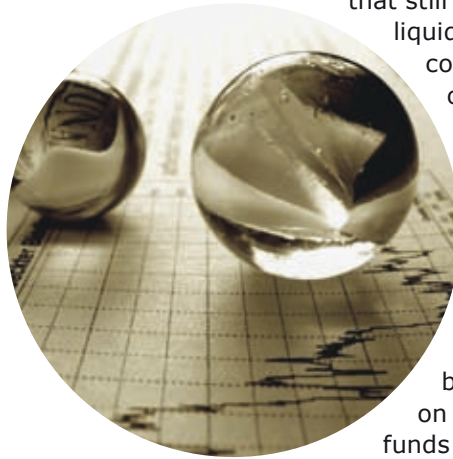
Risks strike back against bank balance sheets due to off-balance-sheet special-purpose companies.

In the summer, a trouble spot developed that shook the German banking sector in particular. By founding off-balance-sheet special-purpose companies and through the creative design of their contractual relations, the banks had found a way to avoid supervision and participate in the interest income from structured products, without having to maintain any regulatory equity. These special-purpose companies are "conduits" that refinance themselves in the short term through the issue of asset-backed commercial papers (ABCP) and also structured investment vehicles (SIV) where the refinancing structure tends to be aimed at the medium term through the additional issue of medium-term notes (MTN). In order to guarantee the smooth sale of the commercial papers and favourable subsequent financing, the initiating banks granted the conduits liquidity facilities for emergency situations and acted as "sponsors" for the SIVs, so that the programmes were given an excellent rating. The investment vehicles primarily purchased long-term asset-backed securities and CDOs with the accrued funds - often also with a link to the US sub-prime market. The business model is therefore essentially aimed at generating income from the difference between long-term and short-term interest rates. As long as the quality of the acquired assets is in order and the yield curve is not inverted, this is a virtually risk-free transaction. However, as the sustained value of assets with a US sub-prime component came into question, the investors refused to retain the mature commercial papers in their portfolios. The sale of money market securities collapsed within just a few weeks. The sponsor banks had to honour their liquidity pledges or take large portions of the assets of the special-purpose companies that could no longer be refinanced via the market on to their own books, partly in order to avoid damage to their reputation. The supposedly outsourced risks struck back with full strength against the bank balance sheets. The liquidity management of most of the credit institutions operating in this area, including several in Germany, was not prepared for such an extreme scenario. Two medium-sized German institutions with a relatively low earning dynamic from their operating business had built up excessively large positions in these special-purpose companies in relation to their size and risk capacity and found themselves in an existence-threatening situation after externalising the pledged liquidity lines, and they were only saved from collapse by support measures from the German banking system.

Crisis of confidence paralyses the inter-banking market.

The unexpected need for liquidity resulting from the investments via ABCP conduits and SIVs led to bottlenecks on the inter-banking market, where banks lend funds to each other in the short term.

The dramatic and continued loss of value of US mortgage liabilities also aroused fears that some banks could slip into insolvency problems. As many institutions were not able or did not wish to disclose the positions that they had taken up on the US sub-prime mortgage market, this led to a serious crisis of confidence which almost completely paralysed the inter-banking market. Banks that still possessed liquidity preferred to hoard their liquid assets as they could not reliably assess the counterparty risk due to the lack of transparency of the sub-prime investments of their potential business partners. Moreover, they began planning extremely carefully in this uncertain environment so that, in an emergency, they would be able to manage any unexpected refinancing needs from their own sub-prime exposure. At times, the market-controlled liquidity compensation between banks was severely disturbed, so that the leading central banks all over the world were obliged to intervene on several occasions and to inject central-bank funds into the market.



● Difficult valuation issues as a factor that intensified the crisis.

The financial and confidence crisis also proved to be so obdurate and troublesome because of valuation problems. According to the international accounting regulations (IFRS), the point of reference must always be market prices, in order to determine a "fair value" ("mark-to-market"). However, as broad sections of the securitisation market had collapsed, there were often hardly any reliable market prices available for the illiquid structured products, so the banks had to turn to substitute solutions ("mark-to-matrix"). Although the IFRS specifications permit model-based valuation approaches ("mark-to-model") in the case of markets disrupted in the long term, they should only be applied extremely restrictively. For instance, both national and international accounting forums pointed out the need for a near-market valuation, even in the context of the difficult market situation. In view of the extreme market situation, it was also questionable whether these institution-specific models are in a position to calculate realistic values. Moreover, the models are not standardised, which makes it much more difficult to compare their application between the individual banks. Financial institutions with strong earnings power and large equity cushions clearly tended to adjust their balance sheets quickly and to form large value adjustments in order to quickly establish a level of clarity. Weaker banks, on the other hand, acted more hesitantly to gain time and to fend off fears of solvency problems for as long as possible or to avoid them completely, because they hoped that the markets would recover in the meantime. All in all, it is virtually impossible for external market participants to assess with sufficient accuracy the lasting value of any investment portfolio including structured financial products in difficult market phases. This considerably worsened the lack of transparency and the uncertainty about the genuine risk of individual banks.

● Massive value adjustments.

Many major international banks had to carry out drastic value adjustments on their sub-prime investment in the second half of the year. The lion's share was allocated to the major US institutions, but many European banks were also affected. Insurance companies and hedge funds – with a few exceptions – escaped extremely lightly. To a large extent, it had been unclear beforehand exactly where the risks transferred via the capital market ultimately landed. However, the uncertainty had not subsided even by the end of 2007, because many parties predicted a considerable and not yet realised need for depreciation in light of the continuing intensification of the crisis and many financial intermediaries still lagged behind the market developments with the merciless disclosure of their actual risk positions.

● 2008 will again be a difficult year.

The start of the year 2008 was extremely turbulent. The prices for structured financial products, which are based on US sub-prime mortgages, could not find any support and fell to new record lows. The value adjustments of numerous major banks on their ABS portfolios increased at times considerably during the first quarter. With the collapse of a US investment bank and its hurriedly organised emergency sale to a competitor, the financial crisis reached a new climax. The turbulences expanded further and gripped not only the banks but also other financial sectors more severely than before. The world's largest insurance group, for instance, had to carry out a high level of depreciation on its credit default swaps (CDS). Hedge funds are increasingly coming under pressure, because the "prime brokers" as financing banks are being confronted by higher liabilities for subsequent payments. The drastic increase in the refinancing costs also affected the commercial real-estate markets, especially in the United States and Great Britain. The issue of commercial mortgage-backed securities (CMBS) came to a virtual standstill, and the subsequent financing of large-scale projects also faltered. As a consequence, the prices came under pressure and the credit quality began to deteriorate in this market segment, too.

So far in 2008, the signs that the sub-prime crisis is gradually transferring to the real economy have started to multiply. The confidence of US consumers has collapsed dramatically in recent months. The falling house prices have crushed assets, so that private households have had to restrict their consumption. In spring 2008, the US economy was faced by an imminent recession. The depth and duration of this economic slowdown will essentially depend on the extent to which the global economy and the credit cycle in the international corporate sector are also dragged down.

Against this background, the German financial system will also face considerable challenges in 2008. The financial crisis will only be able to subside when the fundamental situation at the epicentre, the US housing market, calms down. There was little sign of that, even most recently; the fall in the housing prices was even continuing to accelerate. It will therefore take a considerable amount of time until the huge imbalances on the US housing market have been evened out.

### **Sub-prime crisis: a chronology of important events in 2007**

#### February

HSBC publishes the first profit warning of its company history. This was due to losses for its subsidiaries operating in the US mortgage business.

23 US mortgage financiers register – in some cases, massive – losses.

#### March

A far higher risk aversion is registered for the first time: bonds register price gains, while international equity markets show a weaker tendency and CDS spreads become more widespread.

#### April

New Century Financial, one of the largest US mortgage financiers, applies for insolvency.

#### May

UBS closes a hedge fund that was invested in structured financial products with sub-prime underlyings.

#### June

Several agencies downgrade the rating of hundreds of MBS, mostly involving relatively low tranches with a sub-prime underlying. The volume of affected papers amounts to approx. \$17 billion. The spreads at European addresses with a relatively poor credit rating increased noticeably. The flight to secure investment products accelerates with the dramatic increase in risk premiums and the growth of the Bund-Future.

Bear Stearns and Goldman Sachs disclose heavily burdened quarterly results.

Two hedge funds at Bear Stearns slide into difficulties due to sales problems with CDOs. Bear Stearns announces that the two funds are practically worthless.

#### July

Reports about the difficulties of originators and hedge funds, as well as rating downgrades of CDOs with Alt-A mortgage underlyings, become more and more common. Significant LBO transactions begin to falter. The market liquidity for structured products falls extremely quickly, and tranches with better ratings and structured products with other forms of collateral are also affected.

The strong risk aversion causes markets to dry up, and this leads to considerable sales problems for ABCPs.

Banks cancel credit lines for Rhineland Funding that are managed off the balance sheet by the IKB. The Reconstruction Loan Corporation (KfW) takes on IKB obligations worth €8.1 billion. At a crisis meeting, the KfW and the German banking industry decided to set up an additional risk screen in the amount of €3.5 billion.

Money market funds with a link to structured products, such as funds of BNP and Sentinel, come under pressure. As a result,

several money market and ABS funds (especially funds set up in Luxembourg and France) suspend redemptions. The high levels of uncertainty also lead to a shortage of liquidity in this segment. The money market rates climb rapidly. The major central banks make considerable liquidity available for the money markets at short notice.

#### August

The US mortgage bank American Home Mortgage Investment can no longer serve its creditors. By this time, about 50 US mortgage financiers have slipped into precarious situations.

WestLB announces that it has invested €1.2 billion in the US mortgage market. Shortly afterwards, it places the majority of its ABS from mature ABCP that can no longer be positioned on to its books (volume by year-end approx. €21 billion).

Goldman Sachs is obliged to support a hedge fund with \$2 billion, and the largest US mortgage financier, Countrywide, confirms financial shortages.

The Sparkassen-Finanzgruppe has to support the precariously positioned Ormond Quay fund of SachsenLB with a credit line worth €17.3 billion. LBBW subsequently takes over SachsenLB.

Rhinebridge, which belongs to the IKB, is the first conventional SIV to begin liquidating its assets. Over 160 US mortgage financiers are already reported to be in serious difficulties.

#### September

The fifth-largest British mortgage financier, Northern Rock, encounters difficulties. Panicking customers withdraw deposits of approx. €2.9 billion. The share price crashes by about 30%. The Bank of England steps in with an emergency loan for the first time in decades.

The US Federal Reserve lowers the key interest rate and the discount rate by 50 basis points; the stock exchange reacts euphorically.

#### October

Numerous institutions announce serious debts and necessary depreciations, including Merrill Lynch with \$7.9 billion, UBS with \$3.6 billion and Deutsche Bank with €2.2 billion.

Citigroup, Bank of America and JP Morgan plan a rescue fund of \$75 billion to buy securities from investment vehicles. In the meantime, difficulties in the valuation of illiquid assets begin to shape the discussions.

The US Federal Reserve pumps massive amounts of liquidity into the money market.

#### November

More companies announce the need for serious depreciations, including HSBC with \$12 billion, Citigroup with \$11 billion, Morgan Stanley with \$3.7 billion and AIG with \$2.7 billion. Fanny Mae announces a collapse in profits, and Freddie Mac completes the third quarter with a loss of \$2 billion.

The losses due to foreclosures (because of sub-prime) in the USA will total up to \$300 billion, according to an OECD study.



Various major issues of covered bonds are postponed by the banks, and the risk premiums increase dramatically.

HSBC takes its two SIVs (Cullinan and Asscher) on to its own books and takes over liquidity guarantees of \$35 billion.

The central banks announce further injections of liquidity worth billions.

The risk shield of the IKB is increased by €0.3 billion to €3.8 billion. The internal KfW risk provision for IKB risks now totals €4.95 billion due to the revaluation and the recent stocking up.

#### December

Further serious depreciations are announced, including UBS with \$10 billion, Morgan Stanley with \$9.4 billion and Merrill Lynch with \$8 – 11.5 billion. Since October, more than ten American banks and funds have supported their money market funds with a total of \$3 billion. Many banks place the assets of SIVs on their own books (for example, Citigroup, \$49 billion).

WestLB supports its non-balance-sheet special-purpose companies (Harrier Finance and Kestrel) with a credit line of approx. \$11 billion.

The US government and leading mortgage banks have agreed a five-year interest moratorium for sub-prime loans with progressively increasing interest rates. According to the specification of the depositor's guarantee fund, 1.7 million contracts with a volume of \$367 billion will be affected by this in the next two years alone.

The parties reach an agreement in the planned takeover of SachsenLB by LBBW.

In a concerted action, international central banks intend to counter the liquidity shortages on the inter-banking market. Later, the US Federal Reserve pumps a further \$20 billion into the money market.

The most significant central banks inject further liquidity into the inter-banking market in a concerted campaign. The European Central Bank provides the highest amount so far in its history. The government fund Temasek from Singapore acquires shares in Merrill Lynch for \$4.4 billion (14 % reduction), while the investment company Davis Selected Advisors purchases shares for \$1.2 billion.

The foundation of the planned rescue fund in the USA is cancelled.

The Canadian investment bank Coventree (largest sponsor for ABCP) is on the brink of bankruptcy.

## 2 Financial markets

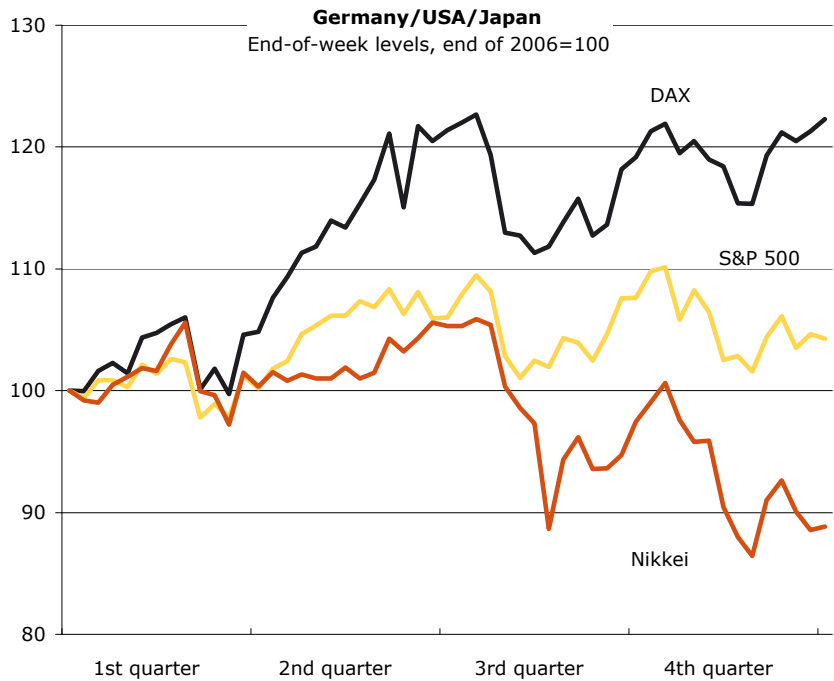
- Tension due to the combination of growth and the financial crisis.

Although the positive growth prospects for the global economy had inspired the international financial markets in the first half of 2007, the onset of the sub-prime crisis on a broad scale led to considerable price losses. The market volatility also increased considerably. The spreading of the real-estate market crisis to large parts of the capital markets hit the credit and bond markets in particular. There were increasing numbers of defaults on the corporate-bond markets during the financial crisis. The spreads climbed strongly in the second half of the year, although they had only lingered at a low level with only slight movements in the first six-month period. Overall, however, the sustained general trend towards growth was able in 2007 to counter the negative effects from the financial crisis, so that the German financial sector in general and the banking sector in particular were able to withstand the immense pressure.

- Equity markets show two faces.

A positive economic outlook, low interest rates, a high appetite for risk among investors combined with good quarterly corporate results led to considerable gains on the international stock indices in the first half of 2007. Positive economic data from the emerging markets and the peaceful tendency in the Middle East also contributed to the rising prices. Negative reports from the Chinese equity market in the first quarter only interrupted the growth trend of the indices temporarily. From the middle of 2007 onwards, the sub-prime crisis, increasing interest rates, the high oil price, more conservative growth forecasts and negative economic reports from the USA led to considerable price losses. However, the reduction in the US key interest rate by 25 basis points in December and the rescue plan for sub-prime creditors passed by the US government pushed prices strongly back upwards in the final month of the year. Overall, the international stock indices – with the exception of the Nikkei – registered a positive result again in 2007. Even so, against the background of the still smouldering financial crisis, the markets were gripped by latent uncertainty despite the new highs at the end of the year, and this provided an early indicator of the price declines at the beginning of 2008.

Figure 3  
**Equity markets 2007 – a comparison**



Source: Bloomberg

● Germany's positive economic data inspires DAX.

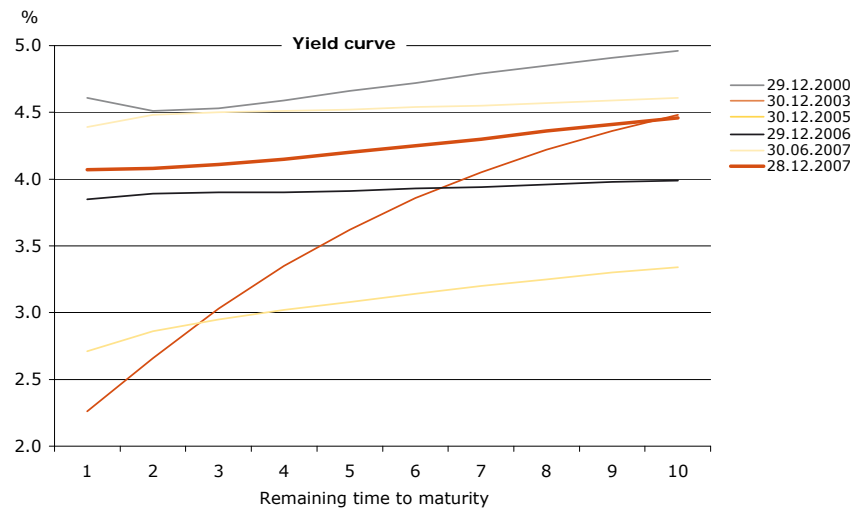
The German stock index DAX performed in a similar way to the international indices, although its figures overall were significantly more positive. Although the DAX, too, suffered from the effects of the financial crisis and the economic difficulties in the USA, it benefited at the same time from the positive economic developments in Germany. The German economy grew by 2.9% in 2006 and by 2.5% in 2007 despite the financial crisis. In June, July, October and December 2007, the DAX repeatedly surpassed the 8 000-point barrier, which was last reached at the beginning of 2000. During the course of the sub-prime crisis, the volatility index VDAX rose strongly towards the middle of the year and reached its high in August. However, after that the index fell back again, presumably partly due to the strength of the economic situation in Germany.

● Yield curve in Germany is at times slightly inverted.

The currently flat and, at times, slightly inverse yield curve gives cause for concern, especially in view of the financial crisis and the receding possibilities of maturity transformation for German banks. The already extremely flat trend of 2006 continued in the early stages of 2007. At the beginning of the financial crisis, the problems of confidence at the banks led to steep hikes in the short-term interest rates on the money market. From October 2007, this caused a slightly inverse trend in the yield curve in the segment of up to one year. The interest difference between short-term (3-month Euribor) and long-term interest (ten-year federal bond) stood at about -38 basis points at year-end. In the USA, the yield curve has already been inverted since 2006. This inverse trend was made even more acute in the USA by the sub-prime crisis. By

the end of 2007, the interest difference in the USA was extremely negative at -66 basis points.

Figure 4

**Yield curve of German bond market\***

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

Source: Deutsche Bundesbank

Financial crisis leads to cuts in US key interest rate and to central-bank activities on money markets.

Due to the positive European economy and growing inflationary tendencies, the European Central Bank (ECB) raised the key interest rate in the first half of the year in two steps from 3.5% to 4% and maintained it at that level until year-end. The US Federal Reserve kept the key interest rate constant at 5.25% for a long time, and it was only during the course of the financial crisis that the Fed reduced it in several steps to its final level of 4.25% in December. As the call-money rates on the inter-banking market increasingly reached new record highs of almost up to 5%, numerous central banks, including the ECB and the US Federal Reserve, provided liquidity for the markets on several occasions through money market activities. This was designed to counter the liquidity shortages that arose after the beginning of the sub-prime crisis due to loss of confidence in the banks and also, from the point of view of the Federal Reserve, to re-energise the slowing economy in the USA.

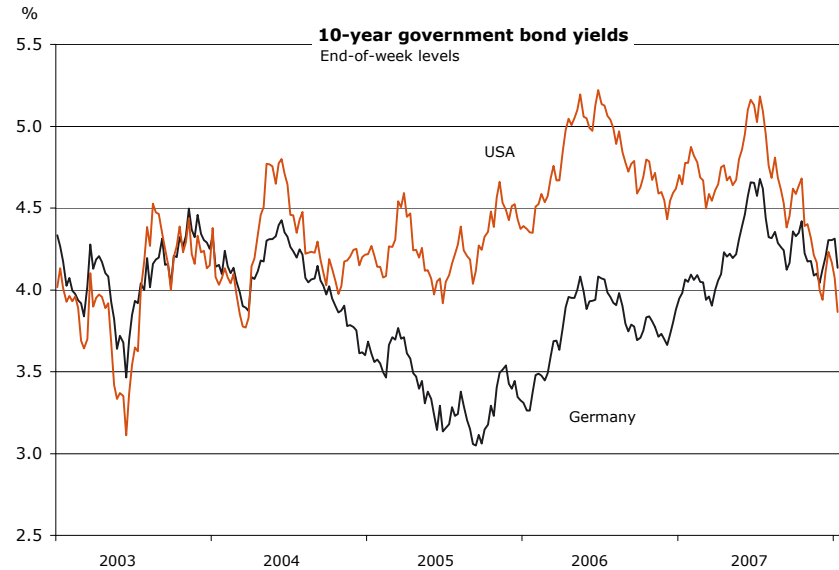
Yield advantage of the USA in long-term governmentbonds lost by the end of the year.

The yields of long-term government bonds in the USA and Germany tended to perform in a similar fashion up to the end of the third quarter 2007. The strong economic growth and expectations of inflation, which were fed by the climbing oil price, pushed the yields up strongly up to the middle of the year. The sub-prime crisis that began at that time led to a strong increase in the demand for safe securities, and especially relatively long-term government bonds, so their yield fell back. Moreover, the imminent economic slowdown in the USA that was also due to the financial crisis dampened relatively long-term yields. In spite of this financial crisis, the economic outlook for Europe and for Germany in particular remained extremely stable against the fears of recession in the

USA, and at the end of the year this meant that the USA lost its yield advantage and for the first time in many years was exposed to a yield advantage for Germany of approx. 20 basis points. Up to the end of November, the yield advantage of the USA had still been between 40 and 60 basis points on average.

Figure 5

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

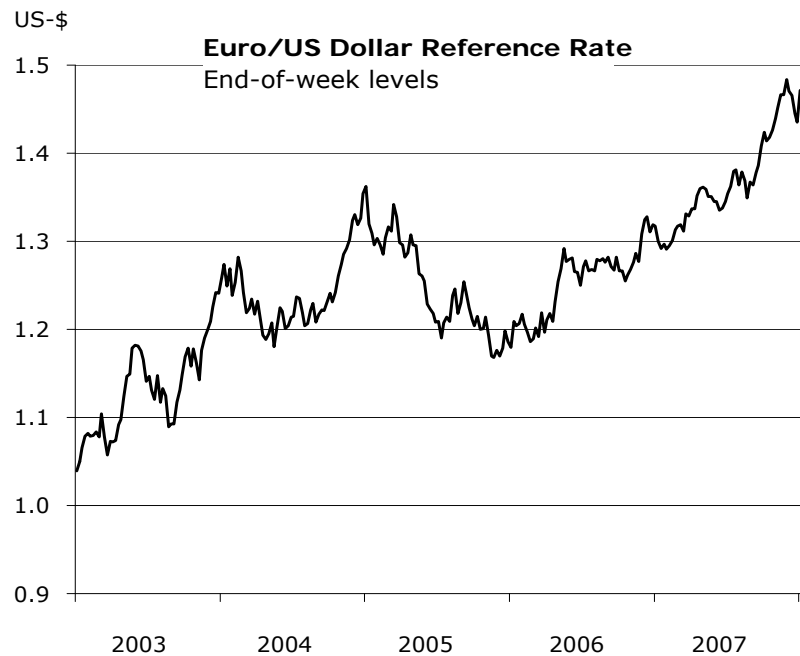


Source: Bloomberg

● Continuous gains in value for the euro.

In 2007, the euro registered a continuous upward trend against the US dollar. It started the year at \$1.30 and ended it at \$1.47. This strong gain in value was primarily due to the excellent economic performance in Europe and the sustained fears of recession in the USA. Moreover, there was also considerable restructuring of portfolios – for example, by Chinese investors – towards euro-denominated investments. The US dollar recovered slightly at the end of the year, as no further cuts in the key interest rate were expected in the near future in the USA because of inflationary fears.

Figure 6  
Exchange rate development



Source: Bloomberg

● Dramatic growth in derivative products due to negligent risk estimates.

The risk premiums for corporate and emerging-market bonds were still extremely low at the start of the year, and this further encouraged investments in complex risk products. The derivative markets also experienced considerable growth in 2007. Investors seem to have invested considerable amounts in risky product areas in an increasingly carefree way and without any detailed considerations of the risk, especially either directly or indirectly in derivative, subordinately hedged mortgage bonds in the US real-estate sector. This ultimately led to the outbreak of the financial crisis, which will continue to show its effects even in 2008. This is no longer purely a mortgage crisis, but it has also gripped other areas such as consumer credit.

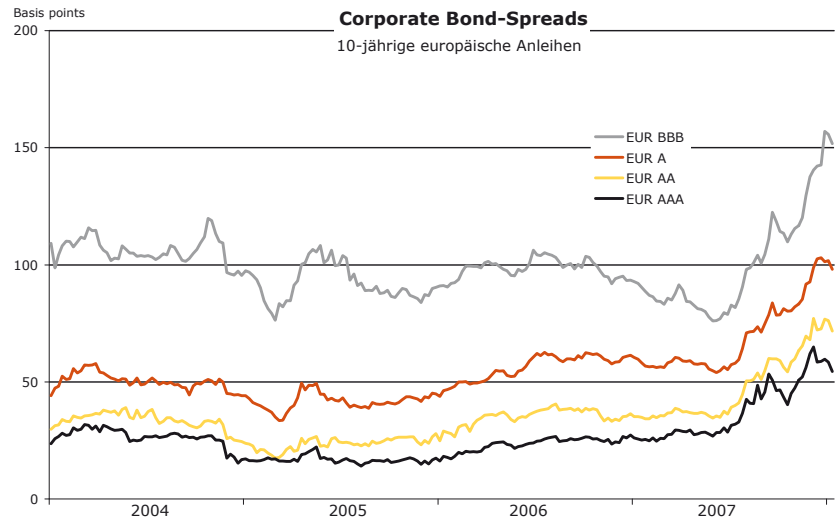
● Sudden growth of spreads.

Towards the end of June, the credit spreads in the company sector and in emerging-market bonds increased strongly due to the economic crisis, and even the German financial sector was affected directly. For a long time, such a connection to the US mortgage market seemed beyond the realm of the possible. However, the two cases of the IKB and SachsenLB were particularly significant and provided a stern test for the German banking and financial system. In 2008, too, numerous bond defaults and rating downgrades of derivative products are to be feared. Moreover, in the case of a recession, the US economy could pull the German financial economy down with it. The global imbalances, especially due to the still high level of the US trade deficit and the trade surpluses of Asian countries, have not yet been significantly resolved and they bring with them the danger that sudden adjustments could shake the financial markets even more. The tense situation on

the financial markets as a result of the turbulence on the credit markets will probably continue to test all the participants in the financial markets, including both financial institutions and the supervisory authorities, to the full in 2008.

Figure 7

### Development of spreads in the corporate sector



Source: Bloomberg

## 3 Banks

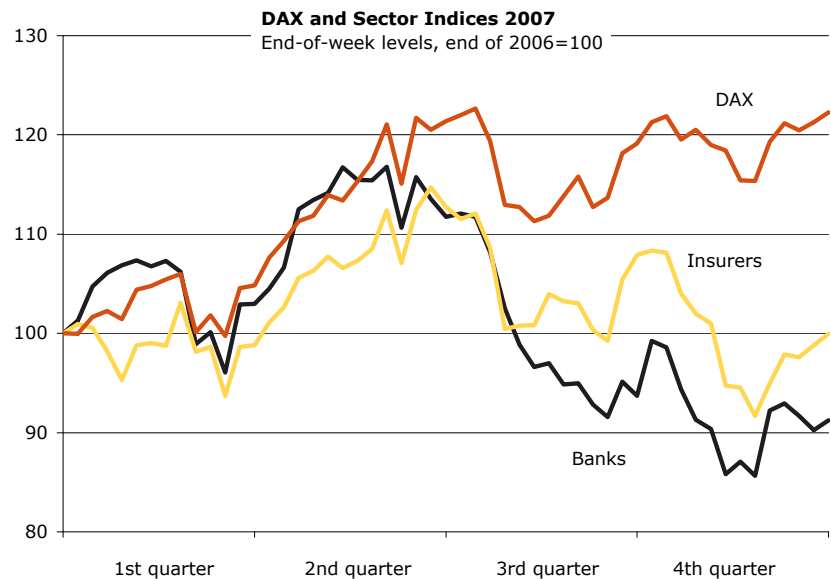
Market indicators clearly show tensions on the credit markets.

In particular from the second half of 2007, the market indicators clearly show the tensions on the credit markets as a result of the sub-prime crisis and also indicate an evident worsening of the situation for the German banking sector as well. As a complement to the mandatory reporting for regulatory purposes, market indicators provide an up-to-date reflection – generally long before the balance-sheet key figures – of sentiment among market participants regarding the future development of a company, thus providing valuable additional information for the regulators.

Up to the beginning of June, the stock index of the German banks climbed by approx. 17%, primarily due to high revenues from the volatile trading business. The index therefore climbed more strongly than the European banking index and the stock index of German insurers. Strong losses and/or uncertainties relating to the sub-prime crisis interrupted this above-average performance, because bank equities had to suffer severe setbacks because of the heightened need for depreciation and the increased risks. During the course of 2007, the banking-industry index suffered losses of about 9%, which is relatively severe in historical terms. The insurance index ended 2007 in much better shape, although it only repeated the level of the previous year after a similarly volatile

performance. Only the DAX, which was strong on the international level, closed with an appreciation of 22% at 8,067 points, which was close to its all-time high of 8,151 points.

Figure 8

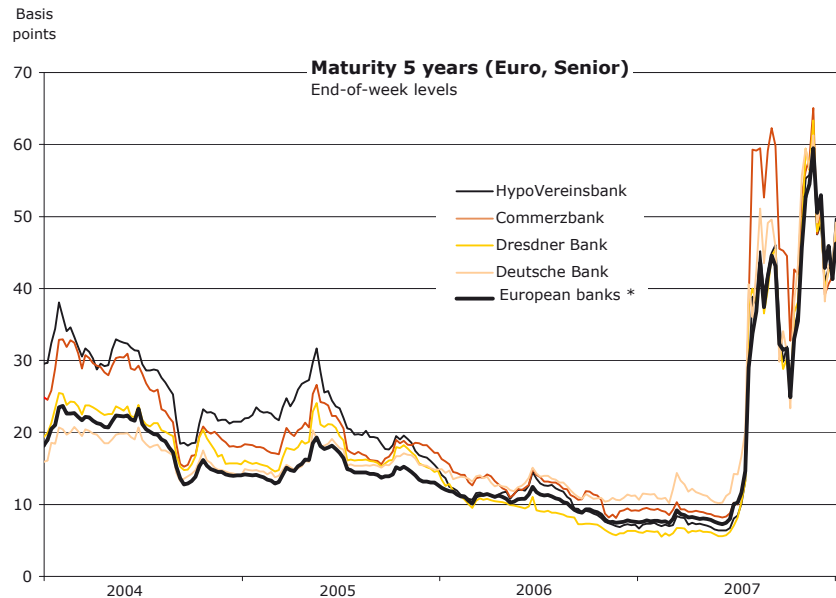
**German financial-sector stock indices**

Source: Bloomberg

The credit default swap spreads (CDS spreads) of German banks reached a historical low of under 10 basis points by the middle of 2007. In other words, in June 2007 a figure of less than €10,000 was sufficient to hedge debts of €10 million. This state of affairs changed abruptly within a month at the beginning of the sub-prime crisis; with CDS values at times reaching over 60 basis points, the spreads climbed in some cases to between six and ten times their previous lows. They therefore exceeded the CDS highs of the year 2004 by 50 to 100%. The CDS values of international competitors, especially in the USA, climbed in some cases even more strongly than the German ones. For example, it was necessary at times to pay a risk mark-up of over 160 basis points for CDS of certain American investment banks.



Figure 9  
**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 and 2006. In 2007, the rating agencies confirmed these estimates from the previous years for most banks. Certain individual banks were even able to improve their classification slightly. A small number of ratings were downgraded, in particular because of losses arising from special non-balance-sheet investment constructs (conduits) as a result of the sub-prime crisis. Nevertheless, a couple of exceptions aside and despite the progress made, German banks still receive poorer ratings than their international competitors.

● Stabilisation of earnings situation.

Thanks largely to higher trading results and the improved state of the economy as a whole, the aggregated earnings situation of the German banking sector stabilised further in the first six months of 2007. Nevertheless, there was a strong divergence even during this period between rapidly improving institutions and those that only improved slightly or even performed worse. As a result of the volatile market environment and the sub-prime crisis in the summer, the second half of the year saw severe earnings fluctuations or even losses, especially in the major banks and the Landesbanks. To cite an example: following a profit of over €4 billion in the second quarter, the aggregated trading result of the major banks in the third quarter was a loss of approx. €400 million. Business volumes that increased again in 2007 hardly generated higher interest earnings, and only partially resulted in higher levels of net commission income.

A growing volume of consumer credits supported higher interest earnings at times in the private customer business. However, depending on the competitive situation, these have either been eroded again by lower margins, or were in any case vital within the context of risk-oriented pricing due to the growth in consumer insolvencies. In addition to strengthened offerings from direct banks, the arrival of various foreign banks on the market also had a sustained negative impact on margins and thus on the earnings of domestic institutions.

Moreover, the flat yield curve caused the previously high earnings for many credit institutions from maturity transformation to fall further – especially in the case of savings banks and cooperative banks (Genossenschaftsbanken). For instance, the difference between the yields of one-year and ten-year German federal securities stood at just 39 basis points at the end of 2007. Moreover, one- to three-month interest rates increased unusually rapidly in the second half of the year in the course of the liquidity shortages. With customer deposits tending to be shorter term and loan commitments longer term, this situation led to a considerable drop in earnings.

In the case of German credit institutions, and of many of their international competitors, the year 2007 showed that certain sub-areas of risk measurement and/or control had been neglected when opening up new sources of revenue. For example, some banks appear to have relaxed their lending standards in the securitisation of loans and advances due to the diversification of risk, without simultaneously taking into account the new concentrations of risk arising from the purchase of such products or from guarantees for special-purpose companies.

Alongside the traditionally strong focus of the savings banks and cooperative banks (Volksbanken) on retail business, the major banks are also striving to expand their activities further in this sector. One proof of this was the great interest of the private banks in the sale of the Berliner Landesbank, where ultimately the German Savings Banks Association (DSGV) won out with the highest bid. For foreign competitors, too, who continued to force their way into the German market with new financial products, the German retail market appears to be attractive.



In terms of costs, the potential for savings is increasingly small following years of restructuring. 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, it is hardly possible to reduce the risk provision any further, because corporate insolvencies have reached their lowest level for six years and

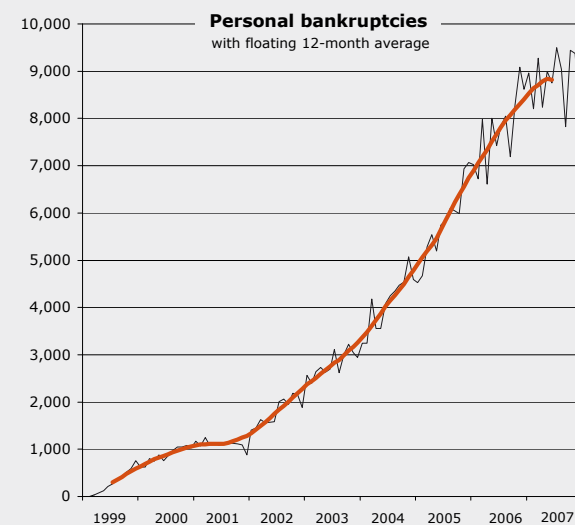
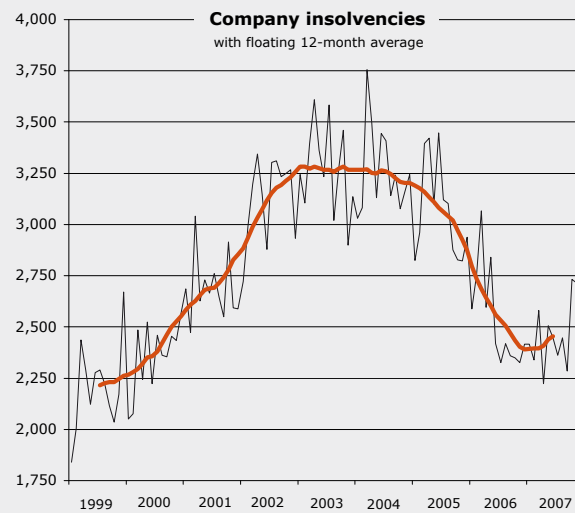
higher defaults are forecast because of the sub-prime crisis and the anticipated lower growth rates worldwide.

### Change in number of insolvency cases

The number of corporate insolvencies tended to fall slightly again in 2007. 29,160 companies failed – around 15% fewer than the previous year. The insolvency frequency therefore fell to the level of the year 2000, although the higher figures for the fourth quarter give cause for concern that the trend may already have reversed. The associated probable claims of creditors for 2007 fell by almost 19% to around €18.1 billion. Nevertheless, lower growth rates are to be anticipated for the entire economy in 2008 due to the credit crisis; they could ultimately also lead to higher insolvency figures and so to a negative development for the banks.

Figure 10

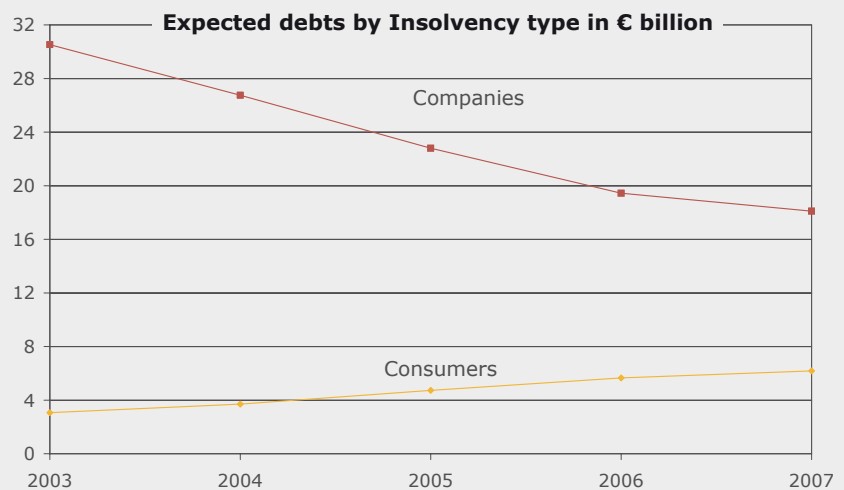
#### Number of insolvencies



Source: Federal Statistical Office, as at December 2007

In contrast to corporate insolvencies, the number of consumer insolvencies continued to increase because of the growing debt of private households. Alongside personal problems such as unemployment and divorce, the constantly more concerted selling of consumer credit is probably an additional factor in this development. In 2007, there was a total of 105,238 consumer insolvencies (+9% compared to the previous year), a new negative record. The probable claims also climbed by 5% to the current level of €6.2 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.

Figure 11  
**Volume of claims**



Source: Federal Statistical Office, as at December 2007

## 4 Insurers

● Positive development in the insurance sector.

The German insurance industry managed to further strengthen its earnings strength, its capital base and so also its solvency during the year under review. Nevertheless, the second half of the year was characterised by uncertainties connected to the sub-prime crisis. Thanks at least in part to the strict supervisory regulations for investment activities, however, the risks from the sub-prime crisis remained limited for German insurers. Various market indicators underline this overall positive assessment of the sector from a supervisory point of view.

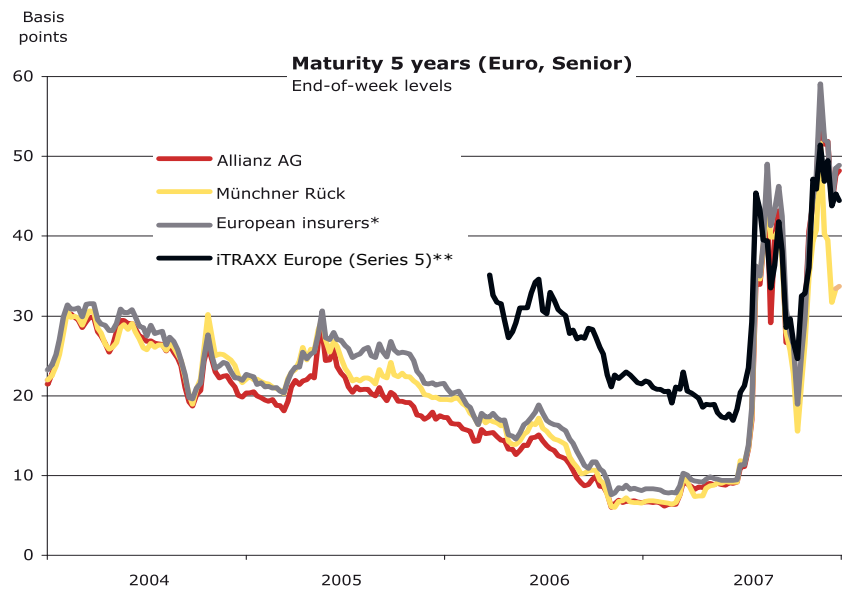
Apart from a temporary downturn affecting the DAX in general in March, the stock index of the insurance industry performed

● Risk premiums of German insurers remain low by international comparison.

extremely positively up to just before the end of the second quarter, but then collapsed at the start of the sub-prime crisis. Towards the end of the year, the insurance index returned approximately to the value at the start of the year.<sup>1</sup> During the course of the year, the performance was therefore considerably worse than that of the DAX, but far more favourable than the figures of the banking index.

The credit default swap spreads for insurers climbed slightly at first from March onwards on the basis of historically low values, and then extremely rapidly from mid-July as the sub-prime crisis took effect. At times in August and November, the risk premiums reached levels not seen since 2003. Towards the end of the year, the figures varied between 35 and 55 basis points. In spite of this increase, German insurers' risk premiums were largely lower than those of their international competitors during 2007. The market obviously views the default risk of German insurers as advantageous by international comparisons, even in a difficult financial-market environment. In the final months of the year, which were marked by the financial crisis, the market participants regarded German companies as no worse than comparable international competitors, and in certain cases the assessment was far better.

Figure 12  
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

<sup>1</sup> See Figure 8, German financial-sector stock indices.

Positive assessment by the rating agencies.

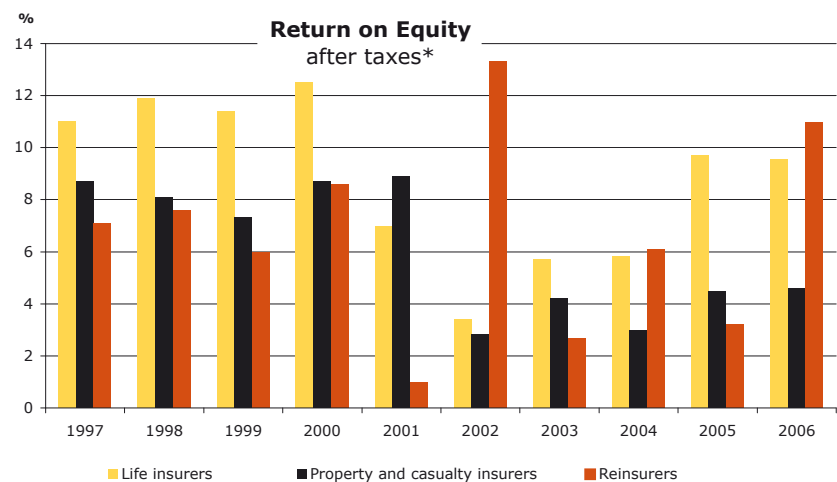


After the large number of downgrades in the years following the capital market crisis at the beginning of the decade, the financial strength ratings since 2004 point to a positive change in the assessment of German insurance companies by rating agencies. The trend towards upgrades continued in 2007. Although the total of upgrades was more modest than in the previous year, they were not offset by any downgrades. The ratings outlook for German primary insurers and reinsurers is still mainly stable or positive, with just a very low number of low forecasts. The outlooks of the rating agencies for the respective segments were also largely stable.

Earnings position of German insurance undertakings remains solid.

In 2006, the earnings position of German insurance undertakings remained solid. The results of the life insurers remained at the same level as the previous year, while the property and casualty insurers improved their profitability slightly. Compared to the costly damage events in the autumn of 2005, 2006 was a year with a tendentially below-average volume of hurricanes. This had an extremely positive effect on the profits recorded by the reinsurers. In terms of the sector average, the reinsurers' return on equity in 2006 was the second-best result in the last decade (behind 2002). The year 2007 is likely to be less favourable. This is primarily due to the damage caused by the unusually persistent winter storm Kyrill, which struck large areas of north-western Europe, and especially Germany, in January 2007.

Figure 13  
Profitability of German insurance companies by sector



\* Net profit after taxes, divided by equity.

Equity ratio hardly changed.

In 2007, total capital investment by all German insurance companies increased slightly by 3.3% to €1,288 billion over the previous year. The largest investment block remains fixed-income investments, that is, loans, Pfandbriefe, municipal bonds and other bonds from credit institutions. The equity ratio of the primary insurers stood at between 8.6% and 10.3% of the restricted

assets, compared to 9% to 10.4% in the previous year. In the life insurance sector, the equity ratio was between 8.3% and 9.9%, and so was virtually identical to the previous year (from 8.3% to 9.7%). Therefore, the risk arising from a sudden fall in share prices is still relatively limited for these companies. A similar pattern can be seen in the hedge-fund investments of German insurers, the rate of which was significantly lower than the regulatory maximum level of 5%. The total investment by German primary insurers in hedge funds was around €4.2 billion at the end of 2007, which represents about 0.4% of their total capital investments.

At the end of 2007, the yield from ten-year government bonds stood at 4.46%, about 50 basis points higher than during the previous year. This scenario had a positive effect on the earnings of life insurers from new investment in fixed-income securities. The interest level was even higher in the middle of the year, but then fell back again in the course of the sub-prime crisis.

● Multitude of natural disasters leads to higher damages payments at reinsurers.

The business performance of the property and casualty insurers was satisfactory overall in 2007, although the technical profit remained behind that of the previous year. The premiums in direct insurance business stagnated. This was partly due to the developments in motor insurance, where the strong price competition led to cuts in premiums. On the other hand, the claims expenditure climbed, so that the ratio of claim costs increased by about four percentage points to 93.0%. Although the reinsurers were spared any major disasters in 2007, more small and medium-scale natural disasters occurred than in any year since records began in 1974. This led to a notable increase in the claims expenditure compared to the previous year. Despite this high claims expenditure, the rating agencies paid tribute to the sector's efforts to improve its risk management techniques and confirmed the stabilisation of its financial strength. The rating outlook for the global industry remained stable.

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

Selected economic data	Units	2001	2002	2003	2004	2005	2006	2007
<b>GDP growth</b> <sup>1)</sup>								
Global economy	%	2.4	3.0	4.1	5.3	4.8	5.4	4.9
USA	%	0.8	1.6	2.5	3.9	3.2	2.9	2.2
Euro area	%	1.7	0.9	0.8	2.1	1.3	2.7	2.6
Germany	%	1.2	0.1	-0.2	1.2	0.9	2.9	2.5
Company insolvencies	number	32,278	37,579	39,320	39,213	36,843	34,137	29,160
DAX (end of 1987=1,000) <sup>a)</sup>	points	5,160	2,893	3,965	4,256	5,408	6,597	8,067
Interest rate money market rate <sup>2)</sup>	%	4.26	3.32	2.33	2.11	2.19	3.73	4.69
Interest rate capital market <sup>3)</sup>	%	4.86	4.81	4.08	4.04	3.36	3.95	4.31
Exchange rate of the €	1 €=...\$	0.90	0.95	1.13	1.24	1.24	1.32	1.47
Gross sale of fixed income securities <sup>4)</sup>	€ bn.	688	819	959	990	989	926	1,022
<b>Credit institutions</b>								
Credit institutions <sup>a) 5)</sup>	number	2,697	2,593	2,466	2,400	2,349	2,301	2,277
Branches <sup>a) 5)</sup>	number	54,089	50,868	47,244	45,467	47,333	40,332	39,838
Credit loans <sup>a) 6)</sup>	€ bn.	2,236	2,241	2,242	2,224	2,227	2,242	2,289
Net interest margin <sup>7)</sup>	%	1.12	1.20	1.16	1.18	1.17	1.15	1.15
Commission income surplus	€ bn.	25.3	24.3	24.4	25.3	27.8	29.9	29.9
Operational costs	€ bn.	81.0	78.3	77.3	75.8	78.8	81.4	81.4
Risk provisioning	€ bn.	19.6	31.2	21.8	17.2	14.1	14.0	14.0
Cost-income ratio <sup>8)</sup>	%	71.4	67.2	66.5	65.5	61.0	62.3	62.3
RoE <sup>9)</sup>	%	6.2	4.5	0.7	4.2	12.7	9.3	9.3
Solvency ratio <sup>a) 10) 22)</sup>	%	12.1	12.8	13.4	13.3	13.1	13.3	12.5
<b>Private banks</b>								
Credit loans <sup>a) 6)</sup>	€ bn.	605	594	579	575	580	587	627
Net interest received <sup>7)</sup>	%	1.15	1.34	1.17	1.25	1.27	1.33	1.33
Cost-income ratio <sup>8)</sup>	%	80.4	74.2	74.0	73.5	59.7	66.0	66.0
RoE <sup>9)</sup>	%	4.7	1.0	- 6.2	- 0.4	21.8	11.2	11.2
Solvency ratio <sup>a) 10)</sup>	%	13.6	14.4	14.5	13.7	12.7	13.7	11.8
<b>Savings banks</b>								
Credit loans <sup>a) 6)</sup>	€ bn.	563	572	577	573	574	576	578
Net interest received <sup>7)</sup>	%	2.28	2.38	2.40	2.35	2.29	2.19	2.03
Cost-income ratio <sup>8)</sup>	%	69.9	66.5	66.4	64.9	65.8	63.1	65.4
RoE <sup>9)</sup>	%	9.2	8.2	10.9	9.7	10.5	9.2	7.5
Solvency ratio <sup>a) 10)</sup>	%	10.8	11.2	11.5	12.1	12.6	13.1	13.2
<b>Credit unions</b>								
Credit loans <sup>a) 6)</sup>	€ bn.	331	335	338	342	348	353	360
Net interest received <sup>7)</sup>	%	2.41	2.49	2.51	2.51	2.46	2.30	2.13
Cost-income ratio <sup>8) 21)</sup>	%	76.7	73.1	69.6	68.7	69.9	64.4	76.3
RoE <sup>9)</sup>	%	7.5	9.7	10.6	10.3	13.9	10.9	7.9
Solvency ratio <sup>a) 10)</sup>	%	11.1	11.0	11.7	12.1	12.2	12.2	13.1
<b>Insurance companies</b>								
<b>Life insurance companies</b>								
Hidden reserves in investment portfolio (IP) <sup>11)</sup>	€ bn.	31.3	6.2	14.9	35.6	44.0	34.9	13.6
as % of IP book value	%	5.5	1.1	2.4	5.5	6.5	5.0	2.0
Ratio of fund units in IP <sup>12)</sup>	%	22.5	23.0	23.3	22.0	23.3	23.4	23.8
Ratio of borrower's notes and loans in IP <sup>12)</sup>	%	17.1	18.1	19.3	22.0	21.9	22.2	22.2
Net rate of return on IP <sup>13)</sup>	%	6.0	4.4	5.0	4.8	5.0	5.4	5.4
Net technical provision	€ bn.	476.4	502.8	520.6	536.2	551.2	566.5	566.5
as % of balance sheet totals	%	83.7	83.8	79.4	78.8	78.1	77.3	77.3
Surplus <sup>14)</sup>	€ bn.	13.4	5.1	9.2	9.7	14.2	14.1	14.1
as % of gross premiums earned	%	21.5	7.9	13.6	14.1	19.5	18.8	18.8
Eligible own funds (A+B+C)	€ bn.	44.2	39.8	42.3	43.9	49.1	54.6	54.6
Solvency margin <sup>15)</sup>	€ bn.	22.2	23.3	24.0	24.8	25.9	26.8	26.8
Coverage of solvency margin <sup>16)</sup>	%	199.0	170.4	176.2	177.4	190.0	203.8	203.8
Return on net worth <sup>17)</sup>	%	7.0	3.4	5.7	5.8	9.7	9.5	9.5
<b>Property and casualty insurance companies</b>								
Hidden reserves in IP <sup>11)</sup>	€ bn.	31.7	22.3	26.0	26.6	27.7	28.5	21.4
as % of IP book value	%	31.4	21.3	23.8	22.6	22.2	21.4	16.4
Ratio of fund units in IP <sup>12)</sup>	%	25.3	27.0	27.3	26.5	29.7	30.9	32.0
Ratio of borrower's notes and loans in IP <sup>12)</sup>	%	13.2	13.2	14.1	16.6	17.7	19.2	19.2
Net combined ratio <sup>18)</sup>	%	100.2	103.2	94.7	92.2	92.6	90.6	90.6
Eligible own funds (A+B)	€ bn.	24.4	25.0	7.8	8.4	8.8	8.8	8.8
Solvency margin <sup>15)</sup>	€ bn.	7.1	7.4	7.8	8.4	8.8	8.8	8.8
Coverage of solvency margin <sup>16)</sup>	%	342.7	336.9	346.0	286.3	255.3	310.7	310.7
Return on net worth <sup>17)</sup>	%	8.9	2.8	4.2	3.0	4.5	4.6	4.6
<b>Reinsurance companies</b>								
Hidden reserves in IP <sup>11)</sup>	€ bn.	89.2	35.8	34.3	37.2	49.9	57.7	61.8
as % of book value	%	54.2	18.5	15.6	17.2	22.0	26.4	30.0
Net combined ratio <sup>18)</sup>	%	115.3	101.6	92.8	93.5	93.8	89.2	89.2
Gross technical provisions	€ bn.	122.3	130.6	135.8	140.8	154.4	143.1	143.1
as % of gross premium income	%	278.6	244	264.4	298.5	340.0	330.3	330.3
Net profit for the year <sup>19)</sup>	€ bn.	0.3	5.4	1.4	3.4	1.8	7.3	7.3
Available capital <sup>20)</sup>	€ bn.	31.5	40.2	51.4	55.1	57.6	66.3	66.3
Return on net worth <sup>17)</sup>	%	1.0	13.3	2.7	6.1	3.1	11.0	11.0

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 I).

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.14 form 2 RechVersV.

20) Total capital - unpaid capital contributions.

21) The cost-income ratio in 2007 totalled 76.3% in 2007 compared to 75.6% for the previous year due to the fiscal special items in 2006 only in the partial operating result including the results from financial and commodity business.

22) Following the implementation of Basel II in the KWG, or rather in the SolvV, on 1 January 2007, the solvency reporting system was also revised. The previously reported solvency ratio is no longer calculated (pursuant to Principle I). However, the institutions still obliged to report all indicators that represent the relationship between all underlying risk positions and own funds. The average total indicators at individual institution level came to 12.5% as of 31 December 2007.

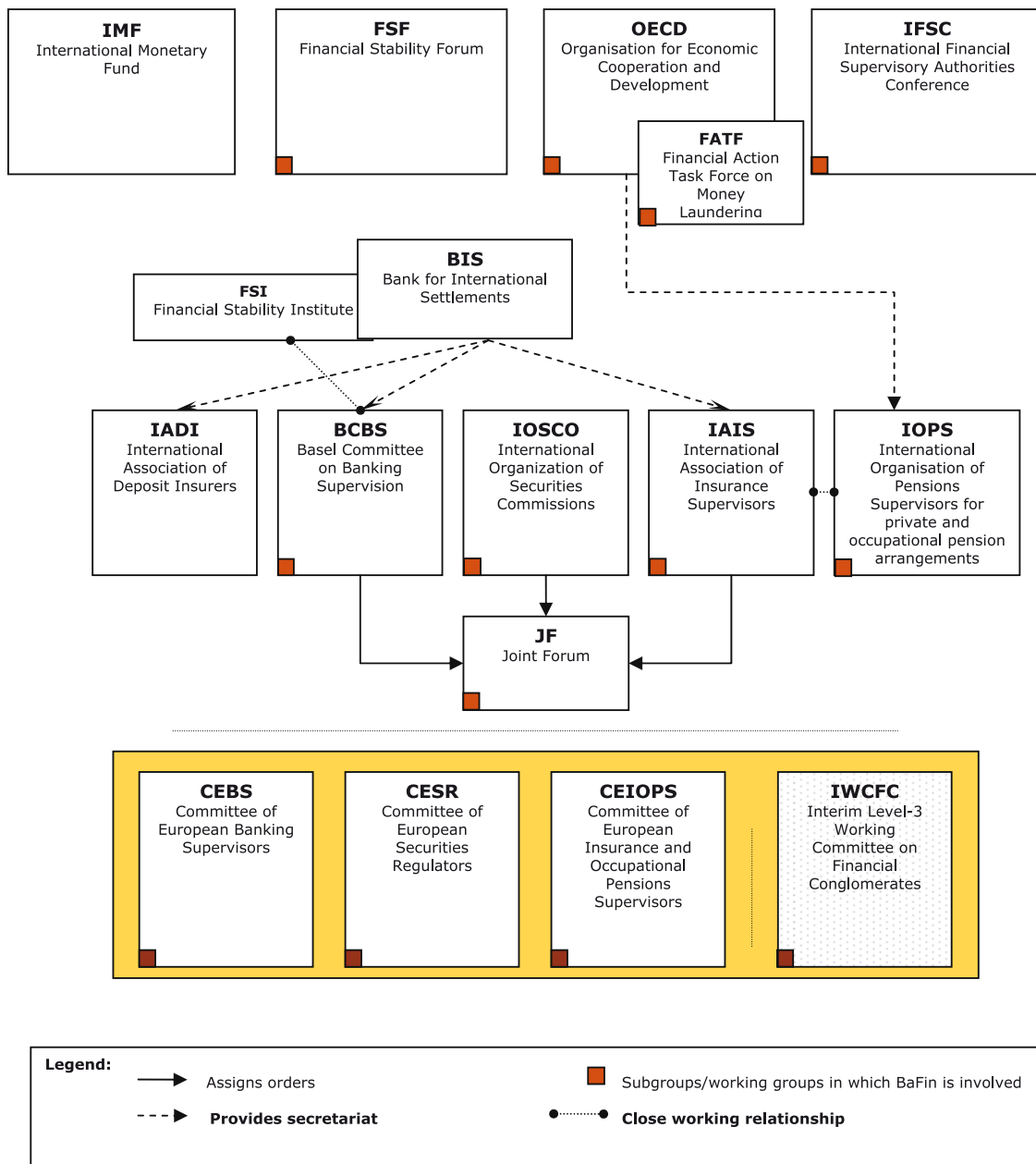




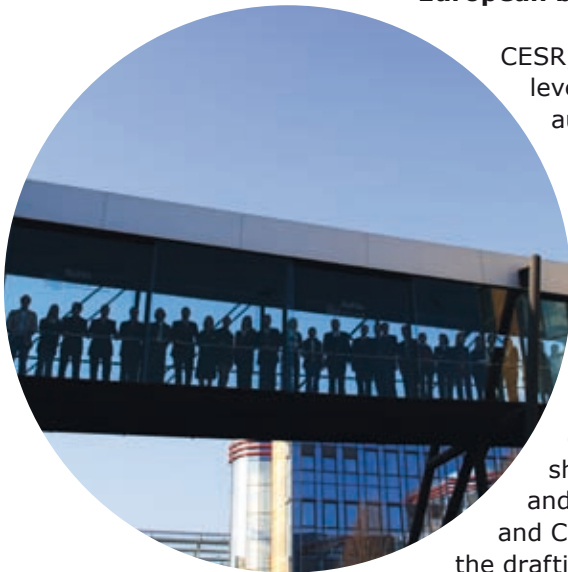
# III International

## 1 International harmonisation

Figure 14  
International institutions and committees<sup>2</sup>



<sup>2</sup> A detailed overview of the individual bodies and organisations can be found on p. 34 ff. of the BaFin 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 » BaFin » International).



### 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. The abbreviation CESR stands for Committee of European Securities Regulators. CEBS is the acronym for Committee of European Banking Supervisors. CEIOPS is the shortened version of 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.

The Interim Working Committee on Financial Conglomerates (IWCFC) is a new addition. The IWCFC is a committee of European banking and insurance supervisors that was founded in 2006 and is responsible for financial conglomerates. It is not a separate body but rather a joint committee of CEBS and CEIOPS. CESR and the European Central Bank are observers.

### International bodies

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

## 1.1 Financial stability and market transparency

### Financial stability

In the autumn, the Financial Stability Forum (FSF) focused its work on the latest market turbulences as a result of the sub-prime crisis. There were discussions as to what steps need to be undertaken to strengthen financial stability. At the initiative of the G7, the FSF decided to set up a new working group. This working group prepared a report diagnosing the causes of the events in the financial markets in the context of the sub-prime crisis,

Financial Stability Forum examines reasons for the sub-prime crisis.

identifying hitherto existing weaknesses and addressing them to the international standard setters (e.g. IAIS, IOSCO, BCBS, IASB). Specific recommended actions to increase market discipline and strengthen financial markets will also be provided in the report.

The FSF sees itself as a coordinating body that collaborates closely with the initiatives of the other bodies. Accordingly, in creating the report, the working group draws on the activities of other international organizations (such as IOSCO, BCBS, Joint Forum) in order to avoid duplication of work. It focussed on examining the role of the rating agencies in the area of structured financing, on risk management procedures of the institutes and on accounting practices, particularly the valuation methods for structured products. In addition, it dealt with core questions relating to supervision after the start of the crisis. The final report was published in April 2008 within the context of the G7 summit in Washington and contains over 60 suggestions for strengthening the global financial architecture.

### **European supervisory architecture**

● Review of the Lamfalussy process.

The review of the Lamfalussy process was on the European agenda in 2007. The EU institutions commissioned the Inter-Institutional Monitoring Group (IIMG), a group of high-level representatives of the European financial sector, to review this four-level process designed to make European financial market regulation faster and better. The IIMG turned particular attention to the 3Level3 committees (3L3) CEBS, CEIOPS and CESR; these bodies are responsible for advising the Commission in the enactment of European financial market rules and for supporting the convergent implementation of these rules in the individual Member States.

The IIMG's findings regarding the work of the Level 3 committees (L3) were positive overall: the provision of advice to the Commission by the L3 committees was particularly praised. The European Commission and the Council endorsed the good overall impression of the IIMG in their statements.

However, there was also some criticism and suggestions for improvement: it was found that the decision making of the L3 committees was sometimes too cumbersome due to the principle of consensus. CESR, CEBS and CEIOPS should therefore in the future be increasingly able to make decisions based on qualified majority. Furthermore, closer links are to be established between the L3 committees and the European institutions. To this end, the L3 committees will present the drafts of their work programmes to the Commission, the Council and the European Parliament and will report annually on their progress. Collaboration and information exchange between state supervisors in the supervision of cross-border banking and insurance groups is also to be intensified. In this context, it will be examined whether the cooperation with other supervisory authorities as well as the convergence of supervisory practice will be included as objectives in the mandates of national

supervisors. In addition, a common European supervisory culture is to be promoted through joint training events and employee exchanges. The discussion on the European supervisory architecture will also be continued in 2008.

### **Financial conglomerates and group supervision**

In 2007, the IWCFC, a joint committee of European banking and insurance supervisors, continued its work on supervision in accordance with the Financial Conglomerates Directive. The IWCFC hopes to contribute to the uniform and full implementation of the Directive in the Member States; the specifications of the Directive are currently being used for the supervision of 68 European financial conglomerates.

On behalf of the Commission, the IWCFC is examining the effects of capital regulations on the supervision of financial conglomerates, in which both banks and insurance companies are involved, and whether it is useful to align the sectoral regulations. The basis for the review is a 2006 report by the IWCFC on a comparison of the capital components that can be used as capital resources in banking and insurance supervisory legislation. This work is still ongoing.

A joint CEBS and IWCFC group examined whether the supervision of banking groups and financial conglomerates carried out in the USA and Switzerland corresponds to the European supervisory standard. If the standards are equivalent, an otherwise necessary additional supervision of the banking group or of the financial conglomerate by the Member States concerned could be dispensed with. The Financial Conglomerates Directive provides for such a possibility for groups whose parent company has its headquarters outside of the European Community (in so-called third states). At the beginning of 2008, the working group, in its recommendation submitted to the Commission, concluded that the consolidated banking and financial-conglomerate supervision of the Swiss and US supervisory authorities largely corresponds to the European standards. However, final statements for the US supervisory authority will not be possible until the Basle II Accord has been implemented.

The supervision of insurance groups is a major issue not only at European level in view of the draft EU Solvency II framework directive but also internationally. A working group in the IAIS is formulating principles for the supervision of insurance groups. The principles are to form a basis for internationally recognised supervision at group level and to ensure that this supervision is appropriate, uniform, consistent, efficient and effective. It is intended that these principles will be adopted in 2008. The working group wants to build further on this. According to the current status of discussion, the IAIS principles for supervision at group level make provisions for the following.

● Comparison of banking and insurance supervision legislation.

● Examination of supervisory standards in third states.

● IAIS principles for supervision at group level.

The supervisory authority assesses whether there are sufficient capital resources available; it assesses the technical suitability and reliability of the board and of executive staff as well as the reliability of holders of significant shareholdings. In addition, the supervisory authority evaluates the establishment of an appropriate risk management system and the internal control system. The supervisory authorities must have the technical know-how and the legal authority to exercise the group supervision. Lastly, all legal requirements and agreements must be in place to ensure an effective and efficient supervision through active cooperation and information exchange between the supervisory authorities involved.

There is no intention to reduce the significance of the supervision of individual companies or to in any way replace the role of the supervisor of individual companies. The IAIS principles for supervision at group level should in fact complement the supervision of individual companies.

### **Opportunities and risks of the insurance group**

In many significant global insurance markets, the insurance companies are often part of an insurance group. Belonging to an insurance group can have both positive and negative effects on the financial situation and the risk profile of an individual insurance company. The insurers that are members of the group are often closely integrated into the structures and processes of the group with regard to company policy, corporate management and risk management; the risk-bearing capacity of these companies can then also benefit from group membership.

On the other hand, the risk of cross contamination between the companies increases primarily due to interlocking capital arrangements and group-internal business relations. Sufficient capitalisation of the group overall and the technical suitability and reliability of the responsible persons are therefore of decisive importance for protecting the interests of the insurance holders and for achieving financial stability.

### **Handling data**

In 2007, the most important task of the MiFID markets group at CESR was to create a functional database to improve market transparency for the start date of MiFID. The database contains information on all shares that are admitted to trading on a regulated market in the European Economic Area.<sup>3</sup> On the one hand, it helps market participants to recognise significant "liquid shares" within the scope of the systematic internalisation in accordance with MiFID. On the other hand, the database also allows threshold values to be determined for an exception to pre-trade transparency and for delayed post-trade transparency.

<sup>3</sup> Available at [www.mifiddatabase.cesr.eu](http://www.mifiddatabase.cesr.eu).

In the future, all data will be updated once yearly on April 1. Continuous updates will be performed during the year with regard to new issues and delistings. Other ad hoc changes can be made if a change in relation to the shares or the issuers considerably influences the calculations on an ongoing basis. CESR has simultaneously set up a web service, which allows the data to be accessed automatically via an XML feed. Lists of systematic internalisers, regulated markets, multilateral trading systems and central counterparties are available in the database. At the turn of the year, the market was consulted regarding proposals for additional functions to be included in the database and these were implemented during the periodic change on April 1, 2008.

● Publication and consolidation of transparency data in the equity market.

Since November 2007, MiFID requires the anonymous publication of data on share transactions. In February 2007, CESR already published guidelines and recommendations on the publication of pre-trade and post-trade transparency data for shares and on the consolidation of market data to make it easier to understand the practical application of the level 2 Regulation Implementing the MiFID in this area. Parallel to this, BaFin entered into an intensive dialogue with market participants at national level particularly in order to clarify in good time questions relating to the practical application of the new post-trade transparency in OTC trading. In this way, it was ensured that the entry into force of the new regulations was as smooth as possible.

● Pre- and post-trade transparency not extended to bond market.

On behalf of the European Commission, CESR examined whether there is a need to extend the pre- and post-trade transparency of MiFID to the bond market. In its July 2007 report – which does not take the later sub-prime crisis into account – CESR arrived at the conclusion, following extensive consultation with the market participants, that there is no obvious market failure in the transparency of the bond market and that professional market participants in particular were satisfied with the market environment. The review is based on specifications in MiFID, whereby the need for an extension of the pre- and post-trade transparency introduced for shares was to be investigated for other financial instruments.

● MiFID: exchange of data on securities and derivatives transactions.

New rules on the reporting of transactions in securities and derivatives entered into force on January 1, 2008. While up to then all companies that are allowed to trade on a German stock exchange had to submit their reports to BaFin, the strict country of origin principle now applies. In order to ensure that other supervisory authorities beyond the addressee of the report can obtain access to the data in question, an EU Commission regulation from September 2006 sets out which data must be exchanged between the supervisory authorities and how the supervisory authorities are to obtain information from one another. With substantial support from the European supervisory authorities, CESR achieved the technical requirements and the requirements in respect of content for the defined data exchange. The exchange system that was thereby developed for reported data started on November 1, 2007. However, the transfer of derivative instruments

is currently excluded from the exchange. The reason for the delay in the data exchange for derivatives was the industry's request to use a different identification of these instruments compared to the original specification. An alternative identification was therefore worked out together with representatives of European associations, the Federation of European Securities Exchanges (FESE) and individual representatives of the industry. Although this solution spares the stock exchanges and the industry from making extensive changes in their systems, it calls for a considerable customisation requirement on the part of the supervisory authorities and CESR. This changeover will be implemented in the course of 2008.

● EU Transparency Directive – network of national storage systems.

In October 2007 and based on CESR proposals from the previous year, the EU Commission issued a recommendation for an electronic network of national storage mechanisms for capital market information in accordance with the Transparency Directive. On the one hand, the non legally binding recommendation formulated minimum standards for the national storage systems, which control the access to saved data and also data security. On the other hand, the recommendation concerns the electronic networking of national storage systems. CESR is therefore to take on the task of developing an administration agreement for the electronic network with the inclusion of the national storage systems. By the end of September 2010, CESR is to draw up guidelines for the further development of the electronic network.

● New CESR expert group set up for Transparency Directive.

CESR set up a new expert group in October 2007 as a reaction to a consultation with the market participants on the necessity of level 3 work on the Transparency Directive. As the Transparency Directive is devised as a minimum harmonisation directive, the Member States can go beyond the standards of the directive when implementing it. In order to make the application easier, the expert group is therefore to publish comparative information on the implementation of important areas of the Transparency Directive in the Member States; in addition, it is to find common solution proposals for practical questions on the Transparency Directive and its Implementing Directive. The expert group is also the correct contact for questions by the Member States regarding the Commission recommendation on the storage of capital market data as well as on the setting up of a network of storage mechanisms.

● CESR sets up Post-Trading Expert Group.

The CESR members set up the Post-Trading Expert Group (PTEG) in 2007. "Post-trading" means the steps that are necessary to ensure the exchange of financial instruments for money is actually carried out following the conclusion of a business transaction on the stock exchange. The group is to serve as a platform with the help of which the CESR members can exchange information and knowledge in this area and discuss regulatory questions that arise for individual projects. The Code of Conduct for Clearing and Settlement is currently an important project in the post-trading area. This is a commitment by the major organisations and companies in the area of clearing and settlement to establish cost transparency, interoperability and mutual access as well as to unbundle services. A project of the European System of Central



Banks is another important initiative in the post-trading area. This project, with the participation of the PTEG, aims at creating a standardised technical platform for the processing of securities transactions in Europe (Target 2 Securities – T2S project). The representatives of the industries affected by the projects are being intensively involved in the dialogue; in 2007 two consultations were held with association representatives. Work on the projects will be continued in 2008.

### Secondary markets

The IOSCO committee concerned with regulating secondary markets is chaired by BaFin. In 2007, it prepared a report on information requirements amongst the supervisory authorities for supervisory purposes. The report concludes with recommendations to the supervisory authorities on how the information can be exchanged effectively and in real time. Information requests should also be subject to a prior cost-benefit analysis. Furthermore, in 2007 the working group examined to what extent licensed traders can provide their customers with direct electronic access to the market. The resulting findings on the risks and benefits are to be included in a report.

### Consumer protection

The OECD Insurance Committee with the participation of German bodies (BaFin, the Federal Ministry of Finance (BMF), consumer protection organisations) produced a paper on the risks associated with insurance products. In autumn 2007, the paper was submitted for consultation to industry representatives, associations and other stakeholders and will be published once it has been passed by the OECD Council, which is expected to be in the first half of 2008. It highlights in particular the importance of education, information and dissemination of knowledge on the risks associated with insurance products. Those taking out insurance should therefore not only receive comprehensive and comprehensible advice from participants in the insurance industry but the education work should already start in schools and other educational institutions. Making consumers aware should be part of an overall culture of responsibility for the personal protection of the consumer.

### Market abuse

In July 2007, following public consultation, CESR published the second set of guidance and information as a practical guide and interpretation aid to the Market Abuse Directive. This set of guidance aims to provide market participants with guidelines on the expectations of the supervisory authorities with regard to what constitutes insider information – in particular the classification of customer orders as insider information. It also describes how to proceed in the event of a legitimate postponement of ad-hoc

IOSCO examination of direct market access.

OECD Insurance Committee.

"2nd set of guidance" on the Market Abuse Directive.

publications and the requirements with regard to insider lists for multiple listings. The reaction of the market participants that were consulted with regard to the degree of regulation was positive and in some areas there was a desire for even more guidance. CESR therefore took on further work on the Market Abuse Directive in relation to, among other things, the code of practice for reporting suspected abuse, the stabilisation rules and the differentiation between the ways the term insider information is viewed in a preventive and in a repressive context.

More transparency regarding the sanctions for market abuse in the EU.

In November 2007, CESR provided the EU Commission with a list of the market abuse sanctions that are available to the individual jurisdictions in the EU. CESR published this list on its website to create transparency regarding the sanction systems that are under national law.

### Prospectus legislation

56 "joint positions" from CESR on the EU prospectus legislation.

The operational expert group on prospectuses that was set up by CESR in January 2006 updated the catalogue of joint positions for the uniform application of prospectus legislation that was published for the first time in June 2006. The last time the catalogue was updated in December 2007, a total of 56 joint positions had been published up to then on questions frequently posed in relation to the prospectus legislation. BaFin regularly exchanges information bilaterally with other supervisory authorities in Europe on matters related to prospectus legislation.

In June 2007, the CESR expert group published a report that deals with the acceptance in practice of the Prospectus Directive and the Prospectus Regulation two years after their implementation. The report contains an analysis of the results of a market survey that was conducted at the beginning of 2007. According to this survey, the new prospectus legislation is essentially being received positively by the market. In addition, the report outlines the measures that, from CESR's point of view, are necessary to resolve the problems described by the market participants in applying the prospectus legislation. The market participants are in particular critical of the notification procedure, which to date has not run smoothly due to the various administration practices on a national level, and of national particularities in the interpretation of the EU prospectus legislation.

### Investment funds

CESR compiles important information for investors.

At the initiative of the EU Commission, CESR revised the concept of the simplified sales prospectus – which in the future is to be "Document with important information". CESR summarised the result of this work in a recommendation to the EU Commission. The document should highlight the essential information for the investment decision in a simplified manner. In 2008, the EU Commission will test whether private investors understand this information correctly.

- Consultations on the new UCITS directive.

In March 2007, the EU Commission published initial proposals for the revision of the UCITS Directive and held a public hearing on this in April 2007. The proposals aim to simplify the cross-border notification procedure, fund mergers and the pooling of assets. Furthermore, it should then also be possible to invest funds across borders in another Member State. On the basis of the consultations, the EU Commission is creating a draft directive that is to be brought to the Council in 2008.

Also in March, the EU Commission enacted the UCITS Implementing Directive on the acquisition of financial instruments for investment funds. The CESR guidelines on this, which were published in March and July 2007, contain additional information on uniform use by the supervisory authorities.

- IOSCO adopts valuation principles for hedge fund portfolios.

In November 2007, the IOSCO Technical Committee adopted recommendations for the appropriate valuation of hedge fund assets. The recommendations are intended to make an important contribution to investor protection. They are aimed first and foremost at the hedge funds themselves, which are largely unregulated internationally, and they describe the techniques that are to ensure control, supervision and independence in the valuation process. The recommendations cover a broad spectrum of hedge funds with regard to their size, organisational form and supervisory environment. Particular attention is paid to the implementation and regular checking of internal, written rules for a consistent valuation procedure and coherent valuation concept. However, aspects of accounting and technical questions on actual valuation models are ignored.

- IOSCO aims for standards for the supervision of funds of hedge funds.

Furthermore, IOSCO is planning international standards for the supervision of funds of hedge funds. To this end, IOSCO firstly sought the opinion of market participants on the procedure for selecting the funds in which a fund of hedge funds is to invest and on the duty of care of the fund manager. An inventory of the supervisory frameworks of the Member States was also taken. Further work will focus on the due diligence processes in the selection of funds of hedge funds and on the liquidity of the funds of hedge funds.

### **Private equity**

- IOSCO examination of significant risks in the private equity area.

With the participation of BaFin, an IOSCO working group examined whether significant risks for the securities markets are emanating from the markets for private equity. The background to this was the increasing influence of private equity on the capital markets taking into account the growing proportion of leveraged buyouts (LBO), which also initially increased strongly in the first half of 2007. The outcome was that the working group advocated that a survey be conducted on the complexity and degree of outside financing of capital structures such as those used in LBO. In addition, the working group recommends an analysis of the

conflicts of interest that can occur among the parties during the course of private equity transactions as well as an analysis of the corresponding control mechanisms that can be applied to protect investors.

## 1.2 Organisational requirements and rules of conduct

### Intermediaries

● CESR promotes the functioning of the EU passport scheme in accordance with MiFID.

With its adoption of various recommendations and protocols at level 3 of the Lamfalussy process, CESR laid the foundation for the smooth practical functioning of the European passport scheme for investment firms, as regulated by MiFID.

The recommendations of MiFID with regard to the EU passport concern a series of practical questions on the cross-border provision of financial services as well as on the establishment and operation of EU branches. In this way, it was possible to standardize and accelerate the notification procedure for the issuing of the EU passport in accordance with MiFID. The paper also brought clarity in respect of numerous open issues from areas such as the registration of associated agents, the granting of cross-border market access and the changeover of existing EU passports.

The protocol on notifications of the EU passport regulates in detail the behaviour of the supervisory authorities in the issuing of the European passport for investment firms. It also contains forms that are used by all supervisory authorities in Europe. In this way, the market participants encounter the same conditions throughout Europe, a fact that reduces supervisory costs and promotes cross-border competition.

● New forms of cooperation for securities supervisors with the European passport scheme.

The protocol on supervision via branches in accordance with MiFID dramatically extends the current tools available for cross-border supervisory cooperation. This was successful because according to the new requirements of MiFID for investment firms throughout Europe, only the organisational rules of the investment firm's home country apply. However, in the case of codes of conduct, the law of the host country applies to some extent in order to be able to better accommodate investor protection. Home-country and host-country supervisors therefore need to cooperate closely in supervising using branches in order to jointly ensure the most efficient supervision possible. Therefore, in addition to the traditional information exchange, the framework protocol adopted in October 2007 makes provisions for two new forms of cooperation for securities supervision:

Home-country and host-country supervisors can thereby agree a supervision from a single source. They coordinate their most important regulatory measures between themselves in order to achieve a sensible division of labour. In principle, each supervisory



authority applies its own law. However, the degree of harmonisation achieved with MiFID and a certain flexibility in the interpretation of national law largely save the institutes from having to apply multiple bodies of rules and regulations in parallel.

In addition, the supervisors can delegate individual sub-areas of the supervisory tasks to the home-country or host-country supervisor, depending on the situation. As a consequence, tasks that, for example, the home-country supervisor is responsible for performing are in fact carried out by the host-country supervisor. The latter fundamentally applies its own law. However, in individual cases, the authorities can also agree otherwise in order to emphasize individual provisions of the law of the delegating authority. This is important so that, for example, customers in the institute's home country benefit from supervision that is as uniform as possible, irrespective of the location in which the actual service is provided.

Legal certainty through guidelines on best execution.

In May 2007, CESR published guidelines on best execution in accordance with MiFID. The paper explains numerous issues that needed clarification, including issues with regard to the quality criteria for the execution, the obligations of companies, the forwarding of customer orders to other companies for execution (so called execution chains) as well as the monitoring of execution principles. The requirements of MiFID with regard to best execution are designed to ensure that customer orders for the purchase or sale of securities are executed at the trading centre, where the best result for the customer is to be attained. The implementation of these requirements demands a high level of investment from the institutes. It was therefore a matter of concern to CESR to establish legal certainty through guidelines at level 3 of the Lamfalussy process.

More clarity with respect to inducements.

CESR published recommendations on the subject of inducements from and to investment firms. These recommendations provide information on the interpretation of the relevant requirements of the MiFID Implementing Directive and they explain these using examples. In 2008, CESR will investigate whether there is additional need for action, for example with regard to material inducements and tie-in sales.

List of obligations relating to record-keeping published.

On the subject of obligations relating to record-keeping, CESR published a list of minimum requirements for the institutes. This list is intended to promote the Europe-wide convergence of the record-keeping obligations of the institutes.

Record-keeping obligations are also a current topic at IOSCO. The various record-keeping obligations applicable in the different jurisdictions and the associated technological demands are currently being reviewed. The final report on this is expected in 2008.

IOSCO – Review of supervisory practices under the patronage of BaFin

In addition, at the initiative and under the patronage of BaFin, IOSCO has, since the end of 2006, been examining the various supervisory practices of the Member States regarding the supervision of compliance with the rules of conduct for intermediaries. The final report is to be prepared during the course of 2008. Furthermore, a report on the handling of conflicts of interest affecting intermediaries in relation to the issue of bonds was completed at the end of 2007. Conflicts of interest 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. Following a public consultation, the report was placed on the IOSCO website.

### Corporate Governance

Financial scandals addressed with Corporate Governance Task Force.

In the past few years, questions of corporate governance have gained in significance in the further development of supervisory standards. In reaction to the major financial scandals of the past few years, particularly Enron, WorldCom and Parmalat, IOSCO has also dedicated more of its resources to this issue. This applies not only for governance problems in investment companies but also for general questions of good corporate management. The objective of these efforts is to uncover possible weaknesses in corporate governance rules, as such weaknesses increase the risk of fraudulent company collapses. As a first step in this direction, IOSCO published a report in March 2007 on the independence of the administrative bodies of companies listed on the stock exchange. The paper, which was authored in close cooperation with the OECD, presents a legal comparison of the rules on the independence of members of supervisory bodies and values these rules highly. In the medium term, this could have an effect on the interpretation and further development of relevant OECD corporate governance principles, which also give impetus to EU legislation in corporate law. As a second step, IOSCO will conduct a similarly broad study on the protection of minority shareholders.

IAIS presents recommendations on corporate governance.

The Corporate Governance Task Force, which was set up by the IAIS in February 2007, successfully completed its work in October 2007 and presented its recommendations internally within the IAIS. Its mandate included taking an inventory of the work on the subject of corporate governance that already exists within the IAIS and other institutions (such as the OECD, the Basel Committee and CEIOPS) as well as presenting the main elements of a comprehensive corporate governance framework, including insurance-specific elements. BaFin, which was represented in the task force, ensured that the German two-tier board system (board of directors and supervisory board) will be given appropriate consideration in the context of the future creation of a framework for corporate governance, as proposals on corporate governance that already exist internationally are largely geared towards a one-tier system (board of directors).

The work of the task force will be continued by the newly set up Governance and Compliance Subcommittee. This subcommittee is to develop a framework for corporate governance for the insurance industry and insurance supervision as well as practical support measures. In addition, the insurance core principles will be examined with a view to corporate governance and an assessment of industry practice is to be carried out with the support of the World Bank.

### 1.3 Occupational pension schemes

● CEIOPS compiles a report on the implementation of the Pension Fund Directive.

In March 2008, CEIOPS approved a report on the implementation of the Pension Fund Directive in the individual EU Member States as well as in the EEA signatory states. The report is to be presented to the EU Commission, which announced a revision of the Pension Fund Directive for 2008, and is to be published on the CEIOPS website. The objective is to promote common understanding and supervisory convergence within the EU and the EEA. The report focuses on capital investment, calculation and cover of technical provisions, reporting obligations with respect to supervisory authorities, duty of disclosure with respect to candidates for benefits and benefit recipients, asset management and custody of assets, protection schemes in the event of insolvency of the employer, meaning of ring-fencing, use of subordinated loans and cross-border activity of occupational pension schemes.

The report highlights the points of the Pension Fund Directive that require clarification due to their varied interpretation or implementation. This concerns in particular the definition of cross-border activity as well as the calculation and cover of technical provisions, use of subordinated loans, meaning of ring-fencing and capital investment.

● CEIOPS report on security levels for occupational pension schemes.

Also in March 2008, CEIOPS approved a report on the calculation and cover of technical provisions and on various security mechanisms for occupational pension schemes. The report builds on the report on the implementation of the Pension Fund Directive. The analysis of the security levels should lead to the further development of the solvency rules for occupational pension schemes. The report is therefore also to form the basis of a consultation on solvency issues planned by the EU Commission in the area of occupational pension schemes. CEIOPS published the report in April 2008.

● Requirements for approval of occupational pension schemes.

In a joint project with the involvement of BaFin, the OECD and IOPS are drawing up international guidelines on supervisory requirements for the approval of occupational pension schemes. These guidelines, which are of relevance for Pensionskassen and pension funds, are designed to create an internationally recognised framework for a convergent approval procedure. In this way, the working group wants to gain the trust of the market participants and to also contribute to supervisory convergence. The guidelines

are based on selected studies from countries such as Germany, Ireland and South Korea as well as on IAIS guidelines that have already been drawn up in respect of the approval of insurance companies. IOPS has already adopted the guidelines.

● Report on risk-based supervision.

In August 2007, IOPS published a report on the core elements of a risk-based supervision of occupational pension schemes. The report, in which BaFin was involved, was created in cooperation with the World Bank. The report goes along with the general trend towards risk-based supervision of insurers and financial services institutions. In the report, IOPS uses selected studies from different countries to describe the various experiences and challenges of risk-based supervision. This was intended to demonstrate risk-based supervision to other supervisory authorities and to simplify its introduction. In order to define the core elements of risk-based supervision, the report also went into the various elements for a quantitative and qualitative analysis of financial and operational risks for the various existing pension systems.

## 1.4 Risk management and capital

### Liquidity

● Supervisory rules for liquidity were analysed.

At the start of 2007, that is to say still some time before the first turbulences on the various financial markets started to emerge around the globe, the Basel Committee and CEBS began analysing various supervisory rules for liquidity in a concerted action. Both bodies found a high degree of similarity in the aims, definitions and components of effective liquidity management in the respective liquidity regimes that were examined. However, as this area had up to then remained untouched by the harmonisation of supervisory legislation, a lot of differences were also identified: the individual states organised their supervisory rules for liquidity in accordance with national characteristics, in particular in relation to the role of deposit protection systems and the central bank in its capacity as lender of last resort. Accordingly, both bodies found differences in the requirements for quantitative and qualitative liquidity risk management in respect of the reporting of key figures and the collateral accepted by the central banks. The more detailed the description of the regime, the greater the differences in practice of the countries.

● Liquidity crisis as a result of the US sub-prime crisis.

The US sub-prime crisis caused a liquidity crisis in the international banking sector. The task is therefore to provide answers to the market turbulences that are still persisting. The Working Group on Liquidity (WGL) of the Basel Committee (BCBS) is conducting a liquidity risk management analysis of banks. An interim report by the group was approved by the BCBS and published. According to this report, both supervision of liquidity risks and liquidity risk management in banks should be improved. To this end, the WGL will revise the BCBS guidelines on liquidity management (Sound



Practises for Managing Liquidity in Banking Organisations). One area to which the WGL is likely to pay a lot of attention is the liquidity risks arising from non-balance sheet special-purpose entities.

Likewise, further interdisciplinary cause analyses are to be conducted. Therefore, under the auspices of the FSF, the following will be examined in considerably more depth for their systemic significance: the effects of complex products, their valuation in the trading and investment book and as non-balance sheet items, the extension of stress testing to include events such as those from 2007 and the examination of liquidity management as part of the overall risk management. The results of these analyses are still outstanding.

The US sub-prime crisis also threw another light on Basel II: under the new rules, non-balance sheet items, liquidity risks and special products such as asset-backed commercial papers would be particularly observed by banks' risk measurement and control procedures. Nevertheless, the BCBS announced that it would also adapt the Basel framework, if required. In addition, on a European level, the EU Commission will incorporate the experiences from the market turbulences in the revision of the Capital Requirements Directive (CRD) planned for 2008.

### Equity

In March 2007, CEBS published a quantitative study on hybrid core capital instruments (i.e. those combining the characteristics of equity capital and liabilities). This was the third CEBS contribution to the examination of the definition of equity by the EU Commission. The study represents an empirical snapshot of the characteristics of hybrid core capital instruments, which were recognised as supervisory equity capital in the EEA. To this end, CEBS analysed data from a representative sample of credit institutions from EEA countries from 2006 in which these financial instruments can be recognised as equity capital components.

In the view of the EU Commission, the study reveals sometimes considerable differences between the Member States in the recognition of hybrid capital as core capital. Therefore, in April 2007, it called upon CEBS to pursue greater harmonisation of supervisory practices in view of the lack of an EU-wide regulation in this area. In detail, CEBS is to develop general principles to be taken into account by supervisory authorities when assessing the recognisability of hybrid capital instruments. The principles particularly concern the three main features of hybrid capital instruments: durability, loss participation and full decision-making authority of the institute with regard to distributions. In addition, a proposal is to be worked out for the harmonisation of the currently different

Proposals from CEBS on the recognition of hybrid core capital instruments.



upper limits for the assessment of innovative and non-innovative financial instruments in core capital as well as for a possible grandfather clause. The proposals drawn up by CEBS in this regard were published in December 2007. Once the opinions of the interested public have been taken into account, the paper will be sent to the EU Commission. In the meantime, the EU Commission has announced that it aims to make an amendment to the relevant Directive so as to achieve greater convergence in this area, on the basis of the proposals from CEBS.

Parallel to this, a BCBS working group is conducting a study on the implementation of the Basel Accord of 1988 in the various signatory states. The working group presented the result to the BCBS in March 2008.

### Commodity derivatives

CEBS and CESR are working on behalf of the EU Commission on regulating the trading of commodity derivatives and other exotic derivatives: two European directives, MiFID and the Capital Requirements Directive (CRD), contain exemptions for trading in these derivatives and these need to be examined. Due to the exemptions, the trading transactions and traders in question have to date been partially excluded from the scope of application of the directives. In Germany, trading in derivatives primarily concerns energy and CO2 certificates. CEBS concluded its work in October 2007 with a report that discusses the risks of commodity trading and its systemic potential. CESR carried out an examination in the individual EU Member States of the regulation of commodity derivatives trading as well as of the rules of conduct applicable for the market players. Moreover, it is a question of better realising the freedom of energy traders (which as an institute do not require any authorisation) to provide services throughout Europe.

CESR and CEBS received a joint assignment from the EU Commission for 2008. The committees are to draw up specific proposals for future regulations and these proposals are to build on the reports of the two committees to date. With this joint assignment, BaFin has reached its objective of dovetailing the work of the two committees as closely as possible.

In parallel to the joint assignment with CEBS, CESR together with the European Regulators' Group for Electricity and Gas (ERGEG) received an additional mandate from the EU Commission: CESR and ERGEG are to deal with questions on the future regulation of the documentation of transactions and on transparency in electricity and gas trading. As an integrated supervisor, BaFin is optimally positioned to take into consideration the cross references of the joint CESR and CEBS working group.

Work of CESR and CEBS on trading of commodity derivatives.

Additional assignments from the EU Commission.

● CEBS published document on the revision of large-exposure rules.

### Large exposure regime

In December 2007, CEBS published a document on some technical aspects of the revision of large-exposure rules. Following consultation with the interested public, the paper will be sent to the EU Commission in response to their consulting assignment of January 2007. In November 2007, CEBS had already replied to the EU Commission on some of the issues in the assignment. At the request of the EU Commission, CEBS dealt very thoroughly with the large exposure regime in its answers and explained, among other things, the whole purpose of the regime, the effectiveness and appropriateness of the limits, questions regarding the possible taking into account of the credit quality and the calculation of the credit values. In the further course of the work, the handling of intergroup and interbank loans as well as "affiliated customers" was discussed. Measures in the event of a breach of the limits and the reporting system were also focussed on. Overall the CEBS views the existence of counterparty default risk on the basis of unforeseen events as a justification for the continuance of the large exposure regime that has been in existence since the 1980s, as these risks would not be covered by Basel II. The committee advocates retaining the regulations as a limits-based "back-stop" regime - although in an improved form. The improvements could involve, among other things, the recognition of credit risk minimisation techniques or the calculation of credit values for which, under certain circumstances, methods of the European Banking Directive, which was revised against the background of Basel II, could be applied.

## 1.5 Rating agencies

● CESR analyses the role of rating agencies.

Due to the turbulences in the international financial markets, the work of the rating agencies has come under more scrutiny by the public. In order to sell individual mortgage loans bundled in the form of bond-like structured financial products to investors, good ratings of the financial products by the rating agencies were required. When the number of overdue receivables increased starkly in mid-2007, particularly for sub-prime loans, investors increasingly questioned the quality of the ratings of structured financial products such as Residential Mortgage Backed Securities (RMBS) or Collateralised Debt Obligations (CDO). The doubt surrounding the quality of the ratings and therefore also the integrity of the rating process contributed to the international financial crisis known as the sub-prime crisis. In the second half of the year under review, a CESR working group therefore focussed its activities on the examination of the role of rating agencies in structured financing. In September 2007, EU Commissioner McCreevy extended and further specified the European Commission's mandate of May 2007. The quality assurance processes of ratings awarded for structured financing and the ongoing review of the transactions were in particular to be examined in more detail. In May 2008, CESR will submit a report

to the EU Commission with proposals for the further regulatory treatment of rating agencies.

The CESR working group therefore surveyed both rating agencies and market participants in the summer in order to gain an exact picture of the situation. After they had evaluated the survey, CESR met with the following international rating agencies: Moody's Investor Service, S&P Rating Service, Fitch Ratings and Dominion Bond Rating Service. The objective of this meeting was to discuss the findings of the survey. The meeting also addressed the distortions in the market for structured financing that had arisen in the meantime as a result of the US sub-prime crisis. The rating agencies were given the opportunity to explain their involvement in the structuring of financing, an involvement which had often come under criticism from various sides. The agencies were, at the same time, able to give their view on the background to the distortions as well as suggest possible measures to strengthen trust in the market. At the end of February 2008, the CESR working group released the final report for consultation and will process the results before finally submitting it to the Commission in May 2008.

● IOSCO Code of Conduct.

As early as the start of 2007, the CESR working group on rating agencies published its report on the examination of the implementation of the IOSCO Code of Conduct by the rating agencies. CESR found that, on the whole, the rating agencies satisfactorily implemented the IOSCO Code of Conduct when creating their own codes of conduct but it also found room for improvement.

Rating agencies are also a current topic on an international level. At the start of 2007, an IOSCO working group published (for consultation) a report on the adaptation of the IOSCO code of conduct to market conditions. This report covered both the implementation of the IOSCO Code by the rating agencies and the potential changes to the Code. However, due to the distortions on the US financial market, the working group's own findings were themselves called into question and the examination process was extended. A particular focus was then placed on examining the internal controls of the rating agencies, the market's understanding of what the ratings mean and the lack of transparency for structured products. In September 2007, the IOSCO working group also met with the seven NRSRO-certified (Nationally Recognised Statistical Rating Organisation) rating agencies and briefed itself on their role in the structuring of products. IOSCO will prepare a report with recommended actions to be submitted to the Technical Committee of the FSF.

## 2 Solvency II

● EU Commission presents draft framework directive.

On July 10, 2007, the EU Commission published the draft of a framework directive on Solvency II.<sup>4</sup> The draft combines 13 existing insurance directives and sets out the fundamental principles for the new supervisory system. It is expected that the Council and Parliament will adopt the framework directive at the start of 2009 and that it will be implemented in the Member States by 2012.

In the draft, the EU Commission largely followed the proposals of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

It is particularly where the Commission did not follow the recommendations of CEIOPS that a need for discussion and revision arose. There is therefore dispute as to how extensive the powers of the group supervisor should be for cross-border groups.

Until now, group aspects were considered as only supplementary to individual supervision. The draft framework directive fundamentally changes this way of viewing things, as from now on, a single supervisory authority is to be responsible for the supervision of the group with regard to solvency, risk management and internal controls. In this way, the group supervisor would finally be granted decision rights that restrict national intervention rights.

### Implementing measures

● Commission wants to enact implementing measures by 2010.

The directive will empower the EU Commission to enact certain implementing measures. These are intended to define the principles of the directive more precisely in order to achieve greater harmonization and standardization of supervision in Europe. The Commission therefore assigned CEIOPS the task of drawing up proposals for the implementing measures in 2008 and 2009. The Commission wants to then enact the provisions by mid-2010 – 18 months before the application of the new regulations.

The Commission is expecting proposals from CEIOPS in May 2008 for the design of the proportionality principle and the group supervision so that it can start developing the implementing measures. The focus in this task is on technical questions related to capital allocation within groups and the handling of diversification effects, cooperation between the supervisory authorities, design of a group-wide risk management system as well as corresponding publication obligations for capital allocation

In October 2009, CEIOPS will submit to the Commission detailed plans on the valuation of assets and liabilities, on the calibration of the solvency capital requirement (SCR) and of the minimum capital

<sup>4</sup> [www.ec.europa.eu/internal\\_market/insurance/solvency/index\\_de.htm](http://www.ec.europa.eu/internal_market/insurance/solvency/index_de.htm).

requirement (MCR) but will also submit plans on simplifications for certain companies in the application of the proportionality principle.

CEIOPS will also submit reports on the use of company-specific parameters in determining technical provisions, on the application and approval process of internal models and partial models as well as recommendations on the second and third pillars of Solvency II. In this area, CEIOPS will give its opinion on the requirements made of corporate management, on reporting to the supervisor and on the use of capital add-ons. In doing so, it must take into account the findings of the impact studies (QIS 3 and QIS 4) as well as international developments in insurance supervision and accounting.

● CEIOPS decides on the rearrangement of its working groups.

In its members' meeting of June 2007, CEIOPS decided to rearrange the working groups to take account of the new tasks – drawing up of proposals for the implementing measures and instructions for the supervisory authorities.

The Financial Requirements Expert Group deals with Pillar 1 issues and QIS. The Internal Governance, Supervisory Review and Reporting Expert Group focuses on the issues of Pillars 2 and 3. In addition, the Insurance Group Supervision Committee is responsible for all group issues and the newly set up Internal Models Expert Group is drawing up the requirements for internal models for the company-specific calculation of the SCR.

### Impact studies

Quantitative Impact Studies (QIS) play an important role throughout the entire Solvency II project. CEIOPS uses these studies to examine the impact of the Solvency II proposals on insurers and whether the planned regulations are suitable for implementation in practice.

● CEIOPS submitted the results of the QIS 3 study to the Commission.

In mid-2007, CEIOPS conducted the third quantitative impact study (QIS) with regard to Solvency II. CEIOPS then submitted the results to the Commission in November 2007.

While constructing the standard formula was the focus in QIS 2, the purpose of QIS 3 was to fine-tune individual risk modules as well as to collect initial findings on the application of the standard formula at group level, on the application of internal models as well as on the qualitative effects of operational risks. QIS 3 focussed not only on the qualitative and quantitative effects on the insurance industry as a whole, but also on special segments such as small and medium-sized companies, groups, insurance associations and national markets.

Approximately 1,000 insurers throughout Europe participated in the study and 840 of these were small and medium-sized insurance companies. The number of participating German insurers increased compared to the second impact study and stood at 179 –

- German insurers well equipped for Solvency II according to the QIS 3 study.

an excellent participation level compared to the rest of Europe.

BaFin conducted the study for the German market. The test results showed that the German insurance industry is well equipped for Solvency II. On average, all sectors showed higher coverage ratios compared to Solvency I.

The reason for this is that equity increased more strongly than capital requirements according to the QIS 3 calibration. Equity is increasing because its amount is substantially determined from the difference between the assets and liabilities on the balance sheet. Under Solvency II, the valuations for investments on the assets side will tend to increase due to the new market-based valuation principles. At the same time, Solvency II introduces a realistic valuation of the reserves, which constitute a major part of the liabilities. Therefore, the technical provisions, which to date have been valued according to the principle of prudence, will fall.

- QIS 4 study planned for April to July 2008.

At the end of 2007/start of 2008, CEIOPS submitted to the Commission a complete proposal for the design of a fourth impact study. It is expected that the QIS 4 study will be carried out from April to July 2008 and its objective is to gain more information on insurance groups and on small and medium-sized insurers. It is anticipated that the result will be given to the Commission in November 2008. Simplifications for the valuation of reserves and for the more complex SCR modules will be covered in the study. For the first time, company-specific parameters can also be used for the calculation of technical risks. In addition, the study will ask further questions in relation to operational risk and internal models.

### **Preparation for Solvency II**

- BaFin organised two Solvency II conferences.

BaFin invited small insurance companies to Bonn for an exchange of ideas at the start of March 2007. The objective of the one-day conference was to discuss the possible problems and consequences of the implementation of Solvency II into German law.

BaFin made it clear that small companies would not be forced out of the market with the introduction of Solvency II. In addition, there are plans for a threshold value (measured according to premium volume) from which an insurer must be included in Solvency II. The BaFin representatives advised the companies to grasp the supervisory reform as their own opportunity to prepare themselves for a balance sheet based on fair values. In the future, this balance sheet will represent the European standard not only on a group level but also on an individual level.

Over 340 company representatives accepted BaFin's invitation to another conference in Bonn on June 20, 2007. This conference – attended by BaFin employees, company representatives, representatives of the EU Commission, the Association of German Insurers (GDV) and supervisors from the United Kingdom –

comprised three rounds of discussions on the qualitative and quantitative requirements of the new solvency system, BaFin's requirements for internal models and the resulting changes for companies and supervision.

### 3 Accounting and enforcement

● CESR work on the equivalence of accounting standards.

During the course of 2008, the EU Commission will decide on the equivalence of accounting standards of third states with the International Financial Reporting Standards (IFRS). The criterion of equivalence, according to the definition by CESR and the EU Commission, is fulfilled if investors would have taken similar decisions independently of whether they had been presented with IFRS financial statements or with other financial statements from third states. In addition, the equivalence should be supported by an enforcement system that is reliable for investors as well as by a reliable certificate.

The focus here is on Japan, the USA and China. To prepare this decision, the EU Commission therefore commissioned CESR to compile a report on the developments with regard to accounting standards in Japan and the USA since 2005. The progress of the respective convergence projects with the International Accounting Standards Board (IASB) is of decisive importance for appraising both Japan and the USA. CESR published a consultation paper on this on its website in December 2007.

CESR also produced an appraisal of the accounting standards in China. The report is currently in the consultation phase. In February 2006, China implemented its "Accounting Standards for Business Enterprises" into a national law. These standards come into effect for financial years as of January 1, 2007 and are based, with a few exceptions, on the provisions of IFRS.

While BaFin wants the project to ensure the smooth functioning of capital markets, the upcoming decision also has significant political implications for the transatlantic relationship. China is also emphasizing the effects on European-Chinese economic relations. The EU side is nevertheless emphasizing the need for a careful and balanced decision, which not least needs to take into account the competitiveness and attractiveness of the European capital markets.

● SEC grants stock market listing with IFRS financial statements.

In November, the US stock exchange supervisory body SEC (Securities and Exchange Commission) decided to allow foreign issuers to be listed on the stock market with just IFRS financial statements, i.e. without having to convert them to US standards. This applies for all foreign issuers whose financial year ends after November 15, 2007. At the same time, the SEC is considering also extending this decision to US companies in the future. The companies would then be able to vote on whether they wanted



to prepare their balance sheets on the basis of the US Generally Accepted Accounting Principles (US-GAAP) or on the basis of IFRS.

This decision by the SEC brings with it cost savings for European companies, which, according to estimates by the EU Commission, amount to approx. €2.5 billion. In addition, the decision paves the way for a uniform global accounting standard. This is underlined by the fact that the SEC uses as a reference the version of the IFRS issued by the IASB and not IFRS versions that were customised by individual countries or economic areas.

● IOSCO adopts debt principles.

In February 2007, IOSCO adopted the disclosure principles for cross-border public offerings of debt securities as well as their admission for trading (debt principles). The adoption was preceded by a public consultation, within the context of which BaFin also held a hearing at its premises. The document grants the respective supervisory authorities a high degree of flexibility, as it was created in the form of principles and not of standards. It serves in particular as a guide for states in which the disclosure obligations are being introduced or revised. The reasoning behind the respective principles was also set out in order to be able to achieve a better understanding of the respective approaches. The paper is designed for the issue of classic corporate bonds ("corporate debt"); in the case of other issuers – such as banks – or bonds in a different form, the disclosure obligations need to be adapted. The document also specifically refers to the European passport for issuers as laid down by the European Prospectus Directive, as in this respect a form of integration for a large number of countries has already been achieved. In addition, a feedback statement with the opinions of the market participants was created.

Since these principles have been adopted, the IOSCO group responsible for disclosure has been focussing on the periodic disclosure obligations of issuers whose securities are admitted for trading on a regulated market. It is expected that the paper will be published for consultation in 2008.

● IOSCO publishes statement on international auditing standards.

In November 2007, IOSCO published a statement on International Standards on Auditing (ISA). In this statement, it supports the work of the International Auditing and Assurance Standards Board (IAASB) to develop and improve the ISA. The IAASB is responsible for the formulation of ISA within the International Federation of Accountants (IFAC).

● IASB publishes discussion paper on Phase II of the insurance project.

In May 2007, IASB published a discussion paper on Phase II of its insurance project. The deadline for comments was mid-November 2007. In Phase II of the insurance project, the existing loopholes in the balance sheet handling of insurance contracts in accordance with IFRS are to be closed off. The IFRS 4 standards published in March 2004 essentially provide for the retention of the existing accounting regulations for insurance contracts. The only thing that was explicitly excluded was the setting aside of reserves for possible damage on the basis of contracts that do not yet exist on the balance sheet date (for example reserves for catastrophes or

equalisation reserves). The discussion paper also does not envisage any fundamental redefinition of the insurance contract. The existing definition in accordance with IFRS 4 will therefore continue to be retained. The IASB is proposing a method for the inclusion and valuation of insurance contracts; this method is intended to generate information that is of relevance for decisions and is in line with other IFRS provisions, for example the provisions in IAS 37 for the inclusion and valuation of "non-financial debts". To this end, the valuation of an insurance liability is performed on the basis of three key elements: the future cash flows are estimated, the fair value of the money is taken into account through discounting and a margin for the acceptance of risk and provision of such services is estimated.

In accordance with the wishes of the IASB, this valuation process is based on the amount that an insurer would foreseeably have to pay on the balance sheet date in order to transfer its existing contractual rights and obligations to a third party ("current exit value"). However, it is at least questionable whether the proposed valuation approach takes account of the actual conditions in the insurance industry. The aspect of this approach that is particularly problematic is the lack of reliability in calculating the amount. This is closely connected with the handling of day 1 profits. BaFin particularly fears the possibility of "asset erosion" among insurance companies if this profit is distributed. Moreover, day 1 profits could lead to the insurance industry being placed at a disadvantage, as the companies would be left with insufficient profit potential for future periods. Finally, international supervisors fear that the provisions for day 1 profits in the valuation of insurance contracts could have a "precedence effect" on other valuation projects within IFRS.

● 120 enforcement decisions already in CESR database.

Up to the end of 2007, CESR employees entered approximately 120 enforcement decisions into the CESR database. CESR published some of these decisions in anonymous form during the course of the year. The database, which was set up in 2005, is intended to keep the national enforcers in the EU Member States informed about enforcement decisions that have been made including the respective reasons and to thereby contribute to a uniform application of international accounting standards in Europe. As the IFRS are to be implemented uniformly not only within Europe but worldwide, IOSCO has also been keeping an electronic collection of enforcement decisions since 2007.

## 4 International cooperation

### 4.1 Cross-border collaboration

● Common European supervisory culture:

In its meeting of May 5, 2006, the European and Financial Council (ECOFIN) called upon the 3Level3 committees (CESR, CEBS and CEIOPS) to promote, in the interest of a common European supervisory culture, the exchange of employees of supervisory authorities and their joint training and further professional development. On the basis of this, all three committees each set up a working group to deal with the issues of personnel exchange and professional development. CESR has already submitted a completed concept on employee exchange. Even though the CEBS and CEIOPS concepts have not yet been completed, these committees are already organising professional development seminars on current sectoral issues. The employee exchange will begin in mid-2008. A joint steering committee was additionally set up. It is to formulate a concept for joint seminars for employees from the banking, insurance and securities supervision sectors by the end of 2008. Two test seminars were already successfully held in 2007: the Financial Services Authority held a seminar on operational risk, while BaFin in collaboration with the Bundesbank organised one on impact assessment.

#### **Impact assessment seminar**

The first 3Level3 test seminar, which was on the subject of impact assessment, took place in the Bundesbank training centre in Eltville, Germany, from October 17 - 19, 2007. The background to this seminar is a joint initiative of the three European bodies CESR, CEBS and CEIOPS for the introduction of multidisciplinary, cross-sector seminars. Several test seminars will be carried out to gain practical experience with regard to organising and conducting them. The seminar on impact assessment was the first and therefore the pilot seminar. It was organised by BaFin in collaboration with the Bundesbank. "Impact assessment" refers to analysing the positive and negative consequences of regulation and supervision.

The 34 participants came from 20 different European countries and 24 different banking, insurance and securities supervisory authorities. The idea of a European multidisciplinary event thereby came to fruition.

The seminar provided the participants with a multifaceted debate on the topic of impact assessment. In addition to theory, there was also an opportunity for animated discussions as well as group work on practical cases. Information was provided, for example, on the level-3 guidelines on impact assessment that were developed by a CESR-ECONET working group, about impact assessment in the European Commission and the practical application of impact

assessment in a supervisory authority. Based on the unanimously positive feedback from the participants and lecturers, the 3Level3 initiative is on the right track.

- CESR Review Panel gains in significance.

In 2007, the CESR Review Panel adopted a protocol that defines its scope of duties and sets out its procedures. The panel thereby has various instruments at its disposal that can be used for examining securities supervision in the Member States. For example, the panel conducts peer reviews that build on the self-assessments of the supervisory authorities. In the self-assessments, the respective supervisory authority firstly appraises its own supervisory practice and explains whether it's working on the basis of an implementation of EU regulations. In the peer review, the panel then examines the results of the self-assessment and assesses whether the European regulations are being applied properly. To increase the pressure to achieve further harmonisation of supervisory practice, the results of the peer reviews are published regularly.

In the reporting year, the Review Panel also published two reports on the powers of the supervisory authorities: one on the Market Abuse Directive and one on the Prospectus Directive. The reports show the results of a comprehensive examination of the powers of the supervisory authorities that arise from the abovementioned directives and from the Level 2 measures that build on these directives in accordance with the Lamfalussy process.

- CEBS and CEIOPS set up review panels.

In 2007, CEBS adopted specifications for the setting up of a review panel. The structure and process organisation are essentially modelled on the CESR Review Panel. In its founding meeting in January 2008, the new panel prepared its first review procedure. The focus here was on parts of the validation guidelines, which are to be used for evaluating the implementation of advanced risk assessment procedures (IRBA and AMA) in the Member States. Also in the case of CEIOPS, work on the establishment of a review panel is well underway and it is expected that it will be set up by the end of 2008.

- SON draws up standard MoU for supervisory cooperation.

In 2007, the CEBS Subgroup on Operational Networks for banking groups that operate across borders (SON) dealt with practical problems of IRBA and AMA authorisation, i.e. of supervisory authorisation of advanced measurement procedures for credit risk and operational risk. As an interface between the national supervisors and as an interface between supervisors and ten selected banking groups, SON has the task of helping to resolve day-to-day problems in the supervision of cross-border banking groups and of promoting convergence in the application of European regulations. Another main focus within this context was the analysis of existing "supervisory colleges". A college is a cooperation and coordination structure for collaboration between home-country and host-country supervisors of a banking group. Some European supervisory authorities have already been using colleges for a long time to coordinate their supervision of



individual banking groups that operate across borders. SON used these experiences and, with the help of suggestions from the financial sector, it drew up a standard agreement (memorandum of understanding– MoU) for European colleges in the year under review. This standard MoU is to be used as a flexible basis for future colleges. It can be adapted to the special requirements of the respective institute and of the authorities involved. CEBS published both the analysis of existing colleges and the standard MoU on its website.

Also in 2007, in its role as an interface between supervisors and banks, SON dealt with questions and requests from SON banking groups on cross-border activities and supervision. In addition to the standard MoU for European colleges, responses to questions from lenders on the implementation of Basel II, particularly with regard to cross-border application and to supervisory review of the Internal Capital Adequacy Assessment Process, were presented in a workshop in December.

SON's mandate initially only encompassed a pilot phase until the end of 2007. Following an evaluation of SON's work, CEBS decided to continue the group. In future, the range of issues is to be extended and the number of banking groups involved is to be increased to seventeen.

● Round table on microinsurance providers.

In April 2007, in its capacity as an IAIS member, BaFin organised a round table on the regulation and supervision of microinsurance providers for the second time. Together with BaFin, high-level representatives of the economy, of state bodies and of welfare organisations discussed the development of IAIS framework guidelines on the supervision of microinsurance providers. The results of the round table were included in an IAIS assessment report in June 2007, which BaFin prepared with the insurance industry and with development organisations. In 2008, the IAIS will conduct an assessment of the regulation and supervision of mutual societies and cooperatives, as these have the largest proportion of the microinsurance premium volume. The results of this examination will also be included in the development of the IAIS guidance paper on the regulation and supervision of microinsurance providers.

● Significant progress in collaboration with Offshore Financial Centres.

In 2007, BaFin also committed itself to improving the information exchange with countries that register a high inflow of foreign capital, typically due to weak regulation of their respective financial markets. An IOSCO group has been in dialogue with three Offshore Financial Centres (OFC) for some time. In 2007, the discussion with one of the three OFC ended in the signing of the IOSCO MoU. BaFin was involved to a large degree in this major success. Significant progress was also made in the collaboration with the two other OFC. In 2007, both countries worked intensively on legislation changes, which are designed to close off the loopholes that were identified. In addition, following the implementation of the legislation changes, both countries want to apply to sign the IOSCO

MoU. Furthermore, IOSCO has engaged three additional OFC in dialogue. Together with the countries, it is to identify weaknesses in international collaboration and develop solutions for the removal of these obstacles. BaFin emphatically supports this dialogue, as it continues to consider the reduction of risks emanating from OFC to be important. Politically, the IOSCO project will continue to be supported by the Financial Stability Forum.

## 4.2 Memoranda of Understanding

Table 2  
Bilateral MoU

Banking supervision		Securities supervision		Insurance supervision	
Australia	2005	Argentina	1998	Australia	2005
Belgium	1993	Australia	1998	China	2001
Brazil	2006	Brazil	1999	Dubai	2006
China	2004	China	1998	Estonia	2002
Denmark	1993	France	1996	<b>California</b>	<b>2007</b>
Dubai	2006	Hong Kong	1998	Canada	2004
Estonia	2002	Italy	1997	Korea	2006
France	1992	Jersey	2001	Lithuania	2003
Greece	1993	Canada	2003	<b>Nebraska</b>	<b>2007</b>
United Kingdom (BE/FSA)	1995	Luxembourg	2004	Romania	2004
United Kingdom (SIB/SROs)	1995	Poland	1999	Slovakia	2001
United Kingdom (BSC)	1995	Portugal	1998	Czech Republic	2002
Hong Kong	2004	Russia	2001	Hungary	2002
Ireland	1993	Switzerland	1998	USA (OTS)	2005
Italy (BI)	1993	Singapore	2000		
Italy (BI-Unicredit)	2005	Slovakia	2004		
Korea	2006	Spain	1997		
Latvia	2000	South Africa	2001		
Lithuania	2001	Taiwan	1997		
Luxembourg	1993	Czech Republic	1998		
Malta	2004	Turkey	2000		
Netherlands	1993	Hungary	1998		
Norway	1995	USA (CFTC)	1997		
Austria	2000	USA (SEC)	1997		
<b>Philippines</b>	<b>2007</b>	<b>USA (SEC)</b>	<b>2007</b>		
Poland	2004	Cyprus	2003		
Romania	2003				
Russia	2006				
Slovenia	2001				
Spain	1993				
South Africa	2004				
Hungary	2000				
USA (OCC)	2000				
USA (NYSBD)	2002				
USA (OTS)	2005				
USA (FDIC)	2006				
<b>USA (SEC)</b>	<b>2007</b>				

- MoU concluded in the area of banking and securities supervision.

At the start of 2007, BaFin concluded a Memorandum of understanding (MoU) with the Philippine Central Bank (Bangko Sentral ng Pilipinas). It regulates cooperation in the area of banking supervision.

In the area of institute and market supervision, BaFin concluded a MoU with the US Securities and Exchange Commission (SEC) in April 2007. The MoU regulates the collaboration of the supervisory authorities and also forms the basis for detailed agreements on collaboration in the area of stock exchange supervision in the event of future cooperation between US and German stock exchanges. On the basis of this MoU, BaFin concluded a first agreement with the SEC with the participation of Deutsche Bundesbank and the Hessian supervisory authority at the end of 2007.

A few weeks prior to that, BaFin had, with the participation of Deutsche Bank, concluded a similar agreement with the authorities responsible for banking supervision and securities supervision in the Netherlands (De Nederlandsche Bank and Autoriteit Financiële Markten).

- MoU concluded in the area of insurance supervision.

In 2007, BaFin concluded two MoUs with the Nebraska Department of Insurance (NDOI) and the California Department of Insurance (CDI). A transatlantic working group comprising representatives of CEIOPS and National Association of Insurance Commissioners from the USA created the basis for these MoUs. The signatory authorities are thus ensuring that the US and German financial centres remain open, fair and transparent. The MoUs place the present cooperation of the supervisory authorities on a solid basis and above all regulate details of the information flow between the authorities. Such agreements are very valuable in times of increasing globalisation: the NDOI plays a leading role in the supervision of the parent company of a major German reinsurance company. The CDI is responsible for the supervision of the US subsidiary of a German financial conglomerate that operates globally.

### **Multilateral MoU**

- IAIS: BaFin applies to join the Multilateral MoU.

On September 18, 2007, BaFin was the first IAIS member to submit its application to join the Multilateral MoU (MMoU) that was agreed in February 2007. The MMoU aims at promoting and improving information exchange and cooperation between insurance supervisory authorities worldwide. Insurance supervision authorities can apply to join the MMoU on a voluntary basis. The success of the application depends in particular on whether a country can prove, in theory and in practice, that it meets the minimum requirements for confidentiality regulations, which must correspond to EU standards. Each application is therefore examined by an independent body.

Through its chairing of the MMoU working group, BaFin contributed substantially to the creation of the MMoU and supports its implementation. To this end, BaFin created a form with minimum

application requirements and a list of frequently-asked questions to support the independent examination of the applicants. For the current four applications, the work of the MMoU working group will be transferred to a new working group made up from the first applicants.

- IAIS workshops on the Multilateral MoU.

It is the goal of the IAIS for as many insurance supervisory authorities as possible to apply to join the MMoU. The IAIS therefore organises workshops worldwide. These workshops aim to give background information on the MMoU and how it works as well as to explain the application details. In 2007, BaFin managed and participated in workshops, which were held in Basel (May 2007) and in Tokyo (November 2007). Additional workshops are planned for 2008 for the regions of Latin America, North America and the Middle East.

- CEIOPS revises Siena Protocol.

In the year under review, BaFin collaborated in the fundamental revision of the Siena protocol. CEIOPS set up a revision task force to which BaFin delegated a representative. The protocol is a multilateral MoU from the year 1997, which had become in great need of revision due, among other reasons, to numerous changes to and extensions of the EU legal supervisory framework. An important point to be taken into consideration during the revision was the strengthening of consumer protection in complaints processes and with regard to consumer information. BaFin advocated clear and transparent procedures as well as better and faster information, particularly in the context of complaints processes. The outcome of the negotiations is still outstanding: the revised protocol was released for consultation at the CEIOPS general meeting in October and was adopted in March 2008.

### 4.3 Technical cooperation

During the year under review, BaFin again also advised and supported international supervisory authorities in the creation of a new supervisory system.

- Twinning project with Turkey.

From January 2006 to November 2007, Germany was, for example, a partner in the twinning project entitled "Assisting the Capital Markets Board of Turkey (CMB) to Comply fully with European Union Capital Markets Standards". The objective of the project was to prepare the Turkish capital market and the Turkish capital market supervisor, CMB (Sermaye Piyasası Kurulu, SPK), for possible EU accession. 155 employees of CMB and 62 employees of the German Federal Ministry of Finance (BMF), BaFin and Deutsche Bundesbank were involved in the project. With 48 short-term experts, BaFin represented the largest group. In 2007, 21 BaFin employees were working on the project.



● Transformation in Turkish law following the example of German implementation.

In working groups and seminars, the German short-term experts familiarised the Turkish partners with the 30 relevant EU capital market directives and ordinances and explained, based on the example of the German implementation, how these directives and ordinance can be transformed into Turkish law. In addition, members of the CMB received training at BaFin in Bonn and Frankfurt on topics such as insider and market manipulation bans, prospectus examination, transparency obligations, MiFID and investment funds.

At two conferences in Istanbul, one which took place in June and the other in November, employees of CMB together with speakers from BaFin and the German Federal Ministry of Finance presented important European capital market regulations and the corresponding Turkish drafts.

● Twinning project successfully completed in December 2007.

Only a few aspects of the current Turkish body of rules and regulations match the applicable EU directives; the implementation requirement in Turkey was correspondingly high. Thanks to numerous assignments and the high level of commitment on both the Turkish and German sides, the project was completed successfully in December 2007. The collaboration between CMB and BaFin will be continued bilaterally in 2008.

● Cooperation with China.

Also during the year under review, delegations from the Chinese supervisory authorities as well as employees of Chinese financial institutes came to information events and seminars held in BaFin. This cooperation is also intended to take into account the growing significance of the Chinese financial market. The collaboration will be continued in 2008.

● Good contacts with Bulgaria, South Korea and Namibia.

In 2007, collaboration with Bulgaria strengthened contacts with the Bulgarian financial supervisor (Financial Supervision Commission – FSC). In January, a delegation from the FSC came to Frankfurt and learned about BaFin's supervisory strategies. In April and October, a BaFin employee held a question and answer session on this subject in Sofia.

Good contacts also continue to exist with the financial market supervisory authority of South Korea. In June and October, employees of this authority completed hands-on training of several weeks in securities and insurance supervision in Frankfurt and Bonn. A representative of the Namibian insurance supervisor also came on a fact-finding visit.

● Support also for Indonesia, Serbia and Montenegro.

In 2007, the good relations with the bank of Indonesia were continued. In June and November, consultations on the supervision of cooperative banks were carried out in Jakarta. Additionally, in November and December, a BaFin employee was at hand with advice and practical support for both the Serbian and Montenegrin insurance supervisors for the implementation of European directives.





## IV Supervision of insurance undertakings and pension funds



### 1 Basis for supervision

#### 1.1 VAG reform

On January 1, 2008, the 9th amendment of the German Insurance Supervision Act (VAG) came into force.<sup>5</sup> The core elements in the new regulations are the obligations of the insurers to implement appropriate risk management and to prepare risk and audit reports for each individual company. This amendment therefore also represents a first step towards principle-oriented supervision and towards Solvency II.

For the first time, this law is demanding the comprehensive implementation of appropriate risk management in the insurance industry (section 64a VAG). The regulation refers to the relevant regulation in the German Banking Act (section 25a KWG), which demands auditable requirements for the business organisation, for internal corporate and control procedures and for the risk management, in advance of Solvency II.

With just a few exceptions, the requirements apply to all insurance undertakings. However, the principle of proportionality must be applied when transposing them: the requirements are designed differently depending on the size of the undertaking and the complexity of the selected business model and of the risks involved.

Experience suggests that it takes at least two to three years to introduce an appropriate risk management system. The new regulations should allow the undertakings to initiate any necessary measures at an early stage in order to prepare any suitable qualitative elements for a developing link between a risk-oriented business organisation and the solvency requirements. The transition deadlines take the proportionality principle into account, in order to avoid an unnecessary burden, particularly for relatively small undertakings. This is necessary because it is precisely these undertakings that would be more heavily burdened by the implementation than larger undertakings, because of less expertise or more limited staffing or financial resources.

Since April 2008, BaFin has had the possibility of requesting that selected insurers should submit their company-specific

● Insurers must implement appropriate risk management.

● Undertakings have to prepare risk and audit reports for each individual company.

<sup>5</sup> Federal Law Gazette (BGBl.) 2007 I, p. 3248ff.

risk and audit reports (section 55c VAG). The reports should be submitted in the same form as they are produced internally for the undertaking's own management. The introduction of this additional reporting system will allow BaFin to check even in 2008 and at least on a spot-check basis whether the relevant insurer has fulfilled the essential requirements for a proper business organisation. In this way, BaFin will be able to assess more effectively whether a company is able to identify, evaluate, control, monitor and communicate the risks to which it is exposed. With these risk reports, BaFin will also be able to judge whether the company is reacting appropriately to changes in its environment. The binding, comprehensive submission of the reports is planned for the year 2009..

- BaFin is planning a MaRisk circular for insurers.

Based on the new VAG regulations, BaFin is planning a circular entitled "Minimum requirements for the risk management of insurance companies – MaRisk (VA)" for the year 2008. The preliminary work is already well advanced, so that a publication is anticipated during the course of 2008 following a public consultation and hearing.

- New regulations for portfolio transfers.

The new regulations for portfolio transfers (section 14 VAG) define the criteria more stringently and more specifically that need to be observed by BaFin when approving transfers of portfolios to other companies. The legislator has applied essential benchmarks from the field of life insurance to other insurance segments and to conversions (section 14a VAG).

The legislation is therefore implementing the specifications of the Federal Constitutional Court (Bundesverfassungsgericht), which declared the regulation concerning portfolio transfers unconstitutional in part in 2005 and commissioned the legislator to draw up a new, constitutional regulation by the end of 2007.<sup>6</sup> In the opinion of the court, the old version did not ensure to a sufficient extent that the interests of the policyholders and of the members of an insurance association are protected on a mutual basis through the payment of an appropriate charge for the loss of membership.

## 1.2 Reform of VVG

Essential components of the new Insurance Contract Law (VVG) came into force on January 1, 2008.<sup>7</sup> It applies to all insurance contracts concluded after that date.

Existing contracts shall be subject to the old law until December 31, 2008, and thereafter the new VVG shall always apply to these contracts as well.

<sup>6</sup> File ref.: BvR 782/94 and 1 BvR 957/96.

<sup>7</sup> Federal Law Gazette (BGBl.) 2007 I, p. 2631ff.; Annual Report of BaFin 2006, p. 83ff.

A significant exception is the participation of the customers in the hidden reserves in a life insurance policy. In this area, the new regulations will also apply to existing contracts from January 1, 2008.

However, the new regulations for calculating the surrender values shall apply even beyond December 31, 2008 only to new contracts, i.e. to contracts concluded after January 1, 2008.

● Basic modification to life insurance.

In terms of life insurance, the extensive changes only crystallised during the course of 2007. These changes primarily affected the rulings on the surrender value and the minimum surrender value, on profit participation, and on the annual report to the policyholder about the performance of his/her claims.

The surrender value (section 169 (1) VVG) is now calculated according to the coverage capital of the insurance, i.e. the capital that must be available to fulfil the claims of the policyholder. This will permit a higher level of transparency and legal clarity. In the past, the law relied on the unclear concept of the "fair value" for calculating the surrender value.

In the case of a contract termination, at least the amount of the coverage capital which accumulates given an even distribution of the set conclusion and sales costs over the first five contract years is paid out following the pattern of the Riester pension scheme. In this way, the policyholder receives a minimum surrender value even if he/she terminates the contract in the first few years.

For the first time, the new Insurance Contract Act embeds regulations for the profit participation of the policyholders in the contract law (section 153 (1) VVG); in the past, there were only requirements stipulated by supervision law. However, the profit participation can be excluded by explicit agreement.

As a consequence of the judgment by the Federal Constitutional Court, the legislator extended the concept of profit to include any participation in the valuation reserves. The law (section 153 (3) VVG) now stipulates that the valuation reserves must be redefined every year and must be allocated according to a causation-based procedure. The Association of German Insurers (GDV) has developed a sample procedure by agreement with BaFin and made it accessible to life insurance companies. Half of the amount determined by such a procedure is paid to the policyholder at the termination of the contract. The other half remains in the company so that value fluctuation risks can be compensated.

Section 155 VVG compels life-insurance companies to inform their policyholders on an annual basis in text form about the performance of their claims, including the profit participation, and to point out any deviations from previous specifications.

## 1.3 Ordinances

### Ordinance on Disclosure Obligations in Insurance Contracts

- Expanded disclosure obligations for insurers.

The Ordinance on Disclosure Obligations in Insurance Contracts (VVG-InfoV)<sup>8</sup> has provided a standardised specification of which information insurers must disclose to policyholders in future. The ordinance has therefore summarised the disclosure obligations that were previously regulated in the VVG and in Appendix D of the VAG. The InfoV also specifies other obligations. A particular new factor is the specification of the conclusion and sales costs for personal insurance in euros and cents. This disclosure requirement was recently the subject of serious dispute because the insurers feared that it would lead to a disadvantage compared to other industries, such as fund brokering.

Another new element is the fact that the policyholders must receive a product information sheet as well as the general consumer information, which must show them the most important contractual information in separate, clearly highlighted form. The information sheet should explain the essential features of the contract in concise and comprehensible terms and so give the applicant a clear overview.

The InfoV ordinance came into effect on January 1, 2008. However, the regulations regarding the cost disclosure and about the product information sheet only have to be fulfilled from July 1, 2008 onwards.

### Amendment to the capital investment regulations for insurance companies

An amendment to the Investment Ordinance (AnIV)<sup>9</sup> came into effect at the end of December 2007. This ordinance is an expression of a transition to Solvency II. A basic concept in this amendment is the orientation towards the "prudent-person" principle, the renunciation of purely quantitative specifications in capital investments in favour of qualitative benchmarks. BaFin will take this into account in its revision of its circular<sup>10</sup> scheduled for 2008.

- Focus of AnIV on qualitative benchmarks.

The qualitative specifications previously included in the AnIV have been placed at the beginning of the ordinance in line with their increasing significance. These qualitative specifications still regulate compliance with the investment principles through qualified investment management, suitable internal capital investment principles and control procedures, a future-oriented investment policy and other organisational measures.

<sup>8</sup> Federal Law Gazette (BGBl.) 2007 I, p. 3004ff.

<sup>9</sup> Federal Law Gazette (BGBl.) 2007 I, p. 3278.

<sup>10</sup> www.bafin.de » Publications » Circular 15/2005 (VA) and Circular 11/2005 (VA).

The qualitative specifications have primarily been supplemented by the obligation to observe all risks on the assets and the liabilities sides of the balance sheet and the relationship of both sides to each other and also to carry out an audit of the elasticity of the investment portfolio in terms of certain capital-market scenarios and investment conditions. This obligation to conduct asset-liability management was previously regulated in the BaFin capital-investment circular.<sup>11</sup> The significance of this instrument has now been strongly emphasised by anchoring it in the AnIV. The insurance undertakings must also ensure that they can react appropriately at any time to changing economic conditions, in particular changes on the financial and real-estate markets, to catastrophic events with damages cases of a major magnitude or to other extraordinary market situations. In this way, the long-term capacity to fulfil the contractual obligations even under the prerequisites of the extended investment freedom should be guaranteed.

Investment horizon expanded to capital investments in full member states of the OECD.

The new AnIV basically extends the investment horizon from the states of the European Economic Area (EEA) to the full member states of the Organisation for Economic Cooperation and Development (OECD). Investments in suitable credit institutions and in funds are excluded. A standardised legal framework has been specified for such capital investments in two European directives.<sup>12</sup>

This continuing liberalisation is intended to create new investment scope without neglecting the security of the investment in the interest of the policyholders. When investing the restricted assets in a state that is not a member of the EEA or a full member of the OECD, the insurers must therefore audit the legal risks connected with the investment comprehensively and particularly carefully (section 1 (3) sentence 2 AnIV). Such legal risks, which may arise by appeal to the state regulations of the relevant state, may endanger the insolvency law laid down in section 77a VAG. In the EU member states, on the other hand, the mutual recognition of insolvency privileges is guaranteed.<sup>13</sup>

The new AnIV also opens up the possibility of investing in loans where an insurer has insured against the default risk (section 2 (1) No. 3 (e) AnIV). In the past, it has only been possible to invest the restricted assets in loans when a specifically designated credit institution had taken on the full guarantee for the loans' interest charges and repayment. Up to now, security in terms of an insurance had not been planned, because no insurance guarantees were available on the market. However, now that guarantees are being offered by insurers, particularly for subordinate construction financing, the ordinance has expanded the group of guarantor undertakings.

Certain investments grouped together.

In the schedule of investments in section 2 (1) No. 9 AnIV, the

<sup>11</sup> [www.bafin.de](http://www.bafin.de) » Publications » Circular 15/2005 (VA).

<sup>12</sup> Directive 2006/48/EC and Directive 85/611/EEA.

<sup>13</sup> Directive 2001/17/EC.



investments in receivables from subordinate liabilities and in profit participation rights are grouped together. Previously, the prerequisite for investments was that the registered office of the undertaking had to be in the EEA. As insurers are increasingly taking up subordinate capital in non-EEA states via issue vehicles, the insurers were no longer able to ascribe such investments to the schedule of investments and were forced to resort to the savings clause.

Although investments in securities from other jurisdictions, especially offshore states, involve heightened legal risks, they are also subject to a regulated market valuation due to a stock-exchange listing, and this justifies their qualification for the restricted assets. There is also a relaxation for unlisted, subordinate receivables, as a registered office of the debtor in a full member state of the OECD is now sufficient for acquisition purposes.

This valuation also applies to profit participation rights. They grant claims in relation to the company to a participation in its profits, but do not give any shareholder rights. Moreover, it can be extremely difficult in individual cases to differentiate between subordinate receivables and profit participation rights where the risk is essentially the same. As the Investment Ordinance also does not stipulate any different handling for these financial instruments, the fact that they are now grouped together also simplifies the investment regulations.

Unlisted subordinate receivables and profit participation rights are incorporated into the restriction of investments in holdings (section 3 (3) sentence 3 AnIV). These are equity instruments and/or surrogates which, like holdings, are not subject to any regulated market valuation and so do not possess the otherwise conventional fungibility.

The schedule of investments groups together all forms of asset-backed securities (ABS) and credit-linked notes (CLN) in a single place (section 2 (1) No. 10 AnIV). This affects both securitisation via bonded loans and also other forms such as bearer bonds or corresponding investments at suitable credit institutions. Moreover, other investments in accordance with section 2 (1) AnIV are also incorporated, where the earnings or the repayment are coupled to credit risks. The same prerequisites apply to their acquisition as to investments in receivables from subordinate liabilities and profit participation rights.

● Insurers may invest in REITs.

The insurance undertakings will also be permitted to participate in the new asset classes of Real Estate Investment Trusts (REITs), insofar as they fulfil the prerequisites of the law on creating German real estate stock corporations with listed equities or the comparable regulations of another state of the EEA or the OECD. Investments in REITs are allocated to the real estate and are credited to the real estate quota, because the field of operations of these companies is restricted to real-estate direct investments and to near-real-estate ancillary

activities.

Moreover, the quantitative mix quotas for capital investment risks have been streamlined in that the mix quotas for investments in securities loans, unlisted bearer bonds and equities and profit participation rights of companies with a registered office outside the EEA have been abolished. As a qualitative corrective, these investments must be restricted to a cautious degree (section 3 (1) AnIV).

Investments in commodities are possible under certain prerequisites.

Commodities investments may contribute to a diversification of the investment portfolio. Insurance undertakings may already invest in certain futures contracts on commodity indices via investments in hedge funds and UCITS III funds. It is therefore also being made possible for them to make comparable investments via other financial instruments. This affects structured products in particular, where the earnings or repayments are linked to commodity indices. They are equated to investments in commodity assets via UCITS III funds and to investments in hedge funds.

### Minimum Funding Ordinance

After more than 10 years' practice, BaFin has revised the regulations for determining the minimum funding for accruals for premium refunds in life insurance (Ordinance on the Minimum Refund in Life Insurance, ZRQuoten-Verordnung).

The new minimum funding ordinance now stipulates that the minimum funding must be calculated according to a standardised procedure. The differentiation according to the R quota (old portfolio) and the Z quota (new portfolio) is therefore being abandoned.

Fixed quotas for further sources of earnings.

The ordinance differentiates between three sources of earnings: The capital investment result, the risk result and the residual result, which consists of the cost result and the other results.

The level of minimum participation in the capital earnings of 90% compared to the previous Z quota has not changed. A fixed quota as a minimum participation has been set at 75% for the risk result and 50% for the residual result. As the previous "appropriate" minimum participation in the risk, cost and other results in the case of new portfolios led to interpretation problems in practice, the new ordinance will ensure legal clarity and reliability in particular.

In terms of old portfolios, the amendment will mean that the minimum funding will no longer be determined according to the unadjusted earnings. The cross-charging of the positive and negative results from the various sources of earnings will therefore be restricted, as required by the Federal Constitutional Court.<sup>14</sup>

<sup>14</sup> File ref.: 1 BvR 782/94 and 1 BvR 957/96.

Moreover, the new ordinance also takes into account the specifications of the Federal Constitutional Court which require that policyholders of insurance contracts that are entitled to a share of profits must participate in future in the valuation reserves. Due to the experience of recent years, it was also necessary to extend the reasons for a possible reduction of the minimum funding. In return, the revision of the ordinance now stipulates a requirement for the consent of BaFin instead of the previous disclosure obligation.

The insurers must apply the new minimum funding ordinance for the first time in the fiscal year beginning December 31, 2007.

### Calculation Ordinance

In order to implement the new statutory specifications of the General Equal Treatment Act (AGG) and of the VAG in the area of private health insurance and to ensure the just distribution of the costs of pregnancy and maternity, BaFin adapted the Calculation Ordinance (KalV)<sup>15</sup> to the new legal situation in 2007.

In the ordinance, BaFin stipulated which services must be regarded as costs for pregnancy and maternity, and how these services should be taken into account in the calculation of tariffs with a gender-dependent premium.

In this context, all costs which are incurred in a period beginning eight months prior to the birth and ending one month after the birth are to be regarded as costs for pregnancy and maternity. These costs shall not be ascribed to the pregnancy costs only if the insurer can prove that the costs involved were incurred in a different way.

The incurring of the costs is not the only point of reference in the distribution of the costs, but also the general social financing task. The so-called series of claims amounts per risk for services due to pregnancy and maternity must therefore be determined regardless of the gender.

However, the insurers may smooth the series of claims amounts per risk in a suitable manner in the various age groups. The aim of this measure is to restrict the premium increase for portfolio-insured men in specific age groups.

The permissible smoothing must satisfy certain requirements. In particular, relatively young female policyholders should not enjoy more relief due to the smoothing procedure than with a procedure that aims at a surcharge for all adults regardless of age.

In order to be able to adjust existing contracts, the ordinance

Costs for pregnancy must be taken into account with a gender-dependent premium.

Extraordinary right to adjust premiums.

<sup>15</sup> [www.bafin.de](http://www.bafin.de) » Supervisory legislation » Ordinance on the Actuarial Methods for Calculating Premiums and the Ageing Provision in Private Health Insurance (Calculation Ordinance).

permits a one-off, extraordinary right to adjust premiums. In its scope, it is restricted to the adjustment of premiums that arises from the gender-independent reallocation of services due to pregnancy and maternity. The modification must be carried out at the same time as the one for new business. The health insurer may determine itself the precise timing of the modification within the stipulated period of time. The ordinance specifies October 1, 2007 as the date when it came into force, in order to guarantee that the insurers can exercise in good time their one-off right to adjust premiums.

## 1.2 Supervisory practice

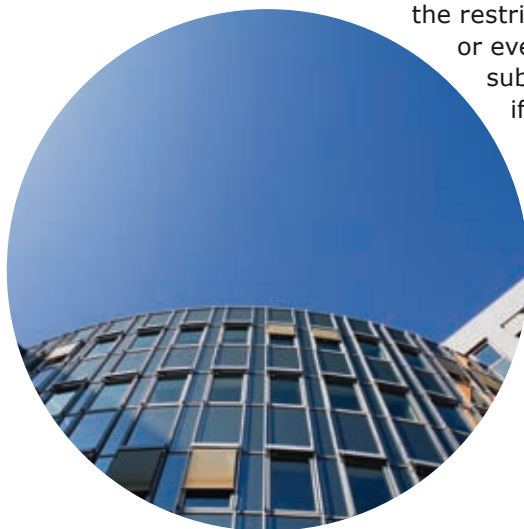
● BaFin makes requirements for structured products more flexible.

In the year under review, BaFin published a statement on structured products that offer extremely low interest at the time of acquisition in relation to the conventional market rates or even zero interest.<sup>16</sup>

Although, on the one hand, these products offer the possibility in specific, contractually defined future market conditions of receiving a coupon positioned above the standard market interest rate, but, on the other hand, they can also close with an extremely low or even zero interest in terms of the entire maturity. This can lead to the risk of an erosion of the economic substance of the asset investment – the interests of the policyholders would be endangered.

In the past, such products would have to have a maximum maturity of twelve years, insofar as they were intended to be incorporated into the restricted assets. The cash value of the capital guarantee had to total at least 50% of the deployed capital.

According to the new supervisory practice, structured products with a longer maturity can now also be incorporated into the restricted assets, insofar as any extremely low or even zero interest that erodes the economic substance is excluded. The prerequisite is given if the structured product either possesses a guaranteed minimum interest rate in the amount of the current actuarial interest rate for life insurers over the entire maturity or if the average coupon over the entire maturity reaches this level. Otherwise, the product must be allocated to the remaining assets due to a lack of adequate security.



<sup>16</sup> BaFinJournal, June 2007.

## 2 Ongoing supervision

### 2.1 Authorised insurance undertakings and pension funds

The number of insurance undertakings subject to the supervision of BaFin fell again in 2007 to 631 (2006: 636). These undertakings included 609 who were actively conducting business and 22 who were not. The information on business development in 2007 includes the 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 3  
Number of supervised insurance undertakings (IU) and pension funds<sup>17</sup>

	IU with business activity			IU without business activity		
	Federal supervision	State supervision	Total	Federal supervision	State supervision	Total
Life insurers	100	3	103	10	0	10
Pensionskassen	152	0	152	0	0	0
Death benefits funds	41	0	41	1	0	1
Health insurers	51	0	51	0	0	0
Property and casualty insurers	224	6	230	5	2	7
Reinsurers	41	0	41	6	0	6
Total	609	9	618	22	2	24
Pensions funds	26	0	26	0	0	0

#### Life insurers

In 2007, BaFin did not authorise any new insurance undertakings to conduct life insurance business. Two undertakings from the EU (Luxembourg, Netherlands) set up a branch in Germany, while 11 foreign life insurance companies from within the EEA registered to provide services in Germany (2006: 23). A number of service providers extended their business operations.

Table 4  
Life insurers from the EEA

Netherlands	3
United Kingdom of which Gibraltar	2 0
Ireland	2
Liechtenstein	2
Sweden	1
Spain	1

<sup>17</sup> These figures do not include relatively small mutual insurance associations that generally operate on a regional basis (BaFin statistics 2006 – direct insurance undertakings, page 8, table 5).

Table 5  
**Property and casualty insurers from the EEA**

United Kingdom of which Gibraltar	12 3
Ireland	5
Hungary	5
France	4
Netherlands	3
Belgium	2
Denmark	2
Latvia	2
Malta	2
Sweden	2
Bulgaria	1
Liechtenstein	1
Lithuania	1
Luxembourg	1
Norway	1
Austria	1
Portugal	1
Czech Republic	1

### Health insurers

In 2007, BaFin granted one public limited company permission to conduct health insurance business.

### Property and casualty insurers

BaFin granted three public limited companies permission to conduct property and casualty insurance business in 2007. Foreign property/casualty insurers from the EU established five branches, of which one each were from Belgium, France, Great Britain, Liechtenstein and Spain. In total, 47 insurance undertakings from the EEA registered to commence the provision of services in Germany (previous year: 52). 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 2007, some insurers ceased their service activities in Germany.

### Reinsurers

BaFin authorised one public limited company to conduct reinsurance business during 2007. During the same period, three companies discontinued their activities as independent German reinsurers as a result of Europe-wide corporation restructuring measures.

### Pensionskassen and pension funds

There were no instances of Pensionskassen being authorised by BaFin to conduct business operations during the year under review. Two new pension funds were authorised. Four occupational pension institutions with their registered office in another EU member state registered to operate in Germany, two of which were from Austria and one each from the UK and Luxembourg.

## 2.2 Interim reporting

### 2.2.1 Sub-prime

Even insurers as significant institutional investors cannot escape from general market turbulences such as the sub-prime crisis, especially if they have oriented their business model to the European Union market or are even active on a global level. Due to the growing complexity of worldwide networks, it is proving much more difficult nowadays than in previous crises to determine the precise risk potential.

In the year under review, BaFin repeatedly analysed the financial effects of the sub-prime crisis for insurers in all sectors. The surveys of selected insurers showed that the risk for German direct insurers and reinsurers as per the end of the year under review is limited. Insurers who had invested more than 3% of their capital assets in credit-risk transfer products also had to submit their quarterly internal stress tests to BaFin. All the insurers passed the tests.

This result is essentially due to the fact that the business purpose of insurers is relatively restricted: for instance, it prevents them from supplying liquidity lines for structured investment vehicles (SIV) or special refinancing structures such as conduits.

Moreover, the insurers have to comply with the strict supervisory stipulations for capital investments relating to the restricted assets. The assessment of the security in terms of the complexity of the product structures is therefore subject to tightened specifications. Above and beyond the necessary investment-grade rating, insurers are therefore also obliged to comprehensively analyse the legal and economic risks involved in such capital investments in an auditable way both before acquisition and during the investment term. Moreover, insurers may only invest a maximum of 7.5% of their entire financial assets in credit-risk transfer products. This quota was far from being exploited in full, as the average figure in 2007 was 1.6% of the capital investments in the industry.

## 2.2.2 Business development<sup>18</sup>

### Life insurers

The volume of newly activated policies in the area of direct life insurance fell in 2007 by 6.4% from 7.9 million to 7.4 million new contracts. The underwritten amount of new insurance policies was €225.8 billion, 2.5% lower than in the previous year, when the figure stood at €231.6 billion.

The share of mixed endowment policies as a proportion of new contracts dropped again from 21.4% to 18.8%. Term insurance accounted for 26.4% compared with 26.8% in the previous year, whilst the share of annuities and other life insurance rose from 51.8% to 54.8%. Endowment insurance comprised 11.0% of the underwritten amount on new policies, compared with 11.9% in 2006. Term insurance remained virtually constant at 34.7% compared with 34.9% in the previous year, whilst the share of annuities and other life insurance rose slightly from 53.2% to 54.3%.

Early withdrawals (surrender, conversion into paid-up policies and other early withdrawals) affected 3.5 million contracts, compared

<sup>18</sup> The figures for 2007 are based on the interim reports as at December 31, 2007 and so are only provisional.

with 3.6 million during the previous year. The total underwritten amount of the contracts that were withdrawn early, at €108 billion, was on a par with the previous year. Early withdrawals fell to 8.8% in terms of the underwritten amount in the case of endowment policies, and 8.1% in terms of number, while the figure was virtually unchanged at 3.2% in terms of underwritten amount and 3.2% in terms of number in the case of annuities and other insurance.

The total number of direct life insurance policies as at the end of 2007 was 94.8 million contracts (+0.6%), with a total underwritten amount of €2,469 billion (+2.9%). The share of mixed endowment insurance continued to fall, down from 52.8% to 51.0% in terms of the number of policies, or from 42.0% to 39.8% in terms of underwritten amount. Accounting for 14.5% in terms of the number of policies and 21.0% in terms of underwritten amount, the share of term life insurance remained more or less unchanged. Annuities and other life insurance accounted for 34.5% compared with 32.2% in the previous year in terms of number of contracts, with the share of the underwritten amount lying at 39.3% compared with 37.5%.

Gross premiums written in direct insurance business rose by 1.5% to €74.8 billion. Mixed endowment insurance fell from 45.4% to 42.8%, whilst the share of annuities and other life insurance rose again from 49.3% to 51.9%.

### **Health insurers**

Gross premiums written in direct health insurance business increased by 3.5% to €29.5 billion in 2007, with the number of insured natural persons rising by 9.4% to reach €31.9 million.

### **Property and casualty insurers**

In 2007, property and casualty insurance undertakings saw gross premiums written in direct insurance business remain virtually unchanged at €58.4 billion.

Gross expenditure for claims during the year under review rose by 10.9% to €21.2 billion, whilst gross expenditure for claims from prior years remained more or less unchanged at €13.1 billion. Gross provisions relating to individual insurance claims from the year under review, at €14.0 billion, were almost identical to the previous year, as were the gross provisions for individual claims from previous years, at €43.6 billion.

Motor vehicle insurance, with gross premiums totalling €20.4 billion, was the biggest area by far. This equates to a fall of 2.6% compared with -3.9% in 2006. Total gross payments for insurance claims for 2007 and payments for insurance claims from previous years were both 1.7% up. 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 2006, at €5.5 billion and €23.9 billion respectively.

In the area of general liability insurance, property and casualty insurance undertakings collected total premiums of €7.6 billion (-1.7%). The companies paid out 0.6% less for claims relating to the reporting year and 2.1% less for claims relating to prior years. Gross provisions for individual claims, which are particularly important in this insurance class, fell by 10.9% (previous year: +6.0%) to €1.7 billion with regard to outstanding claims from the reporting year and by 3.7% (previous year: +8.6%) to €11.1 billion in relation to outstanding claims from the previous year.

In the area of fire insurance, insurance undertakings posted gross premiums of €1.8 billion (-4.8%). Gross expenditure for claims from 2007 fell by 10.8%.

Viewed together, comprehensive residential buildings insurance and comprehensive household insurance generated premiums at an unchanged level of €6.6 billion. Expenditure for claims relating to the financial year rose by 50.3% year-on-year, with provisions up by 5.8%. Expenditure for claims from previous financial years was up by 13.9%, with provisions for such claims 2.9% higher than in 2006.

Premiums from general accident insurance totalled €6.3 billion as in the previous year. Gross expenditure for claims relating to the financial year also remained unchanged at €1.7 billion. Provisions for individual claims outstanding from 2007 were up by 2.8% on the previous year.

### 2.2.3 Investments

Total investment by all German insurance companies increased in 2007, up 3.3% to €1,287.6 billion. (2006: €1,246.3 billion). The proportion of properties fell to 2.1% with a decline in the book value of property investments. The proportion of investments in fund units, at 21.5%, was more or less unchanged on the previous year. These were the largest items alongside Pfandbriefe, municipal bonds and other bonds issued by credit institutions, accounting for some 19.9%. Overall, the breakdown of individual investments was similar to the situation in 2006. There was above-average growth in total investments – to a considerable extent in terms of health insurance, to a major extent in the case of Pensionskassen and to a slight degree for life insurance undertakings and death benefits funds. In contrast, property/casualty insurers and reinsurers suffered losses.

Table 6  
Investments 2007

Investments of all Insurance Undertakings (IUs)	Balance as at 31/12/2007		Balance as at 31/12/2006		Change in 2007	
	in € million	in %	in € million	in %	in € million	in %
Real property and equipment rights and shares in property companies	26,874	2.1	29,803	2.4	-2,929	-9.8
Shares in funds, public investment companies and investment companies	276,668	21.5	266,019	21.3	10,649	4.0
Loans secured by mortgages on property	62,672	4.9	62,979	5.1	-307	-0.5
Loans against securities and receivables secured against bonds	3,690	0.3	3,768	0.3	-78	-2.1
Loans to EEA states, their regional governments, regional corporations, international organisations	81,644	6.3	72,105	5.8	9,539	13.2
Corporate loans	10,526	0.8	8,010	0.6	2,516	31.4
ABS	664	0.1	815	0.1	-151	-18.5
Policy loans	5,208	0.4	5,215	0.4	-7	-0.1
Pfandbriefe, municipal bonds and other bonds from credit institutions	256,764	19.9	237,811	19.1	18,953	8.0
Listed bonds	109,150	8.5	113,864	9.1	-4,714	-4.1
Other bonds	10,324	0.8	6,472	0.5	3,852	59.5
Receivables from subordinated debt	23,334	1.8	22,829	1.8	505	2.2
Participation rights	13,336	1.0	14,202	1.1	-866	-6.1
Registered debts and liquidity papers	2,384	0.2	3,088	0.2	-704	-22.8
Listed shares	26,003	2.0	31,463	2.5	-5,460	-17.4
Unlisted shares and company holdings excl. shares in private equity	130,391	10.1	117,318	9.4	13,073	11.1
Shares in private equity	4,695	0.4	4,613	0.4	82	1.8
Investments at credit institutions	208,417	16.2	195,456	15.7	12,961	6.6
Investments in opening clause	14,512	1.1	15,042	1.2	-530	-3.5
Other investments	20,342	1.6	35,436	2.8	-15,094	-42.6
<b>Total investments*</b>	<b>1,287,598</b>	<b>100.0</b>	<b>1,246,313</b>	<b>100.0</b>	<b>41,285</b>	<b>3.3</b>
Life insurers	697,177	54.1	669,195	53.7	27,982	4.2
Pensionskassen	98,644	7.7	92,603	7.4	6,041	6.5
Death benefits funds	1,700	0.1	1,625	0.1	75	4.6
Health insurers	153,269	11.9	130,841	10.5	22,428	17.1
Property and casualty insurers	130,579	10.1	133,130	10.7	-2,551	-1.9
Reinsurers	206,229	16.0	218,919	17.6	-12,690	-5.8
<b>All IUs*</b>	<b>1,287,598</b>	<b>100.0</b>	<b>1,246,313</b>	<b>100.0</b>	<b>41,285</b>	<b>3.3</b>

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

- All insurance sectors demonstrate good solvency.

## 2.3 Solvency

Overall, both primary insurers and reinsurers were already meeting the minimum capital requirements very well in 2006. Provisional estimates suggest that this was also the case in 2007.

The solvency in the life insurance sector was maintained at a positive level. This was indicated by the evaluation of the scenario-based assessment as per the reference date of October 31, 2007. At year-end in 2007, estimates put the coverage ratio at 205% , as in the previous year.

Based on forecasts made as at December 31, 2007, all the health insurers also fulfilled the solvency regulations. The coverage ratio for the solvency target of the industry is expected to be slightly up on the previous year's figure of 225%.

In the case of property and casualty insurance, the coverage ratio increased considerably again in 2006 from 255% to 303%, after having fallen in both of the previous years. The coverage ratio therefore still stands at an extremely high level, well above the minimum capital requirements. This was due to the strong increase in own funds based on the one hand on a higher number of companies involved and, on the other hand, to capital increases and retentions of earnings. This also reflected the positive income situation of the property and casualty insurers in the last financial year.

The coverage ratio of reinsurers subject to supervision in Germany was extremely satisfactory. The supervisory requirements for the solvency capital of the reinsurers who do not perform a holding function at the same time amounting to €6,717 billion were offset by equity amounting to €20,911 billion.

In the case of the Pensionskassen, a BaFin forecast calculation as at June 30, 2007 indicated that one Pensionskasse would have encountered difficulties at the end of the year with its equity capital. Thanks to immediate countermeasures, it was possible to ensure that the company was able to fully cover its solvency margin again as at December 31, 2007. Another Pensionskasse, which BaFin had banned from all new business in 2004 due to economic difficulties, carried out reorganisation measures in 2007. The company now plans to build up the necessary equity gradually in the coming years.

All the pension funds were able to demonstrate in the BaFin forecast calculations as at the reference date of June 30, 2007 that they possess the necessary equity to cover their respective solvency margin. Moreover, the calculations showed that the funds can fully cover their pension-fund provisions even in the case of unfavourable developments on the capital markets. As pension funds invest most of their capital for the benefit and at the risk of employees and employers, the value fluctuations of the capital investments primarily have a positive or negative effect for 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. However, the majority of the business volume of all the pension funds is allocated to products without a guaranteed minimum level.

## 2.4 Stress testing

As at the balance sheet date of December 31, 2006, the insurers carried out a stress test once again and submitted it to BaFin. The parameters were the same as in the previous year – except that the allocation of structured products and asset-backed securities to the investment categories in the stress test was defined more clearly.

● Positive calculation results for all life insurers.

BaFin integrated 101 life insurers into the evaluation; six companies were exempt from submitting a stress test due to their risk-averse capital investment. In the four scenarios, all the life insurers registered positive results.

● Only one of 44 health insurers recorded a negative result.

BaFin integrated 44 health insurers into the evaluation, whereby eight companies were exempt from the obligation to submit a test due to their risk-averse capital investment. One health insurer registered negative values in the stress test, and measures to develop a risk-bearing capacity were initiated. In terms of all the other companies, it was sufficiently certain that enough assets would have been in place even in the event of significant price falls or interest-rate rises, taking account of technical provisions and statutory capital adequacy requirements.

● Seven property and casualty insurance companies ...

BaFin called on 182 property and casualty insurers to submit their stress-test results. 43 companies were exempt from submitting a stress test.

175 of the property and casualty insurers registered positive stress-test results. Five companies recorded negative results in all four scenarios, while one insurer had a negative result in three scenarios and one further company in one scenario.

The primary reason for this was the increased adjustment of the target values stipulated by the stress-test model. Sparked off by strong company growth, reserve increases 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 undertakings with a negative stress-test result, it can be assumed – based on the current circumstances – that the risk-bearing capacity was sufficient. On the one hand, the high growth rates will fall further due to the ongoing pressure of competition. On the other hand, the insurers concerned have since introduced measures to increase their risk-bearing capacity, which in some cases have already been implemented in practice.

● ... and six Pensionskassen with negative results.

Of the 152 Pensionskassen supervised by BaFin, 25 were not required to submit stress-test results due to their investments showing no or only little risk. 121 of the 127 Pensionskassen required to submit their result recorded positive results in all four stress-test scenarios. The level of the shortfall was generally low in the case of the six Pensionskassen which recorded a negative result. These undertakings adopted measures during the course of 2007 to ensure that risk-bearing capacity is re-established.

## 2.5 Composition of the risk asset ratio

All primary insurance undertakings reported on their investment portfolio in its entirety as at December 31, 2007. The undertakings were required to break down the different classes of investment on the basis of the schedule of investments given in the Investment Ordinance and on the basis of their particular risks.<sup>19</sup>

The following evaluations are based on the data for life, health and property/casualty insurance undertakings and Pensionskassen. The book value of all of the investments of these areas of insurance was €1.09 trillion at this time, compared to €1.03 trillion in the previous year.

Insurance undertakings may invest 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.



<sup>19</sup> Section 1 (1) AnIV; documentation 670.

Table 7  
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	Shares	Absolute in € million	Share	Absolute in € million	Share	Absolute in € million	Share
Total investments*	672,869	100.0%	149,417	100.0%	117,257	100.0%	97,938	100.0%	1,037,481	100.0%
Thereof:										
Loans against securities (no. 2), provided that shares (no. 12) are the object of the loan	360	0.1%	0	0.0%	0	0.0%	0	0.0%	360	0.0%
Receivables from subordinated debt (no. 9)	13,428	2.0%	4,271	2.9%	1,918	1.6%	1,982	2.0%	21,599	2.1%
Participation rights (no. 10)	8,726	1.3%	1,885	1.3%	1,183	1.0%	336	0.3%	12,130	1.2%
Fully paid-up shares which are included in a regulated market (no. 12)	9,034	1.3%	1,380	0.9%	1,182	1.0%	68	0.1%	11,664	1.1%
Unlisted 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)	9,194	1.4%	1,545	1.0%	1,880	1.6%	317	0.3%	12,936	1.2%
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 EEA market	47,287	7.0%	7,234	4.8%	12,585	10.7%	10,614	10.8%	77,720	7.5%
- cannot be definitively allocated to another form of investment; residual fund value and non-transparent funds	10,604	1.6%	2,765	1.9%	2,267	1.9%	1,571	1.6%	17,207	1.7%
Investment in high-yield bonds	4,054	0.6%	862	0.6%	839	0.7%	576	0.6%	6,331	0.6%
Increased market risk potential of funds**	3,348	0.5%	702	0.5%	1,078	0.9%	214	0.2%	5,342	0.5%
Investments linked to hedge funds (partly in categories other than the AnIV nos. set out above)***	2,893	0.4%	545	0.4%	248	0.2%	493	0.5%	4,179	0.4%
Total investments subject to the 35% risk capital ratio	108,928	16.2%	21,189	14.2%	23,180	19.8%	16,171	16.5%	169,468	16.3%

\* 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 December 31, 2007 for life, health and property/casualty insurers, as well as Pensionskassen, from the documentation 670, Circular 11/2005 (VA)

- Equities accounted for between 8.6 and 10.3%.



The so-called residual value, in the amount of 1.7% 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 8.6% and 10.3% of restricted assets. However, this level varies considerably across the different insurance classes, at 5.7% to 7.6% for health insurers, and between 11.7% and 13.6% in the case of property/casualty insurers. Property/casualty and health insurance undertakings have the highest proportion of non-transparent funds.

The risk asset ratio also includes 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% 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 0.6% of the restricted assets, are also included in the 35% ratio.

In accordance with the German Investment Act or the corresponding provisions of another state, a fund may, through the use of certain derivatives, leverage potential market risk. This increased potential market risk of a fund is counted towards the risk asset ratio in accordance with the AnIV.

Table 8  
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*	696,486	100.0%	153,119	100.0%	140,661	100.0%	98,939	100.0%	1,089,205	100.0%
Thereof:										
Investments in private equity holdings (in restricted assets according to section 1 (1) no. 13 AnlV)	2,906	0.4%	482	0.3%	645	0.5%	132	0.1%	4,165	0.4%
Directly held asset backed securities and credit linked notes	4,982	0.7%	511	0.3%	474	0.3%	535	0.5%	6,502	0.6%
Asset backed securities and credit linked notes held in funds according to C 1/2002	6,120	0.9%	957	0.6%	2,170	1.5%	948	1.0%	10,195	0.9%
Investments in hedge funds and investments tie to hedge funds (in restricted assets according to C 7/2004)	3,407	0.5%	689	0.4%	534	0.4%	766	0.8%	5,396	0.5%

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

Source: Sector totals as at December 31, 2007 for life, health and property/casualty insurers, as well as Pensionskassen, from the documentation 670, Circular 11/2005 (VA)

- As in the past, only a small proportion of the investments are ascribed to alternative investments.

The table shows that the level of alternative investments as a proportion of total investments scarcely changed compared with the previous year. For instance, the share of direct investments in asset-backed securities and credit-linked notes fell slightly from 0.7% to 0.6%, with fund-based investments in asset-backed securities and credit-linked notes increased slightly from 0.8% to 0.9%.

## 2.6 Risk-oriented supervision

- Supervision increasingly risk-oriented.

BaFin is increasingly adopting a risk-oriented approach in its supervision of the relevant undertakings. It is thereby temporally anticipating the European specifications for a new quantitative and qualitative solvency supervision – Solvency II. For the insurers, Solvency II will involve a new alignment of their business policy, and for BaFin it will mean an even stronger orientation towards risk in its supervision.

### Solvency II – Internal Models

Under Solvency II, the insurers will be able to prove their compliance with the supervisory capital requirements in two risk-based ways: with a standard approach or with one of the “Internal Models” approved by BaFin.



32 insurers express initial interest in developing Internal Models.

In autumn 2007, BaFin conducted an initial survey to discover which insurers and/or groups were planning to use an Internal Model. Of the 91 responses, 27 participants indicated that they were planning the certification of a full Internal Model. Five insurers and/or groups intend to have a partial Internal Model certified and 33 were not yet able to make a definitive statement at the time of the survey. As a result, a market share of approx. 70% in Germany would be covered by Internal Models, in terms of the gross premium income. A further 29 participants rather tended towards using the future European standard approach. In the last two years, BaFin has already conducted intensive bilateral discussions on site – so-called “pre-visits” – about the development status of the respective model at approximately one third of the undertakings that intend to introduce an Internal Model.

In 2007, the Internal Models Working Group also held various discussions again. This series of discussions, which was set up in 2006, gives interested company representatives who want to introduce an Internal Model the chance to find out in good time about the national and international developments. In return, BaFin can get to know the Internal Models of “its” undertakings from the very outset. Basic modelling issues and problems can often be detected as early as the development phase and can give the auditor important data for the later certification at an early stage.

In terms of human resources, the more risk-oriented alignment means that the number of employees in this area needs to be stocked up. During the year under review, the Administrative Council at BaFin approved 30 new posts specifically for auditing Internal Models. Due to the required special qualification and the various technical fields, it proved impossible to fill all of the free posts immediately for the beginning of 2008, and a second application phase will be needed.

### **Risk classification**

BaFin allocates the supervised undertakings to a risk class through methodical questioning. This risk classification helps to measure the supervision intensity and so influences the supervision process. In order to safeguard this process, BaFin developed a user manual in 2007 which standardises the procedure within the supervisory authority.

In order to classify an insurer in the matrix, two factors are significant: on the one hand, the effect of the undertaking on the market, i.e. its system relevance and, on the other, its quality. BaFin determines the criterion of system relevance for life insurers, death benefits funds, Pensionkassen, health insurers and pension funds using the total of their capital investments. In the case of property/casualty insurers and reinsurers, the gross premium income is the decisive factor. The system relevance can be assessed as high, medium or low.

The assessment of the quality of the undertakings is derived from three sub-areas, which are marked with grades. In contrast to 2006, BaFin has merged the sub-areas of "safety" and "success" together to form the new sub-area "asset, financial and income situation". The sub-areas of "growth" and "quality of management" have remained unchanged. Each of the sub-area scores reflects specific insurance-industry indicators or qualitative criteria. The evaluation system combines the scores in each sub-area to form an overall score, which is then transferred to a four-level scale from A (high) to D (low).

In December 2007, BaFin carried out this sort of risk classification for insurers.

Table 9

**Results of risk classification 2007**

(previous year's figures in brackets)

Companies in %		Quality of the company				Total*
		A	B	C	D	
System relevance	High	1.3% (1.6%)	7.0% (6.3%)	0.5% (1.4%)	0.0% (0.0%)	8.7% (9.3%)
	Medium	4.4% (4.6%)	11.7% (11.9%)	2.2% (2.8%)	0.2% (0.2%)	18.5% (19.5)
	Low	15.1% (13.0%)	43.3% (43.5%)	13.2% (12.7%)	1.3% (2.0%)	72.7% (71.2%)
Total		20.8% (19.2%)	62.0% (61.7%)	15.8% (16.9%)	1.4% (2.2%)	100.0%*

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

BaFin did not classify any insurer with a high market significance as low in the "quality" criterion in the fourth quarter of 2007. There is a high concentration in the fields "low system relevance" combined with high and medium quality. These fields accounted for 58.4% of all undertakings.

**On-site inspections**

BaFin integrated its findings from the risk classification process into its 2007 supervision planning for insurers and Pensionskassen. The supervisory authority planned its on-site inspections by taking the results of the risk classification into account. It therefore inspected as a priority any companies that demonstrated a high risk potential and that had not been inspected in the recent past.

The following risk matrix shows the distribution of the inspections across the risk classes.

Table 10  
**Distribution of on-site inspections 2007 according to risk classes**

On-site inspections		Quality of the company				Total	Companies in %
		A	B	C	D		
System relevance	High	2	6	4	0	12	21%
	Medium	3	7	5	0	15	12%
	Low	3	18	17	1	39	8%
Total		8	31	26	1	66	10%
Companies in %		6%	8%	24%	13%	10%	

## 2.7 Performance in the individual sectors<sup>20</sup>

### Life insurers

● Life insurers with stable income situation.

The life insurers supervised by BaFin during the 2007 reporting year recorded gross premiums in direct business of €74.8 billion. This equates to a rise of about 1.5% on the previous year. The investment portfolio rose by approximately 4% to about €682 billion.

The profit prospects of the undertakings were positively influenced in 2007 by the increase in the capital-market interest rates. However, this interest-rate rise also ensured that the valuation reserves of the undertakings fell. Nevertheless, this is only a temporary effect because the interest assets are generally retained until maturity and there is then a repayment at the nominal value.

The favourable performance overall of the equity markets in 2007 also had a positive influence on the economic situation of the life insurers.

<sup>20</sup> The figures for 2007 are based on the interim reports as at December 31, 2007 and so are only provisional.

### Scenario-based assessments

Alongside the stress test, scenario-based assessments are an additional risk-oriented supervision instrument. They particularly help BaFin to assess more efficiently the possible effects of unfavourable developments on the capital markets on the company success, the solvency and the valuation reserves in the capital investments. With its scenario-based assessments, BaFin can react flexibly to particular market circumstances. For instance, BaFin can also gain an overview of whether the board decision in the annual surplus declaration corresponded to the proposal made by the responsible actuary and took appropriate account of the individual undertaking's economic situation.

As in previous years, BaFin conducted two scenario-based assessments of the life insurers for the cut-off dates of June 30 and October 31.

In 2007, the scenarios for equity prices moved within a range of up to 25% below the equity price at the given time. The scenario applied to interest rates involved a parallel increase in the yield curve of 20 basis points above the market situation on the cut-off date. The results of this scenario-based assessment indicated that all the life insurance undertakings would have been in a position to cope economically with the various different scenarios.

- Net interest return for 2007 estimated at 4.6%.

The average net return on investments for 2007, based on provisional estimates, stood at approximately the same level as the previous year at 4.6%.

- Surplus declaration for 2008 with a slightly upward tendency.

In its scenario-based assessment as at October 31, BaFin requested information on surplus bonuses for 2008. The surplus declarations provided by the life insurers were generally slightly above those of the previous year. The arithmetical average of total bonuses declared for endowment policies for 2008 was 4.3% (previous year: 4.2%).

- Stable income situation with fairly moderate volume of new business.

### Private health insurance

The 52 private health insurers subject to supervision by BaFin generated total premium income of approximately €29.5 billion in the 2007 financial year, a year-on-year increase of approximately 3.5%. The market for private health insurance continued to be difficult in the year under review. Due to the ongoing political debate on reform of the healthcare system, potential customers were unsettled and tended to wait before concluding a private health-insurance contract. Since February 2, 2007, voluntary holders of statutory insurance have only been able to change to private insurance if their income has been above the taxable wage base for three calendar years in succession. BaFin therefore anticipates that new business will continue to develop at only a moderate rate, particularly in terms of full medical costs insurance. Apart from new business, a large proportion of the premium

growth is therefore due to premium adjustments. The investment portfolio rose by 9.2% to about €142 billion.

The year 2007 was characterised by a further recovery on the equity markets and an increase in capital-market interest rates. Both of these factors had a positive influence on the economic situation of the health insurers. Although the increase in the capital-market interest rates led to a considerable reduction in the hidden reserves in interest-bearing securities, the negative effect of this on the undertakings was only limited. The reason for this was the fact that the health insurers generally retain these interest-bearing securities until maturity and that the nominal value is repaid at that point. Overall, BaFin assesses the interest-rate increase as positive, because the undertakings can therefore generate sustainable, higher interest income from new investments, which also helps to stabilise their income situation.

BaFin required 43 health insurers to carry out scenario-based assessments as at June 30, 2007 and to submit their results. Nine undertakings were exempt from the requirement to submit results due to the low-risk nature of their investment structure, 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 2007 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.

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. It would have been possible to compensate for any negative influence on the unadjusted surplus through possible nominal-value accounting and/or accounting as a fixed asset.

The negative scenarios used in the scenario-based assessment did not materialise. BaFin therefore expects the companies in question to achieve a level of net interest earned of slightly under 5%.

At the end of March 2007, the act for strengthening competition in statutory health insurance (GKV-WSG) was announced.<sup>21</sup> This act also contains specifications for private health insurance.<sup>22</sup>

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

● Net interest return slightly under 5%.

● Health reform brings fundamental changes to private health insurance.

<sup>21</sup> Federal Law Gazette (BGBl.) 2007, p. 378ff.

<sup>22</sup> Annual Report of BaFin 2006, p. 81f.

From January 1, 2009, every citizen with residence in Germany will be obliged to conclude a medical costs insurance policy for himself/herself and for all persons who he/she legally represents with an authorised insurer. The contract must at least include a cost refund for in-patient and out-patient curative treatment.

This obligation does not apply to persons who are insured with statutory health insurance, are liable for insurance deductions, who have a right to free curative care, are entitled to government aid or have comparable rights.

If the application for a contract is submitted more than a month after the start of the liability for insurance deductions, a premium surcharge must be paid. If the policyholder falls into arrears with a premium payment despite a reminder, the insurer may stipulate the suspension of the insurance contract. During the suspension period, the insurer must exclusively refund expenses for acute illnesses and cases of suffering, pregnancy and maternity.

It has been possible since as early as July 1, 2007 for persons who have lost their private health insurance or who have never been insured and who should be allocated to private health insurance in view of their professional biography to demand insurance cover in the so-called modified standard rate. The insurers who run substitutive health insurance in Germany may not reject any corresponding applications, insofar as the applicant fulfils the statutory requirements.

● Transitional solution for the uninsured.

#### **Modified standard rate**

The modified standard rate in accordance with section 315 SGB V is based on the standard rate in private health insurance, a standardised rate within the industry that has been available since 1994. It is primarily aimed at older policyholders who need an attractively priced rate for financial reasons. The scope of benefits is aligned to the schedule of services of the statutory health insurance. Risk surcharges and service exclusions are not permissible. The premium amount depends on the pre-insurance period and the age of the policyholder. In the modified standard rate, the premium must not exceed the average maximum premium in statutory health insurance. If the payment of the premium alone leads to a need for aid in accordance with social law, the premium shall be reduced by half for the duration of this need for aid. If a need for aid is still present even with a reduced premium, the responsible social-aid provider shall take over the premium payment in full or in part.

In the initial months following the introduction of the modified standard rate, only relatively few uninsured persons applied for the relevant participation in this rate. Even so, the inclusion of previously uninsured persons initially led to implementation difficulties.

### Property and casualty insurance

Overall, the business performance of the property and casualty insurers was satisfactory in 2007. The stagnating premium level and an increasing volume of claims expenditure had a negative effect.

The premium income in direct insurance business stagnated at approximately the same level as the previous year. The automotive business had a significant influence on the premium performance, as it only suffered a minor premium decline due to the sustained competitive pressure. Casualty insurance with a return of premium registered premium growth, although the increase in income failed to match the growth of the previous year.

In the financial year 2007, property and casualty insurers suffered a perceptible increase in claims expenditure. Many natural disasters, such as the storm designated Kyrill, had a negative effect on the claims performance, especially on comprehensive automotive insurance and in the property-insurance segments.

The combined ratio increased by about 4% to 93.0% compared to the previous year. Overall, there was a profit in technical insurance terms, but it did not approach the level of the previous year.

In automotive insurance, BaFin is continuing to focus on possible discrimination against foreigners, even though the number of complaints has declined considerably in recent years.

Given that the insurers have only had to submit their insurance conditions in the compulsory insurance sector since deregulation in 1994, e.g. in automotive liability insurance, BaFin is obliged to use other sources of information. The supervisory authority is able to investigate the problem in on-site inspections, in particular.

For instance, BaFin discovered during an on-site inspection at an insurer that the relevant undertaking designated certain foreigners as "undesirable risks" in its acceptance guidelines for automotive insurance, with the corresponding consequences in their acquisition in automotive insurance. BaFin lodged a complaint about this behaviour as impermissible discrimination against foreigners, with reference to a circular.<sup>23</sup> Thereupon, the insurer declared that it was willing to delete the clause from its acceptance guidelines without any substitution. BaFin also objected that the undertaking had previously not paid any commission for the brokering of automotive insurance contracts with policyholders of specific nationalities. The insurer finally declared its willingness to pay a commission even for these risks.

● Natural disasters had a negative effect on the claims performance.

● BaFin complained about discrimination in automotive insurance.

<sup>23</sup> BAV Circular R 6/1995, section III 4.

## Reinsurance

More natural disasters occurred in 2007 than in any year since records began in 1974. The number of cases of damages increased from 100 to 950 compared to 2006. As there were no extreme disasters, the volume of the claim burden was far below the record of 2005, but the claims payments of the reinsurers still increased considerably when compared to 2006.

Natural disasters caused general economic damage worth €52 billion worldwide (previous year: €26 billion). Of this total, just under €21 billion (previous year: €10 billion) were insured. The largest claim event in Germany was the winter storm Kyrill, which caused insured damage amounting to €2.4 billion.

The industry estimates premium income for 2007 at just under €40 billion, and the estimated capital stands at almost €65 billion.

- BaFin did not find any new cases of improper financial reinsurance.

In 2007, financial reinsurance was another focus of BaFin's activities. BaFin was not able to find any further cases of improper use of financial reinsurance contracts, even in on-site inspections. It was not possible to implement the original planning of the legislator to enact the financial reinsurance ordinance in 2007. Even so, the approval procedure is now well-advanced, so BaFin assumes that the ordinance will be enacted in 2008.

- Recognition of non-EU reinsurers in Germany.

In 2006, the legislator transposed the European reinsurance directive into national law.<sup>24</sup> Reinsurers with their registered office in a non-EU country/an EEA member state are now permitted to conduct reinsurance business in Germany through a branch office or from their registered office in the sense of freedom of services.

It is planned to develop criteria for the relevant assessments of equivalence. The aim is to assess the supervision systems in non-EU countries in a standardised manner. Until definitive agreements have been concluded, the affected reinsurers from non-EU countries must submit certification to BaFin from the supervisory authority in the country where the registered office is located. This certificate must show that the undertakings comply with the statutory criteria, have their headquarters in that country, that they are supervised in the country where the registered office is located according to internationally recognized principles and that a satisfactory cooperation between the responsible authorities in that country and BaFin is guaranteed.

## Pensionskassen

- Premium income grew just slightly.

As in the previous year, the premium income of the Pensionskassen increased just slightly in 2007. Several of the relatively recent competitive Pensionskassen have now achieved a considerable premium volume. The market is therefore also increasingly

<sup>24</sup> Directive 2005/68/EC.



saturated. The investment portfolio of the 152 undertakings supervised by BaFin increased in the year under review by approx. 7.7% to about €98.6 billion.

In addition to the investment risks accounted for by stress testing and forecast calculations, Pensionskassen also face what is known as the longevity risk of policyholders. This can mean that Pensionskassen are forced to adjust their bases of calculation and increase their technical provisions for the following years. The year 2007 was characterised by an increase in the level of interest rates on the capital market, which made it increasingly easy for companies to generate the surpluses needed to finance such adjustments.

BaFin made forecasts for 134 Pensionskassen as at June 30, 2007. 18 Pensionskassen were exempt from submitting calculations due to the low-risk structure of their investments.

The companies were required to forecast their expected development over the 2007 financial year on the basis of four capital market scenarios. Using the submitted forecasts, BaFin recognised at an early stage that one Pensionskasse would have encountered difficulties at the end of the year with its equity capital. Thanks to immediate countermeasures, it was possible to ensure that this company also was able to fully cover its solvency margin as at the year-end.

### Pension funds

The dominant topic for the German pension-fund industry in 2007 was the transfer of existing pension guarantees from employers to pension funds. The majority of German pension funds designed new products to participate in this growth market. Moreover, two other industry undertakings represented on the DAX 30 founded pension funds in the year under review in order to outsource a proportion of their pension guarantees. Due to the general fiscal conditions, the undertakings transferred already ongoing pension to pension funds.

The number of pension recipients in all 26 pension funds therefore increased in the year under review by 33.3% to approx. 219,236 as at the year-end. The number of future beneficiaries increased by 16.5% to approx. 353,818, which was due to the only moderate increase in the field of premium guarantees.

BaFin anticipates that the new business of pension funds will continue to focus on the takeover of existing guarantees in the future. This tendency will be supported by the VAG amendment 2008, which will aim at a further increase in flexibility in the cover regulations for pension schemes that are not based on an insurance.

● Forecast calculation led to early detection of risks.

● Takeover of existing pension guarantees as a significant business field.

● A continued strong increase in the capital investments for the benefit and at the risk of employees and employers.

As in the previous year, there was an increase particularly in the capital investments for the benefit and at the risk of employees and employers; they rose by 56.4% to €12.2 billion as at the year-end. Based on provisional estimates, the investments for the benefit and at the risk of the pension funds grew in 2007 by 18 % to approx. €602 million.

● Forecast statement gave no cause for concern.

BaFin prepared forecast statements for 23 pension funds as at June 30, 2007. The funds were required to portray their expected development over the 2007 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. As pension funds invest most of their capital for the benefit and at the risk of employees and employers, the value fluctuations of the capital investments primarily have a positive or negative effect for 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.



# V Supervision of banks and financial services institutions

## 1 Basis for supervision

### 1.1 Act Implementing the MiFID

On November 1, 2007 the Act Implementing the Markets in Financial Instruments Directive (Finanzmarktrichtlinie-Umsetzungsgesetz – FRUG) came into force.<sup>25</sup> It pursues the principal goal stipulated by the European Markets in Financial Instruments Directive (MiFID) of further harmonising and refining the regulations that apply throughout Europe for the registration and operation of financial services institutions and trading platforms. Its aim is to make both financial markets, as a whole, and investment services provided for individual investors more transparent and efficient.

The FRUG has expanded the catalogue of financial services subject to licensing requirements in the Banking Act (Kreditwesengesetz – KWG): Apart from those effecting independent transactions and securities placement transactions, investment consultants now require a licence from BaFin. However, this applies only to investment consulting in respect of financial instruments: Pursuant to KWG, consultancy and the brokerage of fund units remain exempt from licence requirements. BaFin and the Bundesbank have together compiled an information sheet on the interpretation of the term “investment consulting”, which deals with the distinction between investment consulting services requiring a licence and that which does not.<sup>26</sup> In an additional leaflet coordinated with the Deutsche Bundesbank, BaFin further clarifies the various scenarios for which a licence is required for securities placement transactions.<sup>27</sup>

Of particular importance is the operation of a multilateral trading facility, which now requires a licence. This includes stock market type trading platforms, which – as a special type of investment brokerage – are now subject to special licence and operation regulations. BaFin supervises these multilateral trading facilities in such cases where they are operated by a credit or financial services institution.<sup>28</sup> In addition, the FRUG has also led to extensive changes in the requirements of credit and financial services institutions in respect of the furnishing of information, conduct, record-keeping and organisation as stipulated in sections 31 ff. of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG). The FRUG further specifies and differentiates these information and reporting

● Stock market type trading platforms require approval.

<sup>25</sup> Federal Law Gazette (BGBl.) 2007 I, p. 1330.

<sup>26</sup> [www.bafin.de](http://www.bafin.de) » Publications » Bulletin 12.11.2007.

<sup>27</sup> [www.bafin.de](http://www.bafin.de) » Publications » Bulletin 27.12.2007.

<sup>28</sup> See Chapter VI, 1.1.



FRUG introduces best execution rule.

requirements for gathering customer data and the best execution of customer orders. A further change involves the classification according to the type of investor, for example: requirements regarding conduct vis-à-vis private customers are stricter than those in respect of professional customers. There is also a requirement to furnish more information for complex financial instruments such as derivatives than for non-complex instruments such as shares for instance.

The basic rules of conduct still stand: investment services must be provided with technical expertise, care and diligence in the interests of the customer. This basic principle has undergone a particularly important development in that there is now an explicit ban on accepting financial or other inducements from third parties, or from granting such inducements, unless they are disclosed to the customer and are basically intended to improve the quality of the service.

Of great importance too is the best execution requirement for client orders introduced by the FRUG. According to this, institutions are, as a rule, obliged to take all reasonable steps to achieve the best possible result for their customers when executing customer orders or when transferring them to third parties. The old statutory primacy of the stock exchange pursuant to section 22 of the Exchange Act (Börsengesetz – BörsG) no longer applies. Rather, a company must also consider alternative trading places such as multilateral trading facilities or the execution of an order against its own portfolio. Criteria for best execution include in particular cost, speed and the probability of the order being executed and processed. In order to guarantee best execution, companies are required to establish appropriate principles and to inform their clients.

### **Ordinance Specifying Rules of Conduct and Organisation Requirements for Investment Services Enterprises**

On November 1, 2007 the new Ordinance Specifying Rules of Conduct and Organisation Requirements for Investment Services Enterprises (Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsanforderungen für Wertpapierdienstleistungsunternehmen – WpDVerOV) came into force.<sup>29</sup> This serves to execute the Implementing Directive of the Commission for the MiFID.<sup>30</sup> The WpDVerOV specifies provisions, which have been amended and integrated by the FRUG relating to the rules of conduct for lending and financial services institutions and for financial analyses. It thus includes detailed regulations on requirements concerning the furnishing of information and reports by investment services enterprises to their clients, on the gathering of customer data for the assessment of suitability

<sup>29</sup> Federal Law Gazette (BGBl.) 2007 I, p. 1432.

<sup>30</sup> Directive 2006/73/EC.

and appropriateness of dealings in financial instruments, and on the best execution requirement of institutions for client orders. The regulation also contains organisational requirements of the company for supervising compliance with statutory requirements themselves, dealing with conflicts of interest and providing reports on investment services. Provisions for procedures for classifying clients as private customers, professionals or eligible third parties are transposed from the MiFID itself.

### **Ordinance on the Examination of Investment Services Enterprises**

● WpDPV revised.

The Ordinance on the Examination of Investment Services Enterprises (Wertpapierdienstleistungs-Prüfungsverordnung – WpDPV) was amended to reflect the provisions of the FRUG. It was extensively revised with effect from November 1, 2007.<sup>31</sup> The WpDPV regulates the inspection of reporting requirements pursuant to section 9 of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) and compliance with rules of good conduct. Apart from the new regulations in the WpHG, it also takes into consideration the requirements of the new WpDVerOV as well as the MiFID Implementing Regulation pertaining to the audit pursuant to section 36 WpHG.<sup>32</sup> Furthermore, the regulation also includes rules for auditing the securities account and the custodian bank. These replace the earlier dynamic cross referencing to the provisions of the Audit Report Ordinance (Prüfungsberichtsverordnung – PrüfbV). Finally, the ordinance takes into account the practical experience of specialists and auditors when applying the old WpDPV.

### **Ordinance on the Analysis of Financial Instruments**

The Ordinance on the Analysis of Financial Instruments (Finanzanalyseverordnung – FinAnV) was also amended on November 1, 2007 to reflect new provisions.<sup>33</sup> Additional organisational requirements were incorporated into the FinAnV; these are intended to make it possible to manage and avoid conflicts of interest as far as possible. The institution's size and business segment, as well as the risk potential of the activity being analysed, determines the way in which conflict of interest management needs to be structured.

The main changes concern section 5a of the FinAnV, which codifies the organisational requirements for investment services providers in connection with the compilation and/or distribution of financial analyses. The most important individual requirements are as follows: control of information flows, independence of remuneration, prevention of inappropriate exertion of influence on employees, separate employee supervision and a ban on inducements and

<sup>31</sup> Federal Law Gazette (BGBl.) 2007 I, p. 2499.

<sup>32</sup> Ordinance (EC) No. 1287/2006.

<sup>33</sup> Federal Law Gazette (BGBl.) 2007 I, p. 1430.

certain employee transactions. In addition, investment services providers must comply with wide-ranging reporting requirements.

### **KWG Tied Agents Ordinance**

If an institution reports to BaFin that it accepts liability for a person, he or she does not require a separate licence if they are providing investment and contract broking services, securities placement or investment consulting services on behalf of the institution. The KWG Tied Agents Ordinance (KWG-Vermittlerverordnung – KWGVermV) introduced a public register of contractually tied agents with effect from January 1, 2008 on the basis of the FRUG, which BaFin has published on its homepage.<sup>34</sup> The register provides information about who is operating as a tied agent for which institution and for which time period.

The recently implemented KWGVermV governs the registration of tied agents and the publication of their names in the register. Consequently, registrations must be submitted to BaFin electronically and include specific details. The data contained in the electronic registration is automatically entered in the register. The ordinance stipulates that the institutions themselves are responsible for registering their tied agents. For this reason, institutions can access the register directly and change or update its contents. BaFin has also compiled two circulars, which supplement the KWGVermV and regulate the electronic transfer of data.<sup>35</sup>

The ordinance includes transition periods: pursuant to this, all tied agents were required to be registered electronically and entered in the register by the end of March 2008. This also applies to such tied agents who had already been registered in accordance with the old BaFin legislation.

### **Securities Trading Reporting Ordinance**

In order to facilitate the exchange of reports on trade in securities throughout Europe, which is required by the MiFID, the Securities Trading Reporting Ordinance (Wertpapierhandel-Meldeverordnung – WpHVMV) was amended to reflect the new reporting requirements.<sup>36</sup> This mainly affects the technical format of the reports. However, BaFin has not changed the basic structure of the reports in order to keep the costs of the amendment as low as possible. MiFID stipulates that transactions be reported first to the company's local supervisory authority regardless of the place at which the transaction took place. This authority then forwards the reports to other supervisory authorities, mainly the authority of the state in which the most liquid market for the financial instrument is located.

● Amended reporting provisions.

<sup>34</sup> Federal Law Gazette (BGBl.) 2007 I, p. 2785; [www.bafin.de](http://www.bafin.de) » Databases & lists » Other databases.

<sup>35</sup> [www.bafin.de](http://www.bafin.de) » Publications » Circular 10/2007 (WA) and Circular 3/2008 (WA).

<sup>36</sup> Federal Law Gazette (BGBl.) 2007 I, p. 3014.

### Amendment of the Market Access Information Ordinance

As of November 1 the Market Access Information Ordinance (Marktzugangsangabenverordnung – MarktangV) was also amended.<sup>37</sup> The MarktangV ordinance includes provisions for foreign regulated markets and their operators if they want to grant domestic trading participants direct access to the market via an electronic trading facility. The amendment takes into account relaxations vis-à-vis the cross-border activities of regulated markets by the MiFID. Consequently, regulated markets from states in the European Union or in the European Economic Area are exempt from the reporting requirement for the granting of remote access at home.

### Circular on the regulation of capital compensation insurance

The FRUG further amends the regulation of what is referred to as capital compensation insurance. Specifically, the amendments relate to the criterion for the suitability of the insurance. In a circular, BaFin explains the circumstances under which it considers an insurance policy to be suitable.<sup>38</sup> In accordance with this, the insurance company must cover a total loss of up to €50,000 caused intentionally and up to €1.5 million caused by negligence. Investment consultants or agents who are not authorised to procure ownership or possession of funds from clients, and who do not deal in financial instruments for their own account, may show that they have taken out a suitable insurance policy for the protection of the client instead of the initial capital.

● Two FRUG information events.

Both BaFin and market participants will be extremely busy in the future as a result of these extensive improvements in the FRUG. Despite the regulation density, there are numerous indefinite legal concepts, which need to be defined more precisely in administrative practice. As early as 2007, BaFin held two public information events on the FRUG, which met with a good response. At these events, BaFin clarified that it would retain a sense of proportion and take into consideration the difficulty of the adjustment process in its supervision of lending and financial services institutions.

## 1.2 New supervisory guideline

● BaFin and Bundesbank agree new supervisory guideline.

After just under six months of intensive negotiations, the presidents of BaFin and the Bundesbank agreed on a revised supervisory guideline on February 1, 2008. Section 7 of the Banking Act stipulates that BaFin and the Bundesbank will cooperate in the ongoing supervision of lending and financial institutions in particular. The supervisory guideline that has been effective since October 2003 specifies how such ongoing supervision should be

<sup>37</sup> Federal Law Gazette (BGBl.) 2007 I, p. 2498.

<sup>38</sup> [www.bafin.de](http://www.bafin.de) » Publications » Circular 2/2008 (WA). Insurance according to section 33 (1) sentence 2 and 3 KWG).



conducted on a practical level. At its board meeting on February 19, 2008, the Bundesbank formally declared its approval of the jointly compiled text. BaFin then implemented the revised supervisory guideline on February 21, 2008 and published it on their website.<sup>39</sup>

● Revision takes DIW report into account.

The main focus of the new version was to render the division of tasks between BaFin and the Bundesbank more transparent, to eradicate the concomitant duplication of work, which had been established in the survey conducted by the German institute for economic research (Deutsches Institut für Wirtschaftsforschung – DIW) and to reduce any areas of overlap between the two institutions. Consequently, BaFin has great expectations of the new supervisory guideline, in particular a more transparent and clearly defined division of tasks, which will benefit all participants, most notably the institutions under supervision as well as the Bundesbank and BaFin, and which will facilitate even more efficient and more effective cooperation. The German Minister for Finance ordered the revision against the backdrop of the amendment of regulatory structures provided for in the coalition agreement.

BaFin and the Bundesbank have successfully implemented this order with the new supervisory guideline. In this way, the statutory functions of both institutions have been comprehensively defined, clearly demarcating the respective areas of responsibility from one another. At the same time, the supervisory guideline goes into the processes, which are particularly significant with a view to the introduction of the supervisory review and evaluation process (SREP). This refers in particular to the creation of risk profiles, risk classification of institutions and supervision planning.

● Clear responsibilities of BaFin.

In the future, BaFin alone will also be authorised to take legal measures following a conclusive assessment of the specific case. It will also stipulate the course of action institutions must take to remedy any shortcomings as to time and content. In this regard, it is based on data that has been defined and evaluated beforehand by the Bundesbank. BaFin also interprets the supervisory regulations and takes the final decision – following consultation with the Bundesbank – as to supervisory audit planning. The same applies to the question as to whether an institution should be classified as one that requires intensive supervision or as a problem institution.

● Tasks of the Bundesbank.

The Bundesbank, however, is responsible for the ongoing supervision of all institutions. This includes in particular, clarification of the circumstances under which it also assesses the risk that might ensue for the institutions. At the same time, the Bundesbank supervises institutions' activities when remedying shortcomings as required by BaFin. The Bundesbank performs audits of banking operations on behalf of BaFin. In the future such audits will only be assigned to auditors by prior arrangement with the Bundesbank. However, BaFin can still perform its own audits in well-founded exceptional cases. The Bundesbank also conducts routine

<sup>39</sup> [www.bafin.de](http://www.bafin.de) » Supervisory legislation » Guidelines.

supervisory meetings, whereby these should not be conducted every year with every institution, based on the respective risk involved. This promises to be a relief to both the smaller and the smallest institutions.

Joint responsibility for the status of Germany as a financial centre.

In addition, the new supervisory guidelines stress more than ever before the joint responsibility of BaFin and the Bundesbank for the status of Germany as a financial centre. This becomes apparent, for example, in the regulations on the coordinated procedure in problem- and system-relevant institutions or in the evaluation of audit reports for specific reasons. Furthermore, the details on institutions requiring intensive supervision in particular make clear the preventive nature of the supervision. Correspondingly, prompt action on the part of the Bundesbank and BaFin should help prevent those institutions which could potentially develop problems, from actually becoming problem institutions.

### 1.3 Group Financial Statements Transition Ordinance

Based on the new version of section 10a KWG.

The Federal Minister of Finance adopted the Group Financial Statements Transition Ordinance (Konzernabschlussüberleitungsverordnung – KonÜV) in the middle of February 2007. It came into force retroactive to January 1, 2007. This was prompted by the amendment to section 10a of the KWG through the Act implementing the redefined European Banking Directive and the redefined European Capital Adequacy Directive on January 1, 2007.<sup>40</sup> The new section 10a KWG permits groups of institutions and finance holding groups to define the regulatory consolidation procedure on the basis of (interim) financial statements at group level – pursuant to the German Commercial Code or the IAS/IFRS international accounting standards. So, in addition to the previous regulation, which was based solely on the individual accounts of institutions in the group, a new procedure has now become available with which the regulatory own fund can be established at group level. This means that a regulatory parallel computation based on individual accounts is no longer required. The revised section 10a KWG thus complies with internationally applicable standards as well as with the practice already being implemented in the insurance supervisory office.

Contents of the KonÜV.

The main purpose of the regulations of the KonÜV consists in transferring data from the consolidated financial statement in accordance with commercial law into the computation for the consolidated group's own funds pursuant to section 10a KWG. While section 10a KWG itself regulates the main provisions for the use of financial statements in accordance with commercial law, the KonÜV contains supplementary measures for their transfer and adjustment. These measures are also known as prudential filters. They are required in order to ascertain the quality and structure of regulatory own funds in IAS/IFRS consolidated financial statements as well. Consequently, the KonÜV neutralises certain

<sup>40</sup> BaFin 2006 Annual Report, p. 111 ff.

IFRS securities such as valuation profits showing on balance-sheet equity capital or other equity capital securities. In addition, the directive stipulates how investments evaluated according to the “at-equity” method are to be treated. BaFin has published the KonÜV along with the explanatory memorandum on its website.<sup>41</sup>

## 1.4 Supervisory practice

### 1.4.1 MaRisk: New outsourcing regulations

Principles-based regulation.

BaFin fundamentally reworked the existing outsourcing regulations and had integrated them into the minimum requirements for risk management (Mindestanforderungen an das Risikomanagement – MaRisk) by the end of 2007. With these new requirements, the Supervisory Authority is pursuing the goal of developing flexible and practicable regulations, which can be seamlessly linked to the basic principles-based strategy of the MaRisk. At the same time, they thus create the basis for a risk-oriented practice in terms of supervision and auditing. New outsourcing standards are now more focused on the management of outsourcing-specific risks and provide institutions with greater scope for practical outsourcing in terms of business management. At the same time the new regulations are opening up scope for developing individual implementation solutions, strengthening the individual responsibility of the institutions.

As the regulations were being reworked, the discussions on the MaRisk expert panel in particular, made it possible to find feasible solutions. The new version of the MaRisk came into force simultaneously with FRUG on November 1, 2007. Both developments at European level and the high level of detail and complexity in the old regulations in particular, made a fundamental reworking necessary. In addition, the old regulations didn’t always take sufficient account of typical outsourcing risks.

Report on deregulation.

Once the revised MaRisk and FRUG came into effect, we were further along the path towards deregulation. Section 25a (2) KWG, which sets the legal regulatory framework for outsourcing situations, was changed by FRUG. Institutions will not be required in future to report either their intention to outsource activities, or the actual outsourcing of significant activities. As soon as the Reports Ordinance was amended at the end of 2006, institutions were no longer required to submit outsourcing contracts to the Supervisory Authority. The updating of the MaRisk also made it possible to withdraw several BaFin publications such as the old Outsourcing Circular 11/2001.

Risk analysis factored into risk management.

Outsourcing-specific requirements such as the stipulation of BaFin’s auditing rights for instance, will continue to be imposed only on specific outsourcing activities. In contrast to the old regulation, however, the institution must now determine independently by

<sup>41</sup> [www.bafin.de](http://www.bafin.de) » Supervisory legislation » Ordinances.

means of a risk analysis whether or not it is engaged in significant outsourcing activities. At the same time, the analysis must cover all aspects of the outsourcing activity, which are relevant to the reasonable integration of the outsourced activities and processes into risk management. In order to guarantee this, both the organisational units affected by the outsourcing activities and the internal audit must form part of the risk analysis. With this approach – in which essential principles of MaRisk are applied – the institution takes responsibility both for classifying the outsourcing activity and for integrating it into its own risk management system. It is up to the institution to decide how it actually structures a risk analysis. By all means, it can therefore provide institution-specific solutions which embody the overriding spirit of the regulation – integration into risk management.

- Scope for developing practical outsourcing in terms of business management.

The new regulation framework broadens the scope of practical outsourcing activities in terms of business management. As a result, all activities and processes can be outsourced as long as the compliance of the business organisation is not compromised in the process. However, this also gives rise to limitations: the outsourcing activity must not involve managers delegating their responsibilities to an outsourcing company. Furthermore, managers cannot outsource their tasks either to their own employees or to an external third party. This applies particularly to tasks, which are specifically reserved for management in compliance with statutory provisions or other regulations. This affects, for example, decisions on large-scale loans pursuant to the KWG or the establishment of strategies. In addition, specialised statutory provisions can give rise to specifics. Thus, for example, in the case of building societies, the home savings collective must be managed by its own employees. Specifics also arise for the full outsourcing of the internal audit. The institute must appoint an auditor whose job it is to draw up an auditing plan in collaboration with the service provider, to write the overall report and to inspect the remedy.

- Treatment of pre-existing cases.

In the case of outsourced tasks, which were arranged prior to November 1, 2007 (pre-existing cases), a new risk analysis is not required as long as the outsourced activities and processes are already integrated into the institution's risk management system. However, if the risk situation should change in any one of these pre-existing cases, the institution must adjust its risk analysis or, if necessary, create it for the first time.

#### 1.4.2 Liquidity risk management

- Liquidity risks and liquidity risk management in the spotlight.

It is not only since the sub-prime crisis that BaFin's interest in banks' liquidity risks and liquidity risk management has increased. As early as March 2006, BaFin passed a resolution to develop the strategic policy measure „Analysis of the liquidity management of banks of systemic importance“. Ever since, the supervision of liquidity risks has taken on greater significance both nationally and internationally. Consequently, the Liquidity Ordinance (Liquiditätsverordnung – LiqV), which came into effect in January

2007 allowed institutions to implement their own internal procedures for measuring and controlling risks (risk model), instead of having to fulfil the requirements of the Supervisory Authority by way of a preset liquidity indicator. In the process, institutions can save costs by switching off the shadow systems, which they maintain for supervision, but not for internal risk management. BaFin, however, must approve the regulatory application of this risk model, which is subject to a prior audit. Furthermore, the MaRisk is also to be applied comprehensively to liquidity risks from January 1, 2008. Accordingly, the institutions must meet qualitative liquidity risk management requirements, conduct stress scenarios and implement a contingency plan for instance.

● New supervisory products for liquidity risk management.

In collaboration with the Bundesbank, BaFin has developed various products it uses to implement its internal stipulations. In this way, an internal supervisory audit plan was developed for the organisational preparatory and follow-up work on acceptance audits pursuant to section 10 LiqV. Following on this, BaFin and the Bundesbank also drew up an internal supervisory audit guideline for the performance of these audits. As a guideline for institutions, BaFin published a new information sheet on its website in October 2007.<sup>42</sup> This explains, among other things, which documents the institutions are required to submit with their application for the acceptance of a liquidity risk model.

● Study on liquidity risk management practices.

At the end of January 2008, BaFin and the Bundesbank published a study on "Liquidity risk management practices at selected German institutions", which is also available on the BaFin website. A total of 16 institutions and groups of institutions – 14 of which are system-relevant – took part in the survey. The survey provides an overview of the definition of liquidity risk used in the institutions and the extent to which liquidity risk management has been centralised. Furthermore, it also deals with the role of management and the question as to how the organisational and procedural structure of the liquidity risk management system in broader terms has been designed. At the same time, the methods and measured values as well as management parameters that are linked to these are also observed. The survey also focussed on the internal stress tests used by the institutions and the contingency plans that they have put in place.

● Supervisor ready for liquidity audits.

With these products the Bundesbank and BaFin are well equipped both for acceptance audits pursuant to section 10 LiqV and for MaRisk inspections. The findings of the survey enable the supervisor to better assess the facts both with regard to the audited institution and vis-à-vis other institutions by way of a cross-comparison. Initially, BaFin anticipates four audits pursuant to section 10 LiqV for the year 2008.

<sup>42</sup> [www.bafin.de](http://www.bafin.de) » Publications » Bulletin 15.10.2007.

### 1.4.3 Interest rate risks in the banking book

Impact of interest shocks are established.

Interest rate risks in the banking book came increasingly to the fore in 2007 both at national and international level. The European Banking Directive requires that national supervisory authorities implement measures with credit institutions that stand to lose a share of their own funds (outlier factor) with the sudden and unexpected change in interest rates the size of which shall be prescribed by the competent authorities, or the interest rate shock. The KWG was amended by the legislator to allow BaFin to meet this requirement.

Internal institution procedures as a basis for appraisal.

Section 24 (1) no. 14 KWG now includes a reporting requirement for credit institutions in which the cash value of their regulatory own funds drops by more than 20% in the event of a supervisory interest rate shock. BaFin has published details on the interest rate shock in a circular.<sup>43</sup> The circular also deals with the question as to how the repercussions of the interest rate shock are to be calculated. In order to ascertain the impact that the interest rate shock will have, institutions can draw on the internal models that they use to manage and supervise interest rate risks. Since the Banking Directive requires that the repercussions of the interest rate shock be determined on a present-value basis, BaFin has made an alternative procedure available to those banks whose internal procedures focus on the impact on the result under commercial law (profit and loss account view). BaFin thus ensures that the basic freedom to choose a method for controlling and supervising interest rate risks is still retained.

Level of interest rate shock.

BaFin determines the extent of the interest rate shock using percentiles as a basis for their observations, which adjust to developments in the interest rate in the past. Following a guideline from CEBS (Committee of European Banking Supervisors)<sup>44</sup> it is based on the 1st and 99th percentile of the changes in interest rates which have been observed over the previous five years. On this basis, BaFin has defined an interest rate shock scenario of 130 basis points upwards and 190 basis points downwards in their interest rate shock circular. Generally, BaFin checks annually whether the applicable level is in line with the updated percentiles. BaFin then decides in each case within the overall context whether – and to what extent – the interest rate shock scenario needs to be adjusted.

BaFin measures for outliers.

Should the outlier factor arise, it cannot automatically be concluded that an institution's interest rate risks will be too high. In these cases, the supervisor will consider the risks of the respective institution as a whole and estimate its risk situation. It will therefore check outlier institutions to establish whether their internal procedures and models ensure appropriate control and supervision of interest rate risks. In addition, it will also examine the extent to which the institution's internal risk cover potential is

<sup>43</sup> [www.bafin.de](http://www.bafin.de) » Publications » Circular 7/2007 (BA).

<sup>44</sup> [www.c-eps.org](http://www.c-eps.org) » publications » standards and guidelines » CEBS Technical Guideline on Interest Rate Risk in the Banking Book.

adequate to cover the essential (overall) risks of the institution.

#### 1.4.4 Bulletin on the waiver regulation

Since the amendments to the KWG came into force on January 1, 2007, institutions can now for the first time obtain an exemption from certain supervision stipulations at individual institution level – this is the waiver regulation pursuant to section 2a KWG. This applies in particular to the regulations governing provision with own funds (section 10 KWG), large exposures (sections 13 and 13a KWG) as well as the setting up of an internal control procedure (section 25a (1) sentence 3 no. 1 KWG). Legislators have thus opened up the opportunity to dispense with the supervision of individual institutions in sub areas and to base supervisory observations solely on the group. The exemption clause is based on Article 69 of the European Banking Directive, the national options of which the German legislature implemented in favour of the German banking industry in section 2a KWG. As long as they fulfil the respective requirements, the facility is equally open to parent companies and subordinate institutions.

Notification is sufficient in order to be able to avail oneself of the regulation in section 2a KWG. In this, the notifying institution must declare the extent to which it is availing itself of the exemption clause. It must also verify that the necessary requirements have been fulfilled. In order to simplify the notification procedure for the banking industry, BaFin has published a fact sheet in collaboration with the Bundesbank. BaFin is currently in consultation with the banking industry on the design of this fact sheet. The final version is to be published in the first half of 2008.

#### 1.4.5 Other circulars

In 2007, BaFin published other circulars in relation to banking supervision. In these it specifies in detail certain KWG provisions, including regulations on the exemption of group companies and deduction at source for the regulatory computation of own funds.

A circular explains how the exemption option for group companies amended on January 1, 2007 (section 31 ( 3) sentences 1 and 2 KWG) is to be applied in practice.<sup>45</sup> According to the new case for exemption, a parent company can, under certain conditions, opt not to include individual subordinate companies in certain consolidation accounts for own funds, corporate partnerships and large loans. The amended provision converts the previously relevant application procedure, which was subject to a charge, into a reporting procedure for which there is no charge.

Supervision of individual institutions not required in sub areas.

Bulletin provides assistance with reporting procedure.

Application of exemption for group companies to pre-existing cases.

<sup>45</sup> www.bafin.de » Publications » Circular 4/2007 (BA).

The circular explains the new exemption regulation to the effect that the procedure – in particular the obligation to submit a group notification for the companies not included – also applies to pre-existing cases. Pre-existing cases are considered to be subordinate companies that had already been granted an exemption from the consolidation by BaFin. The fact that BaFin is now extending the regulation to pre-existing cases, it can refrain from demanding the annual financial statements established by subordinate companies for checking their exemption requirements. In fact, the institutions are now required to take responsibility for checking exemption requirements themselves.

Deduction at source requirement for base and supplementary capital.

A further circular also substantiates the revised deduction at source requirement pursuant to section 10 (6) sentence 3 KWG introduced with effect from January 1, 2007.<sup>46</sup> Accordingly, institutions can opt not to deduct shares in other institutions, financial companies, insurance companies and insurance holding companies from the base and supplementary capital for the computation of own funds for supervisory purposes. The focal point of the circular is the factor of trade on financial markets “on a continual basis by purchasing and selling these shares”. The interpretation made is intended to prevent the creation of capital within the financial sector, on the one hand, but also to guarantee a working trade in own fund components on the other hand. Consequently, BaFin – in order to avoid the deduction-at-source requirement – requires an active trade in such figures, daily scheduling with a view of short-term trading achievements as well as a basic accounting continuity in the trading book.

#### **Administration practice for own fund requirements**

BaFin is continuing to gradually build on its administrative practice for implementing the German Solvency Ordinance (Solvabilitätsverordnung – SolvV), the LiqV and the amended regulations governing large exposures and loans of €1.5 million or more. To this end it makes what are referred to as explanatory statements, which are published and updated regularly on the BaFin website.<sup>47</sup> In these, for instance, BaFin has determined for a number of third-party states that they have a materially equivalent supervisory system. In addition, it has approved various rating agencies for regulatory risk weighting. Other interpretation decisions included the maximum loss limits to be observed in accordance with the “hard test” for the German commercial collateral loan. Finally, further issues from the area of securitisation were also clarified in the process.

<sup>46</sup> [www.bafin.de](http://www.bafin.de) » Publications » Circular 11/2007 (BA).

<sup>47</sup> [www.bafin.de](http://www.bafin.de) » Companies » Banks & financial service providers » Capital requirements.



## 2 Solvency supervision

### 2.1 Authorised banks

By the end of 2007, a total of 2,074 lending institutions and securities trading banks were under BaFin supervision (2006: 2,110). BaFin classifies supervised banks into four types of institution: lending institutions, institutions belonging to the savings bank sector, institutions belonging to the cooperative bank sector and other institutions. The lending institutions sector includes, for example, major banks, private banks and bank branches outside the EEA. The savings bank sector includes not only the Landesbanks and public law savings banks, but also the "free savings banks". Allocation to the savings banks or cooperative banks sector depends largely on economic ties. As a result, DZ Bank and WGZ Bank are assigned to the cooperative sector for instance. "Other institutions" include building societies, Pfandbrief banks and securities trading banks as well as both the federal and state housing promotion banks.

Table 11

#### Number of banks by type of institution

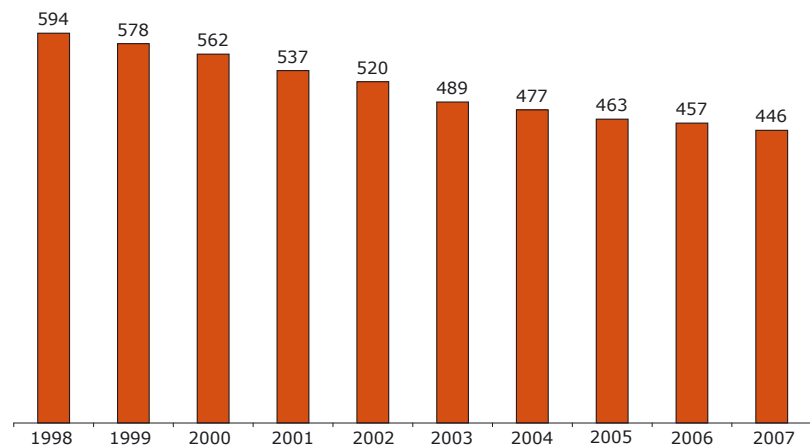
Institution type	2007	2006
Lending institutions	204	199
Institutions in the savings bank sector	458	469
Institutions in the cooperative sector	1,281	1,306
Other Institutions	131	136
<b>Total</b>	<b>2,074</b>	<b>2,110</b>

● Merger process amongst saving banks remains moderate.

The merger process amongst savings banks sustained a moderate pace during the year under review. By the end of the year there were 446 savings banks whereas the figure for the previous year was 457.

Figure 15

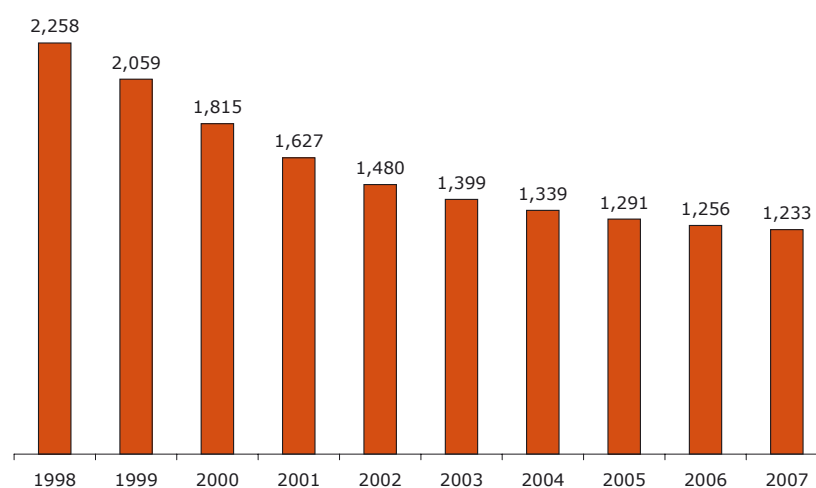
#### Number of savings banks



- Merger process in cooperative bank sector slowed down.

As at the end of 2007 BaFin's supervisory work in the cooperative bank sector covered a total of 1,233 primary institutions, two central banks, 11 central bank type institutions and 45 building cooperatives with savings schemes, which also belong to the cooperative bank sector. The number of primary institutions thus dropped by 23 – a decline of 1.8%. Nevertheless, compared with previous years, the pace of mergers in the cooperative banking sector slowed down.

Figure 16  
Number of cooperative primary banks



- Building societies and Pfandbrief banks.

In 2007 the state building societies in Kiel and Hamburg merged to form the LBS Schleswig-Holstein-Hamburg, bringing the number of building societies under BaFin supervision down to 25 from 26 in the previous year. Consequently, BaFin now supervises 15 private and 10 building societies governed by public law. In contrast, the group of issuers of Pfandbriefe grew in the year under review to over 60 institutions of varying sizes. It is evident from this development that the interest in a Pfandbrief licence has been constant. The Pfandbrief business is spread throughout all bank groups; the most recent addition to the group of Pfandbrief issuers is Deutsche Postbank AG which joined in December 2007.

Table 12  
Foreign banks in the Federal Republic of Germany  
(As at 31.12.2007 with figures for previous year in brackets)

Country	Bank subsidiaries	Subsidiaries of non-banks	Branches	EU branches	Representative offices
Egypt	1 (1)				
Afghanistan					
Andorra					1 (1)
Azerbaijan			1 (1)		0 (1)

Country	Bank subsidiaries	Subsidiaries of non-banks	Branches	EU branches	Representative offices
Australia			1 (1)		
Bahrain					
Belgium	2 (2)			1 (1)	1 (0)
Bosnia-Herzegovina					0 (1)
Brazil			1 (1)		1 (1)
China, PR			3 (3)		2 (2)
Denmark				3 (3)	2 (1)
Finland				1 (1)	
France	4 (4)			20 (17)	12 (11)
Gibraltar					
Greece	0 (1)			1 (1)	
United Kingdom	5 (5)			9 (8)	2 (2)
India			1 (1)	1 (1)	
Iran	1 (1)		3 (3)		
Ireland				2 (2)	1 (2)
Iceland			0 (1)	2 (1)	
Israel					3 (3)
Italy	2 (3)			8 (4)	1 (2)
Japan	2 (2)		3 (3)		4 (4)
Jordan					
Yugoslavia, FR					0 (1)
Canada		1 (1)		1 (1)	
Croatia					
Latvia				1 (1)	
Liechtenstein	1 (1)				
Luxembourg	1 (1)			1 (1)	
Morocco					
Mongolia					
Netherlands	4 (5)			17 (16)	
Norway				1 (1)	
Austria	1 (1)			11 (10)	7 (5)
Pakistan			1 (1)		
Philippines					3 (3)
Portugal					6 (6)
Romania					
Russia	1 (1)				4 (4)
Saudi Arabia					
Sweden	0 (1)			2 (2)	
Switzerland	4 (4)			4 (3)	2 (2)
Slovenia	1 (1)				
Spain	1 (1)			2 (1)	8 (8)
South Africa					
Republic of Korea	2 (2)				3 (3)
Tajikistan					1 (1)
Taiwan					
Czech Republic					1 (1)
Tunisia					
Turkey	5 (4)				5 (6)
U.S.A.	8 (8)	7 (7)	5 (5)	8 (8)	
Belarus					1 (1)
	<b>46 (49)</b>	<b>8 (8)</b>	<b>19 (20)</b>	<b>96 (81)</b>	<b>71 (72)</b>

## 2.2 Economic development

During the year under review the economic development of the banking sector was affected – directly or indirectly – by the sub-prime crisis on the mortgage market in the US. By the end of July 2007 the turbulences on the US market had also reached the German financial market.<sup>48</sup> Independently, however, the fundamentally good overall economic development provided for some positive impetus for the institutions under supervision.

### Effects of the US sub-prime crisis

The majority of private, regional and specialist banks were only indirectly affected by the consequences of the sub-prime crisis. Significant increases in refinancing costs affected the earnings position here particularly in the second half of the year. For institutions deeply involved, either directly or indirectly, in the sub-prime sector, the shocks on international financial markets represented a serious stress test. In individual cases, for example, correcting entries were assigned to the liable equity capital in order to guarantee an appropriate ratio of risk assets and own funds. Shareholders were also compelled to compensate for losses or to make further capital contributions in some other way.

Private, regional and specialist banks affected differently.



#### IKB Deutsche Industriebank AG

The credit rating of IKB Deutsche Industriebank AG (IKB) was severely affected by the crisis on the mortgage market in the US. IKB was in danger of having to take recourse to liquidity facilities for their conduit, Rhineland Funding, which it manages, since previous refinancing arrangements via the issue of commercial papers had been disrupted as a result of shifts on the market.

At an emergency meeting at the end of July 2007, the German reconstruction loan corporation (Kreditanstalt für Wiederaufbau – KfW) and several banking associations agreed on a multi-billion risk umbrella for the IKB's portfolio investments. In addition, the KfW stepped in as principal shareholder of IKB on July 30, 2007 in its liquidity facilities to Rhineland Funding. It also appointed a new board of directors.

In November 2007 the risk umbrella had to be extended as additional risks from the conduit, Rhineland Funding, resulted in the need for further value adjustments. These were borne by the KfW together with the banking pool. A third package of measures became necessary in February 2008 following a re-evaluation of IKB's portfolio investment. The underlying losses in value reflected both the additional negative development of capital markets – particularly the market for structure products – as well as the wide-

<sup>48</sup> For chronology, see Chapter II.1.

Earnings position of the Landesbanks worsened overall.

ranging downgrading of ratings and the dramatic surge in projected losses for sub-prime mortgage credit. The aim of the package of measures is to compensate for losses in valuation and to restore the capital market viability of the bank. The re-evaluation of IKB risks in the KfW lead to an increase in risk provisioning to €4.95 billion.

In 2007, only a few Landesbanks were able to maintain their earnings at the previous year's level or even improve them. Overall the earnings position in the Landesbank sector deteriorated in comparison to the previous year. The stock exchange environment in particular, which was disrupted by the sub-prime crisis in the US caused the trading results from commercial transactions to drop sharply. On the other hand, general market liquidity problems – another consequence of the sub-prime crisis – affected the Landesbanks to varying degrees. Apart from one exception, however, none of the institutions had any noteworthy liquidity shortages.

#### Landesbank Sachsen

Landesbank Sachsen (Sachsen LB) was also affected early on by the crisis in the mortgage market in the US. At the beginning of August detailed findings by BaFin indicated that in the short term a significant liquidity shortage was to be expected at the subsidiary bank Sachsen LB Europe plc. This was due in particular to the fact that it was becoming increasingly difficult to refinance the largest conduit structure in terms of volume, Ormond Quay, using commercial paper.

In an initial step in mid-August 2007, which was facilitated by BaFin, it was possible to guarantee the continuous refinancing of this conduit structure through a collaboration between DekaBank and the group of Landesbanks. This appeared to be necessary as a liquidation of the affected conduit structure during the general confidence crisis on the markets would have been extremely difficult from an economical point of view. In addition, liquidation because of Sachsen LB's obligation to assume liability for the obligations of its Irish subsidiary would have caused significant problems afterwards.

In a second step at the end of August, the decision was made against the backdrop of the acute threat of significant losses, to integrate Sachsen LB into the Landesbank Baden-Württemberg (LBBW) group. The continuing deterioration in market conditions finally made a third round of negotiations necessary. Facilitated once again by BaFin, these took place in mid-December and resulted in an agreement on the basis of a risk umbrella for Sachsen LB. This was required to safeguard the solvency of Sachsen LB and created the conditions for the integration in the LBBW group agreed, upon finalisation, at the end of 2007.

Sub-prime crisis only affects Pfandbrief market indirectly.

Although the sub-prime crisis does not concern the Pfandbrief per se, it too did not fully escape the resultant jolt to the confidence of international capital markets. However, Pfandbrief spreads

were relatively moderate. Not least due to strict statutory security requirements of the Pfandbrief cover and the associated supervision by BaFin, the Pfandbrief was in a position to bear up relatively well on the market in 2007. Firstly, Pfandbriefe cannot be covered by products that are directly affected by the sub-prime crisis. Neither mortgage backed securities (MBS) nor collateralised debt obligations (CDO) are included in permitted cover values. Furthermore, institutions are permitted to use available properties as collateral, also in the U.S., and use Pfandbriefe to refinance the loans. However, in accordance with the restrictive Mortgage Lending Value Ordinance (Beleihungswertermittlungsverordnung – BelWertV) they can only use up to 60% of the collateral value as cover. Besides, in practice hardly any residential property in the US is financed by the cover pools of Pfandbrief issuers. Overall, by the end of 2006, these accounted for fewer than 0.1% of cover pools for mortgage-backed Pfandbriefe.<sup>49</sup>

### Other developments

Business development in the private, regional and specialist banks was quite varied during the year under review. The well-established national private banks, which mainly look after wealthy private customers, were able to maintain their position on the market, and some were even able to grow it. They generated stable and, in some cases, higher income. In contrast, growth in universal banks with a regional focus, is still closely linked to the economic conditions in the respective region. On the whole, it becomes apparent in the process that the competitive pressure on smaller universal banks, which don't focus on specific profit-yielding business segments, is continuing to mount. This applies in particular to specialist banks subject to supervision, especially "Autobanks" (banks owned by car manufacturers, which offer banking services including car financing). The decline in the number of vehicles registered compared with the figures for the previous year affected those "Autobanks" in particular, which act simply as a manufacturer's marketing tool and are designed to promote the sale of new vehicles by offering the cheapest loans possible ("captives"). Some of the consumer credit institutions under supervision are still in the start-up phase. Very often, they sell a few standardised products in bulk via the network of warehouses belonging to the group. Their aim is to make a profit using a high degree of automation, rigid cost management and a high level of outsourcing.

To a large extent, the savings banks managed to escape the shocks on the financial markets in the year under review. Only a few institutions invested in the financial products affected, and so were in a position to bear any losses that occurred. The average balance sheet total for the German savings banks also increased somewhat in 2007. In contrast, however, poor growth in interest rates posed

Heterogeneous picture for private, regional and specialist banks.

Savings banks faced with problem of interest rate trends.

<sup>49</sup> Source: Association of German Mortgage Lending Institutions, Press Release dated 22.08.2007.

problems, giving rise to fears that the interest surplus and, in turn, the earning potential will fall significantly. Consequently, BaFin is keeping a close eye on the trend in interest rates, especially since it will play a critical role in the profitability of savings banks in the future.

However, the German Landesbanks were in a position to significantly increase their interest surplus in the year under review notwithstanding the turbulence on the financial markets. Taken by itself, the positive growth in the economy as a whole led to an increase in credit demand in nearly all Landesbanks.

● Building societies' loan business more competitive.

Due to the long duration of buildings savings plans, building societies are particularly exposed to interest rate risks. As in the previous year, BaFin provided information on interest rate risks in the industry on the basis of predefined scenarios. On the whole, in 2007 building societies were in a position to benefit from the slightly raised market interest rate, which gave their loans the competitive edge again over construction financing offers. And so the previously low level of investment gradually began to improve. To this is added the fact that all building societies are now operating on the market with low interest rates, and are mostly in the early stages of saving. Consequently, at the moment institutions need only pay out minimal credit interest, while the low interest on loans will only have an impact on the earnings situation in later years. Furthermore, the new interest yield rates are regularly characterised by the fact that high bonus payments are only granted for a limited period. As part of its preventive rate control, BaFin has made sure that the tariffs are sustainable on the basis of projected forecasts. The building societies are anticipating additional stimulus from the planned integration of private property ownership in government-funded pension plans.

● Securities trading banks and stock exchange brokers benefit from growth on the stock exchange.

In 2007 securities trading banks and stock exchange brokers were once again in a position to benefit from growth on the stock exchanges. Although the environment for corporate finance, particularly in the sector of small and medium-sized companies, was more unfavourable in the second half of the year. However, stock market turnover as such saw an upswing again last year. At the same time, business development in the securities trading banks and stock exchange brokers continue to be characterised by sudden technological and regulatory upheaval on the stock exchange landscape. Only those institutions that remain flexible and bring their businesses into line with the respective market conditions, continue to benefit from the positive market environment. A trend that has emerged is an increased Europeanisation of the market. Accordingly, German institutions are forced to adjust their service offering to international customer preferences and circumstances. Moreover, increasing competitive pressure is forcing institutions to join forces with one another to form larger units. Larger institutions in particular have already made the change to become deposit-taking credit institutions or still aspire to achieving this status.

● First European passport for the trade of electricity.

In the year under review, institutions used the facility of a “European passport” for the trade of electricity for the first time. This opportunity was first created with the transposition of the MiFID on November 1, 2007. Both the German energy market, the EEX (European Energy Exchange) itself, and the EEX clearing house supervised by BaFin – the ECC – face international competition, reinforced with new products and partnerships. In the process, energy prices which continued to rise in 2007 encouraged interest in futures trading with electricity. However, the EEX trading volumes are only a partial indication of the actual business transacted. Most transactions take place outside the market (OTC). Energy companies are still interested in licences for trade in energy derivatives.

● Backlog of confirmations for OTC derivatives.

Once most banks managed to significantly reduce their backlog of confirmations for OTC credit derivatives initially, a reverse trend emerged in July 2007: the backlog quota shot up again. Some banks have even exceeded the peak levels of September 2005. The reasons for this are the enormous transaction volumes, which are eclipsing the hitherto dynamic growth on the worldwide derivatives market. Although backoffices are standardised and automated to a greater degree, they cannot absorb current volume peaks. BaFin has been involved in an exclusive international campaign since 2005 in which participating supervisors are working towards getting banks to reduce their backlog of confirmations for OTC credit derivatives. However, rapid market growth is not going to stop even in the face of equity derivatives. But in this instance too, growth in transaction volumes is presenting market participants with clearing and settlement problems which have led to a considerable backlog of confirmations. The banks are now faced with the even bigger challenge of trying to reduce it because – unlike the situation with the credit derivatives – standardisation and automation are still in their infancy. In contrast to credit derivatives, equity derivatives are mostly tailor-made. Whereas institutions handle about 90% of credit derivatives automatically, this percentage is the reverse for equity derivatives – about 85% of the transaction volume is handled by the banks manually. After the positive experience with the exclusive campaign to reduce the backlog of confirmations for credit derivatives, international supervisors extended their campaign to address equity derivatives.

● New regulations for calculating own funds.

### Solvency

The Solvency Ordinance (Solvabilitätsverordnung – SolvV) which came into force on January 1, 2007 includes various risk-oriented approaches that institutions can use to calculate their regulatory own fund requirements. However, a transitional provision applied up to the end of 2007, which gave institutions an option: they could opt to calculate their own fund requirement either according to the previously applicable Principle I or they could calculate their capital charges for the counterparty default risk and the operational risk



using the new SolvV procedures.<sup>50</sup> Most institutions continued to use the standard Principle I method, and a predominance of institutions located in the other EU member states also opted to use the previously applicable regulatory own fund requirements. Of the approximately 2,100 banks in Germany, only 37 institutions had calculated their capital charges in accordance with the SolvV in the year under review. 16 institutions used an internal ratings-based approach (IRBA), 21 used a credit risk approach. 22 institutions used a basic indicator approach and 15 used a standard approach to calculate the capital charge for their operational risk. From January 1, 2008, capital charges must be calculated according to the regulations of the SolvV only and must be reported on a quarterly basis as of April 2008.

### 2.3 Risk classification

#### ● Risk-oriented supervisory actions.

Using a risk-oriented approach to supervision, BaFin is consistent in its implementation of the European standards for the supervisory review process. The intensity of the supervision is determined by the risk situation of the respective institution under supervision. Risk classification is used as a basis for this. Within the scope of banking supervision, BaFin collaborates with the relevant headquarters of the Deutsche Bundesbank to develop a risk classification model. At least once a year, it assesses the quality of an institution and its relevance to the financial centre. The results of this assessment are reflected in a 12-position risk matrix. Using this risk classification model as a basis, BaFin assesses each individual institution and decides on the appropriate level of supervisory action required for it, thus complying with the principle of proportionality.

#### ● Basis for risk classification.

Risk classification is derived from the risk profile, which describes and evaluates, among other things, an institution's risk situation and capital adequacy, risk management as well as the quality of the organisation and its management. It is based on the results of the annual financial statement and includes all other relevant information on the institution. In addition, it takes into consideration the results of a model-based ratings system, which itself is based on the banking supervision reporting system. The Bundesbank draws up the risk profiles into which critical findings flow throughout the course of the year; they are then finalised and passed by BaFin.

<sup>50</sup> Due to the differences in the procedures, it is not possible to show a standard graph for capital adequacy ratios by banking segment for the year under review. For the previous year refer to the BaFin 2006 Annual Report, p. 126.

Table 13  
**Results of 2007 risk classification**  
 (previous year's figures in brackets)

Institutions in %		Quality of the institution*				Total
		A	B	C	D	
System relevance	High	0.3% (0.6%)	1.0% (1.2%)	0.3% (0.2%)	0.0% (0.0%)	1.7% (2.0%)
	Medium	3.1% (2.6%)	3.7% (3.2%)	1.3% (1.4%)	0.4% (0.3%)	8.6% (7.5%)
	Low	40.3% (35.6%)	34.7% (37.2%)	11.0% (12.6%)	3.9% (5.2%)	89.8% (90.5%)
Total		43.7% (38.8%)	39.5% (41.6%)	12.5% (14.2%)	4.4% (5.5%)	100%**

\* 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.

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

## 2.4 Supervisory actions

● Different types of special audit.

To begin with, there are two types of special supervisory audit: those carried out on request and those initiated by the supervisor. In the case of the former, BaFin conducts an inspection following a request by the institution concerned, whereas in the case of the latter, the audit is initiated by the supervisor alone. Requested audits include in particular those acceptance audits based on the IRBA (internal ratings-based approach), AMA (advanced measurement approach) and the internal market risk models. Supervisor-initiated audits are normally conducted either for a specific reason – on the basis of specific notes in the auditor's report on the company's annual financial statement – or randomly as a matter of routine. These audits enable the supervisor to obtain his own, in-depth view of the risk situation of an institution. Apart from this, audits in which the supervisor becomes involved also take place on account of an audit cycle required by law. This applies in particular to audits of cover assets in the Pfandbrief sector for which the German Mortgage Bond Act (Pfandbriefgesetz – PfandBG) stipulates a regular two-year cycle.

### Special audit of WestLB AG

In March 2007, BaFin received information about significant losses in the proprietary trading of the German bank WestLB. Consequently, it ordered a special audit, which was to investigate the compliance of transactions at WestLB AG. During the course of the audit, BaFin was informed by the appointed firm of auditors about serious infringements of the law and of the Articles of Association by WestLB's board of directors. As a result of this, the supervisory board dismissed Dr. Fischer and Dr. van den Adel.

● A total of 280 special audits.

During the year under review, the banking supervision services carried out 280 special audits (2006: 287). Of these audits, 168 were initiated by the supervisor, 82 were requested and 30 audits were required by law. On examination of supervisor-initiated audits, it is clear that the number of special lending-related audits (Kreditsonderprüfungen – KSP) had dropped significantly from 103 in the previous year to only 35 audits in 2007. This attests to the supervisor's additional focus on the institution's risk measurement and control procedures required by the implementation of Basel II, which goes hand in hand with a higher quality supervision by BaFin. The special audits initiated by the supervisor during the year under review focused in particular on the implementation of the institutions' special organisational requirements (section 25a KWG), which the MaRisk provisions specify in detail. With 112 audits this number was slightly up on figure for the previous year (98).

Table 14

#### Number of special audits

	2007	2006
KSP	35	103
Section 25a (1) KWG.	112	98
Organisation	4	14
Cover	30	15
Other	17	11
Risk models	4	12
IRBA	70	29
AMA	8	5
<b>Total</b>	<b>280</b>	<b>287</b>

● Audits of cover assets doubled.

The audits of cover assets required by the Mortgage Bond Act (PfandBG) doubled for the year under review. In 2007, BaFin ordered 30 audits of cover assets (2006: 15). Eighteen of these were assigned to external auditors; 12 audits were performed by BaFin staff. Insofar as the institution being audited also engages in foreign business, the core area of the auditor's inspection for the year under review was naturally in foreign lending. This also included an investigation as to whether the loan values had been calculated correctly (section 25 BelWertV). On the whole, it was evident that Pfandbrief banks are essentially handling the cover business correctly. In individual cases, however, there were findings in the loan value calculations which also lead to corrections in the cover; however, thanks to the surplus cover available, this did not lead to problems in the congruence of cover.

#### Audits of cover assets

Audits on cover assets are the oldest type of banking supervisory audits ever. They were introduced by the Prussian Minister of Agriculture, Domains and Forests – the supervisory authority for Prussian mortgage banks at the time. Since then, audits on cover assets have been an important instrument in the supervision of mortgage banks. As such, they were also maintained after 1961, when responsibility for the supervision of mortgage banks

was transferred to the German Supervisory Authority for credit institutions at the time, and have been used by BaFin since 2002. Since the PfandBG came into force in July 2005, cover assets must be audited for all Pfandbrief banks and not only – as was the case in the past – for the mortgage and ship mortgage banks.

The subject of the auditing of cover assets is the proper cover of Pfandbriefe being issued. These can be mortgage Pfandbriefe, public Pfandbriefe or ship Pfandbriefe. The auditor examines three items in particular on the basis of an appropriate random sample: firstly, whether the mortgages used to secure the covering loan had been registered correctly, and secondly, whether any disruptive prior charges exist; and thirdly, whether the loan value of the properties or leasehold rights had been calculated and fixed correctly in accordance with the BelWertV.

● Low rate of audits in cooperative bank sector.

The distribution of audits throughout the institution types is shown in the table below. It is striking here that only 7% of institutions in the cooperative bank sector were audited. On the one hand, the significantly higher audit rate for lending banks, other institutions and institutions in the savings bank sector reflect the high system relevance of these institutions in terms of the risk matrix. On the other hand, however, the one-time charge resulting from the requested IRBA and AMA audits, as well as the cover assets audits required by law are also reflected in these types of institutions. Both types of audit hardly occurred in the cooperative bank sector in 2007.

Table 15

#### Breakdown of 2007 special audits by type of institution

	Lending banks	Institutions in the savings bank sector	Institutions in the cooperative bank sector	Other Institutions	Total
Number of institutions	204	458	1,281	179	2,122
Bal in € bn.	3,381.4	2,756.7	886.9	1,495.8	8,520.7
KSP	2	13	20	0	35
25a Abs. 1 KWG	14	31	57	10	112
Organisation	1	3	0	0	4
Cover	0	17	0	13	30
Other	3	5	6	3	17
Risk models	3	1	0	0	4
IRBA	44	9	4	13	70
AMA	7	1	0	0	8
<b>Total</b>	<b>74</b>	<b>80</b>	<b>87</b>	<b>39</b>	<b>280</b>
<b>in %</b>	<b>36.3</b>	<b>17.5</b>	<b>6.8</b>	<b>21.8</b>	<b>13.2</b>

The types of institution listed in the table also include their respective central banks; thus the Landesbanks, for instance, are assigned to the savings bank sector, and DZ Bank and WGZ Bank to the cooperative sector. "Other institutions" include the old mortgage banks, building societies, specialist institutions and guarantor banks. Furthermore, these also include other special-purpose banks as well as financial services institutions that are permitted to obtain

● Risk matrix and special audits.

possession or ownership of money or securities for their customers, or that carry out business or trading for their own account.

The risk matrix gives a clear indication of how the special audits are spread throughout the individual risk classes. The table below only includes the audits that were carried out on the initiative of the banking supervisor. Institutions under supervision are assigned to a risk class for these audits only.

Table 16  
**Distribution by risk class of supervisor-initiated special audits in 2007**

Supervisor-initiated special audits		Quality of the institution*				Total	Institutions in %
		A	B	C	D		
System relevance	High	0	6	4	0	10	29.4%
	Medium	2	5	7	3	17	10%
	Low	27	60	42	11	140	7.4%
Total		29	71	53	14	167	7.9%
Institutions in %		3.1%	8.6%	20.2%	15.4%	8%	

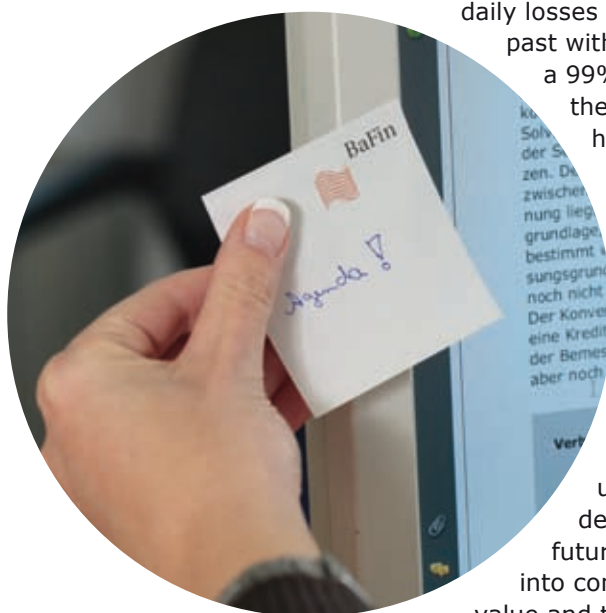
\* Including financial services institutions that are permitted to obtain possession or ownership of money or securities for their customers, or that carry out business or trading for their own account.

● Quality determines audit intensity.

The audit rate always increases as the quality of the institution decreases. Depending on the category, this ratio compares the number of audits with the institutions in a specific risk class. According to this, a clear concentration of audits – 20.2 and 15.4% – can be seen among the institutions assessed as C and D. At the same time, when compared directly, the somewhat lower ratio of institutions assessed as D can be explained by the fact that the subject of the audit has often already been fully calculated, which means that there is no requirement to carry out a special audit again. However, the supervisory measures taken in the process have not (yet) permanently improved the situation in the institution concerned, or it has not been possible to have an impact on it using bank-supervision means. This pertains to both business decisions and the economic environment of the institutions. However, the Supervisory Authority cannot fully disregard even category A institutions by deciding not to carry out any audits and to simply rely on the auditors' reports on the annual accounts, but must obtain an in-depth insight into the institution's risk situation at appropriate intervals. If banking supervisors were only to act for

specific reasons, there would also be the danger that a bank would automatically be perceived by the public to be a “problem case” should the Supervisory Authority initiate a special audit.

#### Risk models in credit institutions



By the end of 2007, a total of 15 credit institutions had received confirmation from BaFin to the effect that their internal market risk models met the supervisory requirements. As in the previous year, six institutions opted to make full, rather than partial, use of internal market risk models. Institutions check the predictive quality of these models using the back-testing procedure. This involves comparing daily losses that were caused by actual price fluctuations in the past with the maximum losses forecast by the risk model using a 99% confidence level. For the year 2007, back-testing of these market risk models indicates that an extraordinarily high number of cases – 55 outliers – had exceeded the market risk (2006: 13). However, in view of the extreme combination of circumstances on the market – mainly in connection with sub-prime turbulences in the summer of the year under review – these figures do not automatically lead to the conclusion that the predictive quality is inadequate. Value-at-risk models are basically not designed to predict extreme market situations.

In 2007 an institution requested, for the first time, to use an internal model for calculating the counterparty default risk from derivatives. In order to forecast potential future shortfalls as realistically as possible, this model takes into consideration both market-driven changes in the portfolio value and the existing obligation to pledge additional collateral. When directly integrated into the routine risk management process, the model enables the institution to monitor and control the counterparty default risk more effectively.

Table 17

#### Risk models and margin factors

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
2007	0	0	0	15	0.0	1.0	0.20

Supervisory complaints and sanctions imposed.

The Supervisory Authority obtains valuable findings from special audits and other sources of information such as the auditor's report, for instance, that often reveal violations of supervisory law and result in the imposition of sanctions. This figure amounted to a total of 94 in 2007 (2006: 113). Table 18 below provides a precise overview of the distribution of sanctions and violations, grouped by type of institution. For example, in 2007 BaFin wrote to 37 institutions in the cooperative banking sector in relation to serious violations. It issued warnings to a total of 7 managers, and even called for their dismissal, at five cooperative banks. Furthermore, BaFin instituted what are referred to as measures in response to acute situations (section 46 KWG) in the case of 1 cooperative bank – and likewise in the case of 5 lending banks and 2 other institutions. This instrument enables BaFin to instruct the management of an institution or to appoint supervisory personnel so that risk to the security of the deposits and assets entrusted to the institution can be countered at an early stage.

Table 18

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

Institution type	Serious findings	Measures against managing directors	Administrative fines	Measures in response to acute situations (section 46 KWG)
Lending institutions	9	0	0	5
Institutions in the savings bank sector	19	1	0	0
Institutions in the cooperative sector	37	7	0	1
Other Institutions	7	5	1	2
<b>Total</b>	<b>72</b>	<b>13</b>	<b>1</b>	<b>8</b>

"Trilateral" – New supervisory methods via Deutsche Bank Group.

As a financial group operating globally, Deutsche Bank has by now generated more than two thirds of its income abroad. In the process, the financial centres of London and New York have been extremely important to the bank. Against this backdrop, BaFin brought the "trilateral cooperation" into being, further intensifying the already existing close collaboration with supervisory representatives of the Federal Reserve Bank of New York (Fed NY), the New York State Banking Department (NYSBD) and the British Financial Services Authority (FSA). The kick-off event at which the Trilateral Agreement was signed, took place in Bonn in March 2007. Since then, the banking supervisors have been having bi-annual meetings. The purpose of these meetings is to exchange information on banking supervision topics of multinational relevance and to coordinate joint supervision and audit planning. Regular conference calls ensure that the cooperation between the banking supervisors in Germany, the USA and Great Britain is always up to date.

The international meetings also provide Deutsche Bank itself with a forum that measures up to its global orientation, which means that it can launch banking supervision topics transnationally and coordinate with BaFin both efficiently and cost-effectively. BaFin's trilateral initiative has thus evoked an equally positive response amongst both banking supervisors and representatives of the Deutsche Bank Group.

**“Small institutions” discussion group**

In January 2007 the first meeting of the “small institutions” discussion group took place at BaFin. The idea of setting up a forum for small credit institutions originated from the MaRisk expert committee in which supervisors and industrial representatives meet. The aim of the new discussion group is to ensure that the interests of smaller institutions are given adequate consideration. Apart from BaFin and Bundesbank employees, the discussion forum also includes in particular, representatives of the institutions and associations, who are mainly from the savings bank and cooperative banking sector, but also from private, specialist and securities trading banks.

In the kick-off meeting, the new committee dealt with the topic of special audits. Small banks in particular often feel that the costs of these audits are a burden and would therefore like to see an easing of this situation. BaFin was in a position to indicate that it had already done something about this: whereas in 2003 alone 218 audits were carried out in cooperative banks – 200 of which were for “no specific reason” – in 2007 there was only a total of 89 audits, two of which came from the money laundering area as well. However, for generally preventive reasons as well, it is not possible for BaFin to completely do away with random audits.

**2.5 IRBA and AMA application procedures**

● Total of 41 IRBA approvals.

With effect from January 1, 2008, 41 institutions and groups of institutions can calculate their own funds requirements for counterparty risks using the IRBA and classification procedures for securitisation items. Furthermore, two institutions can also use what are referred to as internal model methods to calculate the counterparty credit risk. Of the 41 IRBA institutions, 15 belong to the lending banks category and 11 to the “other Institutions” category. The savings bank sector accounts for 11 institutions and the cooperative banking sector for 4. About half of the institutions have been granted permission to use the advanced IRBA, use of which is permitted for the first time on January 1, 2008 pursuant to the SolvV. In the previous application procedure, BaFin was home supervisor in 35 cases and host supervisor in 6 cases. Overall, the supervisor confirmed the eligibility of around 350 internal rating systems and classification procedures for securitisation items.

● Ten AMA approvals.

In 2007, 5 institutions and institution groups were granted permission to use the AMA as of January 1, 2008. A further 5 institutions and groups of institutions were also granted permission by BaFin retroactive to January 1, 2008. Of the 10 institutions and groups of institutions that were successful in their requests for AMA approval, 6 belong to the lending banks category and one to the “other institutions” category. In addition, the savings bank sector is represented with 2 institutions, while the cooperative banking sector is represented with 1. BaFin was involved as home supervisor in 6 of the 10 application procedures and as host



Cooperation with foreign supervisory authorities.

supervisor in the remaining 4 procedures. The main reason for retroactive approval was that it was not possible for the European banking supervisors to take a decision in certain cases until the beginning of 2008. At the same time, very often results from certain sections of the audit which couldn't be performed until the second half of 2007 were to contribute to these joint decisions.

Cross-border cooperation amongst the European supervisory authorities picked up speed in the year under review. BaFin gained extensive practical experience particularly with the joint IRBA and AMA acceptance and approval procedures. As home supervisor, BaFin takes responsibility for large parts of the approval procedure and coordinates the various activities of the supervisory authorities involved. As host supervisor over a subsidiary of a European institution, it only performs parts of the acceptance and approval procedure, while coordinating with the respective home supervisor. BaFin also involves those supervisory authorities outside the EU that are responsible for subsidiaries of German banks in the approval process. To this end, it concludes bilateral agreements and complies with the standards of the Basel Committee on Banking Supervision. Unlike simple European approval procedures, the decisions taken by BaFin as home supervisor in these cases are not binding for the host supervisor.

#### **International cooperation in IRBA/AMA procedures**

If banking groups or financial holding groups apply for IRBA approval at group level, they must specify in the application, which institutions in the group are to be included in the calculation of minimum capital adequacy requirements in accordance with the IRBA. If parent or subordinate institutions are located abroad, the banking supervisor coordinates with the supervisory authorities in the relevant states. The supervisory authority, which is responsible for the parent institution of a banking group or finance holding group, acts as home supervisor in the coordination of IRBA and AMA approval procedures for the institutions in the group. The supervisory authorities responsible for subordinate institutions in other EU member states are directly involved as host supervisor in the approval procedure in accordance with the regulations of the European Banking Directive.

All supervisory authorities involved in the approval procedure endeavour to reach a joint decision on approval of the IRBA or AMA within 6 months of receipt of the application. If they fail to do so, the home supervisor alone takes a decision on the application from the institution or financial holding group. Both the joint decision and the final decision of the home supervisor are binding for all relevant EU supervisory authorities. In the old cross-border procedure, however, the supervisory authorities involved always reached a joint decision. This underscores the aspiration of the European banking supervisor to achieve pragmatic and good cooperation.

As home supervisor for a parent institution, BaFin takes the decision on an IRBA or AMA application both for the group and for the subordinate institutions with their registered office in Germany by

means of a joint decision.

If BaFin is host supervisor, the decision of another EU supervisory authority does not have a direct impact on German institutions belonging to a European group. For this reason, BaFin implements these decisions by way of its own notification pursuant to German law (section 10(1a) sentence 9 in conjunction with sentence 8 KWG). In the process, it writes these approval notifications directly after the joint decision is taken in accordance with the respective home supervisor's standards and requirements as to content.

- Reasonable application of the standard approach.

In the year under review only 15 institutions used the standard approach for calculating their own fund requirements for the operational risk. Two further institutions were granted authorisation to use an alternative indicator in the standard approach with effect from 1 January 2008. In earlier surveys about 130 institutions had declared their intention to continue using the standard approach. BaFin therefore assumed that a greater number of banks had opted to use this approach. The supervisor will keep a close eye on the use of the different approaches and the implementation of suitable management systems for the operational risk.

## 2.6 Non-performing loans

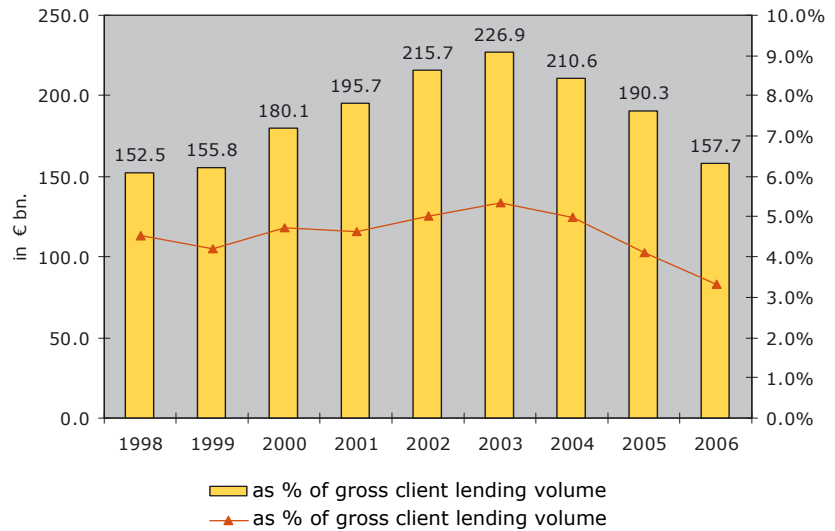
- NPL level drops again.

BaFin calculates the gross client lending volume requiring specific allowances annually on the basis of the annual audit reports. Although the resultant figures are not a precise indication of the volume of non-performing loans (NPL) this aggregated variable can be interpreted as an indicator of the basic market potential of NPL in Germany. In 2006 the NPL level computed on bank balance sheets in this way dropped by 17% from the previous year's figure of €190.3 billion to €157.7 billion.



The significant downturn might be attributable on the one hand to the fact that German credit institutions are increasingly outsourcing their NPL portfolios. On the other hand, the economic recovery in Germany is also reflected in the improved credit quality of the banks. Accordingly, the NPL percentage of the overall gross client lending volume in 2006 dropped from 4.1% to 3.3%. This is the lowest it has been since 1998.

Figure 17  
NPL market potential\*



\* The audit reports relating to the financial statements for 2007 were not yet available to BaFin in full at the time of going to print. The cumulative data may deviate slightly from figures in the 2006 Annual Report due to data cleansing.

Federal Court of Justice ruling on the sale of loans.

In the year under review there were court rulings specifying the civil-law framework to be applied to NPL sales. Of significance here is the ruling of the German Federal Court of Justice (Bundesgerichtshof – BGH), in which the court clarified that “neither banking confidentiality nor the Federal Data Protection Act is in conflict with the effective assignment of loans receivable by a credit institution”.<sup>51</sup> In a further decision, the Schleswig Higher Regional Court (Oberlandesgericht – OLG) ruled that the sale of “problem loans” by a savings bank was permissible and in this respect put savings banks on a par with private banks, thus reducing legal uncertainties and operational risks for the selling banks.<sup>52</sup> Nevertheless, it is yet to be established that in accordance with these rulings, infringement of the secrecy requirement at contractual level can also result in liability for damages. Therefore, the banks and financial investors are still compelled to prepare potential transactions with diligence and to develop sustainable solutions. In respect of the “common good” philosophy of the savings banks, loan sales by public institutions are also currently under discussion. Consequently, some associations have recommended to their member institutions that they only sell loans under certain conditions.

## 2.7 Financial services institutions

BaFin supervised 724 financial services institutions.

By December 31, 2007, BaFin had supervised 724 financial services institutions (2006: 730). 73 institutions were domestic branches of foreign companies (2006: 60). The number of financial service

<sup>51</sup> Ref.: XI ZR 195/05.

<sup>52</sup> Ref.: 5 U 19/07.

institutions that operated investment and contract broking services alone was 132 (2006: 148), and 519 institutions held a licence for financial portfolio management (2007: 487). 4 of the financial services providers were authorised to procure ownership or possession of funds or securities from clients (2006: 4). The number of financial services institutions permitted to trade in financial instruments for their own account was 27 (2006: 31).

68 applications for licences to provide financial services.

In the year under review 68 companies applied for a licence to provide financial services (2006: 50). 17 financial services institutions applied for an extension of their licence (2006: 14).

6,439 contractually tied agents under liability.

In addition to financial services institutions, more than a thousand<sup>53</sup> freelancers acted as intermediaries and distributed financial instruments for authorised financial services institutions. The institutions are liable for these "tied agents" who do not require a licence of their own to provide these financial services. The institutions under supervision must notify BaFin of the agents for whom they assume liability. Since the institutions are fully responsible for the agents under supervisory law, they are indirectly supervised by BaFin. If an agent's conduct is inappropriate, BaFin will approach the liable institution.

New regulations for assumption of liability.

With the FRUG the institutions are no longer required to take out an insurance policy for their tied agents. Discontinuation of the insurance requirement is based on the guideline not to exceed the requirements of the MiFID. The tied agent is also permitted to work for one institution only. Up until October 31, 2007, freelance agents were permitted to broker financial instruments for more than one institution, if they had assumed joint and several liability for their activities.

When entering contractually tied agents in the new public register, the guarantor must now confirm in the notification that the agent has the requisite expertise and is reliable. The parties assuming liability are responsible for prompt and correct registration of the data. BaFin does not check the institutions' details. If a company fails to comply with the regulations for selecting or monitoring its contractually tied agents, or if it infringes the requirements assigned to it in connection with maintaining the register, BaFin can prohibit the company from engaging tied agents.

Only a few applications for investment consulting.

Investment consulting was granted the status of a financial service with effect from November 1, 2007. In accordance with the transitional arrangement, companies providing investment consulting services as of November 1, 2007 were granted a temporary licence if they applied for a full licence by January 31, 2008 (section 64i (1) KWG).

By January 31, 2008 BaFin had received 38 applications for investment consulting licences. An additional 38 applications were received for investment consulting, and investment and/or contract broking services. For these companies, the licences for investment

<sup>53</sup> The exact figure was not available at the time of going to print because of the change-over to the public register.

consulting services were deemed to have been granted since November 1, 2007. The low number of applications for investment consulting licences can be explained, on the one hand, by the fact that financial services institutions had already been granted a licence by virtue of legislation and were not required to make a formal application. On the other hand, investment consulting services can be provided in conjunction with fund brokering without a licence as long as the service relates to fund units alone. Nevertheless, BaFin observed that certain institutions offered fund unit brokers a maximum liability limit with a reference to the legal reform in order to gain their loyalty. However, because of the exemption clause, fund brokers still do not require a licence or a maximum liability limit. This is why the new licence requirement for investment consulting merely affected fee-only consultants who charge clients for their services without brokering financial instruments at the same time.

19 applications for securities placement business.

The securities placement business has also been a financial service since implementation of the FRUG. The securities placement business licence was also deemed to have been granted temporarily from November 1, 2007 for a company that had a contract brokering services licence on that date if it applied for a full licence by January 31, 2008 (section 64i (5) KWG). By the end of January 2008 BaFin had received 19 applications for the securities placement business.

### Cooperation

Meetings focus on MiFID transposition.

In its annual working group meeting in November 2007 the Bundesbank and BaFin mainly discussed issues relating to the transposition of the MiFID. On the Bundesbank side, representatives from all headquarters participated.

The annual meeting with the WpHG working group of the German Institute of Chartered Accountants took place in October 2007. Topics included the new Ordinance on investment services audits (WpDPV), transposition of the MiFID through the FRUG, risk provisioning for the anticipated charge to the Compensatory Fund of investment services enterprises for the insolvency case, Phoenix Kapitaldienst GmbH, as well as audits on German asset management companies and the special funds issued by them. The two workshops with the auditors and the auditing associations focused on the issues of the WpDPV and the audit year 2008.

### Risk-oriented supervision

Initial experience with risk-oriented supervision.

In the year under review BaFin resumed the classification of financial services institutions into risk groups, which had been initiated in 2006. All financial services institutions that provide investment and contract brokering services as well as portfolio management services are classified, provided they are not authorised to procure ownership or possession of funds or securities from clients, and they do not deal in financial instruments for their own account. The number of

such institutions is currently 630. BaFin categorises the impact of particular risks in the financial services provider sector as “medium” or “low”; this includes the sale of particularly high-risk products, the engagement of a high number of tied agents, the number of clients and a strong international dimension. The risk category “high”, which is geared towards system relevance, does not apply because financial services institutions are basically not associated with the same level of system risk as the credit institutions. However, financial services institutions that are authorised to obtain possession or ownership of funds or securities for their clients, or that trade on their own account in financial instruments (own business) or conduct proprietary trading subject to a licence are included in the risk matrix for credit institutions as their level of system risk is similar.<sup>54</sup>

Currently, 516 institutions, or about 82% of financial services institutions are included. The risk matrix enables BaFin to supervise financial services institutions as appropriate depending on their risk situation. Institutions that show deficiencies are supervised more intensively than those that do not. The risk matrix provides an insight into the institutions, allowing BaFin to deploy audit-monitoring visits, prioritise or schedule on-site inspections or arrange special audits more efficiently. BaFin mainly obtains the information about the institutions required for risk classification from the audit reports pursuant to the KWG and the WpHG, but also from information obtained throughout the course of the year such as monthly returns, notifications in accordance with the KWG and complaints.

Table 19

**Results of 2007 risk classification**

(previous year's figures in brackets)

Institutions in %		Quality of the institution				Total
		A	B	C	D	
System relevance	High					
	Medium	10.3% (8.8%)	4.5% (3.9%)	1.0% (0.4%)	0.4% (0.4%)	16.1% (13.5%)
	Low	65.5% (64.4%)	15.3% (18.1%)	2.9% (3.5%)	0.2% (0.4%)	83.9% (86.4%)
Total		75.8% (73.2%)	19.8% (22.0%)	3.9% (3.9%)	0.6% (0.8%)	100%* (516)**

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

\*\* Absolute number of financial services institutions classified so far.

<sup>54</sup> See Chapter V, 2.3.

● On-site meetings are an important component of supervisory activities.

● 70 licences revoked.

### Audits and measures

In the year under review BaFin supervised 86 audits in financial services institutions and conducted 89 supervisory meetings with managers or the boards of the institutions. These meetings generally concerned both solvency and market supervision. On-site meetings facilitate communication between the institutions and the supervisory authority and are conducive to a swift clarification of any upcoming questions. Audit monitoring visits also make it possible to arrange with the auditors the manner in which the audit should be conducted and how the audit report should be structured. In individual cases an audit monitoring visit replaces a special audit. This is to the benefit of the institution because, in contrast to the special audit, there are no additional costs for the institution associated with an audit monitoring visit. BaFin conducts audit monitoring visits and supervisory consultations both by arrangement and randomly.

In the year under review, 70 licences held by financial services institutions were revoked; 63 of these were returned by the institution. Three financial services institutions returned their licences following a BaFin hearing regarding the proposed revocation of their licences pursuant to the KWG. One of the hearings involved solvency problems and organisational shortcomings in the reporting and notification system. Once the management proposed resigning from the institution, it returned the licence. In another case, a financial services institution returned its portfolio management licence after BaFin had heard the institution for the second time because of insufficient own funds as well as organisational shortcomings. When the financial services institution procured sufficient own funds following an initial hearing in the year 2006, BaFin issued a warning at the time because of a considerable number of organisational shortcomings. However, since the own funds were again inadequate in the year under review and no improvement had been made in the organisation of the institution, it returned its licence in anticipation of it being revoked following another hearing.

A financial institution, which brokered mainly penny stocks, was the subject of a hearing to revoke its licence. The institution had been repeatedly in breach of the KWG and the WpHG, and had also been engaging in cold calling. BaFin deemed the managers to be unreliable. The financial services institution returned its licence within the deadline for the hearing. A further financial services institution, which dealt mainly with British customers, returned its licence after the State Office of Criminal Investigation in Berlin (Landeskriminalamt – LKA) together with BaFin had searched the premises. The search was based on a letter rogatory from the public prosecutor's office in Britain. It disclosed gross infringements of the regulations of the WpHG. A further financial services institution issued certificates for the implementation of Eurex trading strategies in the year 2006.

Because of economic problems in spring 2007, the institution misused capital collected for this purpose to cover the costs of the day-to-day business and had to cease operating due to insolvency. The insolvency proceedings are still continuing.

In view of the anticipated special charge for the Phoenix Kapitaldienst GmbH indemnification case by the Compensatory Fund of Securities Trading Companies, certain financial services providers also returned their licences during the course of the year under review. Some of these institutions closed their businesses completely, others merged or established new companies in other countries in the EU and continued their business as branches in the original location.

● Four licences revoked.

BaFin withdrew the licence from a financial services institution on the basis of a special audit conducted in 2006, which disclosed a considerable number of shortcomings in the organisation and rules of conduct. In a further case, BaFin found indications that the manager of a financial services institution had been using funds – which had been made available to his institution for conducting its own business transactions – for purposes other than those agreed with the investors. A special audit performed by BaFin confirmed the suspicions and BaFin then deployed a supervisory officer. The manager was replaced immediately. Subsequently, however, the proprietors did not succeed in raising the requisite capital to run the institution, so BaFin filed for insolvency for the institution and revoked the licence.

BaFin revoked the licence of a financial services institution after insolvency proceedings had been filed relating to the institution's assets and liquidation of the institution had commenced. The institution's insolvency was triggered by a series of rulings in which the institution had been ordered to pay compensation for unacceptable consulting services. BaFin also revoked the licence of a further institution that had not fulfilled the requirement to submit reports and notifications, as well as the requirement to conduct audits over a longer period of time. The licence was cancelled after the institution did not respond to several reminders and a warning. Finally, BaFin prohibited a financial services institution from providing cross-border services to the Czech Republic on the basis of organisational shortcomings.

● One special audit pursuant to section 44 KWG.

Pursuant to section 44 KWG, BaFin ordered a special audit for a financial services institution. The reasons for this were shortcomings in the organisation, capital and in their compliance with regulations pertaining to large exposures. Furthermore, BaFin wanted to investigate the ownership structure at the institution. The financial services institution was fully owned by another financial services institution that had returned its licence in May 2006 following a hearing. The parent company had declared that it had sold all shares in the financial services institution. However, there were indications that the former financial services institution still held shares in the subsidiary. BaFin is preparing supervisory law sanctions against the institution.



## 3 Market supervision

### 3.1 Credit institutions and financial services providers

#### Savings banks and cooperative banks

● Focus: complaint management.

The Federal Office focussed their supervisory activities for savings banks and cooperative banks directly on complaint management. Effective complaint management can give the institution an indication of any organisational weak points. Even if a client contacts the institution frequently with a grievance, the significance of the complaint as an indicator of organisational shortcomings must not be underestimated. In order to be able to draw conclusions from complaints about possible organisational shortcomings, the institutions must assess the complaints centrally. An appropriate analysis is only possible if the complaints converge at a single point in the institution, and the departments and branches that are most often affected are of interest in this respect.

#### Credit institutions

● 74 audit monitoring visits.

BaFin carried out monitoring visits with regard to 74 audits on securities transactions at credit institutions and conducted 16 supervisory meetings on issues relating to market supervision.

● A special audit pursuant to section 35 WpHG.

At the beginning of 2007, the supervisory authority ordered a special audit for a specific reason at a credit institution operating at regional level. The appraisal of the last audit report provided indications of serious conflicts of interest in the sale of profit participation certificates. The issuer of the certificates was itself a sister company of the credit institution; the customer portfolios consisted almost exclusively of these profit participation certificates. The profit participation certificate capital was intended for the partial financing of real estate, while the remaining part was to be financed by borrowed capital. The issuer promoted the certificate at an above-average interest rate, which was to have resulted from the difference between the low interest on the borrowed capital and higher returns on the real estate. In its promotion it also highlighted that the certificate holder's claims would subsequently be secured by being entered in the Land Register, as well as the conservative nature of an investment in real estate. At the same time, the issuer also pointed out in its sales prospectus that the investment in the profit participation certificate would be made at best from a speculative standpoint and that the purchaser should observe the principle of risk spreading. Apart from selling the certificates, the bank also adopted the role of trustee for the profit participation certificate holder. In this capacity, one of the tasks of the credit institution was to monitor the issuer's assets. As trustee for the profit participation certificate holder, the bank also had to approve the purchase and the sale of real estate. The audit showed that the risk category to which the certificate had been assigned by the credit institution was too low and, to this extent, customers had not

been appropriately informed as to the risks. Furthermore, it transpired that the bank had not adequately met its monitoring obligations as trustee. Nevertheless, the customers did not suffer any financial loss because the issuer had paid the interest that was expected for the years 2005 and 2006. The bank took appropriate steps in connection with a change in ownership and a strategic reorientation in order to guarantee investment consulting services in accordance with regulations. It transferred the role of trustee for the profit participation certificate holders to a different credit institution.

### **Cold calling**

BaFin considers cold calling, or unsolicited sales by telephone, to be an unreasonable invasion of privacy and an intrusion in the investor's freedom of decision. Consequently, it issued a general ordinance relating to advertising in the form of cold calling on 27 July 1999.<sup>55</sup> This prohibits investment services providers from contacting customers by telephone with whom a business relationship does not already exist. If the party being contacted by telephone has clearly declared beforehand that it consents to being contacted by telephone, the call is not a cold call. However, consent must have been given directly to the investment services provider. Consequently, it is not sufficient if an account representative, who moves to a new employer, obtains consent from his or her customers to continue contacting them before commencing the new post. In this instance, consent has indeed been granted to the account representative, but not to the investment services provider for which the representative is then working.

17 special audits on cold calling.

Against the backdrop of a highly competitive market of affluent private customers, the acquisition of new customers for the institution is becoming increasingly significant, putting more pressure on the account representative to sell. In view of these developments, BaFin asked auditors in selected banks, to focus their annual audit in accordance with the WpHG on customer acquisition. Auditors were to ascertain what kinds of activities the institutions are developing for acquiring customers. In particular, auditors were to clarify the extent to which the institutions conduct market analyses, use external databases, take up the recommendations of third parties and administer the data of potential customers. Furthermore, the auditors were to ascertain on the basis of random samples, whether the customer's files contained any indications of cold calling. BaFin conducted this type of special audit with 17 credit institutions in the year under review but, for the most part, did not find any indications of systematic cold calling.

Only a few cases gave rise to suspicion. These included one case in which BaFin had already established numerous infringements of the ban on cold calling in 2006. In view of the gravity of the infringements, BaFin, at the time, initiated regulatory proceedings as a result of which the institution relieved the branch manager

<sup>55</sup> [www.bafin.de](http://www.bafin.de) » Supervisory legislation » General ordinance 27.07.1999.

of his duties and re-structured their customer acquisition system. In the year under review, a suspicious activity report and another unarranged visit by BaFin to the same bank disclosed further infringements of the ban on cold calling. In January 2008, BaFin ordered that the institution pay a fine.

BaFin proposes to extend the above audit category to other credit institutions throughout the year 2008 particularly since some of the audited credit institutions had erroneously assumed that potential customers could be contacted by telephone on the basis of advice from a third party. Certain credit institutions assumed that they were permitted to call potential customers if they notified the customer in writing beforehand. Very often, account representatives working for a new employer had contacted customers by telephone known to them from their previous employment even though the customer had not granted their consent to the new employer.

● New advertising regulations.

In the future, the supervisory authority will focus their supervision activities on the institutions' advertising. For the first time, the FRUG makes detailed statutory provisions with regard to advertising design, for example, it stipulates that advertising must provide a balanced description of the prospects and risks of a financial instrument. The WpDVerOV includes other detailed provisions relating to advertising.

#### **Advertising and the WpDVerOV**

While section 31 (2) sentence 1 WpHG stipulates in general that the advertising information of investment services providers for private customers must be honest and clear, and should not be misleading, section 4 WpDVerOV includes a range of specific technical requirements. According to this, advertising material must point out possible risks as long as the potential benefits of an investment service or a financial instrument are being highlighted. Comparisons of securities-related services or their auxiliary services as well as of financial instruments must be presented in a balanced way. If reference is made to previous growths in value, the period of the immediately preceding five years must be shown, and not less than a full twelve-month period, however, if the product or the service had only been launched on the market a year ago. Furthermore, if growth in gross values is mentioned, there must also be a reference to the implications of commission, fees and other charges. The same applies to information on future growth in value. More importantly, this must not be based on a simulated previous growth in value either. Information on a specific tax treatment must clearly state its dependence on the customer's personal circumstances.

#### **Financial services institutions**

● Contractually tied agents in the spotlight.

During the year under review, BaFin did not conduct any special audits on financial services institutions in accordance with section 35 WpHG. However, it did increase its attention on the activities of the agents. Evidence of cold calling by a company in Holland instructed by a tied

agent prompted one such investigation. In the case of another financial services institution, which provided derivatives through tied agents, BaFin focused on certain aspects of the annual audit in order to investigate more closely the nationwide sale of papers by the tied agents. And in yet another case, one of the focal points of the audit involved the activities of tied agents.

### Exemptions from audits

BaFin granted 49 credit and financial services institutions exemption from the requirement to perform an annual audit in accordance with section 36 WpHG (2006: 124). 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. A total of 29 exemptions related to credit institutions, composed of 25 savings banks and cooperative banks and four private banks. A total of 20 exemptions were granted to financial services institutions. BaFin also granted 24 credit institutions exemption from the requirement to audit their safe custody business (2006: 70). This further decline in the number of new exemptions can be attributed to the fact that most institutions have by now availed themselves of the existing exemption option. Since May 2004, BaFin has been able to grant an exemption from the requirement to perform an audit for a period of up to three years. Furthermore, BaFin may also grant long-term exemptions, which are punctuated with cyclical audits at specific intervals, depending on the period for which the institution has been granted exemption. Consequently, following the audit, which interrupts the long-term exemption, it is not necessary to apply for a further exemption. By December 31, 2007 BaFin had granted 391 credit and financial services institutions exemption from the requirement to perform an annual audit of investment services and/or safe custody business in accordance with section 36 WpHG.

Further decline in exemptions from audits.

In 2007 BaFin initiated new administrative offence proceedings against banks and financial services institutions in four cases. Ten cases were still pending from the previous year. In two cases BaFin imposed fines of up to €10,000. The proceedings related to non-compliance with record-keeping requirements and an infringement of the ban on cold calling. Two cases were dropped, one of which was abandoned as it was not in the interest of the public. Ten cases were still pending as at the end of the reporting period.

BaFin ordered two fines.

## 3.2 Rules of conduct with regard to financial analysis

### Credit and financial services institutions

With effect from November 2007, the FRUG introduced new organisational requirements for investment services providers that compile financial analyses, commission their compilation or circulate such analyses. These should make conflicts of interest manageable and avoidable as far as possible. The new regulations also broaden the old concept of financial analysis in two ways: Firstly, all analyses of

FRUG reregulates financial analyses.

● BaFin clarifies legal position.

financial instruments are deemed to be financial analyses, regardless of whether or not they are traded on the stock exchange. Secondly, the term now also refers to the circulation of such financial analyses to customers even if they are not intended for distribution to the public.

In co-ordination with market participants, BaFin brought its previous supervisory practice into line with the new legal position and furnished information to this effect in a letter at the end of 2007.<sup>56</sup>

The details of the new regulations are as follows:

Analysts' remuneration must be kept separate from the income and premiums of other employees, or from the corporate earnings which they generate, if combining them could lead to a conflict of interests. However, this does not exclude a bonus, which is assessed according to the total output achieved by the institution.

If analysts are employed in other departments in the institution as well, such an arrangement should not jeopardise their independence and neutrality. BaFin normally considers such a risk to be common if analysts are also engaged in investment banking. In particular, this includes corporate financing, requests for proposals for the acquisition of a new business (or pitches), presentations for the first issue of financial instruments (road shows) and other marketing campaigns run by the issuer.

Investment services providers must ensure that their employees do not come to any agreement with issuers, which hold out the prospect of a favourable investment recommendation. Nor may employees of the institution engage in prohibited transactions such as placing security orders, for instance, which are at odds with their own recommendations.

● No serious shortcomings in the year under review.

In 2007 BaFin supervised 471 credit and financial services institutions, which compiled or distributed financial analyses (2006: 450). No serious shortcomings were established. The auditors' reports on the investment services business are the main sources of information which give the Supervisory Authority an insight into whether analyses are being properly compiled and presented, and whether any conflicts of interest are being handled and disclosed appropriately from an organisational point. It appears that in the majority of institutions it is guaranteed that financial analyses are compiled correctly and transparently. BaFin investigated specific companies more closely for specific reasons:

In one case, a credit institution had placed a larger block of shares for an issuer and simultaneously published a recommendation to purchase for the issuer. In this instance BaFin investigated whether or not any confidential information had been exchanged between the business divisions involved – financial analysis and investment banking – and whether research was not employed in a biased way in order to obtain a higher price for the block of shares. There was

<sup>56</sup> [www.bafin.de](http://www.bafin.de) » Publications » Coordination decision 21.12.2007.

no evidence of misconduct. In order to keep conflicts of interest to a minimum, sensitive areas of business should be strictly separated from one another (Chinese Walls). The exchange of information between the organisational units should be restricted to the absolute minimum necessary and be managed by an independent office, such as the Compliance Office for instance.

BaFin investigated in a separate instance, the direct contact and exchange of information between the manager of a company and analysts, at analysts' conferences for example, where it is not permitted to give analysts access to insider information on the one hand. The issuer, on the other hand, is also not permitted to distribute information selectively, by providing only a select number of analysts with certain financial data, for instance. This would constitute an inadmissible exertion of influence by the issuer and the information advantage would lead to a conflict of interests amongst the analysts.

Furthermore, BaFin took a closer look at the cooperation between banks and independent analysts. Certain institutions cooperate with specialised independent analyst firms in order to reduce costs or to expand their own research offering. To this end, they purchase research services for specific branches of industry or sectors of companies listed on the stock exchange. BaFin keeps a close eye on whether the statutory requirements relating to the proper compilation of financial analyses and disclosure of conflicts of interest are being fulfilled in the case of outsourcing.

● Administrative offence proceedings due to infringement of reporting requirement.

All natural and legal entities, who are responsible for the compilation of financial analyses or their circulation in pursuit of their profession or within the scope of their business activities, must report this to BaFin immediately in accordance with section 34 c WpHG. In 2007, BaFin initiated administrative offence proceedings against a company that did not fulfil this obligation. A case was still pending from the previous year relating to an infringement of the requirement for financial analyses to comply with the obligations regarding expertise and transparency (section 34b WpHG). So, at the end of the period under review, two cases were still pending.

### **Independent analysts**

In 2007, 114 self-employed financial analysts and independent analyst firms were subject to the supervision of the Supervisory Authority. BaFin monitors independent analysts – just as they do credit and financial services institutions – to determine whether they are fulfilling the obligations relating to expertise, transparency and organisation as provided for in the WpHG for financial analyses. In specific cases, BaFin found shortcomings, particularly regarding the disclosure of conflicts of interest and compliance with instructions on assessment methods and investment risks. In these instances, BaFin held meetings with the institutions under supervision to try and work towards an improvement.

● Supervision focus: order research.

In 2007, supervisory activities focused on order research. This business model is of financial significance, particularly for independent analysts. Research is conducted on behalf of the issuer who pays a fee. Because of possible conflicts of interest, this fact needs to be referred to in the analyses. BaFin checked whether it had been disclosed in the analyses that they had been ordered by the issuer. In practice, analysts are not directly commissioned by the issuer, but receive their contracts indirectly via a consulting company or an investor relations agency. BaFin also considers this arrangement to be order research, which must be disclosed in the analyses.

In addition, BaFin examined the way in which independent analysts ensure at an organisational level that order research is neutral and unbiased. Thus, for instance, the client can be prohibited by the contract from exercising any influence on the content. Draft analyses may only be brought to the attention of the client without specification of the recommendation or the target price. More often it proved problematic that the commissioned analysts indicated merely to have concluded verbal contracts with their clients. These were instructed by BaFin to record such contracts in writing in the future.

### Media

● Reporting on the stock exchange, newsletter, stock newsletters.

Financial analyses are often distributed by the media. Apart from reports on the stock exchange on the radio and television, there are numerous stock newsletters containing the appropriate investment recommendations. The rules of conduct of the WpHG do not apply if journalists, who compile financial analyses themselves or distribute third-party analyses, are subject to an equivalent form of self-regulation including effective control mechanisms. Equivalent effective self-regulation is deemed to exist if the publishing house follows internal professional conduct guidelines or a body of rules and regulations from a higher self-regulatory body, such as the German Press Code for instance. This exception regulation can be traced back to the freedom of the press, which is guaranteed in the German Constitution.

In addition to print media and private radio stations, public broadcasting companies also adapted their programming principles in 2007, thus implementing an equivalent self-regulation. This should ensure that financial analyses distributed via these media are presented in the appropriate manner and conflicts of interest are made transparent.

● Cooperation with State Regulatory Authorities for Broadcasting.

In the year under review BaFin was actively involved with State Regulatory Authorities for Broadcasting and met with representatives of their board of directors in the summer of 2007 to exchange practical know-how. The State Regulatory Authorities for Broadcasting are responsible for licensing private broadcasting stations (radio and television) in Germany and monitor them with regard to the legality their programme content. BaFin and the State Regulatory Authorities for Broadcasting agreed to work together more closely in the future in cases of deficient financial analyses in media reports by exchanging information beforehand for instance.





## VI Supervision of securities trading and investment business

### 1 Basis for supervision

#### 1.1 Trading platforms

FRUG re-regulates trading platforms.

The German law implementing the Markets in Financial Instruments Directive (FRUG) not only extends the list of financial services requiring a licence and the rules of conduct for investment services enterprises<sup>57</sup>, but it also transposes into German law the provisions of the MiFID for the licensing and operation of trading platforms. The FRUG additionally makes rules for the over-the-counter execution of securities transactions, with special rules provided for systematic internalisers. The FRUG has also abolished the current subdivision of the organised markets into official and regulated markets.

Publication requirements for trading platforms.

In order to make securities trading, and in particular the trading of equities, more transparent, comprehensive publication requirements have been established for regulated markets and multilateral trading facilities. Prior to trading, continuous publication of the spread between current buy and sell orders and the volume tradable at these prices is required. After close of trading, the prices and volumes of the transactions executed via the respective trading platform must be published. It must be emphasised that under German law these requirements only apply to the trading of those shares and depositary receipts that are admitted on a regulated market.

The increased transparency of equities trading is supplemented by the requirement that investment services enterprises publish their transactions in shares and depositary receipts executed outside of regulated markets and multilateral trading facilities.

Publication requirements for systematic internalisers.

The FRUG also created a separate body of provisions within the Securities Trading Act (Wertpapierhandelsgesetz – WpHG) for systematic internalisers: Institutions that deal on their own account, executing their customers' buy and sell orders must, for example, maintain quotes for buy and sell prices on a regular and continuous basis. This, in conjunction with other specific rules of conduct, is intended to counteract possible disadvantages arising for investors in internal order execution.

BaFin supervises multilateral trading platforms.

The operation of a multilateral trading platform distinguishes itself in that it brings together the interests of a large number of persons to buy and sell financial instruments within the facility and according to defined rules in such a way that it results in an

<sup>57</sup>See Chapter V.1.



agreement on the purchase of these financial instruments. For this purpose BaFin has been given a new responsibility. As of November 2007, it is responsible for supervising multilateral trading facilities. An exception exists if the multilateral trading facility is operated by an exchange operator – e.g., over the counter. In such a case, supervision is the exclusive responsibility of the supervisory authorities of the German Federal States in which the exchanges are located.

There are two aspects to supervision of a multilateral trading facility by BaFin: Firstly, the operation of such a facility is a financial service requiring an authorisation under the Banking Act (Kreditwesengesetz – KWG) and, secondly, it is also a securities service as defined in the WpHG. In the year under review, BaFin began to evaluate several facilities with regard to their MTF nature. In three cases transfer applications were made regarding the authorisations. The new sections 31f and 31g inserted in the WpHG to transpose the provisions of MiFID contain specific requirements regarding conduct, organisation and transparency for the operation of such a facility.

## 1.2 Ordinance implementing the Transparency Directive

The Transparency Directive Implementation Ordinance, which entered into force on March 21, 2008, transposes the European Implementing Directive on the Transparency Directive into German law.<sup>58</sup> The Transparency Directive was transposed into German law by the Act Implementing the Transparency Directive (Transparenzrichtlinie-Umsetzungsgesetz – TUG) effective January 20, 2007 and introduced additional notification thresholds for changes in voting rights (3, 15, 20 and 30%).<sup>59</sup> In addition, the TUG revises the rules governing the content of annual, half-yearly and interim financial reports, their requirement for publication, and extends the two-stage system of accounting controls to half-yearly reports. Issuers now must also disseminate capital market information throughout Europe without delay via suitable media and forward it to the newly formed German central company register ([www.unternehmensregister.de](http://www.unternehmensregister.de)).

The ordinance further specifies the application of the new legal provisions. For example, it contains minimum standards for the dissemination throughout Europe of capital market information and for the disclosure of financial data in half-yearly reports. It also defines more clearly the minimum requirements to acknowledge the parity of the equivalence of third-country regulations. Thus one of the areas on which the ordinance focuses is to what extent publication requirements pursuant to the WpHG also apply to issuers with their registered office in a third country.

<sup>58</sup> 2008 Federal Law Gazette I, p. 408; Directive 2007/14/EC, OJ EU No. L 69, p. 27.

<sup>59</sup> Directive 2004/109/EC; 2007 Federal Law Gazette I, p. 10.

### 1.3 Act Amending the German Investment Act

● New investment regulations in force.

On December 28, 2007, the Act Amending the Investment Act (Investmentänderungsgesetz – InvÄndG) entered into force.<sup>60</sup> This comprehensive amendment act is intended to create a modern and efficient regulation and supervision framework in order to enhance the competitiveness of the German fund industry, to promote innovation activities and to counteract the exodus of assets to other locations without neglecting the important and necessary issue of investor protection. To this end, the Act provides numerous measures.

● Deregulation.

The InvÄndG reduces the complexity of the Investment Act (Investmentgesetz – InvG) back to the level of the mandatory harmonisation requirements of the UCITS Directive.<sup>61</sup> In so doing, the legislature also abolishes the classification of German asset management companies as credit institutions and reduces the burden on institutional investors in the specialised funds segment. The legislature simultaneously extends investment opportunities in terms of the assets that can be acquired. The licensing procedure of BaFin is further simplified and the market-entry period for new products is reduced.

● Regulation of open-ended real estate funds modernised.

The Act introduces various new instruments for the appropriate control of open-ended real estate funds even in difficult market situations. These include the option to deviate from the existing requirement for daily redemption as well as the requirement to introduce suitable risk-management systems. Furthermore, investment companies must in future adopt rules of procedure, the draft of which must be co-ordinated with BaFin. This is to standardise the requirements for the activity of the expert committees.<sup>62</sup> In addition, the independence of the expert committees is strengthened. Finally, the InvÄndG changes the valuation rules in order to increase transparency.

● Product innovations promoted.

Two newly created asset classes enable the introduction of new products into the market. Thus investors can invest in public-private partnership projects via infrastructure funds. Because of their less restrictive investment requirements, “other” investment funds offer a vehicle to set up innovative financial products and micro-finance funds. The public limited investment company with variable capital is structured in such a way that it can henceforth also be launched as a UCITS-compliant investment fund.

● Improvements in investor protection and corporate governance.

The InvÄndG provides improvements intended to prevent conflicts of interest between custodian banks and investment companies and to strengthen the independence of the supervisory boards of German asset management companies. Furthermore, the legislature closed an important gap in the law in order to protect German investors:

<sup>60</sup> 2007 Federal Law Gazette I, p. 3089.

<sup>61</sup> Directive 85/611/EEC.

<sup>62</sup> Sample rules of procedure for expert committees of real estate funds are available at [www.bafin.de](http://www.bafin.de) » Unternehmen » KAGen & Investmentfonds » Investmentfonds.

The restriction of advance assessment of costs in fund savings plans is now also extended to UCITS-compliant foreign funds. That means that these, too, may now no longer claim their distribution costs in full in the first year. On the contrary, no more than a third of the distribution costs may be deducted from the agreed payments in the first year; the remaining costs must be spread evenly over subsequent payments.

## 2 Prospectuses

● Concerted market supervision campaign.

### Internet Surf Week

A vast array of securities and investments are offered and promoted on the Internet – not always in keeping with legal requirements. In the autumn of 2007, BaFin conducted a concerted campaign to obtain an overview of breaches of the Securities Prospectus Act (Wertpapierprospektgesetz – WpPG) and the Securities Sales Prospectus Act (Wertpapier-Verkaufprospektgesetz – VerkProspG) on the Internet. This involved searching the Internet for public offers of securities and investments without a prospectus. It also focused on issuer advertising. In 110 cases BaFin discovered violations of the legal requirements. Offers without a securities prospectus (41 cases) or sales prospectus (49 cases) constituted the majority. In these cases, BaFin contacted the providers responsible for the Web sites, pointed out the violation and ensured that the public offer was discontinued without undue delay. A further 20 cases involved the advertising of securities that did not contain the required reference to the securities prospectus (section 15 (2) WpHG). Here BaFin ensured that the providers stopped the improper advertising.

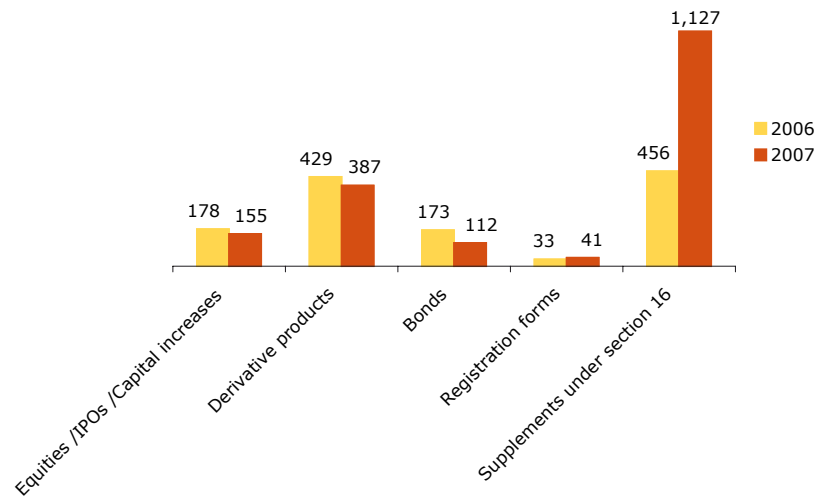
### 2.1 Securities prospectuses

#### 2.1.1 Prospectus examination

● Approval reviews increased significantly.

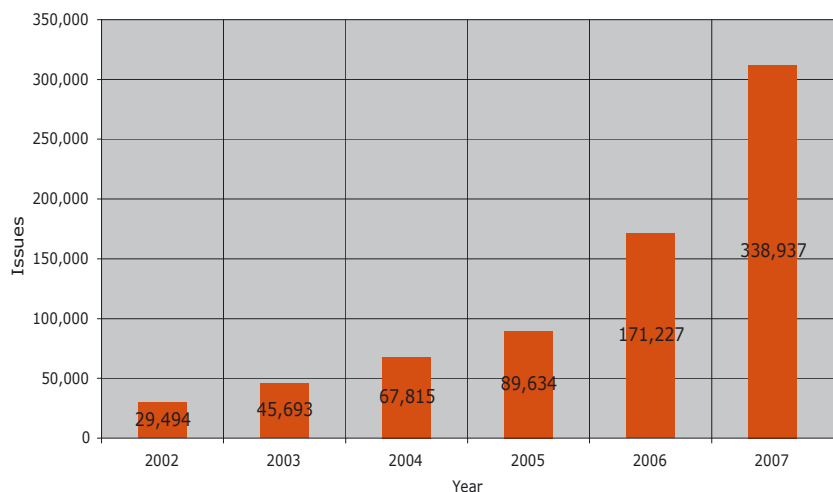
In the year under review, BaFin approved a total of 1,822 securities prospectuses, registration forms and supplements (2006: 1,269). BaFin reviews all securities prospectuses to ensure that they are complete, comprehensible, and do not contain contradictory statements. In nine cases BaFin withheld its approval of prospectuses and supplements. Compared with 2006, the number of reviews increased by more than 40%. This is because issuers submitted considerably more than twice the number of supplements for approval than during the prior year. But the number of prospectuses submitted fell slightly. In 2007, large-scale issuers increasingly submitted basic prospects that can be used for a large number of issues. Although there was a significant increase in the volume of issues and in the number of products offered, the number of prospectuses decreased.

Figure 18  
Approval reviews in 2007



Again there were more prospectuses for derivative products than for other types of securities. However, compared with the prior year (429), the number has actually decreased (387). One reason is that especially the issuers of derivatives have increasingly changed from complete prospectuses in one volume to base prospectuses plus the appropriate final terms and conditions. Base prospectuses offer the advantage that they can be used to issue a large number of securities with similar structure. The individual terms and conditions of the offer are then finalised only shortly before the respective securities are issued.

Figure 19  
Total issue volume in 2007

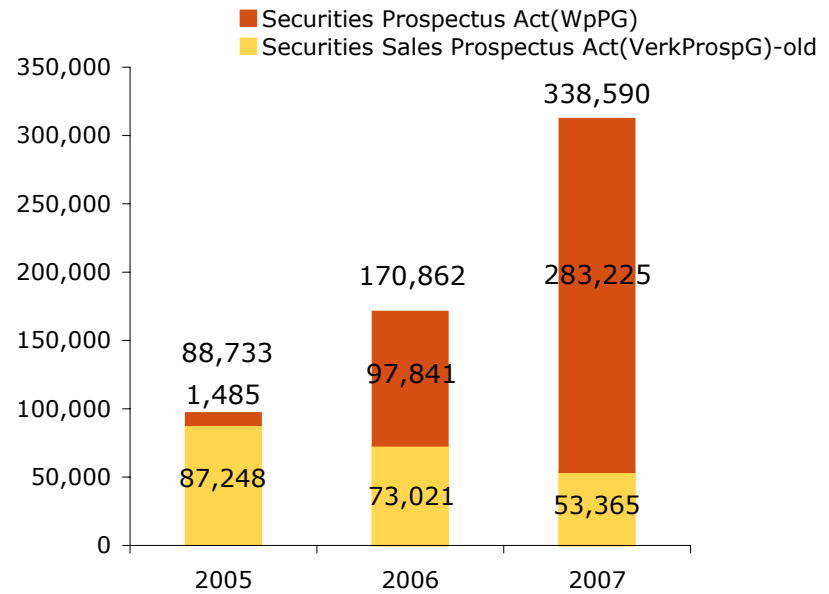


Total issue volume again nearly doubled.

Compared with an already strong 2006 (171,227), total volume increased to 338,937 issues in 2007. Total issue volume is the result of the number of full prospectuses, final terms and conditions, and the supplements under previously existing law. This result was mainly due to the significant increase in issues via base

prospectuses plus the appropriate final terms and conditions. In 2007, issuers submitted final terms and conditions in 338,590 cases; in 2006, these had numbered only 170,862.

Figure 20  
**Final terms and conditions in 2007**



● Notifications to European countries more than doubled.

Securities issuers had already taken greater advantage of the opportunities provided by the European Passport in 2006, and in 2007, the number of notifications to other European countries again increased more than twofold: while BaFin provided notifications for 791 prospectuses and supplements in 2006, 1,648 prospectuses including supplements received the Certificate of Approval in the reporting year. This high number of notifications to other countries speaks for Germany’s attractiveness as a supervision location. Issuers of the neighbouring EU member states also used the European Passport and provided notifications of 1,071 securities prospectuses to Germany. This represents an increase of approximately 48%.

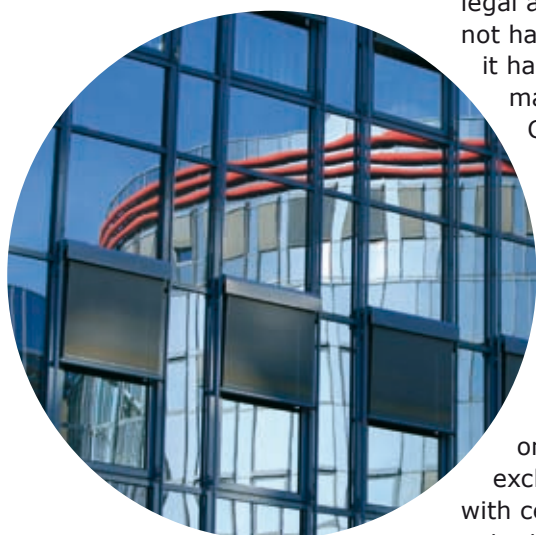
Luxembourg (425) heads the list of countries from which notifications were received and is followed by the United Kingdom (254), Ireland (164), the Netherlands (136), Austria (52), and France (29). In contrast, outgoing notifications are spread more widely. But the majority (almost 50%) of notifications went to Austria (775). BaFin issued 20% of the outgoing notifications for Luxembourg (324), while only approximately 5% went to Italy (94), the Netherlands (74) and France (64). The other countries are more or less at the same level: 45 went to the United Kingdom, 38 to Belgium, 33 to Sweden, 30 to Spain, 27 to Poland, 24 to Norway, and 21 to Ireland.

- Six administrative fine proceedings initiated.

In 2007, BaFin initiated six new administrative fine proceedings for WpPG violations. 21 proceedings were still pending from the prior year. In one case BaFin imposed an administrative fine of €4,000. 18 cases were discontinued, eight of these due to a lack of public interest. At the end of the year, eight proceedings were still pending.

- Legal action against refusal to approve a securities prospectus.

In the year under review, the Frankfurt Administrative Court ruled in the case of a GmbH that had demanded approval of a securities prospectus. BaFin had refused approval of the prospectus because it did not meet the legal requirements. The company had been notified several times through consultation letters of the respective faults in the prospectus and of the possibility that approval might be refused. Among other things, plaintiff had asserted that while the legal assessment of BaFin might not be incorrect, approval should not have been refused without prior warning. According to plaintiff, it had not been aware of the fact that corrections could only be made within a limited period. The Frankfurt Administrative Court rejected the action as inadmissible and unfounded.<sup>63</sup> In particular, approval had not been refused without warning. In principle, the court ruled, it was not surprising that application for an administrative action could result in a refusal. Furthermore, according to the court, plaintiff had been sufficiently informed of the possibility of a refusal by way of the consultation letters. The decision of the court is final.



In 2007, only two real-estate investment trusts were listed on the stock exchange. Apart from the generally difficult exchange environment, market participants cite dissatisfaction with certain restrictions of the REIT law as a cause. In addition, potential issuers want to wait for the expected benefits resulting from the 2008 tax reform. But companies from the real estate sector initiated a large number of prospectus approval procedures in 2007 as well. Some of these issuers stated explicitly in their prospectuses that they intended to obtain REIT status. Interest in REIT status was also expressed in some of the preliminary meetings in advance of prospectus procedures. By the end of March 2008, eleven companies were registered as pre-REIT with the German Federal Tax Office (Bundeszentralamt für Steuern). The expiry of the favourable exit tax as of January 1, 2010 could also initiate some movement among those interested in REIT. Deutsche Börse AG, through its introduction of a special REIT segment, has already begun calculating of specific REIT indices.

### 2.1.2 Register for qualified investors

- Investor register used only to a limited extent.

The register for qualified investors is hardly used. BaFin maintains this register in its transposition of the Prospectus Directive pursuant to the provisions of the WpPG. This law permits offers of securities directed exclusively to qualified investors to be

<sup>63</sup> Case: 1 E 1163/06(1).



Criteria for registration.

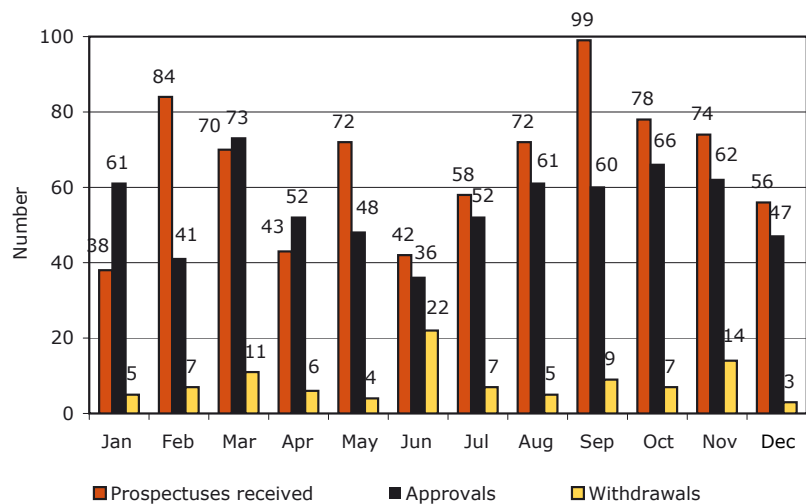
made without a prospectus. Natural persons as well as small and medium-sized companies that wish to be regarded as qualified investors may request to be entered in this register.

Issuers may view the register to ensure that an offer is directed exclusively to qualified investors. Since WpPG entered into force on July 1, 2005, there have been only a few applications for registration and no applications to view the register. In 2005, investors submitted one, in 2006 eight and in the reporting year four applications for registration. Unless there is a re-application, entries are deleted after one year. Investors must submit their application in writing. BaFin checks that at least two of three legally prescribed criteria for registration are met. The criteria are that natural persons must have carried out extensive transactions at stock markets, own a securities portfolio of more than €500,000, or have been active in a professional capacity for which securities investment expertise is a prerequisite. Small and medium-sized companies must, according to their latest annual or consolidated financial statements, have had less than 250 employees on average and total assets not exceeding €43 million or net annual revenue not exceeding €50 million.

## 2.2 Non-securities investment prospectuses

Figure 21

Prospectuses received, approvals and withdrawals in 2007\*



\*In the procedure figures as of 2007, the statistics take into account that several prospectuses may be combined in one document for printing.

The number of prospectuses submitted remained at a high level in 2007. BaFin received a total of 786 prospectuses for non-securities investments. Non-securities are, for example, partnership shares in a KG (German limited partnership), GbR (civil law partnership), a non-German limited partnership, or registered bonds. In 657 cases, BaFin approved publication of the prospectuses. In one instance

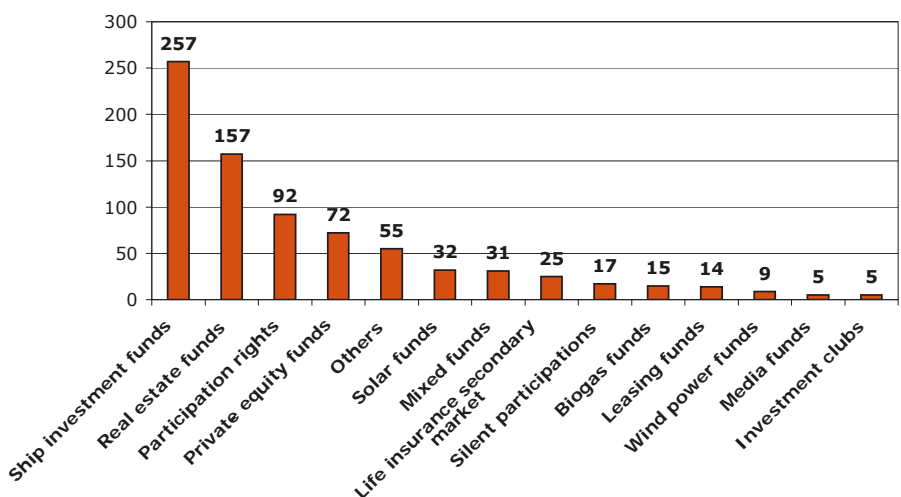
it prohibited publication because the prospectus did not contain the required minimum information. In 100 cases, issuers withdrew their application for approval, in some cases for the above reason. BaFin expects the approval figures for 2008 to lie approximately at the 2007 level.

In 2007, issuers wanted to raise equity capital of up to €14.9 billion from investors. The most frequently submitted type of prospectus concerned ship investment funds, followed by real estate funds, profit participation rights, and private equity funds.

The sector generally favours high-yield fund models. An overview of the approved sales prospectuses is available on the BaFin Web site.<sup>64</sup>

Figure 22

#### Prospectuses by fund type in 2007



● Frequent errors in prospectuses.

A significant source of errors in 2007 was once again the presentation of the risk section. All risks must be presented in a separate section that contains only this information. However, issuers frequently mention opportunities alongside risk-minimising measures within the risk section. Other frequent errors included insufficient information on the costs associated with acquiring the investment, the total amount of commission paid, and insufficient mention of the total remuneration of the founding shareholders and management. If a prospectus contains such errors and is not modified, BaFin is unable to approve it for publication.

● Dialogue with market participants.

In its annual workshop, BaFin met issuers, providers, solicitors and auditors to discuss topical questions relating to demarcation and interpretation under the Securities Prospectus Act and the Securities Sales Prospectus Act. BaFin also pointed out frequent errors in the preparation of prospectuses and offered practical help

<sup>64</sup> www.bafin.de » English Version » Consumers » Prospectuses.

in presenting the required prospectus information. The participants were also interested in the question whether certain banking transactions or financial services required an authorisation. Under the KWG, the operation of a business in deposits, guarantees and financial commissions requires a corresponding authorisation. BaFin provided information on transactions requiring an authorisation in order to alert persons responsible for the preparation of prospectuses at the conception stage and thus prevent violations.

In the year under review, BaFin initiated two new administrative fine proceedings. One proceeding was still pending from the prior year.

● Two administrative fine proceedings initiated.

## 3 Supervision of investment business

### 3.1 German asset management companies

At the end of 2007, the 78 German asset management companies (prior year: 77) managed 1,746 retail funds (prior year: 1,517) with assets totalling €353 billion (prior year: €354 billion) and 4,249 specialised funds (prior year: 4,367) with assets totalling €689 billion (prior year: €672 billion). The number of newly approved retail funds rose to 377 (prior year: 154). This represents an increase of approximately 145%. In the last quarter of 2007 alone, BaFin approved 205 funds. One reason for the high increase might be the impending introduction of the flat rate tax. Merger approvals were granted for 27 retail funds; 30 retail funds (prior year: 40) were dissolved. The number of public limited investment companies with variable capital rose from six to eight.

The number of complaints fell from 72 to 55. Mostly, the owners of fund units complained about the performance of funds. However, the performance of investment funds is dependent on the condition of the securities markets; BaFin cannot help with such complaints.

● Approval procedure optimised.

One significant change due to the InvÄndG is that the approval procedure for retail funds is now shorter. Approval must now be granted within four weeks following receipt of the approval application if the terms and conditions comply with legal requirements. At the same time, the procedure was tightened for purely formal activities, such as the general approval to select and change the custodian. Accordingly, the company no longer needs approval if it selects a custodian bank that has been generally recognised by BaFin as a custodian for specialised investment funds. A list of custodian banks is published on the BaFin Web site.<sup>65</sup> German asset management companies can select a bank from this list as custodian and only need to notify BaFin of their choice.

<sup>65</sup> [www.bafin.de](http://www.bafin.de) » Companies » Funds » Investment funds.

The new investment legislation also provides the option of granting preliminary approvals for funds. Instead of the specific terms and conditions for the issue of a fund that conforms to the UCITS directive, sample clauses can be approved from which the company can later select and compile the terms and conditions. After issuing of a new fund, the investment company need only notify BaFin accordingly.

Outsourcing controlling constituted the focus of special audits of German asset management companies. BaFin placed the emphasis here because the trend to outsource certain tasks, especially portfolio management, continued unabated in 2007. The supervisory authority examined whether and to what extent companies complied with their controlling obligations regarding outsourcing companies, which are often located abroad.

### Risk-oriented supervision

In 2007, BaFin completed its work in developing a computer-based classification procedure for German asset management companies. With the aid of this application, which contains risk-relevant information, such as audit results, type and volume of business as well as notifications and complaints, BaFin can evaluate the risk factors relating to solvency and market supervision, and modify the existing risk indication. Risk classification of investment companies is determined via an expert-supported rating system that rates certain criteria. The criteria themselves are set out in appropriate criteria catalogues and allocated to three subdivisions that apply throughout BaFin: Cash flows, financial condition and results of operations (Subdivision 1), Quality of management (Subdivision 2) and Quality of organisation (Subdivision 3). The threshold values for determining effect dimensions are fixed. The total classification rating consists of the quality rating and the rating of the effect dimension. The result of the rating procedure is represented in a twelve-field matrix.



● Classification procedure developed.

Risk classification of German asset management companies is planned to commence in 2008, using an InvRisk-ROA module that has yet to be developed. Such an individualised analysis of a particular investment company not only allows a holistic view of that investment company's risk structure, it also contributes to the assessment of possible effects on the stability of the financial sector. The results of these analyses form the basis for risk-oriented planning and controlling of supervision intensity.

- Effects on German retail funds limited thus far.

### Sub-prime crisis

So far, the effects of the sub-prime crisis on retail funds managed by German asset management companies have been rather limited. BaFin found that while in some funds the involvement of German asset management companies in structured products is above average, it is nevertheless quite low in relation to the total volume of these funds. Only very few funds contain securitisations of lesser-quality US mortgages, and even then only to a small extent. In the majority of cases, the companies managed to avoid emergency sales (with potential domino effects) of the ABS and MBS concerned. To date, no investment company has suspended the redemption of fund units. Significantly high investment outflows also occurred in only a few cases, and only temporarily in money market and ABS funds. In the other German funds, BaFin also did not observe any unusual movements of money.

In the case of some foreign retail funds whose units are also traded in Germany based on the European Passport there were temporary suspensions. One foreign investment company was able to avert complete temporary suspension of the fund, with the approval of its domestic supervisory authority, by only suspending the issue of new unit certificates and the investment manager redeeming the returned fund units at its own expense.

- Flat rate tax affects fund business.

### Flat rate tax

Although the flat rate tax on capital gains introduced by the new corporate tax reform act will not come into effect until 2009, it already had an effect on the investment business at the end of 2007. Due to the fact that risk certificates are already included in the general withholding tax beginning in March 2007, the situation of the investment sector is already improved. Thus the gains from the sale of units of open-ended investment funds held as personal assets remain tax-exempt if the unit holder acquires these units before January 1, 2009 and holds them for longer than one year. However, gains from the sale of certificates held as personal assets are only tax exempt if they were either acquired before March 14, 2007 or, if acquired after March 14, 2007, held for longer than one year and sold again before June 30, 2009.

Nevertheless, even with the advent of the flat rate tax, the investment fund vehicle still offers certain advantages over direct investment: The flat rate tax will in future also cover distributed gains from the sale of securities if those securities were acquired by the fund after December 31, 2008. However, gains from sales reinvested at the level of the retail fund (with the exception of gains from the sale of real estate held for ten years or less) will continue to be tax-exempt because they are not considered income equivalent to distributions. For the private investor, these gains are subject to the aforementioned transition regulation for the taxation of gains from the sale of investment units. Following the end of the transition regulation, i.e., when fund units are acquired as personal

assets after December 31, 2008, reinvested gains will be subject to downstream taxation (subject to the special provisions regarding real estate mentioned) because these gains are only taxed at the level of the normal private investor when fund units are redeemed or sold.

### 3.2 Real estate funds

● Portfolios restructured.

In 2007, the investment levels in real estate retail funds continued to normalise. German real estate fund companies steadily continued the restructuring of their portfolios, especially by further reducing the proportion of German properties. Despite lending becoming more restrictive during the year due to the sub-prime crisis, they were able to continue to benefit from the strong interest of numerous investors in German real estate. Again there were sales of large portfolios during the reporting year. In order to ensure that only the investors who had already committed themselves to the fund benefited from the gains thus achieved, the German asset management companies temporarily ceased issuing new fund units for the funds involved until the sales agreements were completed in full. However, units could be redeemed at any time with respect to all real estate retail funds.

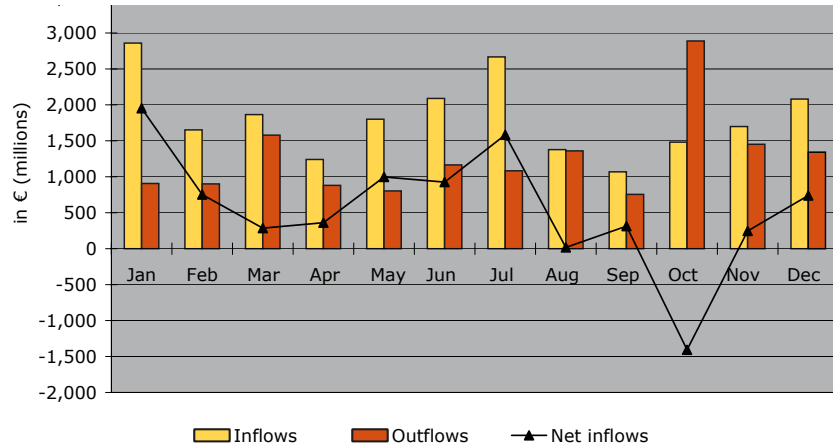
#### General development of open-ended real estate funds

● Continued interest in open-ended real estate funds.

At the end of 2007, German asset management companies managed 45 real estate retail funds (prior year: 41) with assets totalling €84.7 billion (prior year: €77.8 billion) and 118 real estate specialised investment funds (prior year: 108) with assets totalling €21.3 billion (prior year: €19.6 billion).

BaFin issued licenses to two companies to operate real estate funds. Interest in open-ended real estate funds and, in connection with that, the establishment of new German asset management companies appears to be continuing, particularly among institutional investors. These often regard real estate funds as the preferred alternative to direct investments in real estate due to the favourable accounting requirements and for tax reasons. Investment levels among open-ended real estate retail funds stabilised during the reporting year. The increase in investment outflows in October 2007 is not a trend reversal; it is due in particular to the particular circumstances affecting one investment company. Whereas the prior year saw net investment outflows of just under €9 billion due to the temporary suspension of the redemption of units imposed by individual real estate retail funds during the first quarter of 2006, net investment inflows of more than €6 billion were recorded in 2007. Assets under management have thus almost returned to 2005 levels.

Figure 23

**Inflow of funds to real estate retail funds 2007**

- Increase in average annual performance.

Measured according to the BVI method (comparison of redemption prices with distributions taken into account), the average annual performance of open-ended real estate retail funds improved over the prior year, from approximately 4% to now 5.7%. This further increase in average performance is again due in large part to the continued geographical reorientation of real estate portfolios in 2007. In December 2007, the German Federal Investment and Asset Management Association (Bundesverband Investment und Asset Management – BVI) reported the results of a study according to which the proportion of German properties of portfolios fell below a third in the course of the year while the investment of real estate funds in foreign market now lies just under 70%.<sup>66</sup> The sale of German real estate often resulted in quite substantial additional proceeds, in part due to larger portfolio sales at market-related portfolio premiums. Due to these one-off effects, some real estate funds recorded an annual performance of nearly or higher than 10%.

### 3.3 Market supervision

- Focus on financial risks.

In 2007, market supervision focused on the assessment of financial risks for German investment funds (issuer, counterparties, liquidity and market risk). BaFin found no fault with the way companies managed the issuer and counterparty risks inherent in the assets contained in the funds.

- Risk management in structured products proved its worth.

Breaches of investment limits were generally recognised and in time and reversed. In the few cases where errors in action taken led to losses in the investment funds, the companies immediately compensated the losses incurred by the affected investors. In view of the growing importance of structured products, BaFin

<sup>66</sup> www.bvi.de » English Version » Press & Media » Press releases 2007.

again examined in 2007 whether companies implemented the organisational measures necessary for proper monitoring of their risks. It became apparent that companies had successfully implemented the procedures for ascertaining the risk potential of funds and are taking measures to prevent critical developments. Due to the sub-prime crisis, some German money market funds also experienced unit redemptions. But the companies were able to avoid closures. BaFin evaluated audit reports and annual reports of approximately 1,550 retail funds in the reporting year.

The evaluation of notifications under the Ordinance on Derivative Financial Instruments (Derivateverordnung – DerivateV) provided indications of how companies dealt with the market risk of their funds. The Ordinance requires that, when selecting the qualified approach, German asset management companies calculate the potential loss risk per fund and inform BaFin if the actual loss incurred on a given day is higher than the previously calculated value at risk (VaR), so-called outliers. Comparison of the actual loss incurred on a given day and the calculated loss risk (back-testing) is intended to allow conclusions to be drawn regarding the forecasting quality of the risk models used. The forecasting quality is important because the risk models are used to calculate the extent to which the 200% InvG limit is utilised. This legal investment limit provides that the market risk potential of an investment fund may not increase more than twofold through the use of derivatives.

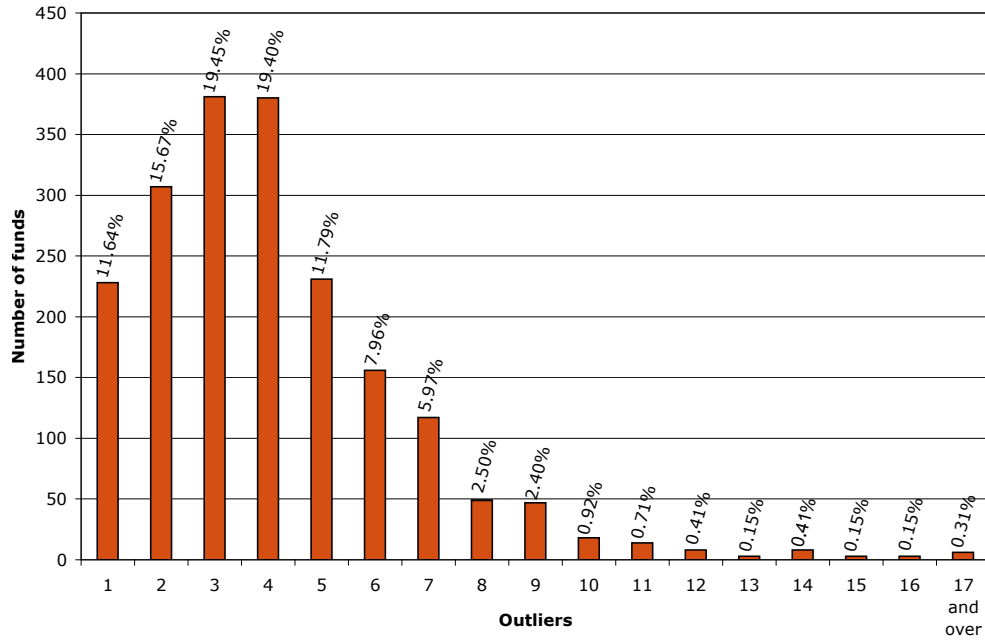
Evaluation of the notifications of forecasting quality in 2007 resulted in the finding that among a large number of funds there were considerably more outliers per year than could be expected based on the probability level of 99% prescribed by the DerivateV.

● Deviating risk models can be recognized.

Based on the prescribed probability level of 99%, an outlier can therefore be expected at 1%, i.e. on one of 100 trading days. For a year of 250 trading days (rounded), the expected number of outliers is thus one to two per year. Based on the Solvency Ordinance, this number may be exceeded by one outlier without giving rise to doubts regarding the forecasting quality of the risk model used. Outside this range, outliers are an indication of weaknesses in the model, but not proof of such. The DerivateV requires companies to use risk models with at least satisfactory forecasting quality. Statistically this is the case if the respective fund records between two and four outliers per year.



Figure 24  
Forecasting quality reports\*



\* Cut-off date: September 30, 2007.

### 3.4 Hedge funds

Public focus on hedge fund regulation.

Once again, hedge fund regulation was the subject of public discussion. At the G8 summit in Heiligendamm, Germany, in June 2007, heads of government discussed the question whether, due to their growing importance for the stability of financial markets in the G8 countries, hedge funds should be subjected to increased transparency requirements.

The InvÄndG has regulated the role of prime brokers. Further legal provisions concern custodian banks, which German hedge funds will continue to rely on even when employing prime brokers.

#### Prime brokers

In international practice, prime brokers act as comprehensive service providers for hedge funds. For example, they generally hold the fund's assets in safekeeping, provide borrowed capital to increase the leverage, lend securities to the fund for short sales, and support the fund in the transaction of other business and in administrative tasks. In return, besides receiving appropriate fees, they are generally given the right to use the fund's assets in their safekeeping for their own purposes and at their own expense. German single hedge funds had already been able to use the services of prime brokers. This had been declared explicitly in the written interpretation by the German Federal Ministry of Finance

on May 26, 2004. Now the term “prime broker” is defined in the Investment Act (section 2 (15) InvG). The crucial qualifying feature is that a prime broker not only holds the assets of the hedge fund in safekeeping, but simultaneously has them transferred to it for its own use. This distinguishes a prime broker from other brokers and service providers of the fund. In addition, prime brokers must have their registered office in a member state of the EU, the EEA or the OECD, must be subject there to effective public supervision and have appropriate creditworthiness.

● Number of hedge funds stable.

The total number of single hedge funds and funds of hedge funds licensed under German law remained stable during the reporting year. At the end of 2007, 25 single hedge funds and 14 funds of hedge funds were licensed, and seven foreign funds of hedge funds were licensed to sell their units to the public in Germany. According to reports from the industry association, approximately €2.1 billion are invested in hedge funds licensed in Germany. BaFin licensed four single hedge funds in 2007, one of these being a public limited investment company. On the other hand, one public limited investment company and four investment funds returned their licences.

● No effects of the sub-prime crisis.

During the year under review, German hedge funds remained unaffected by severe negative effects of the sub-prime crisis.

● Supervisory visits and annual meetings.

In the reporting year, BaFin conducted numerous meetings with supervised companies as well as seven on-site supervisory visits and annual meetings. All companies that received a licence to operate a hedge fund in 2007 were visited before the licence was granted. Such inspections allow an initial assessment as to the ability of investment companies and funds to meet the legal and contractual requirements. Furthermore, experience shows that open questions can be resolved more quickly through direct contact. The other supervisory visits were not triggered by a particular event. In general, supervisory visits are intended to improve the exchange between the supervisory authority and the supervised entities. This provides BaFin with direct insight into the market. As especially the experiences of 2007 have shown, regular contact also allows the quick and efficient collection of the required information during times of crisis.

### 3.5 Foreign investment funds

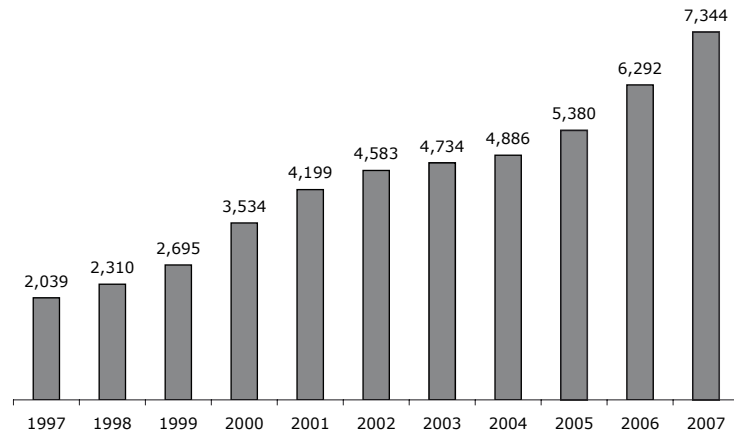
#### UCITS-compliant investment funds

● Distribution licenses again reach all-time high.

In 2007, BaFin received 1,505 new notifications for the distribution of investment funds compliant with the relevant EU directives (“UCITS funds”). The number of new notifications once again exceeded that of the prior year (1,395), constituting yet another all-time high. The total of foreign UCITS funds with a licence for distribution increased to a new record high of 7,344 (prior year: 6,292). The significant increase in UCITS funds is due, among other

things, to the extended investment opportunities under the so-called Eligible Assets Directive<sup>67</sup> and, in part, to the future flat rate tax. As in previous years, the home countries of these funds were mainly Luxembourg and Ireland.

Figure 25

**UCITS-compliant individual assets**

● Focus: marketing activities.

Supervision focused on various activities of individual foreign UCITS funds in Germany, such as marketing. In ten cases, BaFin formally notified companies of its prohibition of the continued public sale of fund units. Other focal points were the answering of numerous legal queries, especially concerning the changes in notification procedure following implementation of the CESR guidelines<sup>68</sup> and dealing with investors' complaints. Some of the latter involved the question whether investment companies had complied with their information requirements (in a timely manner).

● CESR guidelines for simplification of advertising procedure implemented.

In 2007, BaFin began implementing the guidelines published by CESR for the simplification of the notification procedure. These guidelines provide significant simplifications for the European investment industry, such as the option to reduce the time limit before commencing distribution, and further harmonise European supervision standards, e.g., through the use of standardised notification letters throughout Europe. In order to enable companies to avail of these simplifications as quickly as possible, BaFin modified the bulletin on the submission of distribution notices in two stages: In 2007, BaFin first published only the changes not affected by the InvÄndG and then updated the bulletin once more in January 2008.<sup>69</sup>

The InvÄndG also resulted in changes to numerous organisational procedures, e.g., in the deregistration of sub-funds of an umbrella fund that are licensed for distribution.

<sup>67</sup> Directive 2007/16/EC.

<sup>68</sup> CESR's guidelines to simplify the notification procedure of UCITS, Ref.: CESR/06-120b.

<sup>69</sup> [www.bafin.de](http://www.bafin.de) » Companies » Funds » Investment funds.

● Conversion of non-UCITS funds almost complete.

● Foreign investment funds licensed for distribution mostly originate from Luxembourg.

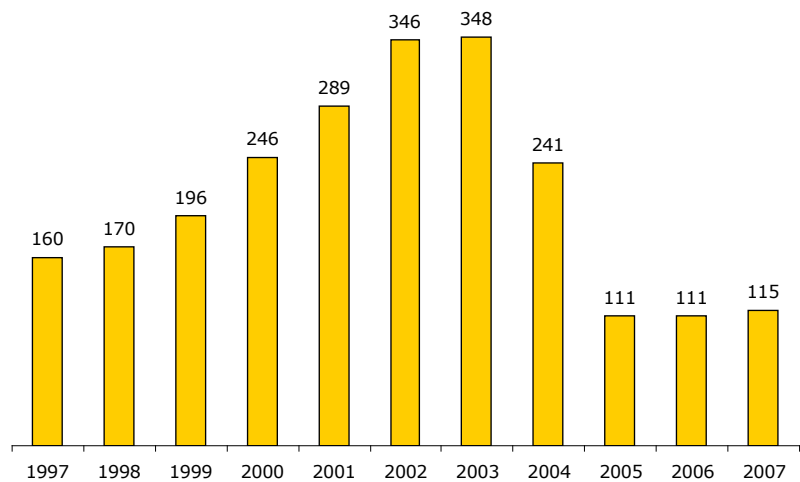
### Non-UCITS-compliant investment funds

By the end of 2007, BaFin was able to complete the InvG conversion of the non-UCITS-compliant investment funds, with the exception of a few cases. The InvG entering into force in 2004 meant that companies had to submit modification applications for all non-UCITS investment funds that at that time were authorised for public sale in Germany. Work also focused on new notifications for non-UCITS investment funds and on providing information in advance of planned notifications. Particularly towards the end of the reporting year, there was a comparatively large number of new notifications. This shows that foreign investment companies also noticeably increased their sales activities in view of the impending flat rate tax.

Compared with the prior year, the number of non-UCITS investment funds authorised for sale rose slightly. All of the newly licensed investment funds have their registered offices in Luxembourg. In the year under review, US and Swiss companies did not apply for sales licenses in Germany for individual funds, so that now by far the largest part of foreign non-UCITS funds authorised for public sale in Germany originates from Luxembourg.

Figure 26

#### Non-UCITS-compliant individual assets\*



\* As of 2006, the statistics include foreign funds of hedge funds authorised for sale (2006: 8; 2007: 7).

## 4 Monitoring of market transparency and integrity

### 4.1 Market analysis

● 750 routine analyses.

BaFin observes the market with regard to insider trading and market manipulation. In doing so, it takes an increasingly risk-oriented approach. In 2007, BaFin analysed 750 cases, significantly fewer than in the prior year (2006: 1,250), but its analysis of these was more intensive. Aside from equity markets, BaFin increasingly scrutinised the markets for bonds, structured products and energy derivatives. The lower number of analyses is due mainly to the fact that cases and financial instruments are becoming ever more complicated, rendering analyses ever more intricate. Especially with regard to information offences and sham activities, several financial instruments are often involved in one analysis.

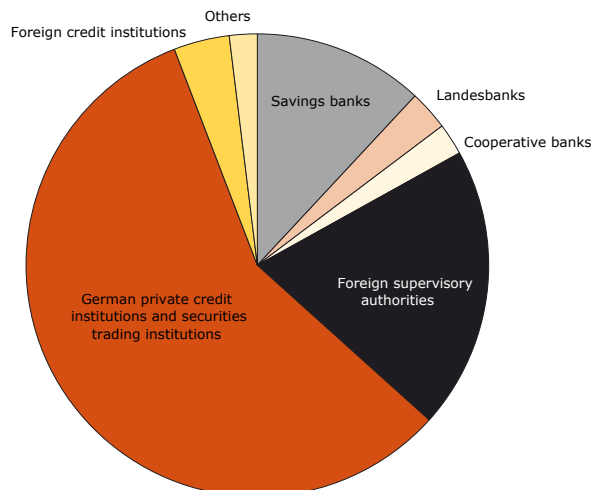
In order to monitor the bans on insider trading and market manipulation, BaFin utilises the data concerning all securities transactions which all credit institutions and financial services institutions must report to BaFin. In the year under review, BaFin received 935 million such transaction reports (2006: 712 million). This increase compared with the prior year reflects the overall high trading volumes in the reporting year. On a daily basis, this translates to an average of about 2.6 million reports (2006: 1.95 million).

● Number of investor reports tripled.

BaFin also evaluates all ad hoc disclosures supplied by companies listed on stock exchanges and follows up reports by third parties. These may be the market surveillance departments of the exchanges, but also the press and especially investors. The number of complaints and reports regarding insider trading and market manipulation has nearly tripled, reaching almost 1,000 in 2007 (2006: 336). Most of them concerned suspected manipulation using market letters and spam e-mails.

Figure 27

#### Suspicious activity reports



● Important source: suspicious activity reports by the credit industry.

Suspicious activity reports by the credit industry also played an important role. In 2007, BaFin received 101 such reports (2006: 74). Foreign supervisory authorities passed on 20 suspicious activity reports to BaFin. Two thirds (67) of the cases reported concerned securities trading, and 19 cases related to options.

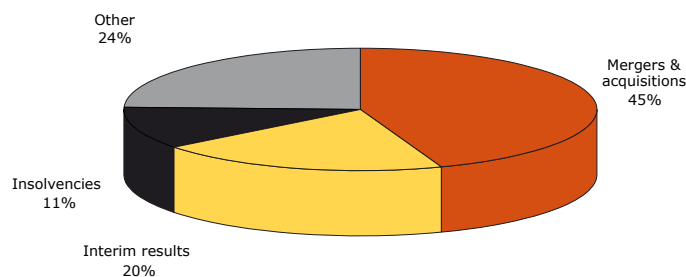
● Mergers particularly relevant with regard to insider trading.

In 80 (2006: 84) of the 750 analyses conducted, BaFin found indications of insider trading (45; 2006: 52) or market manipulation (35; 2006: 32) and referred these for formal investigation.

Many of the insider violations (45%) were again related to mergers and acquisitions in 2007 (2006: 46%). In addition, insiders often used their knowledge of impending interim results, insolvencies and liquidity problems.

Figure 28

#### Background of positive insider analyses



Three quarters of the positive insider analyses related to the regulated market, the rest to OTC.

● Manipulation through market letters and spam e-mails.

Nearly half of the positive market manipulation analyses (17) concerned information offences (2006: 9). These include mainly incorrect and misleading information as well as scalping. Scalping refers to the practice of acquiring securities for the purpose of then recommending them for purchase and of selling them again when their price rises due to the recommendation.

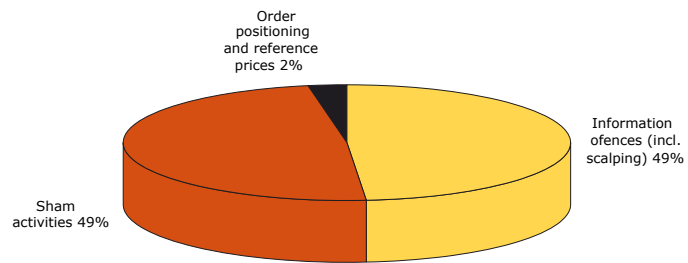
Another frequent problem was the so-called pump-and-dump method using spam e-mails and market letters. This occurs when shares, mostly of foreign companies in the commodity sector, are included in the OTC trade at German stock exchanges. After some time, market letters by allegedly independent experts forcefully recommend the purchase of these shares. Often investors are also swamped with spam e-mails encouraging purchase. These e-mails usually contain a purchase recommendation, quoting extremely high future prices or price forecasts without providing any detailed reasons for these. Quite a few investors then purchase the usually completely illiquid shares. Following the increase in trading volume and price due to the artificially stimulated demand, the authors of the market letters and e-mails sell their shares, acquired before the recommendation, at a high profit. With the positive reports and recommendations at an end, prices and trading volumes

quickly drop to their original level. In March and June 2007, BaFin published on its Web site information on how to deal with stock recommendations and newsletters.<sup>70</sup>

Just under 50% of the positive analyses (17) involved sham activities, such as prearranged transactions or deals in which the beneficial owner does not change (2006: 21).

In the year under review, BaFin also frequently analysed trading in energy derivatives. It did not find any indications of market manipulation here.

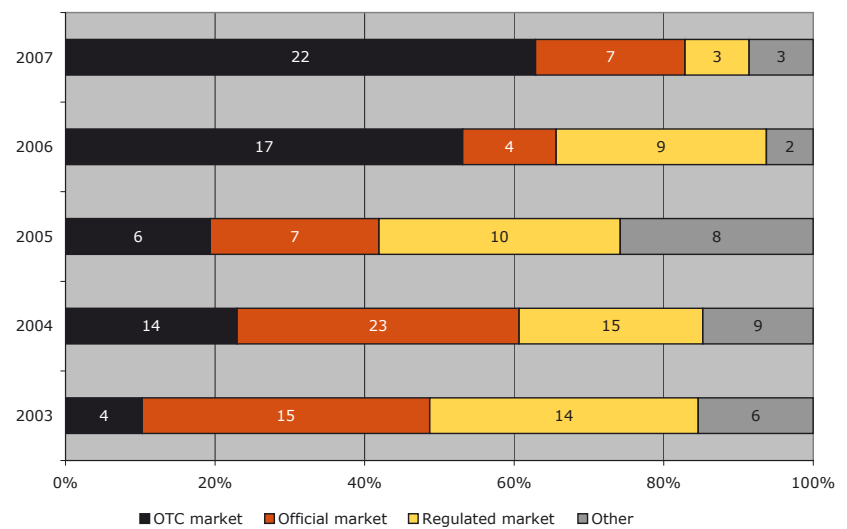
Figure 29  
**Background of positive market manipulation analyses**



● Manipulation mainly in OTC instruments.

Just under two thirds of the positive manipulation analyses concerned shares that are traded exclusively over the counter (22). This represents the continuation of a long-running trend: manipulation takes place mainly in shares with limited liquidity traded on the OTC market. However, the proportion of manipulation on the regulated market continues to decrease. This is further proof that liquid markets offer the best protection against manipulation.

Figure 30  
**Positive manipulation analyses by segment**



<sup>70</sup> www.bafin.de » Publications » Consumer notes.

Discontinuation of mandatory reporting for OTC instruments.

As a result of the transposition of MiFID into German law, credit institutions and financial service providers are no longer required to report transactions in pure OTC instruments. In its monitoring of OTC trading for insider trading and market manipulation, the supervisory authority can thus no longer access these data directly. BaFin will try to make up for this loss of data through closer co-operation with the market surveillance departments of the exchanges.

#### OTC market

The OTC market is a segment on German stock exchanges organised under private law, a special case of the so-called multilateral trading facilities. It is supervised by the stock exchange supervising authority of the respective German federal state. The OTC market is subject to significantly lower (transparency) requirements than the regulated market. In order to commence trading it is sufficient that the security is included in the OTC market by the exchange. A sales prospectus is only required if the listing is simultaneously accompanied by a public offer. There are also no exchange-specific publication requirements. The issuer does not have to provide either ad hoc disclosures or directors' dealings reports, large-scale investors do not have to disclose their voting rights. Furthermore, issuers do not have to publish annual reports or financial statements; there is no examination by the German Financial Reporting Enforcement Panel. However, the ban on insider trading and market manipulation also applies to the OTC market; this is monitored by BaFin. The market surveillance departments of the stock exchanges check the proper calculation of prices. On the OTC market, investors must exercise considerably higher initiative and effort regarding the collection and evaluation of information than is the case on the regulated market. Investors should be aware of this.

BaFin filed complaints against 64 persons for suspected insider trading.

## 4.2 Insider trading

In the year under review, BaFin filed complaints against 64 persons for suspected insider trading (20 cases) with the public prosecutor's offices. 29 cases were discontinued because the investigations provided insufficient indications of insider trading.

BaFin opened 42 new investigations relating to suspected insider trading. At the end of 2007, 99 investigations (some from previous years) were still pending.



Table 20  
**Insider investigations**

Period	New investigations	Results of investigations			Pending investigations
		Discontinued	Referred to public prosecutor's offices		
	Insider	Insider	Cases	Persons	Total
2005	54	17	23	95	102
2006	51	23	24	106	106
2007	42	29	20	64	99

There were only three convictions for insider trading in 2007, all of these following summary proceedings. The prosecutor's offices discontinued 79 cases, 14 of these in out-of-court settlements against payment of a penalty. If a prosecutor informs BaFin that it intends to discontinue a case, the latter submits its opinion in writing. Pursuant to section 40a (1) WpHG, the prosecutor must hear BaFin if it intends to drop proceedings.

Table 21  
**Announcements by prosecutors concerning 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
2005	99	69	19	0	4	5	2
2006	71	42	17	0	6	5	1
2007	82	65	14	0	3	0	0

International co-operation in insider proceedings.

In the year under review, BaFin replied to 36 enquiries by foreign supervisory authorities concerning insider-related matters. Thus the trend of previous years continued (2006: 21; 2005: 14). Most of the enquiries came from the United Kingdom, France, the Netherlands and Belgium. BaFin itself enquired 83 times at foreign supervisory authorities (2006: 56; 2005: 100). By far the most enquiries went to Switzerland, followed by Austria and the UK.

In addition, BaFin exchanged information relating to current investigations during numerous conference calls with other supervisory authorities worldwide, e.g., in the United States, Canada, Hong Kong or Bermuda. On these occasions, the possibilities of obtaining information in the respective countries were also discussed.

Some of the cases closed in the reporting year are described below.

### **Henkel KGaA**

On February 5, 1999, Henkel KGaA issued an ad hoc announcement indicating its intention to spin off its chemical products segment into a legally independent business. This resulted in a considerable price increase in Henkel KGaA shares. The accused, a member of the consulting team of Henkel KGaA, instructed an asset manager in Switzerland to purchase 35,000 call options on Henkel KGaA shares beginning on February 1, 1999. On February 9, 1999, the asset manager sold the options again. This resulted in a profit for the accused amounting to approximately €120,000, corresponding to about DM 235,000 at the time of the offence.

The Frankfurt am Main Regional Court, having received the indictment at the beginning of February, discontinued proceedings on March 20, 2007 against payment of a €120,000 penalty pursuant to section 153a of the German Code of Criminal Procedure (Strafprozessordnung – StPO). Among other things, the court justified its decision to drop the case by stating that the offence had taken place almost seven years ago.

### **Plambeck Neue Energien AG**

On November 14, 2003, Plambeck Neue Energien AG published its financials for the third quarter of 2003. These showed total revenue of €59.5 million for the first nine months (prior year: €118.6 million) and EBITDA of €6.3 million (prior year: €12.3 million). Then, on March 29, 2004, the company stated in its 2003 annual report that some of its credit lines were set to expire on March 31, 2004 and that in March the usual extension discussions had been held with the banks. As a result, the price of the Plambeck share fell by 5.5%.

On November 5, 2003, one of the suspects, an employee with executive responsibilities at Plambeck Neue Energien AG, placed a sell order for the account of Plambeck Neue Energien AG for approximately 210,000 Plambeck shares. This order was executed at an average share price of €2.61 between November 5 and 12, 2003. The suspect thus avoided a loss of €44,100.

On November 12, 2003, the same suspect placed an order to sell additional large quantities of shares. A total of 383,256 shares were sold at an average price of €2.48 between November 12 and 19, 2003. The suspect thus avoided another loss, this time amounting to €61,320.96.

The suspect placed four more sell orders between November 24, 2003 and March 18, 2004. Overall, he was thus able to avoid a loss of €449,275.02.

The second suspect, also an employee with executive responsibilities at Plambeck Neue Energien AG, placed an order on November 19, 2003 to sell 70,000 Plambeck shares. Between

November 19 and 21, 2003, he sold a total of 70,249 shares at €2.44 each, thus avoiding a loss of €8,429.88.

The State prosecutor's office discontinued the proceedings against both suspects pursuant to section 153a (1) StPO, also taking into account additional alleged offences, upon payments by the suspects of €250,000 and €5,000 respectively.

### **Einbecker Brauhaus AG**

On April 15, 2005, Einbecker Brauhaus AG announced that its net profit had fallen from €2,398 million in the 2003 financial year to €819,000 in the 2004 financial year.

One day earlier, a board member of the company had authorised his bank to sell 65,000 shares at a price of approximately €1.228 million. On April 14, 2005, the order was executed in part only: 300 shares were sold at €18.90 each for a total of €5,670. The suspect thus avoided a loss of €570.

BaFin was alerted to the case by a suspicious activity report from the bank.

Upon payment of a penalty of €2,500, the Göttingen prosecutor's office discontinued proceedings pursuant to section 153a (1) StPO.

### **Infor business solutions AG**

On November 14, 2003, the Dutch company Agilisys B.V. announced its intention to extend to the shareholders of infor business solutions AG a voluntary public offer (cash offer) to purchase their shares at €4.25 for each non-par-value share. Agilisys B.V. had already presented a non-binding expression of interest in this respect in July of 2003. As a result, the price of the infor share doubled, and had nearly quadrupled by the time the final announcement was made.

In advance of the announcements, the executive director of a consulting company of infor business solutions AG had acquired a total of 26,083 infor shares for €78,401 via a foundation registered in Liechtenstein and a bank in Luxembourg. By selling the shares after the announcements, he made a profit of €28,106.

While the BaFin investigation was still ongoing, the managing director turned himself in to the prosecutor's office and confessed to part of the share dealings transacted via Liechtenstein. He had been informed of the BaFin enquiry by the Liechtenstein supervisory authority, the FMA. In Liechtenstein, the FMA gives customers of locally registered banks the opportunity to respond before it reveals their identity to BaFin. The Saarbrücken prosecutor's office discontinued proceedings against the accused pursuant to section 153a StPO against payment of a penalty of €30,000.

### **HBAG Real Estate AG**

On July 20, 1998, HBAG published an ad hoc disclosure to the effect that in the first half of 1998 it had achieved income from ordinary operating activities in the amount of DM 493,093. This figure was DM 162,796 in the prior year. In the days following the announcement, the price of HBAG shares rose by approximately 40%.

In advance of the announcement, a board member of HBAG had acquired 2,750 HBAG shares via two banks on behalf of various members of his family, for a total of DM 91,650.

On October 21, 2002, the Hamburg Local Court convicted the accused of seven cases of insider trading and imposed a fine totalling €7,800 (260 daily instalments of €30 each).

The same accused had come to the attention of the authorities in another case. In an ad hoc disclosure of April 12, 1999, WCM Beteiligungs- und Grundbesitz AG had announced its acquisition of a 100% holding in Cockerill Sambre Beteiligungsgesellschaft mbH. The accused had become aware of this before the announcement. Cockerill itself held 95% of YMOS AG at that time. Following the announcement by WCM Beteiligungs- und Grundbesitz AG, the price of YMOS shares rose by 170%.

The accused then bought for his own private securities account and those of his mother and his daughter 4,000 YMOS shares for a total of €67,000 via several banks. Between April and June 1999, he sold the majority of the shares again, thus achieving a profit of €50,718.

The Hamburg Local Court cleared the accused in this case. According to the court, the accused did have knowledge of a fact not in the public domain that, had it become known in public, could have had considerable effect on the share price. However, he had not obtained this information as a primary insider nor as part of his function.

The accused lodged an appeal against the HBAG decision, and the prosecutor's office against the YMOS decision. However, both sides withdrew their appeals in October 2007. Thus the rulings became final.

### **Kleindienst Datentechnik AG**

On March 18, 2004, Beta Systems Software AG announced that it had acquired 51.31% of the voting rights, and thus a controlling interest, in Kleindienst Datentechnik AG. Beta Systems AG simultaneously extended a mandatory takeover offer to the remaining outside shareholders of Kleindienst Datentechnik AG at €7.50 per share. The price of the Kleindienst share had already risen since January 2004, from €4.55 to €5.70 just before the announcement.

An employee with executive responsibilities at Beta Systems Software AG who was aware of the takeover negotiations instigated a third person to buy Kleindienst shares for him. Through a private securities account, this third person ordered 2,000 shares on March 9, 2004, and another 5,000 shares on March 16, 2004. Subsequently, on March 12, 2004, two purchases of 1,000 shares each were executed, at a price of €5.25 and €5.50 respectively. On March 18, 2004, the third person bought a further 2,363 shares at €5.70 each. On April 24, 2004, the person accepted the offer of Beta Systems Software AG of €7.50 per share and received a payment of €32,723. The employee thus made a profit of €8,503.

The Ulm Local Court convicted the accused via summary judgement of 22 December 2006 of insider trading and imposed a fine of €45,000 (90 daily instalments of €500 each). The summary judgement became legally effective in 2007.

### **Silicon Sensor International AG**

On July 31, 2001, Silicon Sensor International AG announced ad hoc that it had received a large order that would increase its order book by 50%. On August 2, 2001, the company then announced that its revenues for the first half of 2001 had increased by 117%, to €5 million, and EBITDA by 606%, from €120 to €848. As a result of the announcement concerning the large order, the share price rose from €3.17 to €3.80; the publication of the half-yearly figures then resulted in another increase, from €3.20 to €4.82.

Shortly before the public announcements, two board members of Silicon Sensor AG had bought 2,000 and 3,000 Silicon shares respectively, at €3 and €3.10 respectively, making a profit of €4,800 and €3,400 respectively.

The Berlin-Tiergarten Local Court convicted both accused by summary judgement of March 2007 of insider trading and imposed a fine of €13,500 each (90 daily instalments of €150 each). The summary judgements became legally effective in 2007.

## **4.3 Market manipulation**

In 2007, BaFin opened 61 new investigations. Some of these were triggered by positive internal analyses, a large part by reports from the trading surveillance offices of the German stock exchanges. They frequently involved trade-based manipulation such as bogus transactions and reference price manipulation. 20 investigations were initiated the prosecuting authorities, with subsequent involvement of BaFin. Ten investigations were based on suspicious activity reports by the institutions.

In the year under review, BaFin discontinued 41 investigations. In 22 cases, the investigations produced evidence of criminal market manipulation. BaFin thus reported 49 suspects to the appropriate

61 new investigations on suspicion of market manipulation.

BaFin filed complaints against 49 persons for suspected market manipulation.

public prosecutor's offices. Some of the suspects figured in several cases of manipulation. Four investigations (involving eight persons) gave reason to suspect attempted manipulation. In these cases, BaFin initiated administrative fine proceedings. At the end of the year, 97 investigations were still pending.

Table 22

**Market manipulation investigations**

Period	New investigations	Discontinued	Results of investigations					Pending investigations
			Referred to public prosecutor's offices (PP) or BaFin administrative fines section (AFS)					
			PP		AFS		Total (Cases)	Total
			Cases	Persons	Cases	Persons		
2005	53	13	11	20	1	1	12	93
2006	60	30	15	38	5	6	20	103
2007	61	41	22	49	4	8	26	97

● Focus: Phishing.

Among other things, the investigations focused on market manipulation through so-called phishing. Phishing involves the attempt to obtain sensitive data such as user names and passwords for online banking or online brokerage, by using forged electronic messages. Phishing messages are usually sent via e-mail or instant messaging. They ask the recipient to disclose confidential access data on a prepared Web site or over the telephone.

The access data obtained in a phishing attack are used to place securities orders in the private securities accounts of the victims, driving up market prices. The perpetrators place simultaneous offsetting sell orders to sell their own shares at these inflated prices. This form of manipulation is especially common in illiquid OTC instruments.

These investigations were frequently triggered through suspicious activity reports by the affected banks or enquiries by law enforcement agencies.

● Prosecution of manipulatory cold IPOs.

Emphasis was also placed on so-called "cold IPOs". A cold IPO is a public offering in which the operations of an unlisted company are brought into a listed shell company that has no operations. First the majority of the shares of the shell company are acquired. Then a shareholders' meeting is held and a resolution to increase capital by contribution in kind (the business of the buyer) is passed. At the same time, the articles of the shell company are amended to reflect the new object of the company and, if necessary, the name is changed too. A company assuming the identity of an already listed company in this way can avoid the bureaucratic effort connected with admission to an exchange.

In general, cold IPOs are legal. But it constitutes market manipulation if the impression is created through false information that a listed shell company is being revived when no such revival is ever intended. The announcement that a listed shell company is

to be revived regularly leads to a significant price increase; in the end, failure of the revitalisation plans is announced, giving only the flimsiest of reasons.

● Four convictions for market manipulation.

In 2007, the courts rendered guilty verdicts for market manipulation in two cases after full proceedings. They also issued two summary judgements. A further case involved breach of trust in addition to market manipulation. Here the court only prosecuted the breach of trust offence. The public prosecutors discontinued proceedings against eleven suspects.

In the year under review, BaFin opened five administrative fine proceedings for attempted market manipulation. Six administrative fine proceedings were still pending from the prior year. Three cases were discontinued, applying the principle of discretionary prosecution. At the end of the year, eight proceedings were still pending.

Table 23

**Reports by the prosecutor's offices, the courts and the internal administrative fines section concerning closed market manipulation proceedings**

Period	Total	Decisions of public prosecutors		Final court decisions in criminal proceedings				Decisions in administrative fine proceedings	
		Discontinued	Discontinued after out-of-court settlement	Convictions by the court	Convictions following summary proceedings	Convictions following full trial	Acquittals	Discontinued	Final administrative fines
2005	17	8	3	0	0	3	0	2	1
2006	15	6	4	0	3	1	0	0	1
2007	18	11	0	0	2	2	0	3	0

● Increase in cross-border manipulation.

In 2007, there were 18 instances of foreign supervisory authorities requesting support from BaFin in market manipulation investigations. In 42 cases, BaFin approached foreign authorities, which is more than twice as often as in the prior year (19). These enquiries mostly involved data of customers who had raised suspicious trading on a German exchange via a foreign institution. The figures show an increase in the number of cases of cross-border manipulation into the German market.

Below are descriptions of selected cases closed in 2007 where BaFin investigated with regard to market manipulation.

**Call option on ABN Amro shares**

Between October and November 2005, one German and one Polish private investor traded a very illiquid option on the Stuttgart EUWAX exchange, and on the Frankfurt Stock Exchange. Through co-ordinated buy and sell orders they created artificial market prices in 115 cases. Here they took advantage of the comparatively wide bid-ask spread of the option. Following a

systematic, repetitive pattern, the two investors first executed a buy transaction on the EUWAX at the low bid price, then sold shortly afterwards at the higher bid price on the Frankfurt stock exchange. They only traded with each other. No other market participants were involved in the deals. Due to the wide spread, they made a profit of €148,482 in one private securities account to the detriment of the other private securities account.

On April 26, 2007, the Berlin-Tiergarten Local Court convicted the two private investors for market manipulation, imposing fines of €6,000 (120 daily instalments of €50 each) and €7,500 (150 daily instalments of €50) respectively. Following the appeal of the German investor, the court reduced his fine from €7,500 to €4,500 (90 daily instalments of €50 each). Both decisions are final.

### **BNP**

In 2003 and 2004, an employee of an asset management company executed a total of 229 exchange transactions. In each case, he co-ordinated a private order with one for an asset-management customer. For this purpose, he had opened a joint private securities account with his wife at a direct bank. In breach of his duty to safeguard his customers' assets, he placed orders in their names at the Stuttgart and Frankfurt stock exchanges that corresponded with his privately placed orders and were accordingly matched up for transactions at the respective stock exchange. The asset manager thus made a profit of at least €111,412 to the detriment of his customers.

The Nuremberg Local Court convicted the asset manager, who admitted the offence, for breach of trust and sentenced him to two years imprisonment. The sentence was suspended.

### **Eurex put options on the DAX**

In September 2002, the managing director of two securities trading firms placed exactly matched offsetting orders for each of the proprietary trading accounts of the firms – so-called cross trades – for put options at the Eurex futures exchange that deviated substantially from the fair value. Eurex requires the submission of a cross request, a notice of an intended cross trade; this the executive did not do in order to ensure that his orders would not be matched with those of third-party market participants. The experienced derivatives trader thus ensured that his limit orders would be executed against each other, creating prices on the exchange that were alien to the real market. He then closed the positions he had entered into for the firms against his private securities account at a profit, again using exactly matched orders. The profit made by the trader in his private account and in the proprietary trading account of the one securities trading firm totalled €270,000, to the detriment of the other securities firm, which incurred a corresponding loss.



The Munich Local Court convicted the accused of market manipulation, imposing a suspended sentence of nine months' imprisonment as well as a fine of €9,000 (90 daily instalments of €100 each). Proceedings for alleged breach of trust were discontinued pursuant to section 154 (2) StPO.

### **Arndt AG**

On November 28, 2006, the user of an Internet forum disseminated a forged ad hoc disclosure purporting that the administrator for Arndt AG had submitted an insolvency plan and that the company was to emerge from insolvency and resume operations. This was to involve a company already established in the marketplace. As a result of the false report, the market price of the (very illiquid) Arndt share experienced increased trading volume and rose by more than 30% on the Frankfurt Stock Exchange.

On May 4, 2007, the Frankfurt prosecutor's office discontinued the proceedings against person(s) unknown because the author of the Internet publication could not be identified through the Internet provider. The provider only stores traffic data as long and insofar as they are needed for billing purposes. However, this was not the case here because the IP address used was based on a flat-rate contract.

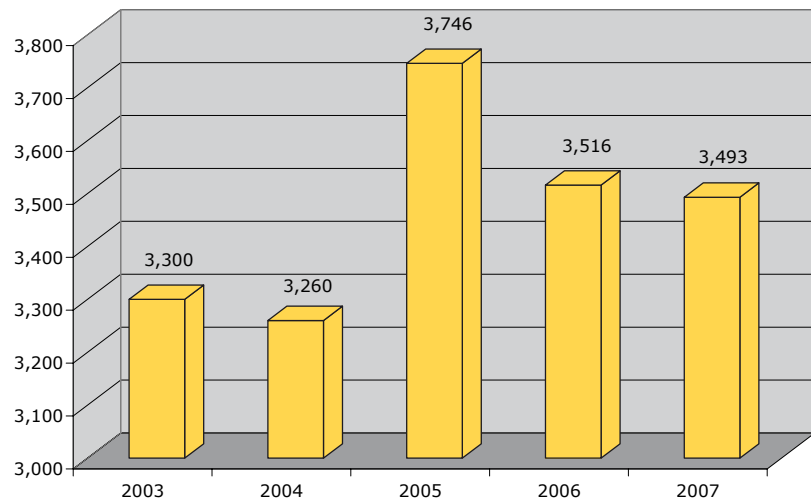
## **4.4 Ad hoc disclosure and directors' dealings**

### **Ad hoc disclosure**

In the year under review, listed companies published insider information ad hoc on 3,493 occasions (2006: 3,516). They are obligated to do so whenever there are new circumstances within their business area that are not publicly known, could affect the price of the financial instrument, and directly affect the company.

Listed companies published 3,493 ad hoc disclosures.

Figure 31

**Ad hoc disclosures from 2003 to 2007**

- German ad hoc disclosure requirement now only applies to domestic issuers.

Since the TUG came into effect in January 2007, the German ad hoc disclosure requirement now only applies to so-called domestic issuers. A large number of companies from other EU member states are thus no longer subject to disclosure requirements in Germany.

Generally, a domestic issuer is

- every issuer whose country of origin is Germany;
- every issuer whose country of origin is another EU member state, if its securities are admitted to public trading only in Germany on an organised market.

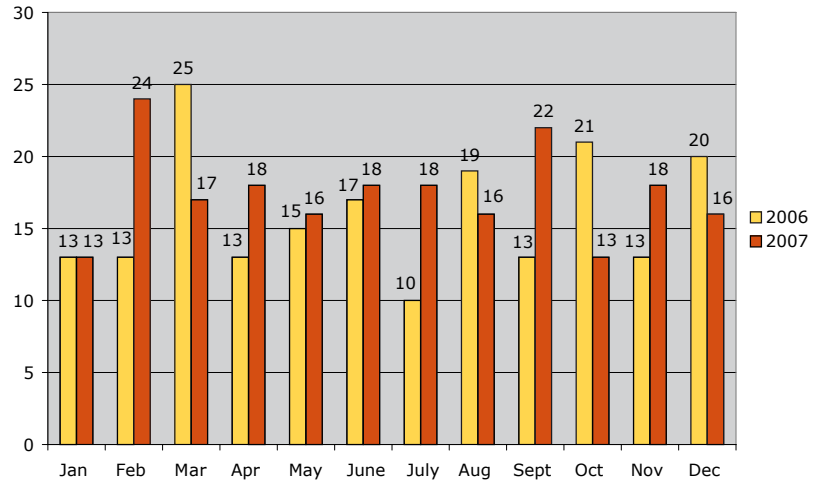
If a company's country of origin is Germany but its securities are admitted for trading in an organised market exclusively in another EU/EEA member state, such a company is not considered to be a domestic issuer.

- 209 exemptions from ad hoc disclosure requirement.

Listed companies may exempt themselves from the ad hoc disclosure requirement if it is necessary in order to protect their legitimate interests, to safeguard the confidentiality of the information, and if there is no danger that the general public may be misled. In 2007, companies availed of this option in 209 cases (2006: 192). They did so mainly in cases involving multi-stage decision-making processes and company takeovers. In multi-stage decision-making processes, the exemption usually lasts until a decision has been made by the supervisory board so as not to prejudice this decision.

Following each exemption, BaFin examines whether the preconditions for such an exemption had actually been present. This was the case in most instances. If a company had exempted itself from its obligation to publish information without meeting the preconditions, BaFin investigated the case and examined whether an administrative fine should be imposed.

Figure 32  
Exemptions in 2006 and 2007



Seven administrative fines for breaches of the ad hoc disclosure requirement.

In 2007, BaFin imposed seven administrative fines of up to €30,000 for failing to disclose insider information, failing to disclose insider information in time or incomplete disclosure of insider information. The supervisory authority discontinued 15 administrative fine proceedings, nine of these due to a lack of public interest. At the end of the year, 52 proceedings were still pending.

BaFin opened a total of eight new proceedings. 66 administrative fine proceedings were still pending from the prior year.

**Directors’ dealings**

Directors’ dealings continue to decrease.

In the year under review, directors and executives of listed companies published 4,603 (2006: 4,687) dealings in shares of their own company. BaFin presents an overview of all reported transactions on its Web site.<sup>71</sup>

The number of directors’ dealings reports fell for the second year in a row. This is due to the fact that those involved now have more practice with the reporting requirements. Notifying parties are also increasingly submitting just one notification at an average price for all dealings conducted on a single day.

New publication procedure.

Since the TUG came into effect, only domestic issuers are subject to directors’ dealings disclosure requirements (as is the case for ad hoc disclosures). The publication procedure has also changed: When a listed company receives a notification from a company insider it must immediately send it to a so-called media bundle. A media bundle consists of at least one electronically-operated system for disseminating information, one news agency, one news provider, one print medium, and one Internet page for the financial market.

<sup>71</sup> www.bafin.de » Databases & lists.

Here the companies must ensure that at least one medium is suited for disseminating the report throughout the entire EU/EEA. Another innovation is that, immediately after publication, the listed company must send the report to the company register.

Ten administrative fines for breaches of the directors' dealings reporting requirement.

In the year under review, BaFin imposed ten administrative fines for breaches of the reporting requirements of section 15a WpHG. Five new proceedings were initiated. 24 proceedings were still pending from the prior year. Ten proceedings were discontinued applying the principle of discretionary prosecution. At the end of the year, nine proceedings were still pending.

#### 4.5 Voting rights and obligations subsequent to stock exchange admission

TUG doubles voting rights reports.

In 2007, BaFin received 9,135 notifications reporting changes in voting rights, more than twice as many as in the prior year (4,178). This is due mainly to the fact that the reporting threshold has been lowered to 3%. Before the TUG entered into force, it had been 5%. Additional thresholds were also introduced at 15%, 20% and 30%. Furthermore, there now is also a requirement to report trading portfolio holdings at a threshold of 5%.

Besides voting rights, companies must now also report ownership of certain financial instruments that can be used to acquire shares. BaFin received 23 such reports concerning financial instruments. Here the reporting threshold is 5%.

As of January 2007, listed companies are obligated to report changes in their share capital with voting rights. If there is a change in the total number of voting rights, e.g., due to corporate actions (issuing of new shares within option programmes or cancellation of own shares), this must be disclosed transparently at the end of the relevant month. In 2007, listed companies reported 559 such instances.

BaFin is now also setting higher standards for the content of voting rights reports. The report must now have the explicit heading "Voting Rights Report". Those subject to the reporting requirements must also quote the absolute number of voting rights held. If a chain of natural and legal persons holds shares in the listed company, this chain must be disclosed.

Changes in voting rights must also be reported more quickly. Whereas a shareholder used to have a maximum of seven days to report, this public disclosure must now take place within four business days. The time limit for disclosure has been reduced from nine calendar days to three trading days. BaFin has published a

calendar of trading days on its Web site.<sup>72</sup> Immediately following publication of the report, the listed company must send it to the electronic company register.

As in the prior year, BaFin organised a work shop to familiarise market participants with the new regulations. While the focal point in 2006 was preparation for the new rules, the 2007 workshop was dominated by first experiences. Initially, those subject to reporting obligations had difficulties with the new requirements relating to form and content, such as the chain of custody, and with the changed attribution rules.

The supervisory authority also published a standardised notification form.<sup>73</sup> The standardised form should make reporting easier and help prevent frequent past mistakes. The BaFin standardised notification form is based on one drafted by CESR and recommended by the European Commission.

● Reporting requirements for REITs.

As they are listed investment companies, REITs are subject to the reporting requirements pursuant to sections 21 et seq. WpHG. However, the REIT Act, which came into effect in 2007, provides for two further reporting thresholds in addition to those of the WpHG, at 80 and 85%. Moreover, REITs may not have a free float of less than 15% and one shareholder may not directly own 10% or more of REIT shares. As of 31 December of every year, a REIT must inform BaFin of the free-float percentage of its shareholders. If a report shows that the minimum free float fell below 15%, BaFin passes this information to the German Federal Tax Office. In the year under review, two REITs were listed on German stock exchanges.

● 1,045 listed companies.

The number of issuers admitted for trading on a regulated market rose in the reporting year to 1,045 (2006: 1,019). Of these, 524 issuers (2006: 505) were listed on the official market and 521 on the regulated market (2006: 514). With the FRUG entering into force, the subdivision of the organised markets into official and regulated markets has been abolished.

● Eleven administrative fines for breaches of reporting requirements.

In 2007, BaFin initiated 29 proceedings for failure to report or disclose, failure to report or disclose in time or incomplete reports or disclosures. In eleven cases, it imposed administrative fines of up to €15,000. 37 proceedings were still pending from previous years. The supervisory authority discontinued 17 proceedings, 15 of these due to a lack of public interest. At the end of 2007, 38 proceedings were still pending.

<sup>72</sup> [www.bafin.de](http://www.bafin.de) » Companies » Listed companies » Major holdings of voting rights » Calendar of trading days.

<sup>73</sup> [www.bafin.de](http://www.bafin.de) » Companies » Listed companies » Major holdings of voting rights » Sample text for notifications and publications.

### Obligations subsequent to stock exchange admission

Since TUG has entered into force, BaFin supervises obligations subsequent to stock exchange admission (sections 30a-g WpHG). This had previously been the responsibility of stock exchange admission authorities. The information requirements formerly regulated in the Stock Exchange Admission Regulation (Börsenzulassungsverordnung – BörsenZulVO) have become part of sections 30a-g WpHG and were supplemented with additional requirements resulting from the Transparency Directive.

Accordingly, issuers of admitted securities must report their intention to change the legal basis. For example, if the shareholders' meeting is presented with changed articles and bylaws, this must be reported. In the year under review, BaFin received 606 such reports pursuant to section 30c WpHG.

Issuers must also report if rights associated with admitted securities change, if funds are borrowed and if important information was published in third countries. In 2007, BaFin received approximately 15,000 reports pursuant to section 30e WpHG; most of these concerned the issuing of bonds.

The BaFin Web site contains frequently asked questions on this topic.<sup>74</sup>

## 5 Company takeovers

Consistently strong takeover market.

Regardless of the negative developments in the financial markets during the second half of the year, the number of takeover bid procedures increased significantly in 2007. A total of 48 takeover bids (2006: 39) were submitted to BaFin, 22 of these in the second half of the year (2006: 19). However, the increase in offers was not as steep in the second half of the year as in the first half. BaFin ensures that the bid procedures in company takeovers are transparent and concluded quickly, and that all shareholders are treated equally.

### 5.1. Takeover bid procedures

BaFin approved 47 offer documents.

In the reporting year, BaFin reviewed 48 offer documents and approved publication in 47 cases (2006: 37) In one case it prohibited the takeover bid. In two other cases, bidders had not properly published their decision to make a takeover bid and had not submitted the required offer documents to BaFin. Therefore, the supervisory authority prohibited these bids as well.

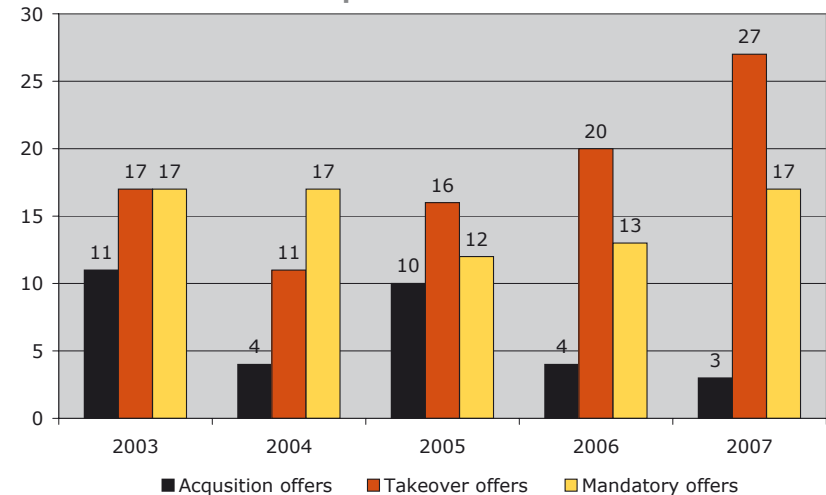
<sup>74</sup> [www.bafin.de](http://www.bafin.de) » Companies » Listed companies » Major holdings of voting rights.

17 were mandatory offers: a shareholder must make an offer if it has acquired 30% or more of the voting rights in a target company and has thus acquired control. A further 27 procedures involved takeover bids by which bidders who were not yet in a controlling position were attempting to acquire control. Three bids were ordinary offers to buy. These are offers where the bidder either wishes to acquire shares in the target company without acquiring control, or where the bidder already has control and wishes to increase his interest.

The published offer documents can be viewed on the BaFin Web site.<sup>75</sup>

Figure 33

### Number of takeover bid procedures



Transaction volumes.

As in previous years, the transaction volume<sup>76</sup> of most takeover bids did not exceed €100 million. The mandatory offer of Dr. Ing. h.c. F. Porsche AG to the shareholders of Volkswagen AG, with a volume of just over €27.8 billion, was the procedure with the largest transaction volume since the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG) entered into force. Other procedures with high transaction volumes were the offers of Lavena Holding 4 GmbH to the shareholders of ProSiebenSat.1 Media AG (€5.8 billion), of SAPARDIS S.A. to the shareholders of PUMA AG Rudolf Dassler Sport (€3.9 billion), and of Red & Black Lux S.à r.l. to the shareholders of Hugo Boss AG (€3.2 billion). The offer with the lowest volume was that of BPRE Biopower Renewable Energy, Inc., to the shareholders of a.i.s. AG (€0.5 million).

Bulletin on section 35 (3) WpÜG.

In July 2007, BaFin published a bulletin on the interpretation of section 35 (3) WpÜG.<sup>77</sup> According to this regulation, a bidder who acquires control through a takeover bid does not have to make

<sup>75</sup> www.bafin.de » Companies » Listed companies » Company takeovers.

<sup>76</sup> The transaction volume is calculated by multiplying the number of shares to be acquired by the bidder by the price per share offered by the bidder in the bid procedure. Ancillary transaction costs are then added to this amount.

<sup>77</sup> www.bafin.de » Service » Publications » Bulletins.

a mandatory offer. The reason for this privileged treatment: The shareholders of a target company must be offered a disinvestment decision only once, and this requirement can also be met by a takeover bid. This is because the minimum standards for takeover bids and mandatory offers are for the most part identical, especially the requirements regarding the offer price. Therefore, shareholders would not gain any material advantage from an additional offer; the bidder, however, would be disadvantaged by an additional offer procedure. The bulletin explains BaFin administrative practice and the most relevant scenarios.

In the year under review, the supervisory authority focused on several takeover bids that also created considerable public interest.

### **Bidding war for Techem AG**

At the end of 2006, MEIF II Energie Beteiligungen GmbH & Co. KG ("MEIF"), owned by the Australian banking group Macquarie Bank, and Heat Beteiligungs III GmbH ("Heat"), owned by the UK investment company BC Partners, had published and made two competing takeover offers to the shareholders of Techem AG.

● Mutual outbidding through parallel acquisitions.

MEIF in its takeover bid (originally valid up to December 21, 2006) offered €44 per Techem share, while Heat promised the shareholders €52. In the case of competing offers, the acceptance period of the first offer is governed by that of the second offer (section 22 (2) WpÜG). Since the acceptance deadline of the Heat takeover bid was January 15, 2007, the acceptance period of the MEIF takeover bid was also extended up to this date. Both offers were subject to several conditions, especially a minimum acceptance threshold.

On December 13, 2006, MEIF acquired Techem shares outside of the offer at €55. Accordingly, the takeover bid of MEIF was also raised to €55 (section 31 (4) in combination with section 31 (6) sentence 1 WpÜG). Furthermore, shortly before the acceptance deadline MEIF, waived one of the offer conditions, but not the minimum acceptance threshold. That extended the acceptance period of the MEIF takeover bid by two weeks to January 29, 2007 (section 21 (5) WpÜG).

● Acceptance periods for competing offers synchronised.

Opinions were divided as to whether this meant that the second offer by Heat would also be automatically extended. WpÜG only states explicitly that the acceptance period of the first offer is dependent on the acceptance period of the second (competing) offer. This also applies if the second offer is changed. However, in the bidding war over Techem AG the first offer was changed. BaFin ruled that in this case, too, the acceptance periods of both offers must be synchronised and the extension of one offer leads to an extension of the other offer.



- Changes in one offer result in withdrawal rights with respect to both offers.

BaFin further ruled that, in extension of the wording of section 21 (4) WpÜG, the right to withdrawal resulting from changes in an offer not only applies to those shareholders who accepted the changed offer, but also those shareholders who decided in favour of the competing offer. Combined with the synchronisation of acceptance periods, this interpretation thus ensures a fair and, especially for the shareholders of the target company, transparent procedure in the case of competing offers.

- Third takeover bid for Techem AG successful.

However, both takeover bids failed because of the minimum acceptance threshold. In November 2007, MEIF therefore published and made a new takeover offer to the shareholders of Techem AG, at €60 per share. This was possible despite the general lock-out period since Techem AG had given the required consent and BaFin had granted an exemption (section 26 WpÜG). At the end of the additional acceptance period, the bidder and the persons acting in concert with the bidder had acquired more than 96% of the voting rights in Techem AG.

- No withdrawal rights if the offer price is increased due to parallel acquisitions.

### **Bidding war for REpower Systems AG**

In the spring of 2007, the bidding war between Société des Participations du Commissariat à l'Énergie Atomique ("AREVA") and Suzlon Windenergie GmbH ("Suzlon") for REpower Systems AG ("REpower") created much public interest. Using parallel acquisitions, both companies repeatedly outbid each other, thus increasing the offer price of €105 first to €126 and then to €140 (AREVA) and to €150 (Suzlon) per REpower share.

As a rule, the privately-autonomous increase of the offer price constitutes a change in the offer (section 21 (1) sentence 1 no. 1 WpÜG). As a consequence, the shareholders who have already accepted the offer have the right of withdrawal (section 21 (4) WpÜG). However, if a bidder, after publication of the offer documents and before the result is published at the end of the acceptance period, acquires shares in the target company at a higher price than that offered initially, the offer price increases under the law (section 31 (4) WpÜG). This does not constitute a privately-autonomous increase within the meaning of section 21 WpÜG. In the case of the competing offers, the result was that the shareholders who had already accepted the lower offer were committed to their declaration of acceptance and were no longer free to accept the higher offer.

- No disadvantage for shareholders due to agreement between the bidders.

Before the end of the additional acceptance period, however, both bidders agreed to co-operate with respect to REpower. As a result of this agreement, the each of the two competing bidders became a person acting in concert with the respective other bidder. Thus shareholders who had accepted the lower offer from AREVA also received the higher price of €150 offered by Suzlon.

### **Mandatory offer of Dr. Ing. h.c. F. Porsche AG for Volkswagen AG**

VW Act does not prevent acquisition of control.

The WpÜG provides that the party that acquires control of a target company must submit a mandatory offer to the remaining shareholders (section 35 (2) WpÜG). Having control means holding at least 30% of the voting rights in the target company (section 29 (2) WpÜG). By the end of March 2007, Dr. Ing. h.c. F. Porsche AG (Porsche) had acquired just under 31% of the ordinary shares of Volkswagen AG ("VW"). But regarding the mandatory offer by Porsche AG to the shareholders of Volkswagen AG, the question arose whether Porsche through its holding of 30% of the shares had acquired control of VW. The VW Act restricts the voting rights of a shareholder to a maximum of 20% even if it holds an ownership interest in excess of 20%. Under the WpÜG, on the other hand, only the holding of shares is relevant for the acquisition of control, i.e., the ownership under civil law of the shares that convey voting rights (section 29 (2) WpÜG). The VW Act constitutes only a temporary obstacle to the exercise of voting rights. It does not affect civil-law ownership and the general granting of voting rights with regard to ordinary shares. In October 2007, the European Court of Justice ruled that the restrictions of voting rights to a maximum of 20% under the VW Act violated EU law.<sup>78</sup>

### **Takeover offer of the acquisition company of S-Finanzgruppe mbH & Co. KG to the shareholders of Landesbank Berlin Holding AG**

Decision on the submission of a takeover bid with simultaneous application for exemption.

In the bidding procedure involving the holding of the state of Berlin in Landesbank Berlin Holding AG ("LBBH"), the acquisition company of S-Finanzgruppe mbH & Co. KG ("S-Finanzgruppe") had been successful. Signature of the acquisition agreement with the state of Berlin meant that the acquisition of control of LBBH was imminent. In connection with the approval of restructuring subsidies granted by the state of Berlin to LBBH (then Bankgesellschaft Berlin AG) in 2001, the European Commission in February 2004 had imposed the condition that the state of Berlin submit a mandatory offer. Against this backdrop, S-Finanzgruppe applied to BaFin at the beginning of June 2007 for exemption from the obligation to submit a mandatory offer. S-Finanzgruppe argued that, in its opinion, exemption was justified taking into account the way control had been acquired and the underlying intentions pursued with the acquisition of control (section 37 WpÜG; section 9 sentence 1 no. 3 of the Ordinance on Offers under the WpÜG (WpÜG-Angebotsverordnung – WpÜG-AngV)). Accordingly, S-Finanzgruppe, among other things, declared that its decision to submit a voluntary bid, published before acquiring control of LBBH, was subject to the resolute condition that S-Finanzgruppe would be exempted from submitting a mandatory offer.

<sup>78</sup> Case: ECJ, C-112/05.

● Application for exemption rejected.

However, exemption from the obligation to submit a mandatory offer was not considered. In particular, there was no reason to grant an exemption based on the actual circumstances that characterised the way control had been acquired. The state of Berlin, not S-Finanzgruppe, was responsible for meeting the conditions of the European Commission. Thus the acquisition of control was not to be regarded as a government-enforced acquisition by S-Finanzgruppe. Furthermore, the fact that LBBH had been allowed to keep the subsidies did not constitute a quantifiable value for the minority shareholders of LBBH because the state of Berlin had several alternatives for selling its holding in LBBH, and the risk that repayment of the state subsidies would be demanded was slight and only hypothetical. Consequently, S-Finanzgruppe went ahead with the bid.

## 5.2 Squeeze-out under takeover law

### **Squeeze-out under takeover law**

In a squeeze-out under takeover law (section 39a WpÜG), introduced through the Act Implementing the Takeover Directive of July 8, 2006, a bidder can exclude all the remaining shareholders of a company if, as a result of a takeover bid or a mandatory offer, the bidder holds 95% of the share capital of the target company. If the bidder only owns 95% of the share capital with voting rights at the time, it can only exclude the remaining shareholders with voting rights. Preferred stock holders cannot be excluded. One difference between a squeeze-out under takeover law and a squeeze-out under stock corporation law (sections 327a et seq. AktG) lies in the assumption provision of section 39a (3) sentence 3 WpÜG: If the preceding takeover bid or mandatory offer has been accepted for more than 90% of the shares covered by the bid, the offer price is considered as adequate settlement for the squeeze-out under takeover law. In the squeeze-out under stock corporation law, the settlement amount for the transfer of shares to the main shareholder must generally be determined by means of an elaborate valuation of the company.

● Squeeze-out under takeover law at Müller Weingarten AG.

2007 saw the first case of a company executing a squeeze-out under takeover law. Following the conclusion of a mandatory offer, Schuler AG owned approximately 96.50% of the capital stock and voting rights of Müller Weingarten AG. A ruling by the Frankfurt am Main Regional Court resulted in all the shares of Müller Weingarten AG not yet owned by Schuler AG being transferred to Schuler AG in return for a settlement amounting to the offer price of the mandatory offer (€15.74 per share).<sup>79</sup>

<sup>79</sup> Case: 3-5 O 138/07.

### 5.3 Prohibitions

Suspension of calculation does not affect admission to a stock exchange.

In 2007, BaFin prohibited two offers because the bidders had not complied with the requirements of the WpÜG. These concerned two offers for shares of condomi AG. Through publication in the electronic Federal Gazette, EO Investors GmbH and the stock corporation TOKUGAWA had made an offer to the shareholders of condomi AG to buy up to a certain number of condomi AG shares at a fixed price. The shares of condomi AG are admitted for trading on the regulated market of the Frankfurt Stock Exchange. Quotation of the stock was suspended indefinitely on February 20, 2007.

This suspension notwithstanding, condomi AG is still a target company subject to the WpÜG, the reason being that a suspension of quotation does not constitute termination of admission to the exchange. Since both offers had been published electronically without in any way observing the provisions of WpÜG, BaFin prohibited the offers (sections 15, 4 WpÜG). As a consequence, all legal transactions based on the prohibited offers are null and void (section 15 (3) sentence 2 WpÜG).

### 5.4 Exemption procedures

BaFin received 230 applications for exemption.

BaFin received 230 applications for exemption from obligations under section 35 WpÜG in acquiring control of a target company (sections 36, 37 WpÜG). In 126 cases, holders of voting rights applied for their voting rights not to be taken into account in accordance with section 36 WpÜG; 104 cases were exemption applications in accordance with section 37 WpÜG. The reason for the significant decrease in exemption applications (2006: 663) was the particularly large number of applications under section 37 WpÜG: In 2006, the Act Implementing the Takeover Directive had temporarily led to a change in the attribution of voting rights of subsidiaries, which resulted in group-wide attribution of controlling positions.<sup>80</sup> The TUG restored the legal environment that had been in place up to the introduction of the Act Implementing the Takeover Directive. In the meantime, all application procedures from 2006 and 2007 involving the changed attribution standard have been closed, with nearly all the applications having been withdrawn.

BaFin approved 58 applications and rejected one application. In 125 cases, applicants withdrew their applications; at the end of 2007, 46 applications were still pending.

Internal group restructuring still main application of section 36 WpÜG.

As in previous years, most applications under section 36 WpÜG related to acquisition of control due to internal group restructuring, two applications involved inheritance or family law issues.

<sup>80</sup> 2006 Annual Report of BaFin, p. 185.

● Reorganisation exemption main application of section 37 WpÜG.

Most of the applications under section 37 WpÜG concerned the reorganisation of the target company (section 9 sentence 1 no. 3 WpÜG-AngV), the inclusion as an underwriting investment bank in a capital increase or IPO (section 37 (1), alternative 1, WpÜG) and the so-called book-value clause (section 9 sentence 2 no. 3 WpÜG-AngV).

● Revocation of exemption approvals in the cases of Pandatel AG and Intertainment AG.

In 2007, BaFin revoked two exemptions it had granted in relation to the reorganisation of target companies. One of these was the exemption of Dowlake Venture Limited, which had not implemented important reorganisation measures at Pandatel AG. This resulted in the obligation to submit a mandatory offer, which took place in September/October 2007. In the other case, BaFin revoked the exemption of Kinowelt GmbH and MK Medien Beteiligungs GmbH. Here the initially exempted applicants declared that they waived their right to exemption because important reorganisation measures at Intertainment AG could not be implemented in the short term. The mandatory offer was announced in December 2007.

● Applicant determines which cause for exemption is to be examined.

In May 2007, Salzgitter AG and Salzgitter Mannesmann GmbH applied for exemption from the obligation to submit a mandatory offer to the shareholders of RSE Grundbesitz und Beteiligungs-AG because they intended to exclude the remaining shareholders in a squeeze-out under stock corporation law (sections 327a et seq. AktG). BaFin granted the exemption on condition that the shareholders be paid a cash settlement of €11.66 per share in the course of the squeeze-out. Salzgitter AG and Salzgitter Mannesmann GmbH appealed against this condition. They no longer cited the intended squeeze-out as the main cause for exemption, but instead the reorganisation of RSE Grundbesitz und Beteiligungs-AG. The companies now also provided proof of the preconditions for reorganisation exemption. In view of this, BaFin waived the condition.

Notwithstanding BaFin's discretion in its decision-making, applicants are free to decide which cause for exemption they cite. In the applicants' view, a reorganisation exemption involved fewer complications than an exemption based on the squeeze-out, and should thus be given priority. As a consequence, BaFin changed the exemption notice that had been appealed so that it stated the new cause for exemption. The appeal procedure was thus concluded.

## 5.5 Administrative fine proceedings

● 20 new administrative fine proceedings initiated.

In 2007, BaFin initiated 20 new administrative fine proceedings for possible WpÜG violations. Two administrative fine proceedings relate to the prohibition of bids due to failure to comply with the WpÜG. 18 proceedings were still pending from previous years. In three cases, BaFin imposed administrative fines of up to €30,000. Ten proceedings were discontinued during the reporting year, six of these due to a lack of public interest. At the end of the year under review, 25 proceedings were still pending.

## 6 Financial reporting enforcement

### 6.1 Monitoring of corporate financial statements

1,075 companies subject to financial reporting enforcement.

At the end of 2007, 1,075 companies from 22 countries were subject to financial reporting enforcement.<sup>81</sup> The following table shows enforcement by country.

Table 24  
Enforcement by country

Germany	870
Netherlands	41
United States	30
Jersey	28
Austria	20
Switzerland	14
United Kingdom	13
Japan	10
France	9
Israel	8
Luxembourg	8
Ireland	4
Spain	4
Italy	3
Cayman Islands	2
Finland	2
Guernsey	2
Canada	2
Norway	2
Australia	1
Iceland	1
South Africa	1
<b>Total</b>	<b>1,075</b>

In a two-tier enforcement procedure, the German Financial Reporting Enforcement Panel (FREP) and BaFin examine the financial statements of companies whose securities are admitted for trading in Germany on the regulated market. The FREP initially conducts random examinations and, if there are specific indications of infringement of financial reporting requirements or at the request of BaFin, it conducts targeted examinations of the legality of the most recently adopted individual annual financial statements or the approved consolidated financial statements including the appropriate management reports. Since the TUG entered into force in 2007, the examination also comprises the most recently published set of condensed financial statements and interim

<sup>81</sup> [www.bafin.de](http://www.bafin.de) » Databases & lists.

management report, but only in specific cases. If a company does not participate willingly in the examination or does not agree with the findings of the examination or if there are substantial doubts about whether the findings of the examination are correct or whether the examination was conducted properly, BaFin comes in at the second level. It can take sovereign measures, e.g., order the company to publish the error identified.<sup>82</sup>

The 1,075 companies comprised 870 German companies, 151 companies from other European countries (104 of these from EU member states) and 54 companies from eight non-European countries. The accounting standards to be examined range from the German HGB through IFRS and US GAAP to other national standards.

BaFin co-ordinates activities when examining foreign companies.

When examining foreign companies whose securities are approved for trading in Germany, BaFin co-ordinates its activities with those of the appropriate enforcement authorities of the home country. In 2007, it worked with the authorities in France, the United Kingdom, Ireland, Israel, Italy, Japan, Jersey, the Netherlands, Austria, the United States and Switzerland.

146 examinations initiated.

In the year under review, the FREP initiated 22 examinations with cause, two of these at the request of BaFin. It also initiated 124 random examinations. The FREP closed 17 examinations with cause and 118 random examinations. It referred 33 examinations to BaFin.

33 procedures closed.

In the year under review, BaFin closed a total of 33 cases. 27 of the companies involved had accepted the error diagnosis of the FREP. In these cases, BaFin ordered publication of the errors. Five issuers did not accept the error identified. In those cases, BaFin, as second instance, ordered a new audit and in four cases confirmed the identified error. In three of the cases, it ordered publication of the error. In one case, the FREP had not discovered an error. But BaFin ordered a second-instance examination in this case as well, because it had grave doubts regarding the accuracy of the FREP examination result. BaFin closed its examination and identified an error, but refrained from ordering publication.

Frequent errors in business acquisitions and disposals.

Companies often make mistakes in the presentation of business acquisitions and disposals. Problems arose mainly in the allocation of the purchase price. Many errors involved information contained in management and risk reports and reports relating to associated companies or persons and to business segments.

When ordered to do so by BaFin, the company affected must immediately inform the capital markets of any error discovered by the FREP or BaFin. Together with the error, the company must also publish the material sections of the argument. BaFin does not order publication of the error if such publication is not in

<sup>82</sup> The enforcement procedure is described in Figure 36 in the 2006 Annual Report of BaFin, p. 189.

the public interest. Upon application, the supervisory authority may refrain from issuing a publication order if disclosure of the error is likely to damage the legitimate interests of the company. In such cases, BaFin weighs the interests of the company in maintaining confidentiality against the interests of the capital markets in obtaining information. If a company does not, or does not fully, comply with the publication order, BaFin can enforce the order using the enforcement measures under the Administrative Enforcement Act. In the year under review, BaFin threatened to impose an enforcement fine in one case after the company initially had not complied with the publication order.

Three new administrative fine proceedings in 2007.

Breaches of the order to publish errors constitute a regulatory offence punishable with a fine of up to €50,000. In the year under review, BaFin initiated three new proceedings relating to suspected breaches of the regulations governing corporate accounting and the publication of corporate financial statements. One proceeding was pending from the prior year. Three proceedings for suspected breach of the order to publish an error (section 37q WpHG) were discontinued due to a lack of public interest. At the end of the year, one proceeding was still pending. This proceeding concerns the suspicion that the issuer failed to provide the FREP with correct or complete information despite having decided earlier to co-operate in the examination (sections 342e, 342b (4) HGB).

## 6.2 Court decisions on enforcement

### Financing of enforcement

The necessary costs incurred by the FREP and BaFin for conducting enforcement activities are financed through separate allocation as provided for by the Ordinance on the Allocation of Financial Reporting Enforcement Costs (Bilanzkontrollkosten-Umlageverordnung – BilKoUmV). In individual cases, the allocation amount is generally calculated based on the relationship between the domestic trading volume of the individual company and the total trading volume of all companies subject to cost allocation. Section 7 BilKoUmV provides for a minimum allocation amount of €250 and a maximum allocation amount of €40,000.<sup>83</sup> Since for some companies subject to cost allocation the minimum allocation amount is higher than the allocation amount calculated on the basis of trading volumes, this produces surpluses that are credited pro rata to the other companies subject to cost allocation through reductions of the allocable amounts. Conversely, the maximum allocation amount for some companies is lower than the allocation amount calculated, resulting in deficits that are charged pro rata to the other companies subject to cost allocation through increases of the allocable amounts.

<sup>83</sup> In 2007, the Second Ordinance to amend the BilKoUmV increased the maximum allocation amount from €15,000 to €40,000.



The latter is due to the fact that BaFin is financed entirely through allocations (section 13 (1) of the Act Establishing the Federal Financial Supervisory Authority – FinDAG).

Legal action alleging unconstitutionality of BilKoUmV.

A total of 98 objections were lodged against the allocation prepayment assessments for 2005 and 2006, mainly by small and medium-sized companies. One company also took legal action against the assessment. It cited alleged breaches of the principle of equal treatment under Article 3 of the German Constitution (Grundgesetz – GG) and of the principles of proportionality and efficiency. It was alleged that larger companies profited disproportionately from the relatively low maximum allocation amount of €15,000 to the detriment of smaller companies.

BilKoUmV constitutional.

However, in its ruling of October 11, 2007, the Frankfurt am Main Administrative Court dismissed the action.<sup>84</sup> In its opinion, the court declared that BilKoUmV was constitutional, particularly with regard to the maximum amount provision. According to the court, the introduction of a maximum amount was justified in order to avoid highly inappropriate costs for individual companies. The court further stated that while the question as to how high the maximum amount should be fixed (€15,000, €40,000 or €100,000) could be answered based on economic aspects and considerations of equity, one may not do so using legal criteria and therefore the fixing of a maximum amount was subject to the competence of the regulator. The decision of the Frankfurt am Main Administrative Court is final.

### Obligation to surrender documents

Auditors must surrender work product.

If BaFin orders a financial reporting audit of a company, it can demand that the company provide information and submit documents (section 37o (4) WpHG). BaFin can direct such requests also to board members and employees of the company and to its auditor. The Frankfurt am Main Higher Regional Court, in its decision of November 29, 2007, ruled that upon appropriate request by BaFin, auditors must also surrender their work product if such surrender is necessary to investigate the case.<sup>85</sup> According to the court, there is no requirement that other means of information had to be exhausted or that BaFin would be unable to complete the examination without the requested documents. Instead it is sufficient that BaFin, in making its forecast decision (which can only be assessed by the court to a limited extent), arrives at the conclusion that the requested documents could influence the outcome of the examination.

### Publication of errors

In another decision of June 14, 2007, the Frankfurt am Main Higher Regional Court confirmed the opinion of BaFin that errors

<sup>84</sup> Case: 1 E 1477/07.

<sup>85</sup> Case: WpÜG 2/07.

in a company's risk reporting may also be material.<sup>86</sup> In the specific case, the error did not affect results. However, the court stated that risk reporting plays a significant role in informing investors since it is intended to provide an accurate picture of the risks involved in the future development of the company. The court further added that the negative effect on the share price of the company alone is not a reason why publication should not be ordered. The negative impression created in the public by the publication of an error is, according to the court, the key instrument of the enforcement procedure. Only in cases where the consequences connected with publication would significantly exceed the typical negative effects involved, is it possible to refrain from ordering publication.

### 6.3 Publication of financial reports

BaFin commences supervision of financial reporting.

As of the beginning of 2007, BaFin is also responsible for supervising compliance with the regulations governing the financial reporting obligations of publicly traded companies (sections 37v et seq. WpHG). With effect from January 1, 2007, the TUG had extended the existing financial reporting obligations and transferred them to the WpHG. The intention is to enable investors to make well-founded judgements regarding the situation of issuers and to provide up-to-date, dependable information throughout the year. The provisions are to be applied for the first time to financial reports for the financial year that began after December 31, 2006. For financial years coinciding with the calendar year, the reporting obligations thus already had to be observed with respect to financial reporting documentation and declarations by management that had to be prepared in 2007.

#### Content and publication of financial reports

Sections 37v et seq. WpHG generally require the preparation and publication of annual and half-yearly financial reports as well as interim management statements. Among other things, a sworn declaration of compliance pursuant to sections 264 and 289 HGB (commonly known as responsibility statement (Bilanzzeit)) is an essential component of annual and half-yearly financial reports of publicly traded companies. In this declaration, the legal representatives of the companies declare that, to the best of their knowledge, the financial statements and the management report correspond to actual circumstances and present the material opportunities and risks involved in the expected development of the company. The declaration is intended to ensure that those responsible in the issuing company correctly present the situation of the company in the financial reports.

<sup>86</sup> Case: WpÜG 1/07.

In their financial reporting, issuers must generally fulfil the following obligations under sections 37v et seq. WpHG:

- to publish an announcement stating from which date on and at which the complete interim management statement will be accessible to the public, by sending it to the media for distribution;
- to notify BaFin of the published announcement;
- to make the complete financial reporting documents or the complete interim management report publicly available on the Internet;
- to send the announcement and the complete financial reporting documents or the complete interim management statement to the company register in order to be stored there.

#### **Publication deadlines**

The **annual financial report** must be made available to the public no later than four months after the end of each financial year. The **half-yearly financial report** must be made available to the public immediately, but no later than two months after the end of the reporting period. The respective **interim management statement** must be made available to the public within a period starting ten weeks following the beginning of the first and second halves of the financial year and ending six weeks before the end of the first and second halves. Accordingly, a company whose financial year coincides with the calendar year could, in the year under review, publish its interim report for the second half of the year during the period between September 10 and November 19, 2007. The companies must publish the required **announcements** before they make the financial report available to the public. They must inform BaFin in advance and send the notice immediately – but not before its publication – to the company register to be stored there. The financial reports must also be sent immediately, but not before publication of the notice, to the company register in order to be stored there. If a company compiles a **quarterly financial report** pursuant to section 37w (2) nos. 1, 2, (3), (4) WpHG, it must publish it at least before the subsequent report; otherwise the quarterly financial report does not have intrinsic information value. A quarterly financial report must also be sent immediately, but not before its publication, to the company register.

In its supervision of compliance with the financial reporting requirements, BaFin followed a risk-oriented approach and conducted random examinations in the reporting year. It plans to extend examinations in the coming year.

● Dialogue with market participants.

In order to support companies, lawyers and service providers with regard to the numerous publication requirements concerning financial reporting, BaFin has replied to a wide range of queries since the TUG entered into force. BaFin has compiled a list


of the most frequent questions and answers of 2007, which it sent to companies and put on its Web site.<sup>87</sup> It also held an information event in November 2007 on the topics of enforcement, supervision of corporate financial statements and transparency requirements. Approximately 190 representatives of audit firms, professional associations, law firms and listed companies accepted BaFin's invitation and came to Frankfurt to discuss topics in financial reporting enforcement and changes in the transparency obligations. BaFin plans to continue this dialogue with practitioners.

<sup>87</sup> [www.bafin.de](http://www.bafin.de) » Companies » Listed companies.» Financial reporting.



## VII Cross-sectoral responsibilities

### 1 Deposit guarantee, investor compensation and protection funds

 BaFin supervises 19 compensation schemes and protection funds.

BaFin supervises all statutory compensation schemes and schemes that protect institutions in the area of banks and securities trading companies. It also supervises statutory protection funds for life and substitutive health insurance. In total, there are 19 schemes and protection funds supervised by BaFin.

Based on the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetzes – EAEG), on the Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG) and on various financing regulations, BaFin's supervision counteracts drawbacks that could compromise the proper implementation of these schemes' tasks or their assets. If compensation schemes and protection funds issue administrative acts such as decisions on premiums, BaFin also decides on corresponding contradictions of member institutions for these schemes. The voluntary protection schemes that exist in addition to the statutory schemes are not subject to any governmental supervision.

#### **Compensation schemes, schemes that protect institutions, and statutory protection funds supervised by BaFin**

##### **Banks:**

- Compensation scheme for private banks (Entschädigungseinrichtung deutscher Banken GmbH)
- Compensation scheme for public sector banks (Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH)
- 13 schemes that protect institutions of the savings banks financial group (Deutscher Sparkassen- und Giroverband (German Savings Bank Association))
- Scheme to protect institutions of the cooperative banks (Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (Central organisation of the German cooperative banking group))

##### **Securities trading companies:**

- Compensation scheme for financial services institutions, securities trading companies (Entschädigungseinrichtung der Wertpapierhandelsunternehmen – EdW (Compensatory Fund of Securities Trading Companies))

**Insurers:**

- Protection fund for life insurers (Protektor AG)
- Protection fund for private health insurers (Medicator AG)

**Compensation proceedings in the case of Phoenix**

Also in 2007, BaFin's supervisory focus was again directed on settling the compensation proceedings in the case of Phoenix Kapitaldienst GmbH (Phoenix).<sup>88</sup> Here, BaFin's supervision during the compensation proceedings is only of a legal nature as per EAEG; the insolvency proceedings being held at the same time are not subject to BaFin's supervision, but they do impact the compensation proceedings.

The insolvency administrator aims to initiate insolvency proceedings by means of an insolvency plan. For this, the insolvency creditors must accept the insolvency plan.

However, due to a complaint by a major creditor, the Frankfurt am Main Regional Court withheld the insolvency plan confirmation on formal grounds with the decision of October 29, 2007. An appeal was made to the Federal Court of Justice (Bundesgerichtshof – BGH).

The background of the litigation is the question as to whether or not Phoenix managed portions of the investors' money on a trust basis only. If, in contrast to the insolvency plan, there were such trust assets, then some investors would be entitled to direct selection vis-à-vis the assets involved in the insolvency proceedings; those investors could demand more vis-à-vis the EdW, provided there is no investor compensation.

The Regional Court has not taken any position on this material legal point. Probably, the insolvency administrator will thus be prevented from making any distributions until a decision is made by the highest court on the insolvency plan.

As long as the selection problems in the insolvency proceedings have not been settled, it is also not possible for EdW to calculate specifically the compensation claims for all the investors. Therefore, compensation initially was to begin only upon the submission of a legally binding insolvency plan.

Although delays have held back the creation of a complete database for all investor claims and the insolvency proceedings have also prevented a swift settlement, the EdW started to prepare partial compensations or partial payments those parties concerned (approx. 30,000) during the year under review. Here, any selection claims on the part of the investors are initially deducted as a precaution.

● Litigation delays insolvency proceedings.

● EdW preparing compensation.

<sup>88</sup> Annual Report of BaFin 2005, p. 127f. and Annual Report of BaFin 2006, p. 129f.

To be able to start the partial compensation, the EdW must calculate the partial compensation claims and procure the funds required by means of raising special premiums.

The EdW estimates that the partial compensation volume will be about €31 million. Since the funds available to the EdW for such a partial compensation are insufficient, it enacted decisions on special premiums in December 2007 vis-à-vis the institutions assigned to it with a total volume of approx. €28 million.

Almost all the companies have filed an objection against the decision on the special premium. Up to now, BaFin has yet to make a decision on the objections. The majority of the objecting parties also filed a petition to suspend immediate enforceability. Here, BaFin was unable to allow the petitions in most cases.

## 2 Licensing/authorisation requirements and prosecution of unauthorised transactions

BaFin assesses investment offers as to whether they require licensing/authorisation according to the Banking Act (Gesetz über das Kreditwesen – KWG) and the Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG), in order to protect investors and the position of Germany as a financial centre. 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. The contracts, which are marketed via websites, the print media and sales personnel, are usually difficult for investors to understand. Often, these products are supplied by companies that are not supervised by BaFin.

### 2.1 Assessment of licensing/authorisation requirements

BaFin offers potential providers the opportunity to have their projects assessed for possible licensing/authorisation requirements as per KWG or VAG 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 licensing/authorisation, those responsible cannot start their business operations until they have received written authorisation from BaFin. BaFin bars providers who start operating without proper licensing/authorisation from operating and instruct them to settle transactions (section 37 (1) sentence 1 KWG). In this case, BaFin also publishes on the Internet its orders on banning operations



416 inquiries on licensing/authorisation requirements.

Licensing/authorisation requirements for investment consultants.

and settling transactions.<sup>89</sup> Providers operating without proper licensing/authorisation may also be punishable as per KWG and VAG.

During the year under review, BaFin assessed 416 inquiries on licensing/authorisation of planned business projects (previous year: 443). Of these, 386 inquiries related to KWG (previous year: 421) and 30 inquiries related to VAG (previous year: 22).

With the Act Implementing the Markets in Financial Instruments Directive (Finanzmarktrichtlinie-Umsetzungsgesetz – FRUG), policymakers expanded the catalogue of financial services requiring licensing/authorisation to include investment consultation. As of November 1, 2007, anyone wishing to provide investors with personal recommendations regarding specific financial instruments shall require BaFin’s authorisation to do so. However, the law provides for exceptions. For example, no licensing/authorisation is needed for anyone who provides investment consultation services exclusively in the framework of another professional activity, such as legal, tax or construction financing consultation and who does not receive any special remuneration for such investment consultation. Also the consultation and brokering of fund units licensed for distribution continue to be exempt from licence requirements as per KWG; here, only licensing as per trade law is required. For fund intermediaries already operating, the local trade offices extend the business licence accordingly, in some cases even automatically.

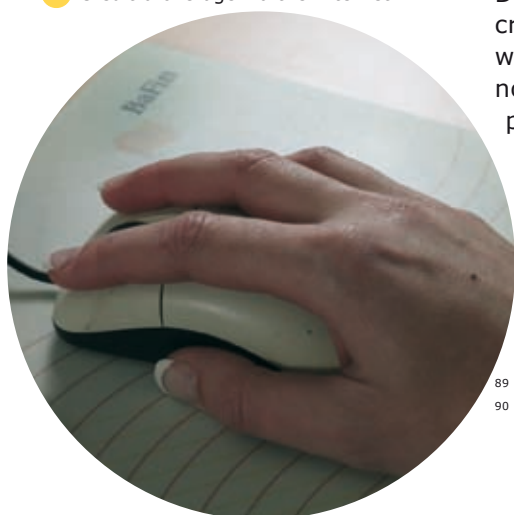
Alternatively, a separate licence is also not required if investment consultants and intermediaries join a so-called liability ceiling of a deposit-taking credit institution or securities trading company. As intermediaries bound by contract (previously: tied agents), they may then provide investment or brokering services, placement business or investment consultation only for the benefit and under the liability of the company liable. The information sheet published jointly with the Deutschen Bundesbank on the new facts regarding investment consultation includes additional notes on the difference between investment consultation that is subject to and that which is exempt from licence requirements.<sup>90</sup>

Credit brokerage via the Internet.

During the year under review, the offerings of so-called Internet credit brokerage platforms increased sharply. The online platforms, which were familiar above all in the Anglo-American region, are now also offering to broker loans from private investors to private persons or companies here in Germany. Many of the recently set-up platforms followed the principle of bringing borrowers and lenders together without involving a credit institution. In general, credit brokerage platforms do not fall under the supervision of BaFin since no banking authorisation is required for the exclusive brokerage of loans. However, BaFin does check in individual cases whether the operators or the users

<sup>89</sup> [www.bafin.de](http://www.bafin.de) » Consumers » Unauthorised business.

<sup>90</sup> [www.bafin.de](http://www.bafin.de) » Publications » Bulletin 12.11.2007.



of the credit-brokerage platform do in fact base their investment on a banking authorisation under banking supervision law. This would be the case for banking operations such as credit or deposit transactions for commercial purposes or are to the extent of being a business. If the operators or users of a credit brokerage platform pursue unauthorised bank operations, BaFin may take action against them as per KWG. If a platform is specifically designed to initiate unauthorised bank operations, the law furthermore provides the BaFin with the option to intervene within the framework of general risk prevention, without even having to prove specific individual cases of unauthorised bank operations.

BaFin has been and is in contact with several potential operators of online credit-brokerage platforms. In this area, BaFin sets particularly great store by the fact that the operators must take contractual and technical measures to exclude the running of unauthorised bank operations via their platform. If there is a lack of convincing measures, BaFin is entitled as per KWG to determine itself whether the users or providers of the platform are running or are involved in transactions that require authorisation. Should this be the case, BaFin may bar unauthorised bank operations and order that they are to be settled immediately. BaFin has published more information on this in a bulletin.<sup>91</sup>

● Cross-border bank transactions and financial services.

At the start of July 2007, the Frankfurt am Main Regional Court (Verwaltungsgericht - VG) dismissed the claim of the Swiss financial services provider Fidium Finanz AG from St. Gallen.<sup>92</sup> With this decision, BaFin's administrative duties regarding cross-border bank and financial services transactions were confirmed for the first time in principal proceedings. As per these administrative duties, there also is a bank-supervision licensing/authorisation requirement (section 32 (1) sentence 1 KWG) in the event the service provider's registered office or usual residence is not in Germany, but focuses on the German market to offer bank transactions or financial services repeatedly and in a businesslike manner.

#### **Fidium Finanz AG**

Fidium Finanz AG makes loans to individuals in Germany via its website and domestic intermediaries. In this case, the company is not physically present in Germany nor does it have authorisation from BaFin to operate a lending business. In August 2003, BaFin thus barred Fidium Finanz AG from operating the cross-border lending business in Germany without the required authorisation. After an unsuccessful objection, the company filed a claim at the VG, which referred the legal dispute to the European Court of Justice (Europäischer Gerichtshof- EuGH) with regard to a possible violation of the free movement of capital from section 56 of the Introductory Law (Einführungsgesetz – EG). After the EuGH made its decision in October 2006 that European law was not violated, the VG dismissed the claim from Fidium Finanz AG in July 2007.

<sup>91</sup> [www.bafin.de](http://www.bafin.de) » Publications » Bulletin 14.05.2007.

<sup>92</sup> File ref.: 1 E 4355/06 (V).

Fidium Finanz AG was operating in Germany as per section 32 (1) sentence 1 KWG since its credit offering was directed at the German market. This was due to the Internet presence of Fidium Finanz AG, to the settlement of loan contracts as per German law, and to the company using German loan brokers. Fidium Finanz AG also explicitly advertised that it granted loans without any prior information from the General Credit Protection Agency (Schutzgemeinschaft für allgemeine Kreditsicherung – Schufa). The feature in Germany was to be interpreted with an eye to investor protection also pursued by KWG using the so-called sales-related and not the institutional-related approach.

The judgment of the VG is not yet final. Fidium Finanz AG has filed a leap-frog appeal to the Federal Administrative Court (Bundesverwaltungsgericht – BVerwG) against the decision, which has yet to be decided.

BaFin has published details on licensing/authorisation requirements for cross-border bank transactions and financial services on its website.<sup>93</sup>

## 2.2 Exemptions

● Exemption from supervision.

If a company requires no supervision due to the type of business conducted, BaFin may make individual exemptions from certain supervisory provisions, in particular the licensing/authorisation requirements (section 2 (4) KWG). Typically, this involves business that a company conducts only as a subordinate auxiliary or secondary business or that is linked essentially to business operations that are exempt from licence requirements. In 2007, BaFin exempted 15 companies for the first time (previous year: 20), 57 other applications were pending at BaFin at year's end. This means there were a total of 268 institutions exempt from licensing/authorisation requirement at the end of 2007.

Companies from countries outside the EU have the option to be exempted from the licensing/authorisation requirement if they are subject to equivalent supervision in their country of origin. In 2007, the number grew again of exempted foreign providers who conduct cross-border business in Germany. In the past year, BaFin exempted a total of four institutions from outside Germany.

BaFin may also exempt companies who only conduct e-financial operations (section 2 (5) KWG). In 2007, BaFin exempted four e-financial institutions for the first time. During the year under review, the supervisor exempted four e-financial institutions. At the end of 2007, there were a total of seven companies exempted on this basis; three other applications were pending at BaFin at that time.

<sup>93</sup> [www.bafin.de](http://www.bafin.de) » Publications » Bulletin 01.04.2005.

## 2.3 Black capital market

To protect Germany's integrity as a financial centre, consistent intervention against the black capital market is essential. The black capital market involves banking, insurance and financial services transactions provided without the required authorisation as per KWG or VAG. BaFin takes action against these businesses in conjunction with the Deutschen Bundesbank. Thus, it also protects those investors who ultimately bear the consequences of unauthorised transactions.

● Private Commercial Office Inc. (USA).

During the year under review, BaFin barred Private Commercial Office Inc. (PCO) from conducting cross-border deposit transactions in Germany. PCO has its registered office in the USA. BaFin also enjoined the company to settle the unauthorised transactions and immediately to return the money collected to the investors. Searches carried out at the company's intermediaries throughout Germany confirmed the suspicion that the company was conducting unauthorised banking transactions on a large scale in Germany. During the investigation, BaFin coordinated with the State Office of Criminal Investigation (Landeskriminalamt – LKA) of Baden-Württemberg, which was investigating these business operations under its own jurisdiction.

PCO had concluded loan contracts with investors in Germany using the slogans "Day trading with capital protection" and "US country banking" and promised returns of up to 6% per month for the money collected. According to the company's information, these completely unrealistic profits were to be made by trading shares and on deals for land slated for development in the USA. The investors were not supposed to bear any risk. The company sold its products in Germany using a network of intermediaries and advertised these products at sporting events and in national newspapers. The company does not offer its business in the USA. PCO also does not have any bank-supervision licensing/authorisation.

● Supposed EU Sparkassen.

In 2007, a new trend also stood out in the area of unauthorised banking transactions: the so-called EU Sparkassen. In this case, the providers in Sweden found a company as a cooperative (Ekonomisk Förening) and the name includes "Sparkasse". This makes them seem to customers to be a bank licensed in Sweden and thus could operate in the entire EU. The companies sometimes even try to give the impression their company belongs to the German Sparkassen sector. These companies regularly offer their investment products over the Internet. The sole and actual purpose of these companies, which are founded by professional service providers specializing in founding fictitious banks, is to conduct banking transactions in Germany without authorisation.

During the year under review, BaFin barred three companies from conducting further unauthorised banking transactions in Germany:

Glatt Sparkasse E.F., NOVEX Sparkasse E.F., and 1911DIRECT Sparkasse E.F. Also, there are four other companies known to be operating in Germany using this method. Here, BaFin assesses whether or not transactions requiring authorisation are being conducted in Germany. BaFin also is in contact with the Swedish banking supervisory office, Finansinspektionen, which also has taken action in the past year against this form of business; Finansinspektionen has ordered a total of 49 cooperatives to stop conducting business.<sup>94</sup>

Cooperation with the Swiss Federal Banking Commission (Eidgenössischen Bankenkommission – EBK).

During the year under review, BaFin investigated an unauthorised business model in several concerted actions together with the Swiss supervisory authority, the EBK. This model featured the selling of shares in Germany and Austria by companies with their registered office in Switzerland and one German branch. The companies did not have any authorisation to conduct banking operations nor be financial services providers in any of the countries concerned. At the same time BaFin carried out its searches, the EBK also took local actions in Switzerland. This coordinated effort made it possible for the activities to be completely clarified in one case of cross-border transactions conducted without authorisation.

### Supervisory and investigatory measures

Total of 472 new preliminary proceedings.

In 2007, BaFin opened a total of 472 new preliminary proceedings (previous year: 622). Most involved unauthorised banking and financial services operations. BaFin investigated only 31 cases involving unauthorised insurance operations (previous year: 43). During the year under review, BaFin approached suspicious companies in 56 cases with formal requests for information and documents (previous year: 87) and imposed 21 fines (previous year: 30). Within the context of the investigations, BaFin carried out 41 local checks and searches (previous year: 26).

39 prohibitions orders and 15 settlement orders.

When BaFin indicates to providers who are operating without a licence of the authorisation requirement, most stop conducting their business voluntarily. Only when this is not the case does BaFin take formal steps against the providers. In 2007, it issued in this regard 39 prohibition decisions (previous year: 24) and 15 settlement orders (previous year: 22). In one case, it engaged a liquidator. BaFin may also take action against companies or individuals who are involved in initiating, concluding or settling transactions conducted without authorisation. This concerns not only companies that are deliberately involved in unauthorised investment concepts, such as the money collection point. BaFin may also take measures against companies that are unwittingly linked to unauthorised business operations, such as only if their regular services are being used. During the year under review, BaFin issued directives to four companies involved with

<sup>94</sup> www.fi.se » Publicerat » Sanktioner » 2007.

unauthorised operations (previous years: two).

● Legal remedies against BaFin measures.

During the year under review, individuals or companies, against whom BaFin took formal action, lodged objections in 56 cases (previous year: 84). In the same period, BaFin concluded 88 objections procedures (previous year: 133); of those, 30 procedures were by rulings on the objections (previous year: 37). In 26 cases, BaFin overruled the objection completely (previous year: 34); in four cases, it sustained the objection. The parties concerned also often took legal action against BaFin's measures. Out of a total of 86 legal disputes (previous year: 122), the courts decided in 46 cases; of these, 34 were in favour of BaFin. In 10 cases, the courts allowed the appeals of the parties concerned; in two cases, BaFin prevailed at least in part.

## 3 Preventing money laundering

### 3.1 International anti-money laundering measures

● FATF held the first joint typology meeting with the private sector.

In December 2007, the Financial Action Task Force on Money Laundering (FATF) held a meeting on certain typologies together with the private financial sector for the first time in London. The aim of this event was to initiate a dialogue and to bring together experts from both areas to exchange their respective views and experiences in the area of money laundering and terrorism financing. Participants discussed questions from the areas of corruption, trade and financing, carousel fraud with value-added tax, and prepaid payment cards. Here, the workshop on prepaid payment cards was held by a BaFin representative.

● Fact sheet on implementing a risk-oriented approach.

In 2007, FATF published a fact sheet on implementing a risk-oriented approach to combat money laundering and terrorism financing. The sheet decisively covered a panel where representatives from banks, international bank associations and associations of the securities industry participated for the first time in addition to representatives of the FATF member countries.

The central idea of the fact sheet is to provide a guide to a more targeted usage of resources on combating money laundering and terrorism financing. The companies should focus their activities combating money laundering on those areas that prove to be especially risky based on a separate threat analysis.

● BaFin hosts the FATF training 2007.

At the end of November 2007, BaFin coordinated the FATF training for participants in the country evaluations for money laundering. In this, it was supported by one representative each from the public prosecutor's office and the criminal investigation department in Bonn, the Federal Criminal Police Office (Bundeskriminalamt – BKA), as well as the Association of German Public Sector Banks (Bundesverbandes Öffentlicher Banken Deutschlands).

The seminar took place at BaFin in Bonn. The week-long event drew 50 prospective evaluators from across the globe. In conjunction with a member country, representatives from the International Monetary Fund (IMF) and the World Bank, FATF holds a corresponding seminar each year.

Country evaluations are one of the most important tasks of the FATF, IMF and the World Bank; they form an essential instrument for harmonising the implementation of international standards on combating money laundering and terrorism financing.

● Basel Committee on Banking Supervision founds expert group.

The Basel Committee on Banking Supervision, which has published many fundamental guidelines on questions of anti-money laundering measures, founded an expert group in 2007 to address questions regarding how to combat money laundering and terrorism financing. The group is concerned with due diligence in electronic payment transactions and transparency in data transfer.

### 3.2 Money-laundering prevention at banks, insurance companies and financial services institutions

● New regulations for money laundering.

During the year under review, BaFin contributed intensively to the national transposition of the Third EU Money Laundering Directive (supplementary law on anti-money laundering). The parliamentary legislative procedure was introduced at the start of 2008. Banks, insurance companies and financial services institutions were included early on to ensure a practical design.

The core of the planned amendment is to provide a legal anchor for a risk-oriented approach to combating money laundering and terrorism financing in institutions and companies. This way, money laundering and terrorism financing are to be exposed in a targeted manner, while at the same time resources at the companies are to be used economically.

Also, the group of companies and individuals who are required to file charges in the event of terrorism financing was expanded. For example, this duty is now to reach beyond credit institutions and insurance companies to include insurance intermediaries, investment companies, lawyers or auditors also. As per this draft, the parties concerned are not only to check the identity of their customers, but also report any suspicion of money laundering and terrorism financing.

● Special audits at credit institutions revealed considerable flaws in supervision.

During the year under review, BaFin carried out 14 special audits (previous year: 18) to investigate whether or not the credit institutions observed the regulations on money-laundering prevention. Of the credit institutions audited, 11 had parent companies in Turkey. At these credit institutions, BaFin found in many cases a lack of company-wide rules for security systems to prevent money laundering. The audits revealed that the Turkish

parent banks could not ensure continuous implementation of due diligence and supervisory duties in money-laundering prevention.

However, banks or bank groups that operate internationally in particular must have the corresponding organisation and company-wide systems to be able to counter money laundering and terrorism financing effectively. Here, awareness for this must be exemplified from the executive levels downwards and anchored in the entire company internationally. This requires binding provisions as per international standards and continuous supervision.

- BaFin employees accompanied 16 annual auditors.

During the year under review, BaFin employees participated in 16 annual audits in the examination of the institutions' measures against money laundering and terrorism financing. Here, they gathered information on the institutions' specific measures and at the same time discussed with the parties responsible questions and problems on site. The discussions and collaboration with the auditors also provided direct insight into the practical audit procedure.

- Collective accounts prove to be problematic.

In 2007, the supervisor also again identified so-called collective accounts as a possible weakness in the credit institutions' prevention work. These types of accounts are set up to pool donations or bundle and inexpensively settle funds transfers to certain countries. Mass cash deposits are made to these accounts via third-party institutions, which the institution holding the account can hardly monitor with regard to the risks of money laundering and terrorism financing. The purpose and intention of these kinds of donation accounts cannot be verified regularly by the institution holding the account so that it is nearly impossible to determine conspicuous payments using patterns of experience, for instance. BaFin has continually seen these accounts to be problematic and has indicated the related risks. Due to BaFin's objections, some credit institutions have done away with these kinds of collective accounts.

- Financial services providers violate outsourcing rules.

During the year under review, BaFin carried out special audits at four financial services providers. The focus was on branches for financial services of foreign banks. In all cases, there were objectionable flaws. BaFin again found that financial services providers violated outsourcing rules by engaging other companies to settle their transactions. In three cases, BaFin issued warnings.

- Special audits at insurers revealed only minor flaws.

BaFin carried out three special audits at life insurers. Overall, the result was satisfactory. In one case, there were no objections to be raised; in the other two cases, BaFin only found minor flaws.

- Prosecuting underground banking.

As in the past reporting years, BaFin found numerous financial services providers operating without authorisation. At the end of 2006, they discovered package services that mainly sent money to Poland. During the year under review, BaFin audited 11 package services and took action in six cases. In 10 other cases, BaFin barred other companies from conducting unauthorised financial transfers or foreign currency transactions.



- Phishing fraudsters switched to Baltic States for recipient countries.

During the year under review, phishing fraudsters again used credulous financial agents to obtain funds by phishing. After BaFin issued a directive making transfer difficult into the original recipient countries, such as Russia or the Ukraine, fraudsters have now switched to using the Baltic States and other EU countries as recipient countries.

## 4 Account access procedure and account blocking

- Account access procedure led to investigation successes.

Also in 2007, the account access procedure as per section 24c KWG has led to significant investigation successes and has thus proven itself as an important instrument in protecting Germany's integrity as a financial centre. The account access procedure has proven to be very effective for the investigating authorities, especially in combating property crime and capital crime, organised crime (gang crime), money laundering and terrorism. During the year under review, this procedure made it possible to determine account details of presumed members of a terrorist ring, whereupon BaFin blocked the accounts as per section 6a KWG. BaFin itself used the account access procedure mainly to prosecute banking or financial services transactions conducted without authorisation.

- Court confirms account block for terror suspects.

Following the failed suitcase bomb attacks on regional trains in Dortmund and Koblenz, BaFin carried out an account block in 2006 as per section 6a KWG, against which a presumed perpetrator filed suit.

The Frankfurt am Main VG declared BaFin's account block to be legal. Its judgment concurred with BaFin's opinion, whereby an account may be blocked in the event preliminary proceedings are initiated due to the suspicion of membership in a terrorist ring. The court's opinion is that if the Public Prosecutor opens this kind of investigation against an individual, it stands to reason that an account in the power of disposal of this individual contributes in some way to the terrorist activities of a respective association. Individual suspicious account movements need not be proven, since otherwise the effectiveness corresponding measures to avert danger would be reduced considerably.<sup>95</sup>

- BaFin processed 93,560 requests.

During the year under review, BaFin processed a total of 93,560 requests (previous year: 81,156) and provided information on about 817,000 accounts (previous year: approx. 665,000). As in previous years, most requests were made by the various criminal prosecuting authorities, public prosecutor's offices, the audit

<sup>95</sup> File ref.: 1 E 5718/06.

bureaus of the tax authorities, the customs investigation offices, and the police. The individual police offices alone directed a total of 54,111 requests to BaFin (previous year: 47,805).

During the year under review, 472 requests came from BaFin itself (previous year: 972). Most requests were made in conjunction with banking or financial transfer transactions conducted without authorisation. Here, the focus included underground banking.

Table 25  
**Authorised agencies in 2007**

Authorised agencies	2007		2006	
	absolute	in %	absolute	in %
BaFin	472	0.5	972	1.2
Police authorities	54,111	57.8	47,805	58.9
Tax authorities*	13,061	14.0	11,838	14.6
Prosecution authorities	18,002	19.2	12,861	15.8
Custom authorities*	7,167	7.7	7,202	8.9
Others	747	0.8	478	0.6
Total	93,560	100.0	81,156	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.

## 5 Consumer complaints and requests

During the year under review, a total of 20,852 customers of insurers, credit and financial services institutions contacted BaFin. This figure is around 7.4% below the previous year's total of 22,520.

The supervisor investigates each complaint and verifies whether an institution or company has breached supervisory duties and whether measures should be taken. If there is concrete cause, BaFin writes to the companies concerned and has the facts of the matter related provided.

BaFin helps individual customers as much as possible, for example by persuading the company to rectify a fault, or by explaining the legal situation in layman's language.

In the event supervisory rules have been violated, BaFin warns the institution or company and orders it to take steps in preventing future violations. If there are organisational flaws, the supervisor

works towards an organisational change and then monitors the implementation.

However, BaFin operates solely in the public interest. It cannot act in the private legal interests of individual complainants. It also cannot decide individual disputes with binding force, like a board of arbitration.

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**

To obtain information and advice, many citizens use the BaFin Consumer Helpdesk by calling 01805 – 12 23 46. Citizens are informed about the supervisory activities, the basic procedure of a complaint and the status of their ongoing complaints.

Since its start on March 1, 2006 up to the end of 2007, there were 47,900 consumer requests made. In 2007, there were about 24,600 requests. Over half of the callers had questions on the insurance area. One quarter of the callers called regarding banks and building societies. Ten percent of the requests referred to securities supervision.


In the middle of 2007, BaFin expanded the services offered and made it easier for customers to file complaints online. In addition, the telephone consultants addressed requests from citizens with hearing impairments. To do this, they communicated via textphone, fax, e-mail, SMS and video telephony using sign language.

## **5.1 Complaints relating to credit institutions and financial services institutions**

In 2007, BaFin processed 3,643 complaints on credit institutions and financial services institutions (previous year: 3,451); BaFin submitted official opinions on 43 complaints made to the Petition Committee of the German Bundestag and answered 532 requests. 567 complaints, four of which were petitions, were successful entirely or in part for consumers. The complaints regarded all areas of banking operations.

#### **Selected cases**

During the year under review, the number of requests and complaints on the sale of loans by credit institutions continued to increase.

 Borrowers fear sanctions for loans sold.



Borrowers were made insecure by reports in the media, which indicated a risk of unauthorised sanctions by the purchaser of a loan or advance. Many people who contacted BaFin were specifically concerned about how they could protect themselves from interference by the purchaser of the loan in the contractual relationship and from unauthorised sanctions. However, no borrower filed any specific complaint on unauthorised sanctions by a loan purchaser.

In its decision on February 27, 2007, the BGH declared the sale of loans to be permissible and legally effective.<sup>96</sup> The contract relationship in its existing form, i.e. with all the rights and duties, goes to the purchaser via the loan contract. There is no special right of termination for the borrower or the purchaser. The purchaser also does not have the option to impose sanctions arbitrarily. As per the Code of Civil Procedure, the bank customer has a number of legal remedies available to take legal action against unauthorised sanctions.

Customers may not immediately access the equivalent value of checks.

During the year under review, customers again complained that they could only access the equivalent value of deposited checks only after the end of a specific period, often 10 bank working days.

The institutions base this access block on the following: If the check is returned unpaid and if the credit balance or credit line is insufficient for the charge, the institution will have great difficulty collecting the resulting debit balance. Therefore, BaFin finds it quite understandable and appropriate when the credit institutions reserve the right to wait a certain period.

During the year under review however, one customer complained that he could only access the equivalent value of the check after an access block of 28 days. The customer felt this period was unreasonable, especially since he was informed too late of this special period. The Sparkasse indicated that in this case the check was deposited at a French bank. However, the return debit of a check to a French bank could take a long time. The credit institution offered to allow the customer access to the funds if he would submit convincing documentation on the credit-rating assessment. The customer did not wish to submit these documents, however.

Internal credit limits increase the risk of improper accesses.

During the year under review, BaFin received the first complaint of a customer who had actually suffered losses due to phishing, i.e. fraudulently acquiring secret account information using disguised e-mails.

The complaint illustrates the following problem: If an institution grants an internal limit that is too generous and that well exceeds the approved credit line, this may lead to further losses if the account is accessed improperly.

<sup>96</sup> File ref.: XI ZR 195/05.

- Discussion on minors' right to dispose of an account.

In the complaint case, BaFin pointed out to the credit institution that it considers internal limits no cause for concern as long as they are short term and absorb relatively minor peak debits. However, limits that are too high could, in the event of improper account access, lead to additional losses for the customer, which is to be avoided. In the complaint case, in which other details were disputed, the credit institution offered the customer a settlement.

- Building society paid back credit balance against the customer's wishes.

One customer complained that a credit institution's advertisements offered minors payment cards that were like those created for adults. Although the institution, when issuing the cards and advertising for them, complied with the banking supervision's statement on the topic of bank transactions with minors,<sup>97</sup> it agreed to a supplementary rule after coordinating with the associations. To protect minors, the institution gave assurances that it will agree to limits below the standard amounts and it will indicate this clearly on the printed forms.

About 40 customers complained that a building society had announced it would settle and pay back the credit balances from the building society savings. The contracts were concluded between 1997 and 1999. The interest on the credit account was 2%. The building society savers were also entitled to a bonus of 3%.

The contracts were for the entire amount of the building society savings saved and mature for allocation. A total of 7,500 customers were involved. Many customers also contacted the Customer Complaints department of the Federation of Private Building Societies (Bundesverbandes der privaten Bausparkassen).

The building society argued that a building society contract was fulfilled upon saving the amount contractually agreed in the building society savings account. The contract's objective was achieved at or even beyond this amount, regardless of whether borrowing or investing was the priority for the building society savers upon concluding the contract.

The ombudsman decided that the termination was justified, but the building society should have observed a three-month period of notice. BaFin also believes that such terminations are justifiable as a rule.

- Institutions charge commitment fees for credit not drawn on.

Some business customers complained that their institution wanted to charge a commitment fee for the portion of working capital credit not drawn on. The rate was normally 3%. Some institutions reduced the borrowing rate, others did not.

Since loan commitments for commercial customers must be backed by capital resources, the fee is factually justified. No objections can be made against a corresponding agreement for new credit or a contractual rearrangement of the loan agreement. The courts have

<sup>97</sup> [www.bafin.de](http://www.bafin.de) » Publications » Coordination decisions.

to decide whether a contractual clause for the change in interest rates is sufficient legal grounds for the type and extent of the additional burden.

## 5.2 Complaints relating to insurance undertakings

### Complaint figures

Also in 2007, most complaints processed by BaFin were in the insurance sector. The amount, 17,675 from the previous year, fell to 15,425. This drop can mainly be traced back to the fact that not all actions could be closed in 2007.

Of the submissions made, 13,320 were complaints, 732 were general requests not based on a complaint, and 101 were petitions, which came via the German Bundestag or the Federal Ministry of Finance (Bundesministerium der Finanzen - BMF). In addition there were 1,272 submissions that were outside BaFin's jurisdiction.

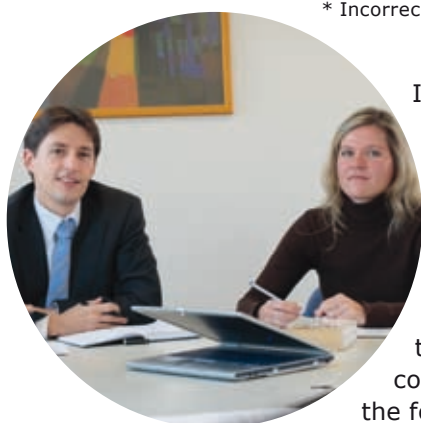
Overall, 33.0% of the proceedings had favourable outcomes for the complainant (previous year 23.9%); 58.7% of the submissions were unfounded; in 8.3% of the cases, BaFin was not the competent authority.

Table 26

### Complaints received by insurance class

Year	Life	Motor vehicle	Health	Accident	Liability	Legal expenses	Building/ Household	Other classes	Other complaints*
2007	4,919	1,687	1,924	973	1,144	1,045	1,532	505	1,696
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

\* Incorrect address, brokers, etc.



In 2007, the largest proportion of complaints 32.9% (previous year: 29.1%) related to claims settlement in life and non-life insurance. This was followed by complaints on contract handling at 27.1% (31.2%), on contract termination at 16.1% (17.4%) and on business conduct when negotiating contracts at 9.2% (9.2%). In addition, 13.6% (12.6%) fell into the "Other" category. Specific provisions of the law relating to proof of age contributed to 1.1% (0.6%) of the complaints. The main grounds for complaint are shown in the following table.

Table 27

**Grounds for complaint**

Grounds	Number
Amount of insurance payment	2,090
Coverage issues	1,433
Manner of claims processing/delays	1,225
Surplus bonus/profit credit	1,139
Advertising/advice/application processing	1,075
Change to contract, extension	1,021
Improper termination	926
Proper termination	899
Other (contract handling)	743
Complaints on intermediaries/brokers	680

**Selected cases**

- Complaints on surrender values and bonuses.

Also in 2007, many consumers again complained about the amount of surrender values and bonuses in the life insurance sector. Initially, some life insurance companies did not think they had to comply with BGH case law regarding non-transparent terms and conditions of insurance. BGH was of the opinion the conditions infringed the rights of the customers if they terminated their contract or waived the premium.

However, during the year under review, the remaining life insurance companies also submitted to the BGH judgments. That led to significant back payments to the customers in several complaint cases. Meanwhile, the BGH expanded its ruling to include mutual societies (Versicherungsverein auf Gegenseitigkeit – VvaG) as well as the special form of the fund-linked life insurance (Fondsgebundene Lebensversicherungen – FLV).<sup>98</sup>

- Binding acceptance confirmation in year-end business.

A physically disabled policyholder had applied for term life insurance with an occupational disability rider. Before the year's end, he then received an acceptance confirmation from the insurer. Two months later after a medical exam, the insurer indicated it could not offer the policyholder any occupational disability insurance. BaFin made it clear to the company that a legally valid contract had already come into force with the unconditional acceptance confirmation. The insurer then acquiesced and provided a policy for the contract as applied. The insurer also ensured that it would proceed similarly in similar cases should the customer complain.

- Technical interest rate remains the same upon change of payment method.

One complainant applied for a change from an annual to a monthly policy payment for her pension insurance. In this case, the general terms of insurance provided for an instalment surcharge.

<sup>98</sup> IV ZR 258/03 and IV ZR 321/05, also see BaFin's Annual Report of 2006, p. 101.

However, the insurer would only agree to change the payment method together with a new tariff that was calculated using a lower technical interest rate (3.25% instead of 4%). As a result, the premium to be paid would have increased significantly. However, the terms of insurance did not provide legal grounds for this change. In the end, the insurer changed the payment method without reducing the technical interest rate.

● No contract without acceptance.

Upon receiving an initial non-binding enquiry, one insurance company sent a consumer a pension insurance policy. At the same time, the company began to debit the first premiums from the complainant's account although she had not yet accepted the offer of the contract. Despite her objections, the insurer continued making direct debits from her bank account. Only after the complainant involved BaFin did the insurer change its interpretation of the law and refund the amounts wrongly debited.

● Modified standard rate also for partially insured.

As of July 1, 2007, all private health insurers are to accept uninsured individuals, who are to be allocated to the private health insurance sector, into the so-called modified standard rate. In several complaints, the complainants were rejected from being included in this rate, the services of which are comparable to the level of service offered in the statutory health insurance.

The insurers were of the opinion that the prerequisites for inclusion were not met if the policyholder already had in-patient health insurance coverage. Die BaFin pointed out to the insurers that individuals, who do not have full private health insurance but only partial insurance, may request insurance coverage with the modified standard rate by December 31, 2008. Consequently, the insurers changed their interpretation of the law and also offered the complainants, who previously only had private insurance for the in-patient area, to be included in the modified standard rate.



### 5.3 Complaints relating to securities business

In 2007, investors filed 734 complaints relating to the securities business of credit and financial services institutions (previous year: 669). During the year under review, BaFin answered 223 written requests on securities trading (previous year: 226) in addition to numerous calls. Above all, investors frequently asked about the professionalism of certain authorised companies. BaFin may not make any statement in this regard. BaFin also answered 252 requests from institutions, auditors, lawyers or investors regarding the amendments to the law by FRUG.



### Selected cases

#### Deleting worthless shares.

Some investors contacted BaFin because their bank refused to delete so-called worthless shares from their securities account. These mainly involved shares from issuers in insolvency proceedings and for which there is mostly no more trading on stock exchanges. Investors wish to delete such shares mainly to avoid security account fees or realize losses for tax purposes. However, since the shares continue to represent the value of the rights under company law, such as the voting right or the subscription right, credit institutes may not delete them. For this reason, some institutions suggested that the customers transfer the shares to their respective institutions, thus waiving any and all rights to these securities. For this, the institutions requested a written transfer order in which the customers expressly indicate the transfer of rights. Some investors felt this procedure put them at a disadvantage. They complained that the shares could at least theoretically achieve a market value, which would then be to the credit institution's benefit. The decision to transfer the securities rests solely with the investors. They must decide whether or not the transfer has more advantages than disadvantages. There bank's procedure is not objectionable under supervisory law.

#### Mistrade applications in OTC certificate trading.

Investors frequently complained that banks would later reverse over-the-counter (OTC) transactions with certificates, which were advantageous for them.

In one case, an investor used the favourable price of the issuer both for a stock exchange trade order and an OTC order. Later, the issuer made a mistrade order. Mistrade rules protect investors and issuers from incorrect order execution. They make it possible to void a business transaction if it arose at a price not in line with the market. Prices not in line with the market may be caused by technical errors or incorrect entries. If the order is granted, then the incorrect transaction is reversed. Since the price was in line with the market as required, the stock exchange rejected the mistrade order. Thus, the issuer had to fulfil the transaction for the stock exchange trade. However, the investor's bank accepted the issuer's mistrade order regarding the OTC transaction, despite the identical mistrade rules.

BaFin contacted the bank in this regard and found that the bank had not properly checked the issuer's mistrade order, contrary to the bank's own internal rules. BaFin warned the bank and pointed out that security services are to be provided with care and in the interest of the customer. The issuer fulfilled the transaction later at the price originally agreed.

#### Settlement at a poor price.

Complaints were also made due to incorrect settlements of security transactions. For example, one investor complained that a bank settled the sale of German Federal Medium-Term Bonds (Bundesobligationen) at a price above the stock exchange price. The bank had transacted the sale as a so-called fixed-price transaction. Here, the investor purchased the securities from his

bank, and the bank set the price for the security. According to the terms and conditions of the bank, this order was to have been executed via the stock exchange. Overall, this would have been more favourable for the investor also considering the accumulated fees in this case. After the investor complained to BaFin, the bank was prepared to settle the transaction at the more favourable stock exchange price. It waived the fees in the process.

The bank's mistake of settling as a fixed-price transaction happened in this case because this mode is preset in the bank's order system for German Federal Medium-Term Bonds. The special enquiry initiated by BaFin showed that this is not an isolated event, but that customers suffered no losses as a result. Generally, the markup charged by the bank corresponded to the fee the customer would have had to pay for a stock exchange execution. However, since the bank had already developed new execution principals in the course of the transposition of the Markets in Financial Instruments Directive (MiFID), no new supervisory measures were required.

● Problems with securities account transfers.

As was the case in previous year, customers complained of problems with securities account transfers. In one case, an investor arranged for a securities account transfer to another bank after he had tried to sell a fund traded on a stock exchange using his own bank but without avail. However, the transfer was not possible since the fund's shares were purchased in the depository receipts method of holding in custody. The bank explained that a transfer posting to the collective deposit of securities was not possible. After the complainant involved BaFin, the bank transfer posted the fund's units into the new method of holding in custody.

#### 5.4 Inquiries made in line with the Freedom of Information Act

● 53 requests as per IFG.

In 2007, there were 53 requests for information access as per the Federal Freedom of Information Act (Informationsfreiheitsgesetz – IFG) at BaFin (previous year: 72). The focus again was on the securities supervision with 27 requests. The bank supervision area had 13 requests and eight were in the area of insurance supervision. The cross-sectoral areas had five requests.

As in the previous year, the access to information served mainly to prepare compensation cases against supervised companies or other third parties. In addition, the number of inquiries on risk profiles of the companies supervised and on stress testing increased.

- BaFin was able to grant access to information in about half the requests, at least in part.

In about 25% of the requests processed, BaFin granted complete access to information; in a further 25%, BaFin granted access at least in part.

BaFin had to reject the other half of the requests. The supervisor's control and supervisory duties would have been jeopardised otherwise. BaFin was also not allowed to divulge operational and business secrets or the personal data of third parties. BaFin rejected some requests since the applicant already had the information requested or the applicant could obtain this information in a reasonable manner from general sources.

Eleven applicants filed objections against BaFin's rejection decisions. BaFin rejected most objections. Five objecting parties have filed suit against BaFin's rejections at the Frankfurt am Main VG. Together with the four suits from the previous year, there were thus a total of nine suits based on IFG pending in 2007.

Table 28

**Inquiries made in line with the IFG**

Inquiries made in line with the IFG in reporting year 2007								
Supervisory section	Number	Application withdrawn	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	13		1	3	9		7	1
Insurance	8			2	6			
Investment	27		10	5	6	6	3	3
Others	5		1	1	3		1	1
<b>Total</b>	<b>53</b>	<b>0</b>	<b>12</b>	<b>11</b>	<b>24</b>	<b>6</b>	<b>11</b>	<b>5</b>
Inquiries made in line with the IFG since 1 January 2006								
Supervisory section	Number	Application withdrawn	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	27		2	7	18		13	4
Insurance	13			3	10		2	
Investment	68	1	19	11	31	6	14	4
Others	17		2	6	9		5	1
<b>Total</b>	<b>125</b>	<b>1</b>	<b>23</b>	<b>27</b>	<b>68</b>	<b>6</b>	<b>34</b>	<b>9</b>

## VIII About BaFin

### 1 Personnel and organisational structure



Inauguration of the new BaFin Executive Board (from l. to r.: Michael Sell, Karl-Burkhard Caspari, Sabine Lautenschläger-Peiter, Dr. Thomas Mirow, State Secretary in the Federal Ministry of Finance, Jochen Sanio and Dr. Thomas Steffen)

#### New BaFin executive structure

Since April 18, 2008 BaFin has been managed by a five-member Executive Board. This Executive Board comprises President Jochen Sanio and four Chief Executive Directors. Sabine Lautenschläger-Peiter has been appointed Chief Executive Director for Banking Supervision. She previously headed up the Supervision of Major Banks and Selected Commercial Banks/Qualitative Supervisory Standards department. Chief Executive Director Karl-Burkhard Caspari is heading up Securities Supervision in Frankfurt. Dr. Thomas Steffen is Chief Executive Director for Insurance Supervision. As a Chief Executive Director, Michael Sell's remit covers Regulatory Services/ Human Resources. He was previously Head of the Taxation Policy, Budget and Financial Markets division at the Federal Chancellery.

#### Organisational development

● Structure and process organisation examined.

BaFin is continually further developing its structures and processes and examining how technical and management processes can be designed more efficiently so that it can also use its resources commercially in the future. In 2006, the authority began examining its structure and process organisation and reassessing its personnel requirements. In 2007, the Human Resources department, the Information Technology (IT) group and the departments Consumer and investor protection; certification of retirement savings contracts and particular legal issues (Q2) and Integrity of the financial system (Q3) were examined.

The results of the individual organisation examinations, which are to last until 2010, are intended to contribute to the supervisory authority being able to complete its tasks in an optimal manner and being able to develop concepts for new tasks.

● Structure optimised.

Furthermore, in the reporting period BaFin restructured its insurance supervision pillar, established contract management throughout the organisation and merged the organisation development, project management and strategic controlling sections with the central department.

● Internal control system developed further.

In the year under review, BaFin also continued its work on the Internal Control System (ICS). BaFin had started setting up this system in 2006; it is a uniform control system founded on an

● ICS evaluated positively.

analytical approach and based on generally accepted standards of control. In 2007, BaFin identified all processes that are of relevance for supervision as well as selected administration, management and control processes and documented them in process manuals. It thereby established internal controls to reduce or avoid process risks.

In 2007, BaFin commissioned an audit firm to establish whether the ICS is in compliance with the principles of auditing standard 261 of the German Institute of Chartered Accountants (Institut der Wirtschaftsprüfer – IDW). IDW auditing standard 261 defines an internal control system as the principles, procedures and measures (regulations) that have been introduced and that are aimed at the organisational implementation of management decisions. The audit found that overall BaFin has appropriate controls in place and that the control system complies with the principles of IDW auditing standard 261. The auditors’ opinion extends to almost 100 processes that are documented in the BaFin process manuals.

● 1,693 employees.

**Staff**

At the end of the reporting year, BaFin employed 1,693 people (previous year: 1,679), of whom 67% were civil servants (1,133, previous year 1,098).

Table 29  
Staff as at December 31, 2007

Career path	Employed			Civil servants	Regular employees
	Total	Women	Men	Total	Total
Senior level	623	231	392	577	46
Upper level	597	283	314	491	106
Middle/lower level	473	309	164	65	408

Women held approximately a quarter of all executive posts at BaFin in 2007. Overall, women accounted for around 50% of all employees.

Twelve 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 18 vacancies among senior posts and 32 among upper-level posts. During 2007, it recruited 103 new staff (including civil service candidates, trainees and temporary staff), mainly fully qualified lawyers and graduates of higher education institutions).

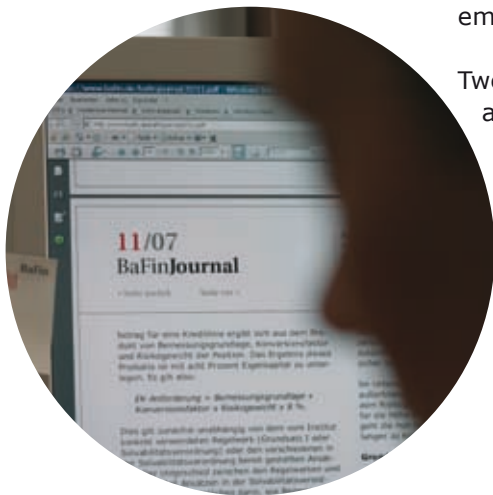


Table 30  
Recruitment in 2007

Career path	Qualifications						
	Total	Women	Men	Lawyers	Economic scientists	Mathematicians	Business educationalists
Senior level	33	15	18	21	8	3	1
				Public administrators	Business lawyers	Economic scientists	Mathematicians/IT specialists
Upper level	39	16	23	5	9	23	2
Middle level	9	8	1				
Civil service candidates	22	14	8				

In 2007, 20 new trainees started their traineeships or career training at BaFin. As at the end of the year under review, there were 73 trainees and trainee civil servants working for the supervisor. BaFin provides training for the following careers: administrative clerk (1), IT specialist (1), office communication specialist (39) 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 (31).

In May 2007, the administrative office and staff association concluded a works agreement with regard to appraisal interviews. The agreement establishes the appraisal interview as a mandatory employee development tool throughout the organisation.

During the year under review, 1,221 employees took part in professional development. This corresponds to 79% of all employees. A total of 537 training events were offered. On average, each BaFin employee took part in 5.0 days of professional development in the reporting year (2006: 4.3 days).

#### Standard Cost Model (SCM)

The standard cost model (SCM) was introduced in Germany as part of the "Simplified bureaucracy and better regulation" programme that the German government passed on April 25, 2006. This represented a new approach to reduce bureaucratic regulations.

The SCM is a methodical approach with which a large portion of the bureaucracy costs can be systematically reduced. Bureaucracy costs refer to costs that are incurred by natural or legal persons due to disclosure obligations. This includes cases where the state obligates businesses, citizens or administrators to fill out applications, forms, statistics or similar or to maintain proof and documentation. The disclosure obligations do not include obligations with regard to content such as the costs that arise due to the installation of a pollutant filter or financial obligations such as taxes, contributions and fees. Initially, the costs of regulations

Employee development tools: appraisal interviews and professional development.

that involve disclosure, proof and documentation obligations for the business sector are being measured as of autumn 2006. The measurement of obligations for citizens and administrators is due to begin in 2008. BaFin, in consultation with the Federal Ministry of Finance (BMF), is responsible for the SCM calculation in the financial markets sector. The work on the simplified bureaucracy project in general, and also in the case of the financial markets, is subdivided into three main areas:

#### 1. Inventory of bureaucracy costs

In autumn 2006, the inventory of disclosure obligations for businesses was started; these are obligations that arise from laws, ordinances or administrative practice – circulars from BaFin, for example. BaFin identified approximately 900 disclosure obligations related to the capital market. In total, all Federal Ministries identified around 10,900 disclosure obligations across all legislative areas. Following the identification of the obligations, the calculation of costs was started and this has not yet been fully completed. The Federal Statistics Office is in charge of calculating the costs. The costs were determined in various ways. For supposedly particularly costly obligations, expert panels with associations and industry were formed or experts were consulted. For the cost calculation, BaFin collected internal case figures, conducted plausibility checks and prepared systematic questions such as the calculation of the proportion of costs that stems from European regulations. It is expected that the cost calculation will be completed all over Germany by mid 2008.

#### 2. Proposals for the reduction of bureaucracy costs

The German government's objective is to reduce bureaucracy costs by 25% by 2011, with half of this amount being reduced by 2009. The first measures for the streamlining of administration were already discussed with the associations in meetings held with BaFin and the Federal Ministry of Finance (Bundesfinanzministerium – BMF).

#### 3. Recording of the cost effects of new regulations

In 2007, there were 25 new regulations to be costed. BaFin generally calculates the standard costs in accordance with a standard approach proposed by the Federal Statistics Office, but also, if necessary, it synchronises the results with the associations and with industry. The calculation is sent – via the Federal Ministry of Finance – to the National Regulatory Control Council (National Normenkontrollrat – NKR), the general institution for the reduction of bureaucracy, which is based at the Federal Chancellery.

## 2 Budget

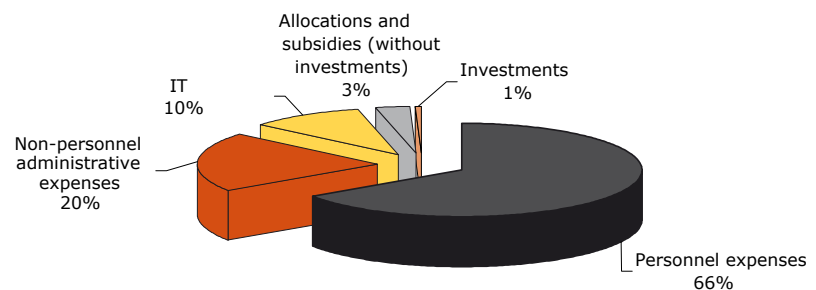
● 2007 budget: €120.5 million.

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 approx. €120.5 million for the year

under review (previous year: €126.8 million). Personnel costs amounted to around 66% of the proposed expenditures, at €79.1 million (previous year: €77.1 million), while non-personnel costs accounted for approximately 20%, at €24.5 million (previous year: €25.3 million).

The special section of the budget plan containing expenditures and revenues relating to enforcement amounted to around €7.8 million in 2007 (previous year: €6.5 million). Of this amount, approximately €6.5 million was allotted to the German Financial Reporting Enforcement Panel (FREP).

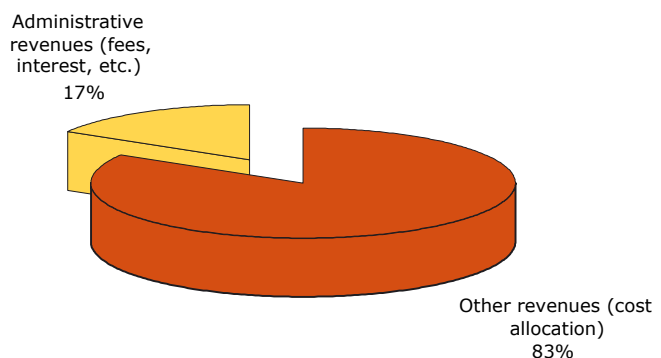
Figure 34

**Expenditures (2007 budget)**

€99.8 million cost allocation payments, €19 million fees.

BaFin does not receive any funding from the federal budget. It is financed primarily by cost allocation payments (2007 estimate: approx. €99.8 million, previous year: €106 million) and fees including separate reimbursements (2007 estimate: approx. €19 million, previous year: €18.9 million) from the companies subject to supervision.

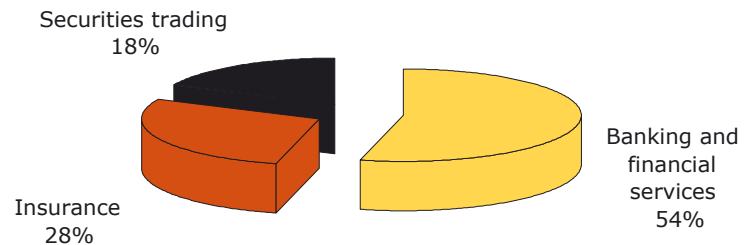
Figure 35

**Revenues (2007 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 supervisory areas in which they originated. According to final calculations for 2006, the banking sector contributed 54%, the insurance sector 28% and the securities trading sector 18% to the overall total of approximately €86 million.



Figure 36

**Cost allocations by supervisory area 2006**

BaFin has also based the calculation of prepayments for 2008 on this proportional distribution. The final cost distribution for 2007 will be calculated during 2008.

● Expenditure of €112.7 million.

According to the 2007 annual accounts which have not yet been adopted by the Administrative Council, spending by BaFin totalled approximately €112.7 million (previous year: €112.3 million). The supervisor generated revenues of around €128.2 million (previous year: €132.9 million).

In the area of enforcement, expenses of approx. €7.3 million were incurred against revenues of approx. €15.3 million (surpluses, prepayments for 2005, 2006, 2007 and 2008).

**BAKred cost allocation is lawful**

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. Those concerned lodged constitutional complaints against this but these were not accepted for decision by the Federal Constitutional Court (Bundesverfassungsgericht – BVerfG). The Federal Constitutional Court is of the view that the distribution of costs provided for in the cost allocation does not contravene Article 3 (1) of the Basic Law (Grundgesetz – GG). The costs are distributed to the credit institutions group and to the financial services institutions group (including securities trading banks) on the basis of staff deployment. It also does not consider that there is a contravention of Article 12 and Article 14 of the Basic Law: it is of the opinion that the cost allocation does not disproportionately restrict the complainants in the exercising of their profession and that there is no apparent effect similar to expropriation associated with the cost allocation amount.

### 3 Public relations

Sub-prime crisis preoccupied Press, Publicity and BaFin.

In the year under review, the sub-prime crisis and its effects on Germany, particularly on the IKB and SachsenLB banks, were very much in the public focus. There were also numerous inquiries regarding the bad speculation in own account trading at the WestLB bank. Recommendations in market letters and spam e-mails, credit-brokerage platforms on the Internet and corporate takeovers were also of great interest. Other issues included Solvency II, the new brokerage law and the VVG amendment. Altogether, BaFin replied to several thousand inquiries from journalists, consumers, investors, students and companies.

New web presence.

In 2007, BaFin completely reworked its web presence. The most important new feature is that the contents are now structured into three sections according to target group and these can be found directly on the home page: Companies, Consumers, BaFin. The "Companies" section contains information concerning the supervision of banks and financial services institutions, funds and German asset management companies as well as insurance companies and pension funds. Companies listed on a stock exchange can also find information here on their legal obligations in respect of capital markets. The second section of the new BaFin website is aimed at consumers. This section contains information on the companies approved by BaFin, on financial products and financial investment as well as on unauthorised financial transactions. The heading "BaFin" contains all important information concerning the supervisory authority. The functions, organisation and funding of BaFin are also explained there, for example, the role of German financial supervision in international cooperation. BaFin's publications – such as annual reports, the BaFin Journal, circulars, interpretation decisions – or also legal foundations such as directives, laws or ordinances can be accessed using the "Publications" and "Supervisory legislation" search functions. The new Internet pages have been online since January 2008.

#### New BaFin home page

The screenshot shows the BaFin website home page. At the top right, there are links for "Site map", "Contact", and "Deutsch". The main header features the BaFin logo and the text "Bundesanstalt für Finanzdienstleistungsaufsicht". Below the header is a search bar with a "Search" button and a "Detailed search" link. A "Service" menu lists various categories: Publications, Supervisory legislation, Press, Events, Vacancies, Call for tender, Drafts/notes & lists, Order forms, and Exchange fees. The main content area is divided into three columns: "Companies" (financial service providers, banks, insurance undertakings and securities trading), "Consumers" (information on companies, financial products and investments), and "BaFin" (functions, organisation and funding plus international). Each column has a "Most searched" list. Below these columns is a news item titled "NYSID and BaFin sign Cooperation Agreement" with a photo of two men shaking hands. At the bottom right, there is a "BaFin Quarterly" section with a small image.

● Consumer brochure published.

In February 2008, BaFin published a brochure for the first time on the subject of financial investment. The 15-page brochure informs consumers what to look out for so as to protect themselves from dubious offerings. The brochure can be downloaded free of charge from the BaFin website.<sup>99</sup>

● 4. Forum on white collar crime and the capital market.

At the start of September, BaFin held its fourth forum on "White collar crime and the capital market". Over 250 representatives of legal and police authorities, of the trading surveillance offices (Handelsüberwachungsstellen – HÜSt) as well as of Deutsche Bundesbank accepted BaFin's invitation to the forum in Frankfurt. The event focussed on practical questions: inquiries in the areas of insider trading and market manipulation often prove – not least because of the complicated legal and evidence situation – to be difficult and protracted. It is only in very few cases that there is a preferral of charges and conviction. Public prosecutors and representatives of BaFin discussed what circumstances need to be taken into account when prosecuting market abuse so that legal proceedings can be carried out and concluded more efficiently. Additional topics included the current developments on the grey and black capital market as well as new authorisation obligations for investment consulting, the placement business or the operation of a multilateral trading system.

● BaFin provides information at trade fairs and on site.

BaFin uses investor fairs and stock exchange open days to provide information on capital market legal issues to consumers and investors but also to providers of financial products. In the year under review, it participated as an exhibitor in the INVEST and IAM investor fairs and in open days at the Dresden, Hanover, Hamburg and Frankfurt stock exchanges. Investors were interested above all in the value of financial assets and in the respectability of various providers. Exhibition visitors often inquired about the new brokerage directive and how the surrender value in life insurance is calculated. In addition, they also wanted to know where they can lodge complaints about companies. BaFin informed the visitors about the scope of its supervisory activities and about the options for complaining to ombudspersons and the supervisory authority. 15 groups, comprised mostly of schoolchildren and students, visited BaFin during the year under review and were able to inform themselves on site. They were particularly interested in the functions of BaFin and how it is organised.

<sup>99</sup> [www.bafin.de](http://www.bafin.de) » Consumers.

# Appendix



# BaFin Bodies

## 1.1 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: April 2008

## 1.2 Members of the Advisory Board

### **Representatives of credit institutions**

Dr. Massenberg, Hans-Joachim (Deputy Chairman)  
Dr. Schackmann-Fallis, Karl-Peter  
Hofmann, Gerhard P.  
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**

Loeper, Erich

### **Representative of the Association of Private Insurers**

Schulte, Reinhold

### **Representatives of academic groups**

Prof. Dr. Dr. h.c. Baums, Theodor  
Prof. Dr. Wagner, Fred  
Prof. Dr. Schnabel, Isabel

### **Representatives of the Task Force for Occupational Retirement Provision – aba –**

Schwind, Joachim

### **Representatives of consumer protection organisations**

Kühnlenz, Stephan (Stiftung Warentest)  
Prof. Dr. Hirsch, Günter (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**

Dr. König, Peter (DVFA)

### **Representative of the trade unions**

Foullong, Uwe (ver.di)

### **Representative of industry**

Härter, Holger P. (Porsche AG)

As at: May 2008

### 1.3 Members of the Insurance Advisory Council

Prof. Dr. Christian Armbrüster	Judge at the Berlin Court of Appeal Freie Universität Berlin Faculty of Law
Dr. Alexander Barthel	German Confederation of Skilled Crafts (ZDH)
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. Georg Bräuchle	Verband Deutscher Versicherungsmakler e.V. Marsh GmbH
Lars Gatschke	Verbraucherzentrale Bundes- verband e.V. Financial Services department
Norbert Heinen	Member of the Executive Board Deutsche Aktuarvereinigung e.V.
Michael H. Heinz	President of the Bundesverband Deutscher Versicherungs- kaufleute e.V.
Werner Hölzl	Auditor and Tax Consultant Member of the Executive Board PricewaterhouseCoopers
Prof. Dr. Gottfried Koch	Universität Leipzig Institute for Insurance Studies
Dr. Gerhard Rupprecht	Chairman of the Executive Board of Allianz Deutschland AG
Dr. Bernhard Schareck	President of the Gesamtverband der Deutschen Versicherungswirtschaft e.V. Member of the Executive Board of Wü- stenrot & Württembergische AG Chairman of the Supervisory Board of Karlsruher HK AG Member of the Supervisory Board of Karlsruher Lebensversicherung AG and others
Prof. Dr. Wolfgang B. Schönemann	Universität Dortmund Chair for Private Law

Reinhold Schulte	Chairman of the Verband der privaten Krankenversicherung e.V. Chairman of the Executive Board of the SIGNAL IDUNA Group
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
Ilona Stumm	Thyssen Krupp Risk and Insurance Services GmbH
Elke Weidenbach	Specialist insurance consultant Verbraucherzentrale NRW e.V. Financial Services Group
Prof. Dr. Wolfram Wrabetz	Representative agent of Hesse Regional Government in insurance matters Member of the Management Team of Helvetia CEO Helvetia Germany
Prof. Dr. Jochen Zimmermann	Universität Bremen Economics department
tba	
tba	
tba	
tba	

As at: April 2008



## 1.4 Members of the Securities Council

Ministry of Economic Affairs, Baden-Württemberg

State Ministry of Economic Affairs, Infrastructure, Transport and Technology,  
Bavaria

State Administration for Economic Affairs, Technology and Women, Berlin

Ministry of Economic Affairs, Brandenburg

Free Hanseatic City of Bremen  
Senator for Economic Affairs and Ports

Free Hanseatic City of Hamburg  
Department of Economic Affairs and Labour

Ministry of Economic Affairs, Transport and Urban and Regional  
Development, Hesse

Ministry of Economic Affairs, Mecklenburg-Western Pomerania

Ministry of Economic Affairs, Labour and Transport, Lower Saxony

Ministry of Finance, North Rhine-Westphalia

Ministry of Economic Affairs, Transport, Agriculture and Viniculture,  
Rhineland-Palatinate

Ministry of Economic Affairs and Labour, Saarland

State Ministry of Economic Affairs and Labour, Saxony

Ministry of Economic Affairs and Labour, Saxony-Anhalt

Ministry of Science, Economic Affairs and Transport, Schleswig-Holstein

Ministry of Finance, Thuringia

As at: April 2008

## 1.5 Members of the Advisory Council (Takeovers)

Hartmut Paulsen	Chairman of the Board and President HOCHTIEF AG
Prof. Dr. Rüdiger von Rosen	Executive Member of the Board Deutsches Aktieninstitut e.V.
Dr. Werner Brandt	Member of the Board SAP AG
Dr. Thomas Kremer	Chief Legal Counsel Thyssen Krupp
Udo Behrenwaldt	Vice Chairman DWS Investment Gesellschaft
Dr. Paul Achleitner	Member of the Board Allianz AG
Jella Benner-Heinacher	Deutsche Schutzvereinigung für Wertpapierbesitz e.V.
Klaus Schneider	Chairman of the Board Schutzgemeinschaft der Kapitalanleger e.V.
Dr. Stephan Schuster	Deutsche Bank AG
Ulrike Ahlers-Murfitt	Director WestLB AG
Andreas Körnlein	Goldman, Sachs & Co. OHG
Claus Matecki	German Confederation of Trade Unions (DGB) – National Executive
Marie Seyboth	German Confederation of Trade Unions (DGB) – National Executive
Prof. Dr. Uwe H. Schneider	Technische Universität Darmstadt
Prof. Dr. Dr. Dr. h.c. mult. Klaus J. Hopt	Max-Planck-Institute

As at: April 2008

# Complaint statistics for individual undertakings

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- 2.4 Motor insurance
- 2.5 General liability insurance
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- 2.7 Household insurance
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## 2.1 About these statistics

For years, BaFin has been publishing a breakdown of complaint statistics according to insurance company and segment in its annual report. 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 2007 is compared against the number of contracts in the respective insurance class as at 31 December 2006. 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 figures 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 relate 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 2006 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.

## 2.2 Life insurance

Reg. no.	Name of insurance undertaking	No. of life insurance policies as at 31/12/2006	Complaints
1001	AACHENMÜNCHENER LEB.	5,374,362	211
1006	ALLIANZ LEBEN	10,269,450	331
1007	ALTE LEIPZIGER LEBEN	985,306	38
1035	ARAG LEBEN	374,368	24
1181	ASPECTA LEBEN	734,307	47
1303	ASSTEL LEBEN	378,045	70
1020	AXA LEBEN	2,099,104	202
1011	BARMENIA LEBEN	244,670	17
1012	BASLER LEBEN	187,271	5
1013	BAYER. BEAMTEN LEBEN	397,949	25
1015	BAYERN-VERS.	1,660,078	48
1145	BHW LEBEN	997,205	41
1132	CIV LEBEN	1,975,418	47
1122	CONCORDIA LEBEN	147,332	12
1021	CONDOR LEBEN	214,451	8
1078	CONTINENTALE LEBEN	637,727	31
1022	COSMOS LEBEN	1,285,947	48
1146	DBV-WINTERTHUR LEBEN	2,306,760	106
1023	DEBEKA LEBEN	3,152,493	53
1017	DELTA LLOYD LEBEN	692,680	62
1136	DEVK ALLG. LEBEN	631,907	13
1025	DEVK DT. EISENBAHN LV	833,107	5
1113	DIALOG LEBEN	218,728	3
1110	DIREKTE LEBEN	138,853	3
1180	DT. ÄRZTEVERSICHERUNG	205,206	17
1148	DT. LEBENSVERS.	274,258	3
1028	DT. RING LEBEN	1,002,118	77
1107	EUROPA LEBEN	428,122	8
1310	FAMILIENFÜRSORGE LV	298,481	12
1175	FAMILIENSCHUTZ LEBEN	169,062	3
1162	FORTIS DEUTSCHLAND	33,266	4
1063	GENERALI LV	1,282,960	143
1108	GOTHAER LEBEN AG	1,261,684	95
1040	HAMB. LEBEN	25,232	3
1184	HAMB. MANNHEIMER LV	6,470,122	290
1312	HANNOVERSCHE LV AG	790,887	25
1114	HANSEMERKUR LEBEN	219,562	14
1192	HANSEMERKUR24 LV AG	n.a.	2

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of life insurance policies as at 31/12/2006</b>	<b>Complaints</b>
1033	HDI-GERLING LEBEN	2,109,633	154
1158	HEIDELBERGER LV	475,048	25
1137	HELVETIA LEBEN	120,331	8
1055	HUK-COBURG LEBEN	736,467	24
1047	IDEAL LEBEN	530,440	6
1048	IDUNA VEREINIGTE LV	2,306,104	108
1097	INTER LEBEN	203,370	10
1119	INTERRISK LEBENSVERS.	86,422	2
1045	KARLSRUHER HK AG	132,144	4
1050	KARLSRUHER LEBEN	1,205,291	66
1130	KARSTADTQUELLE LV AG	1,270,506	27
1062	LEBENSVERS. VON 1871	732,506	24
1112	LVM LEBEN	716,298	16
1109	MECKLENBURG. LEBEN	159,174	11
1173	MONEYMAXX LEBENSVERS.-AG	n.a.	4
1064	MÜNCHEN. VEREIN LEBEN	143,682	2
1193	NECKERMANN LEBEN	66,792	1
1164	NEUE LEBEN LEBENSVERS	708,858	9
1147	NÜRNBERG. LEBEN	3,025,566	199
1177	OECO CAPITAL LEBEN	19,105	1
1056	OEFF. LEBEN BERLIN	139,679	4
1115	ONTOS LEBEN	42,208	1
1194	PB LEBENSVERSICHERUNG	345,782	9
1123	PLUS LEBEN	37,005	3
1309	PROTEKTOR LV AG	213,834	59
1081	PROV. LEBEN HANNOVER	812,177	23
1083	PROV.NORDWEST LEBEN	1,809,080	43
1082	PROV.RHEINLAND LEBEN	1,292,032	32
1141	R+V LEBENSVERS. AG	4,193,032	106
1090	SCHWEIZERISCHE LEBEN	1,257,906	87
1157	SKANDIA LEBEN	356,216	16
1153	SPARK.-VERS.SACHS.LEB	384,508	4
1104	STUTTGARTER LEBEN	463,823	36
1091	SV SPARKASSENVERS.	1,638,449	44
1152	UELZENER LEBEN	11,497	2
1092	UNIVERSA LEBEN	230,542	7
1314	VHV LEBENSVERSICHER.	7,671	1
1140	VICTORIA LEBEN	2,553,736	171
1139	VOLKSFÜRSORGE DT. LV	4,154,049	130
1099	VOLKSWOHL-BUND LEBEN	1,135,241	47

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>No. of life insurance policies as at 31/12/2006</b>	<b>Complaints</b>
1151	VORSORGE LEBEN	69,608	11
1160	VPV LEBEN	1,251,570	38
1005	WÜRTT. LEBEN	1,772,448	57
1103	WWK LEBEN	992,755	47
1138	ZURICH DTSCH. HEROLD	3,594,705	189
1096	ZÜRICH LEBEN	183,454	3

## 2.3 Health insurance

Reg. no.	Name of insurance undertaking	Number of insured persons as at 31/12/2006	Complaints
4034	ALLIANZ PRIV.KV AG	2,405,007	188
4010	ALTE OLDENBG. KRANKEN	117,080	9
4112	ARAG KRANKEN	266,071	17
4138	ASSTEL KRANKENV.AG	16,997	1
4095	AXA KRANKEN	506,867	86
4042	BARMENIA KRANKEN	1,009,107	45
4134	BAYERISCHE BEAMTEN K	863,148	72
4004	CENTRAL KRANKEN	1,608,883	108
4118	CONCORDIA KRANKEN	76,592	3
4001	CONTINENTALE KRANKEN	1,185,528	46
4101	DBV-WINTERTHUR KRANK.	866,414	40
4028	DEBEKA KRANKEN	3,307,950	84
4131	DEVK KRANKENVERS.-AG	146,589	3
4044	DKV AG	3,139,490	197
4013	DT. RING KRANKEN	595,476	30
4115	DÜSSELDORFER VERS.KR.	7,285	24
4121	ENVIVAS KRANKEN	109,338	6
4089	EUROPA KRANKEN	207,323	9
4119	GOTHAER KV AG	461,496	27
4043	HALLESCHE KRANKEN	522,805	37
4018	HANSEMERKUR KRANKEN	828,972	42
4122	HANSEMERKUR S.KRANKEN	1,936,237	11
4117	HUK-COBURG KRANKEN	533,826	20
4031	INTER KRANKEN	388,172	30
4126	KARSTADTQUELLE KV AG	767,191	10
4011	LANDESKRANKENHILFE	424,463	41
4109	LVM KRANKEN	246,039	13
4123	MANNHEIMER KRANKEN	79,459	2
4037	MÜNCHEN.VEREIN KV	225,389	17
4125	NÜRNBG. KRANKEN	173,254	4
4143	PAX-FAMILIENF.KV AG	142,695	3
4135	PROVINZIAL KRANKEN	117,422	5
4116	R+V KRANKEN	361,914	7
4002	SIGNAL KRANKEN	1,977,786	113
4039	SÜDDEUTSCHE KRANKEN	475,160	9
4108	UNION KRANKENVERS.	921,597	22
4045	UNIVERSA KRANKEN	346,804	25
4105	VICTORIA KRANKEN	1,122,697	48
4139	WÜRTT. KRANKEN	98,560	3



## 2.4 Motor insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31/12/2006	Complaints
5342	AACHENMÜNCHENER VERS.	2,083,243	26
5498	ADAC-SCHUTZBRIEF VERS	n.a.	3
5581	ADLER VERSICHERUNG AG	n.a.	2
5312	ALLIANZ VERS.	15,141,775	169
5405	ALTE LEIPZIGER VERS.	361,309	8
5455	ARAG ALLG. VERS.	n.a.	6
5397	ASSTEL SACH	n.a.	11
5515	AXA VERS.	3,951,800	83
5316	BAD. GEMEINDE-VERS.	498,843	2
5317	BARMENIA ALLG. VERS.	329,848	4
5633	BASLER SECURITAS	512,594	16
5310	BAYER. BEAMTEN VERS.	222,234	8
5324	BAYER.VERS.VERB.AG	1,803,698	8
5098	BRUDERHILFE SACH.AG	391,800	11
5338	CONCORDIA VERS.	1,199,236	13
5339	CONDOR ALLG. VERS.	93,587	1
5340	CONTINENTALE SACHVERS	334,877	7
5552	COSMOS VERS.	426,107	10
5529	D.A.S. VERS.	448,555	18
5343	DA DEUTSCHE ALLG.VER.	1,370,110	41
5311	DBV AG	308,581	5
5854	DBV-WINSELECT	n.a.	3
5037	DBV-WINTERTHUR	651,778	11
5549	DEBEKA ALLGEMEINE	636,195	5
5513	DEVK ALLG. VERS.	2,760,752	51
5344	DEVK DT. EISENB. SACH	952,715	7
5055	DIRECT LINE	494,421	24
5347	DT. HEROLD ALLG.VERS.	n.a.	2
5084	DTSCH. INTERNET	n.a.	4
5541	EUROP ASSISTANCE	n.a.	1
5508	EUROPA SACHVERS.	417,417	22
5470	FAHRLEHRERVERS.	314,146	3
5024	FEUERSOZIETÄT	175,670	5
5505	GARANTA VERS.	1,080,734	24
5456	GENERALI VERS. AG	1,574,208	32
5368	GERLING-K. ALLGEMEINE	1,252,404	16
5589	GGG KFZ REPARATURVERS	n.a.	1
5531	GOTHAER ALLG.VERS.AG	1,277,885	42
5585	GVV-PRIVATVERSICH.	237,854	1

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5420	HAMB. MANNHEIMER SACH	533,568	11
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI DIREKT	2,880,604	64
5512	HDI-GERLING FIRMEN	n.a.	6
5096	HDI-GERLING INDUSTRIE	593,786	11
5044	HDNA VVAG	n.a.	2
5384	HELVETIA VERS.	259,776	5
5086	HUK24 AG	898,716	37
5375	HUK-COBURG	6,947,833	86
5521	HUK-COBURG ALLG. VERS	5,113,181	89
5401	ITZEHOER VERSICHERUNG	811,013	5
5078	JANITOS VERSICHERUNG	212,501	31
5509	KARLSRUHER VERS.	415,556	6
5562	KARSTADTQUELLE VERS.	n.a.	1
5058	KRAVAG-ALLGEMEINE	982,350	23
5080	KRAVAG-LOGISTIC	703,789	11
5402	LVM SACH	4,507,652	38
5412	MECKLENBURG. VERS.	735,234	12
5414	MÜNCHEN. VEREIN ALLG.	n.a.	3
5426	NÜRNBG. ALLG.	248,558	5
5686	NÜRNBG. BEAMTEN ALLG.	332,443	8
5791	ONTOS VERS.	166,456	6
5519	OPTIMA VERS.	n.a.	2
5446	PROV.NORD BRANDKASSE	729,641	8
5095	PROV.RHEINLAND VERS.	1,223,818	16
5438	R+V ALLGEMEINE VERS.	3,551,883	24
5798	RHEINLAND VERS. AG	213,992	4
5528	ROLAND SCHUTZBRIEF	n.a.	1
5051	S DIREKT VERSICHERUNG	n.a.	7
5773	SAARLAND FEUERVERS.	143,358	2
5690	SCHWARZMEER U. OSTSEE	n.a.	2
5448	SCHWEIZER NATION.VERS	n.a.	1
5125	SIGNAL IDUNA ALLG.	1,006,288	20
5781	SPARK.-VERS.SACHS.ALL	140,522	6
5036	SV SPARK.VERSICHER.	912,090	10
5463	UNIVERSA ALLG. VERS.	n.a.	1
5441	VEREINTE SPEZIAL VERS	425,694	16
5042	VERS.KAMMER BAYERN	139,825	1
5400	VGH LAND.BRAND.HAN.	1,775,422	8
5464	VHV	n.a.	1

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5862	VHV ALLGEMEINE VERS.	3,683,455	47
5472	VICTORIA VERS.	1,610,965	25
5473	VOLKSFÜRSORGE DT.SACH	1,082,698	23
5093	WESTF.PROV.VERS.AG	1,363,326	11
5525	WGV-SCHWÄBISCHE ALLG.	737,548	4
5479	WÜRTT. GEMEINDE-VERS.	947,680	5
5480	WÜRTT. U. BADISCHE	n.a.	3
5783	WÜRTT. VERS.	1,975,555	29
5476	WWK ALLGEMEINE VERS.	n.a.	3
5483	ZÜRICH VERS.	n.a.	1
5050	ZURICH VERS. AG	2,951,414	50

## 2.5 General liability insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31/12/2006	Complaints
5342	AACHENMÜNCHENER VERS.	1,306,910	40
5581	ADLER VERSICHERUNG AG	n.a.	4
5035	AGILA HAUSTIER AG	n.a.	2
5370	ALLIANZ GLOBAL AG	1,434	2
5312	ALLIANZ VERS.	5,082,680	132
5405	ALTE LEIPZIGER VERS.	225,772	12
5068	AMMERLÄNDER VERS.	n.a.	1
5800	ARAG ALLG. RS	n.a.	1
5455	ARAG ALLG. VERS.	20,917,369	25
5397	ASSTEL SACH	n.a.	3
5515	AXA VERS.	1,906,324	59
5317	BARMENIA ALLG. VERS.	n.a.	3
5633	BASLER SECURITAS	271,563	14
5310	BAYER. BEAMTEN VERS.	n.a.	2
5324	BAYER.VERS.VERB.AG	960,974	6
5098	BRUDERHILFE SACH.AG	257,564	1
5338	CONCORDIA VERS.	356,547	9
5340	CONTINENTALE SACHVERS	279,204	8
5552	COSMOS VERS.	n.a.	5
5529	D.A.S. VERS.	223,877	12
5343	DA DEUTSCHE ALLG.VER.	n.a.	5
5771	DARAG DT. VERS.U.RÜCK	73,592	3
5311	DBV AG	621,377	7
5037	DBV-WINTERTHUR	1,030,680	11
5549	DEBEKA ALLGEMEINE	1,063,855	7
5513	DEVK ALLG. VERS.	989,818	19
5344	DEVK DT. EISENB. SACH	614,509	4
5582	DT. ÄRZTE-VERS. ALLG.	n.a.	2
5350	DT. RING SACHVERS.	146,810	4
5508	EUROPA SACHVERS.	n.a.	1
5516	FAMILIENSCHUTZ VERS.	n.a.	7
5024	FEUERSOZIETÄT	125,430	11
5505	GARANTA VERS.	n.a.	1
5365	GEGENSEITIGKEIT VERS.	n.a.	3
5456	GENERALI VERS. AG	939,242	36
5368	GERLING-K. ALLGEMEINE	900,898	26
5531	GOTHAER ALLG.VERS.AG	1,386,088	1

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5485	GRUNDEIGENTÜMER-VERS.	n.a.	2
5469	GVV-KOMMUNALVERS.	2,840	3
5374	HAFTPFLICHTK.DARMST.	660,129	11
5420	HAMB. MANNHEIMER SACH	591,740	34
5085	HDI DIREKT	506,018	12
5512	HDI-GERLING FIRMEN	n.a.	6
5096	HDI-GERLING INDUSTRIE	20,992	5
5384	HELVETIA VERS.	376,591	11
5086	HUK24 AG	n.a.	1
5375	HUK-COBURG	1,806,118	7
5521	HUK-COBURG ALLG. VERS	858,036	6
5573	IDEAL VERS.	n.a.	1
5546	INTER ALLG. VERS.	80,700	14
5780	INTERRISK VERS.	n.a.	1
5401	ITZEHOER VERSICHERUNG	172,421	4
5078	JANITOS VERSICHERUNG	n.a.	4
5509	KARLSRUHER VERS.	211,264	5
5562	KARSTADTQUELLE VERS.	n.a.	2
5080	KRAVAG-LOGISTIC	n.a.	1
5402	LVM SACH	1,084,621	10
5061	MANNHEIMER VERS.	143,092	4
5412	MECKLENBURG. VERS.	260,503	7
5334	MEDIENVERS. KARLSRUHE	n.a.	2
5414	MÜNCHEN. VEREIN ALLG.	35,200	1
5426	NÜRNBG. ALLG.	299,825	16
5686	NÜRNBG. BEAMTEN ALLG.	n.a.	2
5015	NV-VERSICHERUNGEN	n.a.	1
5787	OVAG - OSTDT. VERS.	n.a.	1
5095	PROV.RHEINLAND VERS.	836,459	31
5583	PVAG POLIZEIVERS.	n.a.	1
5438	R+V ALLGEMEINE VERS.	1,467,246	26
5798	RHEINLAND VERS. AG	141,692	9
5773	SAARLAND FEUERVERS.	n.a.	1
5690	SCHWARZMEER U. OSTSEE	n.a.	3
5448	SCHWEIZER NATION.VERS	n.a.	1
5125	SIGNAL IDUNA ALLG.	591,545	17
5781	SPARK.-VERS.SACHS.ALL	n.a.	3
5036	SV SPARK.VERSICHER.	711,272	11
5459	UELZENER ALLG. VERS.	141,980	6
5463	UNIVERSA ALLG. VERS.	n.a.	2

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5042	VERS.KAMMER BAYERN	16,868	6
5400	VGH LAND.BRAND.HAN.	697,461	10
5464	VHV	8,739	1
5862	VHV ALLGEMEINE VERS.	809,329	14
5472	VICTORIA VERS.	1,111,456	59
5473	VOLKSFÜRSORGE DT.SACH	964,835	29
5484	VOLKSWOHL-BUND SACH	n.a.	2
5093	WESTF.PROV.VERS.AG	807,872	18
5525	WGV-SCHWÄBISCHE ALLG.	297,380	7
5479	WÜRTT. GEMEINDE-VERS.	258,584	3
5783	WÜRTT. VERS.	1,010,204	38
5476	WWK ALLGEMEINE VERS.	n.a.	1
5050	ZURICH VERS. AG	1,013,369	35

## 2.6 Accident insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31/12/2006	Complaints
5342	AACHENMÜNCHENER VERS.	1,981,848	40
5498	ADAC-SCHUTZBRIEF VERS	1,140,462	5
5312	ALLIANZ VERS.	5,618,092	101
5405	ALTE LEIPZIGER VERS.	88,293	1
5455	ARAG ALLG. VERS.	20,888,293	15
5515	AXA VERS.	847,252	18
5792	BADEN-BADENER VERS.	293,812	20
5317	BARMENIA ALLG. VERS.	127,491	4
5633	BASLER SECURITAS	142,771	5
5310	BAYER. BEAMTEN VERS.	97,977	4
5324	BAYER.VERS.VERB.AG	605,076	3
5040	CIC DEUTSCHLAND	n.a.	1
5790	CIV VERS.	196,582	7
5338	CONCORDIA VERS.	283,211	6
5339	CONDOR ALLG. VERS.	86,272	2
5340	CONTINENTALE SACHVERS	741,711	14
5552	COSMOS VERS.	192,640	7
5529	D.A.S. VERS.	269,332	34
5343	DA DEUTSCHE ALLG.VER.	53,888	1
5311	DBV AG	209,793	3
5037	DBV-WINTERTHUR	287,620	10
5549	DEBEKA ALLGEMEINE	1,677,296	7
5513	DEVK ALLG. VERS.	657,837	6
5582	DT. ÄRZTE-VERS. ALLG.	8,154	3
5350	DT. RING SACHVERS.	416,715	17
5516	FAMILIENSCHUTZ VERS.	298.387	52
5024	FEUERSOZIETÄT	47,815	1
5456	GENERALI VERS. AG	1,548,916	31
5368	GERLING-K. ALLGEMEINE	2,672,634	6
5531	GOTHAER ALLG.VERS.AG	735,128	50
5485	GRUNDEIGENTÜMER-VERS.	11,976	1
5469	GVV-KOMMUNALVERS.	15,259	1
5585	GVV-PRIVATVERSICH.	17,163	1
5374	HAFTPFLICHTK.DARMST.	117,315	3
5420	HAMB. MANNHEIMER SACH	2,152,436	92
5085	HDI DIREKT	130,572	3
5512	HDI-GERLING FIRMEN	205,303	4
5384	HELVETIA VERS.	133,819	4

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5375	HUK-COBURG	1,067,246	3
5521	HUK-COBURG ALLG. VERS	495,387	1
5573	IDEAL VERS.	12,864	3
5546	INTER ALLG. VERS.	78,282	1
5780	INTERRISK VERS.	393,261	4
5401	ITZEHOER VERSICHERUNG	115,754	3
5078	JANITOS VERSICHERUNG	87,377	1
5509	KARLSRUHER VERS.	150,378	4
5562	KARSTADTQUELLE VERS.	366,151	6
5058	KRAVAG-ALLGEMEINE	44,056	1
5402	LVM SACH	870,553	4
5061	MANNHEIMER VERS.	76,399	1
5412	MECKLENBURG. VERS.	143,110	3
5414	MÜNCHEN. VEREIN ALLG.	37,116	1
5426	NÜRNBG. ALLG.	607,929	58
5686	NÜRNBG. BEAMTEN ALLG.	112,324	8
5074	PB VERSICHERUNG	74,659	4
5446	PROV.NORD BRANDKASSE	339,642	1
5095	PROV.RHEINLAND VERS.	1,288,675	8
5583	PVAG POLIZEIVERS.	316,448	4
5438	R+V ALLGEMEINE VERS.	1,477,921	14
5798	RHEINLAND VERS. AG	89,790	7
5690	SCHWARZMEER U. OSTSEE	59,115	3
5125	SIGNAL IDUNA ALLG.	1,398,148	39
5586	STUTTGARTER VERS.	249.729	16
5036	SV SPARK.VERSICHER.	320,003	2
5463	UNIVERSA ALLG. VERS.	80,771	1
5400	VGH LAND.BRAND.HAN.	5,665,028	1
5862	VHV ALLGEMEINE VERS.	270,926	2
5472	VICTORIA VERS.	984,138	50
5473	VOLKSFÜRSORGE DT.SACH	679,384	14
5484	VOLKSWOHL-BUND SACH	175,232	5
5461	VPV ALLGEMEINE VERS.	148,322	2
5082	WALDENBURGER VERS.	2,532	1
5525	WGV-SCHWÄBISCHE ALLG.	69,798	2
5479	WÜRTT. GEMEINDE-VERS.	143,291	1
5783	WÜRTT. VERS.	641,671	28
5590	WÜRZBURGER VERSICHER.	56,437	2
5476	WWK ALLGEMEINE VERS.	168,724	2
5050	ZURICH VERS. AG	2,469,511	22



## 2.7 Household insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31/12/2006	Complaints
5342	AACHENMÜNCHENER VERS.	892,623	34
5581	ADLER VERSICHERUNG AG	n.a.	2
5312	ALLIANZ VERS.	3,035,556	68
5405	ALTE LEIPZIGER VERS.	157,682	6
5068	AMMERLÄNDER VERS.	n.a.	2
5455	ARAG ALLG. VERS.	970,098	20
5397	ASSTEL SACH	n.a.	3
5077	AXA ART VERSICHERUNG	n.a.	1
5515	AXA VERS.	979,877	17
5357	BAD. BEAMTENBANK	n.a.	1
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SECURITAS	234,768	4
5310	BAYER. BEAMTEN VERS.	n.a.	3
5098	BRUDERHILFE SACH.AG	199,056	1
5338	CONCORDIA VERS.	221,539	3
5340	CONTINENTALE SACHVERS	135,756	5
5552	COSMOS VERS.	n.a.	1
5529	D.A.S. VERS.	140,652	10
5311	DBV AG	204,696	5
5037	DBV-WINTERTHUR	301,723	8
5549	DEBEKA ALLGEMEINE	652,148	5
5513	DEVK ALLG. VERS.	805,119	11
5344	DEVK DT. EISENB. SACH	455,432	3
5328	DOCURA VVAG	n.a.	1
5516	FAMILIENSCHUTZ VERS.	n.a.	2
5024	FEUERSOZIETÄT	n.a.	1
5456	GENERALI VERS. AG	593,190	20
5368	GERLING-K. ALLGEMEINE	457,483	4
5531	GOTHAER ALLG.VERS.AG	803,750	49
5420	HAMB. MANNHEIMER SACH	432,392	13
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI DIREKT	231,787	6
5512	HDI-GERLING FIRMEN	n.a.	4
5086	HUK24 AG	n.a.	1
5375	HUK-COBURG	1,232,067	13
5521	HUK-COBURG ALLG. VERS	507,792	8
5573	IDEAL VERS.	n.a.	2
5546	INTER ALLG. VERS.	n.a.	2

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5780	INTERRISK VERS.	n.a.	5
5401	ITZEHOER VERSICHERUNG	n.a.	1
5078	JANITOS VERSICHERUNG	n.a.	2
5509	KARLSRUHER VERS.	131,594	4
5562	KARSTADTQUELLE VERS.	n.a.	2
5402	LVM SACH	636,790	10
5061	MANNHEIMER VERS.	94,202	4
5412	MECKLENBURG. VERS.	162,017	3
5414	MÜNCHEN. VEREIN ALLG.	n.a.	2
5070	NECKERMANN VERS.	n.a.	1
5390	NOVA ALLG.VERS.	n.a.	1
5426	NÜRNBG. ALLG.	158,811	10
5686	NÜRNBG. BEAMTEN ALLG.	n.a.	1
5017	OSTANGLER BRANDGILDE	n.a.	1
5446	PROV.NORD BRANDKASSE	301,481	2
5095	PROV.RHEINLAND VERS.	552,715	21
5583	PVAG POLIZEIVERS.	n.a.	4
5438	R+V ALLGEMEINE VERS.	761,167	7
5798	RHEINLAND VERS. AG	101,116	8
5121	RHION VERSICHERUNG	n.a.	1
5491	SCHLESWIGER VERS.V.	n.a.	1
5125	SIGNAL IDUNA ALLG.	364,460	13
5781	SPARK.-VERS.SACHS.ALL	n.a.	4
5036	SV SPARK.VERSICHER.	395,244	6
5463	UNIVERSA ALLG. VERS.	n.a.	3
5400	VGH LAND.BRAND.HAN.	481,971	9
5862	VHV ALLGEMEINE VERS.	258,564	4
5472	VICTORIA VERS.	708,568	31
5473	VOLKSFÜRSORGE DT.SACH	864,322	21
5484	VOLKSWOHL-BUND SACH	n.a.	1
5461	VPV ALLGEMEINE VERS.	183,692	3
5093	WESTF.PROV.VERS.AG	2,433,260	8
5525	WGV-SCHWÄBISCHE ALLG.	n.a.	2
5480	WÜRTT. U. BADISCHE	n.a.	2
5783	WÜRTT. VERS.	695,039	32
5476	WWK ALLGEMEINE VERS.	n.a.	1
5050	ZURICH VERS. AG	697,488	14

## 2.8 Residential buildings insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31/12/2006	Complaints
5342	AACHENMÜNCHENER VERS.	348,547	16
5581	ADLER VERSICHERUNG AG	n.a.	1
5312	ALLIANZ VERS.	2,071,610	44
5405	ALTE LEIPZIGER VERS.	139,929	6
5455	ARAG ALLG. VERS.	n.a.	3
5515	AXA VERS.	542,548	19
5593	BAD. ALLG. VERS.	n.a.	2
5316	BAD. GEMEINDE-VERS.	n.a.	1
5633	BASLER SECURITAS	161,304	6
5043	BAYER.L-BRAND.VERS.AG	2,564,218	16
5324	BAYER.VERS.VERB.AG	502,679	10
5098	BRUDERHILFE SACH.AG	n.a.	1
5338	CONCORDIA VERS.	176,601	3
5339	CONDOR ALLG. VERS.	n.a.	2
5340	CONTINENTALE SACHVERS	64,748	2
5552	COSMOS VERS.	n.a.	2
5529	D.A.S. VERS.	58,182	2
5771	DARAG DT. VERS.U.RÜCK	26,617	1
5311	DBV AG	96,747	5
5037	DBV-WINTERTHUR	114,114	4
5549	DEBEKA ALLGEMEINE	203,587	5
5513	DEVK ALLG. VERS.	293,746	9
5344	DEVK DT. EISENB. SACH	161,915	1
5350	DT. RING SACHVERS.	48,915	1
5508	EUROPA SACHVERS.	n.a.	1
5024	FEUERSOZIJETÄT	86,836	6
5456	GENERALI VERS. AG	329,013	24
5368	GERLING-K. ALLGEMEINE	178,249	4
5531	GOTHAER ALLG.VERS.AG	291,986	19
5372	GOTHAER VERS.BANK	n.a.	1
5485	GRUNDEIGENTÜMER-VERS.	59,213	2
5032	HAMB. FEUERKASSE	163,787	4
5420	HAMB. MANNHEIMER SACH	127,832	8
5085	HDI DIREKT	88,877	5
5384	HELVETIA VERS.	169,376	2
5375	HUK-COBURG	515,468	7
5521	HUK-COBURG ALLG. VERS	147,410	8
5546	INTER ALLG. VERS.	n.a.	2

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5780	INTERRISK VERS.	n.a.	3
5401	ITZEHOER VERSICHERUNG	n.a.	1
5078	JANITOS VERSICHERUNG	n.a.	2
5509	KARLSRUHER VERS.	70,499	4
5362	LANDESSCHADENHILFE	n.a.	1
5402	LVM SACH	412,380	10
5061	MANNHEIMER VERS.	51,109	4
5412	MECKLENBURG. VERS.	92,852	5
5426	NÜRNBG. ALLG.	70,389	2
5446	PROV.NORD BRANDKASSE	326.357	4
5095	PROV.RHEINLAND VERS.	638,341	47
5438	R+V ALLGEMEINE VERS.	743,695	17
5798	RHEINLAND VERS. AG	75,152	11
5773	SAARLAND FEUERVERS.	78,263	2
5491	SCHLESWIGER VERS.V.	n.a.	1
5125	SIGNAL IDUNA ALLG.	133,955	12
5781	SPARK.-VERS.SACHS.ALL	n.a.	1
5036	SV SPARK.VERSICHER.	2,570,019	38
5400	VGH LAND.BRAND.HAN.	488,189	12
5862	VHV ALLGEMEINE VERS.	66,921	3
5472	VICTORIA VERS.	348,373	26
5473	VOLKSFÜRSORGE DT.SACH	197,144	6
5484	VOLKSWOHL-BUND SACH	n.a.	1
5461	VPV ALLGEMEINE VERS.	60,771	3
5093	WESTF.PROV.VERS.AG	2,035,403	13
5525	WGV-SCHWÄBISCHE ALLG.	n.a.	4
5480	WÜRTT. U. BADISCHE	n.a.	1
5783	WÜRTT. VERS.	383,485	25
5050	ZURICH VERS. AG	376,363	17

## 2.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31/12/2006	Complaints
5342	AACHENMÜNCHENER VERS.	n.a.	1
5826	ADAC-RECHTSSCHUTZ	2,733,527	5
5809	ADVO CARD RS	1,460,704	83
5312	ALLIANZ VERS.	2,658,731	74
5825	ALLRECHT RECHTSSCHUTZ	248,408	19
5800	ARAG ALLG. RS	1,672,086	125
5455	ARAG ALLG. VERS.	n.a.	14
5801	AUXILIA RS	523,237	11
5838	BADISCHE RECHTSSCHUTZ	133,859	3
5310	BAYER. BEAMTEN VERS.	n.a.	10
5319	BAYER. HAUSBESITZER	n.a.	1
5098	BRUDERHILFE SACH.AG	112,394	3
5831	CONCORDIA RS	387,670	33
5338	CONCORDIA VERS.	n.a.	1
5340	CONTINENTALE SACHVERS	n.a.	5
5802	D.A.S. ALLG. RS	2,855,346	149
5529	D.A.S. VERS.	n.a.	1
5343	DA DEUTSCHE ALLG.VER.	n.a.	7
5037	DBV-WINTERTHUR	160,147	4
5549	DEBEKA ALLGEMEINE	324,788	7
5803	DEURAG DT. RS	577,633	46
5513	DEVK ALLG. VERS.	n.a.	2
5829	DEVK RECHTSSCHUTZ	990,726	17
5834	DMB RECHTSSCHUTZ	680,056	9
5347	DT. HEROLD ALLG.VERS.	n.a.	1
5365	GEGENSEITIGKEIT VERS.	n.a.	1
5368	GERLING-K. ALLGEMEINE	208,026	6
5531	GOTHAER ALLG.VERS.AG	n.a.	5
5828	HAMB. MANNHEIMER RS	450,421	1
5420	HAMB. MANNHEIMER SACH	n.a.	4
5827	HDI-GERLING RECHT.	288,738	26
5086	HUK24 AG	n.a.	2
5818	HUK-COBURG RS	1,516,482	34
5401	ITZEHOER VERSICHERUNG	n.a.	10
5078	JANITOS VERSICHERUNG	n.a.	1
5812	JURPARTNER RECHTSSCH.	n.a.	3
5509	KARLSRUHER VERS.	99,650	4
5815	LVM RECHTSSCHUTZ	671,909	11

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Number of insured risks as at 31/12/2006</b>	<b>Complaints</b>
5412	MECKLENBURG. VERS.	131,517	6
5334	MEDIENVERS. KARLSRUHE	n.a.	2
5805	NEUE RECHTSSCHUTZ	445,319	20
5813	OERAG RECHTSSCHUTZ	1,223,382	46
5095	PROV.RHEINLAND VERS.	n.a.	3
5438	R+V ALLGEMEINE VERS.	n.a.	2
5836	R+V RECHTSSCHUTZ	571,882	10
5806	RECHTSSCHUTZ UNION	408,554	48
5807	ROLAND RECHTSSCHUTZ	1,121,488	61
5459	UELZENER ALLG. VERS.	n.a.	1
5400	VGH LAND.BRAND.HAN.	169,301	1
5472	VICTORIA VERS.	n.a.	1
5525	WGV-SCHWÄBISCHE ALLG.	385,167	20
5783	WÜRTT. VERS.	546,584	29
5483	ZÜRICH VERS.	n.a.	1
5050	ZURICH VERS. AG	455,707	17

## 2.10 Insurers based in the EEA

Reg. no.	Name of insurance undertaking	Complaints
5902	ACE EUROPEAN (GB)	8
5595	AIG EUROPE S.A. (F)	8
1306	AIG LIFE NIEDER.(IRL)	2
5029	AIOI MOTOR (GB)	13
7239	ALLIANZ ELEMENT.L.(A)	1
7644	ALLIANZ WORLDW. (IRL)	3
7230	AMEV SCHADEVERZ.(NL)	1
7671	ASPECTA ASSUR. (L)	3
7203	ATLANTICLUX (L)	46
5090	AXA CORPORATE S. (F)	4
1319	AXA LIFE EUR.LTD(IRL)	2
1300	CANADA LIFE (IRL)	19
7786	CANADA LIFE A. (IRL)	1
7539	CAPITALLEBEN VERS(FL)	2
1182	CARDIF LEBEN (F)	2
5056	CARDIF VERS. (F)	20
7902	CATLIN INSURANCE(GB)	1
7693	CIGNA EUROPE (B)	5
7690	CIGNA LIFE (B)	1
1189	CIGNA LIFE INS. (B)	8
7453	CLERICAL MED.INV.(GB)	26
7724	CREDIT LIFE INT. (NL)	15
7985	CSS VERSICHERUNG (FL)	1
5048	DOMESTIC AND GEN.(GB)	4
7474	DTSCH.POST INS.(IRL)	1
1161	EQUITABLE LIFE (GB)	1
5115	EUROMAF SA (F)	1
7813	FINANCE LIFE (A)	2
5053	FINANCIAL INSUR.(GB)	3
7807	FINAREF INS. (IRL)	1
7811	FINAREF LIFE (IRL)	2
7353	FÖRSÄKR.VIATOR (S)	1
7481	FORTUNA LEBEN (FL)	2
7814	FRIENDS PROVID. (GB)	2
7268	GENERALI VERS.AG (A)	1
7776	GENWORTH FINANC. (GB)	1
5030	GOUDA VERS.-AG (NL)	2
5728	HERMES TR. I.L. (B)	1

<b>Reg. no.</b>	<b>Name of insurance undertaking</b>	<b>Complaints</b>
5079	HISCOX INS. (GB)	1
7956	INTER PARTNER (B)	1
5057	INTERLLOYD (D)	7
7587	INTERN.INSU.COR.(NL)	8
7734	LIBERTY EUR. (IRL/E)	7
9031	LIBERTY EURO.(IRL/E)	13
7899	LIGHTHOUSE LIFE (GBZ)	4
5592	LLOYD'S VERS. (GB)	1
5054	LONDON GENERAL I.(GB)	3
7828	MASSMUTUAL (L)	1
7858	MGM INTERNAT. (IRL)	1
7237	MUTUELLE DES ARCH.(F)	2
7579	NEMIAN LIFE & P. (L)	3
7806	NEW TECHNOLOGY (IRL)	11
7225	OBERÖSTERR.VERS AG(A)	5
7723	PRISMALIFE AG (FL)	22
7455	PROBUS INSURANCE(IRL)	1
7894	QUANTUM LEBEN AG(FL)	2
1317	R+V LUXEMB. LV (L)	19
7415	R+V LUXEMBOURG L (L)	5
7730	RIMAXX (NL)	13
1320	STANDARD LIFE (GB)	1
1174	STANDARD LIFE (GB)	11
7763	STONEBRIDGE (GB)	7
7691	THE HULLBERRY (NL)	6
1311	VDV LEBEN INT. (GR)	2
7456	VDV LEBEN INTERN.(GR)	6
7483	VORSORGE LUXEMB. (L)	17
7929	ZURICH INSURANCE(IRL)	1



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## Abbreviations

<b>A</b>	<b>3L3</b>	3Level3	
	<b>ABCP</b>	Asset Backed Commercial Papers	
	<b>ABS</b>	Asset Backed Securities	
	<b>ARM</b>	Kredit mit variablen Zinsen (adjustable rate mortgage)	
<b>B</b>	<b>BaFin</b>	Bundesanstalt für Finanzdienstleistungsaufsicht	
	<b>BAKred</b>	Bundesaufsichtsamt für das Kreditwesen (German Federal Banking Supervisory Office)	
	<b>BAV</b>	Bundesaufsichtsamt für das Versicherungswesen (Federal Insurance Supervisory Office )	
	<b>BCBS</b>	Basler Ausschuss für Bankenaufsicht (Basel Committee on Banking Supervision )	
	<b>BGH</b>	Bundesgerichtshof (German Federal Court of Justice)	
	<b>BMF</b>	Bundesministerium der Finanzen (German Federal Ministry of Finance)	
	<b>BVerfG</b>	Bundesverfassungsgericht (German Federal Constitutional Court)	
	<b>BVerwG</b>	Bundesverwaltungsgericht (German Federal Administrative Court)	
	<b>BVI</b>	Bundesverband Investment und Asset Management (German Federal Investment and Asset Management Association)	
	<b>C</b>	<b>CDI</b>	California Department of Insurance
		<b>CDO</b>	Collateralised Debt Obligation
<b>CDS</b>		Credit Default Swaps	
<b>CEBS</b>		Committee of European Banking Supervisors (Committee of European Banking Supervisors)	
<b>CEIOPS</b>		Ausschuss der Europäischen Aufsichtsbehörden für das Versicherungswesen und die betriebliche Altersvorsorge (Committee of European Insurance and Occupational Pensions Supervisors)	
<b>CESR</b>		Ausschuss der Europäischen Wertpapierregulierungsbehörden (Committee of European Securities Regulators)	
<b>CMB</b>		Capital Markets Board of Turkey	
<b>CMBS</b>		Commercial Mortgage Backed Securities (commercial mortgage-backed securities)	
<b>CO2</b>		Kohlendioxid (carbon dioxide)	
<b>CRD</b>		Capital Requirements Directive	

<b>D</b>	<b>DSGV</b>	Deutscher Sparkassen- und Giroverband (German Savings Banks Association)
<b>E</b>	<b>EAEG</b>	Einlagensicherungs- und Anlegerentschädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
	<b>ECB</b>	Europäische Notenbank (European Central Bank)
	<b>ECOFIN</b>	Rat für Wirtschaft und Finanzen der EU (European and Financial Council)
	<b>EEA</b>	Europäischer Wirtschaftsraum (European Economic Area)
	<b>ERGEG</b>	Gruppe Europäischer Aufseher für Strom und Gas (European Regulators' Group for Electricity and Gas)
	<b>EU</b>	Europäische Union
	<b>EWR</b>	Europäischer Wirtschaftsraum (European Economic Area)
	<b>EZB</b>	Europäische Notenbank (European Central Bank)
<b>F</b>	<b>FATF</b>	Arbeitsgruppe zur Bekämpfung der Geldwäsche (Financial Action Task Force on Money Laundering)
	<b>Fed NY</b>	Federal Reserve Bank of New York
	<b>FESE</b>	Zusammenschluss der regulierten Märkte (Federation of European Securities Exchanges)
	<b>FREP</b>	Deutsche Prüfstelle für Rechnungslegung (German Financial Reporting Enforcement Panel)
	<b>FRUG</b>	Finanzmarktrichtlinie-Umsetzungsgesetz (Implementation Law on Markets in Financial Instruments Directive)
	<b>FSA</b>	Financial Services Authority
	<b>FSC</b>	Financial Supervision Commission
	<b>FSF</b>	Forum für Finanzstabilität (Financial Stability Forum)
	<b>FSI</b>	Institut für Finanzstabilität (Financial Stability Institute)
<b>G</b>	<b>GbR</b>	Gesellschaft bürgerlichen Rechts (civil law partnership)
	<b>GDV</b>	Gesellschaft Deutscher Versicherer (Association of German Insurers)
	<b>GG</b>	Grundgesetz (German Basic Law)
<b>H</b>	<b>HÜSt</b>	Handelsüberwachungsstellen (trading surveillance offices)
<b>I</b>	<b>IAASB</b>	International Auditing and Assurance Standards Board
	<b>IADI</b>	Internationale Vereinigung der Einlagen

		sicherung (International Association of Deposit Insurers)
	<b>IAIS</b>	Internationale Vereinigung der Versicherungsaufsichtsbehörden (International Association of Insurance Supervisors)
	<b>IASB</b>	International Accounting Standards Board
	<b>ICS</b>	Internes Kontrollsystem (Internal Control System)
	<b>IDW</b>	Institut der Wirtschaftsprüfer (German Institute of Chartered Accountants)
	<b>IFAC</b>	International Federation of Accountants
	<b>IFRS</b>	International Financial Reporting Standards
	<b>IFSC</b>	Konferenz der Allfinanzaufsichtsbehörden (International Financial Supervisory Authorities Conference)
	<b>IIMG</b>	Inter-Institutional Monitoring Group
	<b>IKS</b>	Internes Kontrollsystem (Internal Control System)
	<b>IMF</b>	Internationaler Währungsfonds (International Monetary Fund)
	<b>InvÄndG</b>	Investmentänderungsgesetz (Act Amending the German Investment Act)
	<b>InvG</b>	Investmentgesetz (Investment Act)
	<b>IOPS</b>	Internationale Vereinigung der Aufsichtsbehörden für Einrichtungen privater und betrieblicher Altersversorgung (International Organisation of Pensions Supervisors for private and occupational pension arrangements)
	<b>IOSCO</b>	Internationale Vereinigung der Wertpapieraufsichtsbehörden (International Organization of Securities Commissions)
	<b>IP</b>	Kapitalanlagen (investment portfolio)
	<b>ISA</b>	internationale Prüfungsstandards (International Standards on Auditing)
	<b>IT</b>	Informationstechnik (information technology)
	<b>IWCFC</b>	Vorläufiger Level 3 Aufsichtsausschuss für Finanzkonglomerate (Interim Working Committee on Financial Conglomerates )
	<b>IWF</b>	Internationaler Währungsfonds (International Monetary Fund)
<b>J</b>	<b>JF</b>	Joint Forum
<b>K</b>	<b>KA</b>	Kapitalanlagen (investment portfolio)
	<b>KG</b>	Kommanditgesellschaft (limited partnership)

	<b>KWG</b>	Kreditwesengesetz (Banking Act)
<b>L</b>	<b>L3</b>	Level 3
	<b>LBO</b>	leveraged buy-out
	<b>LKA</b>	Landeskriminalamt (State Office of Criminal Investigation)
<b>M</b>	<b>MCR</b>	Minimum Capital Requirement
	<b>MMoU</b>	multilateraler MoU (multilateral MoU)
	<b>MoU</b>	Mustervereinbarung (Memorandum of Understanding)
	<b>MTN</b>	Medium Term Notes
<b>N</b>	<b>NDOI</b>	Nebraska Department of Insurance
	<b>NPL</b>	notleidende Kredite (non-performing loans)
	<b>NRK</b>	Nationale Normenkontrollrat (National Regulatory Control Council)
	<b>NRSR</b>	Nationally Recognised Statistical Rating Organisation
	<b>NRSRO</b>	Nationally Recognised Statistical Rating Organisation
	<b>NYSBD</b>	New York State Banking Department
<b>O</b>	<b>OECD</b>	Organisation für wirtschaftliche Zusammenarbeit und Entwicklung (Organisation for Economic Cooperation and Development)
	<b>OFC</b>	Offshore-Zentrum (Offshore Financial Centre)
	<b>OLG</b>	Oberlandesgericht (Higher Regional Court)
	<b>ÖPP</b>	öffentlich-private Partnerschaftsprojekte (public-private partnership projects)
<b>P</b>	<b>PTEG</b>	Post-Trading Expert Group
<b>Q</b>	<b>QIS</b>	Auswirkungsstudien (Quantitative Impact Studies)
<b>Q</b>	<b>RMBS</b> <b>RoE</b>	Residential Mortgage Backed Securities Eigenkapitalrentabilität (Return on Equity)
<b>S</b>	<b>S&amp;P</b>	Standard & Poors
	<b>SCM</b>	Standard-Kostenmodell (Standard Cost Model)
	<b>SCR</b>	Solvency Capital Requirement
	<b>SEC</b>	Securities and Exchange Commission
	<b>SIV</b> <b>SKM</b>	Structured Investment Vehicles Standard-Kostenmodell (Standard Cost Model)

	<b>SON</b>	Untergruppe zu operationalen Netzwerkwerken (Subgroup on Operational Networks)
	<b>SPK</b>	Sermaye Piyasası Kurulu
	<b>StPO</b>	Strafprozessordnung (German Code of Criminal Procedure)
<b>T</b>	<b>TUG</b>	Transparenzrichtlinie-Umsetzungsgesetz (Act Implementing the Transparency Directive)
<b>U</b>	<b>US-GAAP</b>	US-Generally Accepted Accounting Principles (US Generally Accepted Accounting Principles)
<b>V</b>	<b>VAG</b>	Versicherungsaufsichtsgesetz (Insurance Supervision Act)
	<b>VaR</b>	Verlustrisiko (value at risk)
	<b>VerkProspG</b>	Wertpapier-Verkaufsprospektgesetz (Securities Sales Prospectus Act)
	<b>VU</b>	Versicherungsunternehmen (insurance undertaking)
<b>W</b>	<b>WGL</b>	Liquidity Working Group (Working Group on Liquidity)
	<b>WpDPV</b>	Wertpapierdienstleistungsprüfungsverordnung (Ordinance on investment services audits)
	<b>WpPG</b>	Wertpapierprospektgesetz (Securities Prospectus Act)
	<b>WpÜG</b>	Wertpapiererwerbs- und Übernahmegesetz (Securities Acquisition and Takeover Act)









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