BaFin

'09

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


Die BaFin stellt sich vor
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Foreword

2009 will go down as one of the most memorable and eventful years in the history of financial supervision – but that is unfortunately no different from the previous few years. 2009 was year one following the insolvency of Lehman investment bank, a dramatic breaking point for the international financial markets. And worse still – 2009 was the year in which the financial crisis became a global economic crisis, and the "great recession" cast its dark shadow over the world economy.

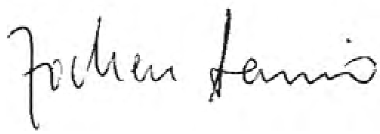
Hard times for financial supervisors, not least in Germany. As for the banks – we were prepared for the worst, in the hope of being pleasantly surprised. So on balance, 2009 was a mixed bag. There was no major banking crisis. The feared mass loan default never materialised as there was only a moderate increase in the number of corporate insolvencies. So a lot of banks actually enjoyed better annual results, although for most, this involved assuming higher interest rate risks or was due to valuation gains in their securities portfolios. Nevertheless, a small number of major banks did encounter serious financial distress; the government had to bail them out with taxpayers' money. These spectacular cases clearly highlight the structural problems of the German banking industry – for which no solution is yet in sight.

What is the outlook for 2010? There are enough dangers still lurking in the international financial system to turn the world upside down – and worse still, in corners where hardly anybody would expect major risks to be. Greece's debt crisis has demonstrated how quickly a seemingly stable situation can deteriorate dangerously. There do not seem to be many safe havens left to provide shelter from the storms over the international financial markets.

This cannot be good news for conservative investors such as German insurers. They may have survived the financial crisis thus far without major damage – which is also thanks to the strict German investment regulations that have often been criticised in good times. However, the extremely low interest rates are becoming an increasing challenge for life insurers, putting a great strain on them in meeting their promised returns. They too must be wishing for a return to normality as soon as possible. But there is no sign of that yet.

We are all going to have to work hard for normality – and that includes us, the regulators, as we are also on the front line. The financial markets will only regain their previous functionality if a new regulatory framework to curb excessive systemic risks is introduced. 2008 and 2009 were the years of groundbreaking political proclamations at the G20 summits. 2010 has to be the year in which the promises are kept and sustainable rules adopted for the international financial markets. A lot of essential questions still have to be answered. We must not let the difficulty of providing convincing answers to these questions lead us to avoid making important decisions. We must not go on with life as if the crisis had never happened. Whoever chooses not to act now – or worse still, intends to prevent any action being taken – will be responsible for the damage caused by the next crisis.

Bonn and Frankfurt am Main | April 2010



Jochen Sanio
President

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I Introduction

Governments, central banks and supervisory authorities around the world were still working through the consequences of the financial crisis in 2009, which began with the closure of the Lehman Brothers investment bank in 2008. The financial system seemed much more stable at the end of 2009 than in the previous year, but a lot of banks are still very vulnerable and dependent on government support measures for survival. In addition, the world economy was in a severe recession at the beginning of the reporting year. A strong and swiftly introduced government impetus was able to cushion the slump, but the economic upswing remains fragile and we should be prepared for setbacks. The news at the end of the year that the Greek budget deficit was getting out of hand sent shockwaves through the financial markets and brought country risk back into the limelight. The nervous market reactions are an indication of how serious the consequences for worldwide financial stability of a bankrupt country could be.

The G20 states have declared it their aim to close the gaps in the worldwide regulatory system, improve the exchange of information between supervisory bodies and establish new rules, such as for banks' capital base. They formulated key parameters for this purpose at the world finance summits in London, Pittsburgh und St. Andrews last year. The former Financial Stability Forum (FSF) now upgraded to Financial Stability Board (FSB) is accompanying the implementation of these new standards; BaFin, the Federal Ministry of Finance and the Bundesbank are actively involved in this process for Germany.

New challenges facing bank and insurance undertaking remuneration systems.

Numerous regulatory corrections – some fundamental - were made during the year under review in the light of the financial crisis. For example, BaFin formulated new requirements for the remuneration systems of banks and insurance undertakings in two circulars at the end of 2009. The new rules for remuneration systems are based on the principles developed by the FSB at the request of the G20. The German legislature will set these rules down in regulations during the course of this year. Another new rule states that rating agencies active in Europe must be registered in order to continue providing ratings for regulatory purposes. This is provided by an EU regulation which came into force last December. The work of rating agencies is viewed as a contributing factor to the financial crisis. Registered agencies are subject to strict rules governing conduct and organisation; the respective national supervisory authorities are responsible for registration and supervision.

At an international level, the consensus is largely that bank risk management must be improved and risk buffers strengthened in order to increase the resilience of the financial system as a whole.

One way of achieving this is through stricter quantitative and qualitative capital and liquidity requirements. BaFin included the extended international provisions for risk management in the amendment to its Minimum Requirements for Risk Management for banks (Mindestanforderungen an das Risikomanagement – MaRisk) published last summer, which also contains experience from its own supervisory and assessment practice.

Basel Committee revises capital requirements.

As recommended by the G20, the Basel Committee for Banking Supervision is working to raise the quality of the capital base, particularly tier 1 capital, and to simplify the definition of capital. It is currently conducting an impact study, the results of which will be considered in the formulation of the final version of the regulations scheduled for the end of this year. The Basel approach initially planned to permit common equity at public limited companies to comprise only subscribed capital and disclosed reserves. However, the German representatives in the Basel Committee succeeded in ensuring that allowances are made for the special requirements of non-public limited companies, such as cooperative banks or savings banks. This means that the respective capital contributions of silent partners in partnerships continue to be counted as common equity.

At the peak of the crisis in September 2008, BaFin prohibited naked short sales for eleven financial stocks (covered short sales were not included). The ban was lifted at the end of January 2010; however, it prompted a transparency obligation for net short-selling positions in ten selected financial stocks in March 2010.

BaFin assesses achievability of interest rate guarantees by life insurers.

There was no end in sight for the low interest phase in the reporting year. For this reason, BaFin collected data in the autumn for the first time to specifically examine the long-term achievability of the interest rate guarantees provided by life insurers. At the moment, companies have to ensure an average annual return of 3.4%. BaFin’s forecast statements showed that the insurance sector would be able to survive financially even if the pessimistic scenarios materialised. BaFin’s study has been the subject of much interest among European supervisory authorities.

Legislature reinforces investor protection.

Investor protection improved a lot last year. The Act Revising the Legal Relationship under Tranches of Debt Issues and Improvement of Enforceability of Investor Claims in the event of False Advice (Gesetz zur Neuregelung der Rechtsverhältnisse bei Schuldverschreibungen aus Gesamtemissionen und zur verbesserten Durchsetzbarkeit von Ansprüchen von Anlegern aus Falschberatung) has been in force since August. It gives investors two important advantages: Firstly, the three-year statutory period of limitation for claiming damages due to false advice now applies from the date on which the damage was recognised, not from the contract conclusion date as was previously the case. The maximum period of limitation is ten years from the time the false advice was given. Secondly, as of 1 January 2010, investment services enterprises are obliged to provide their clients with a written record of any investment advice. The new documentation obligation is designed to help reveal misunderstandings between advisor and client and make it easier for investors to prove the content of their consultations in the event of dispute. BaFin is currently examining the changes institutions are implementing in their business models in reaction to the new regulations on recording investment advice.

BaFin is also examining how institutions are implementing these investor protection rules in another case: Standards have been in place since 2007 regarding all information made available by investment service providers to their clients or prospective clients. Since the statutory regulations came into force, BaFin has been closely observing whether and how institutions have been following them, and has identified those regulations which are generally not applied correctly. In its official interpretation of February 2010, BaFin provides institutions with an interpretation guideline to help them implement the statutory regulations in as uniform a manner as possible.

EU resolves new financial supervision system for Europe.

The EU resolved in September last year to restructure financial supervision in Europe. The amendments are due to be implemented at the beginning of 2011. In accordance with the first regulation drafts from Brussels for a new European supervisory architecture, supervision will in future be based on two cornerstones: Macroprudential supervision by the European Systemic Risk Board (ESRB), and microprudential supervision by the European System of Financial Supervisors (ESFS). The ESFS will comprise three new European Supervisory Authorities (ESAs) in addition to the national supervisory authorities. These ESAs will be created by turning CEBS into the European Banking Authority (EBA), CEIOPS into the European Insurance and Occupational Pensions Authority (EIOPA) and CESR into the European Securities and Markets Authority (ESMA).

II Economic environment

1 En route to more stability

Meltdown of the financial system averted.

In the wake of the failure of the US investment bank Lehman Brothers in autumn 2008, the international financial system was on the brink of collapse. It was only thanks to the wide-scale implementation of emergency fiscal and monetary policy measures that confidence could be restored and that a systemic meltdown with unforeseeable consequences for economic activity and prosperity could be avoided. Although the global economy slipped into a deep recession at the beginning of 2009, the speed and decisiveness with which governments responded helped both cushion the fall and reduce its impact. Indeed, the economy recovered noticeably in early summer. At the same time, investors began to regain their appetite for risk. Premiums for high-risk assets fell to such an extent that, for certain asset classes, they reached levels as low as those seen prior to the onset of the financial crisis.

The clean-up operation began in earnest once the rescue packages that were hurriedly put together took effect. The financial industry endeavoured to clean up its balance sheets, to reduce risks incurred to a manageable level and to raise capital in order to compensate for accrued losses. In many instances, institutions were dependent on state support. Moreover, an improvement in the earnings situation has been spurred on by key factors such as the low cost of refinancing due to an expansive monetary policy, and the fact that the situation on the financial market has improved. In particular, the large investment banks profited from the favourable conditions and the considerable need of companies, financial institutions and governments to raise capital, thus compensating in many cases for the write-downs of toxic securities, which remained high. At the end of 2009, the financial system was considerably more stable than was the case a year before, when the overall risk-bearing capacity of institutions was nowhere near a comfortable level.

The international financial system on government life support.

In view of this situation, the early support provided by governments had to be kept in place throughout the entire year. Governments around the world provided badly hit financial institutions with comprehensive guarantees for non-performing securities and recapitalisation funds. Although a number of international banks, which had already returned to profit, were able to acquire capital from private sources to repay state capital injections and free themselves from the clutches of state control in the second half of the year, many institutions would still not be able to survive on their own without state support. As a result, the financial system is still fragile and susceptible to further setbacks.

Country risk returned to the spotlight at the end of 2009.

The scope of economic stimulus packages and support provided to the financial industry stretched government budgets in many parts of the world to breaking point. Sovereign debt rose sharply and, in a number of extreme cases, sowed doubt on capital markets about the long-term solvency of the states concerned. The announcement of a Dubai state holding company that it would suspend debt payments, coupled with the ballooning budget deficit in Greece, sent brief shock waves throughout the financial markets at the end of 2009. In view of the events, the issue of country risk returned to the spotlight. The sensitive and nervous way in which the market reacted underlines just how serious an impact a possible sovereign default could have on international financial stability.

Country risks in Central and (South-)Eastern Europe

Following the support measures implemented by many governments to stabilise the economy, country risk around the globe rose considerably in 2009 in view of the swollen level of sovereign debt. Moreover, emerging markets were further affected by the associated outflow of foreign capital. In Europe, not just emerging markets in Eastern Europe found themselves in a precarious situation in terms of liquidity, but also EU member states such as Latvia and Hungary, and euro zone members such as Greece. The International Monetary Fund (IMF) had to provide credit lines in order to shore up the solvency of these states. Similarly, the heavily indebted state holding company Dubai World had to be rescued by its neighbouring emirate, Abu Dhabi, in 2009 with a multi-billion dollar loan. Dubai World had previously requested a six-month suspension of payments to settle its debts, triggering concerns on financial markets around the world of a second financial crisis wave. Rating agencies responded to the deteriorating liquidity situation of states by either downgrading ratings or issuing negative outlooks (Greece, Portugal, and Spain). Prime borrowers such as the USA and the UK were also told to consolidate their state finances to avoid the risk of losing their prized AAA rating.

German banks’ lending exposure to Central and (South-)Eastern Europe has increased considerably over the past few years in view of the estimated growth potential of countries in this region. Countries which even before the financial crisis were suffering from budget and current account deficits and which had a high level of foreign currency debt were particularly affected by developments on the financial markets and in the real economy. In October 2009, the European Commission forecast a deficit quota of 12.2% for Greece, for example, despite the fact that this was just 3.7% in 2007. In the same period of time, it is expected that Greece’s debt quota will rise from 95.6% to 124.9%. In response to the unacceptable state of Greece’s finances, the European Commission has imposed strict requirements to consolidate Greek finances. The objective here is to reduce Greece's budget deficit to 2.8% by 2012, returning it a level below the maximum of 3% as defined in the EU Stability and Growth Pact. The following image illustrates the development of risk premiums for Greece, Poland and Russia.

Figure 1
5-year CDS spreads for Greece, Poland and Russia

Source: Bloomberg

After CDS spreads rose sharply at the end of 2008, risk premiums dropped considerably towards the end of the first quarter in 2009. This trend went in step with the stock market recovery and illustrates the rising appetite for risk of market actors at this time. The IMF support measures, the economic recovery and the return of capital inflows in emerging markets were the main drivers behind the positive trend in the following months. However, the situation remained delicate, particularly in heavily indebted countries such as Greece, a fact which is reflected in the recent steady rises of CDS spreads. At the beginning of 2010, the 5-year CDS spread for Greece was at times at a level of over 400 basis points. It is interesting to note that, at the beginning of February 2010, the Greek CDS spread curve was clearly inverse – premiums were significantly higher to insure debt in the short term than was the case for longer periods of time. This underlines the seriousness of the situation in Greece as such trends are usually only observed in the case of borrowers that are on the brink of insolvency. The Greek government's concession that its sovereign debt is considerably higher than previously claimed is to be seen in this context. In 2010, it is forecast that Greece will have to take on an additional €50 billion of sovereign debt just to be able to service existing debt and to plug its budget deficit for the current year. In view of the deteriorating economic situation in Greece, the EU placed the Greek budget under supervision at the beginning of February 2010 and began infringement proceedings. Furthermore, euro zone members announced that financial stability in the monetary union would be safeguarded by a range of support measures should Greece become insolvent.

As many banks reported a strong increase in lending exposure to Central and (South-)Eastern Europe and countries in this region are suffering from an increasingly precarious liquidity situation, BaFin surveyed German banks on their exposure to this region in 2009.

Strategies needed for an orderly end to state support.

In order to avoid placing too much strain on the confidence of the financial markets, it is important for governments to begin setting a credible course for consolidation and gradually reducing the high level of debt. However, this also means that there are only very limited funds available in most countries to afford additional expenditure programmes and support measures for the finance industry. Difficult decisions must also be taken concerning monetary policy. If central banks continue to pursue a very loose monetary policy necessitated by the crisis for too long, they risk either stoking inflation or creating asset bubbles, which may be tantamount to sowing the seeds for the next financial crisis. On the other hand, tightening both fiscal and monetary policy prematurely could provoke withdrawal symptoms in financial institutions and severely test the resilience of the financial system.

Recession increasingly impacts the financial system.

The global recession which hit hard at the beginning of 2009 weakened the financial position of companies and private households. Economic activity fell at a speed and to an extent which was unprecedented in post-war history, spreading throughout regions simultaneously. Banks which were already suffering from the effects of the financial crisis were hit additionally by deteriorating credit quality, and they will face further problems in connection with loans granted to corporate and private clients. In a similar vein, insurers are also suffering from the rising level of corporate insolvencies and unemployment. The results are lower premium income, rising claims expenditure and higher cancellation rates. However, the main effect of the economic slump on the balance sheets of financial institutions will only begin to show once the credit cycle has reached its low point. Experience from similar economic phases in the past shows that this process is just beginning and that credit quality will probably continue to deteriorate over an extended period of time even though economic activity has since begun to pick up noticeably again. However, economic recovery remains fragile. A self-supporting recovery did not take hold in 2009, meaning that setbacks to economic growth must be expected.

Follow-up financing drying up.

The upcoming wave of refinancing is particular cause for concern. Over the coming years, an increased amount of debt will mature, which was issued under rather lax conditions during the boom years before the crisis began and which will now require follow-up financing. However, the value of collateral has, in many cases, been eroded so heavily in the course of the financial crisis that established credit clauses are being breached. Thus, banks are requiring a higher level of equity or additional collateral from borrowers before the loan is extended. If borrowers are unable to provide the required funds, they may face forced liquidation.

Banks attempt to avoid distress sales of commercial property.

Financing commercial property is currently classified as particularly crucial, although Germany, with its conservative financing structure and only moderate overheating in several segments of the market, is less affected than other countries that are more heavily centred on the capital market with considerable securitisation activities, which gave impetus to excessive lending because of their harmful incentive mechanisms. In the majority of these countries, the commercial real estate market had been the stage for the growth of a significant asset bubble, which subsequently burst almost everywhere during the financial crisis in 2008 and 2009. Banks are still trying to avoid distress sales and to sit out this difficult economic phase, otherwise they would be forced into realising losses immediately, which would trigger a vicious cycle of falling property prices and rising loan defaults as a result of the extra supply of property coming on to the market. It is, however, doubtful if it is possible to sustain this strategy of sitting tight and looking forward to better times.

Regulatory lessons from the crisis become clearer.

Pursuant to the political requirements set out by the G20 states, the responses of supervisors to the financial crisis are being coordinated internationally under the auspices of the Financial Stability Board (FSB). After a number of initial difficulties, the shape of regulatory and supervisory reform emerged with increasing clarity during 2009. The primary objective is to make the financial system more stable, to plug regulatory loopholes and to develop further international cooperation between supervisory authorities. All financial markets, financial products and market actors are to be supervised and regulated. Much has already been started. Examples of particularly successful measures include setting up of cross-border supervisory colleges for large, cross-border financial institutions, defining the rules for remuneration systems, supervising rating agencies and making it mandatory to use central counterparties when trading in over-the-counter derivatives.

At an international level, the consensus is largely that bank risk management must be improved and risk buffers strengthened in order to increase the resilience of the financial system as a whole. Stronger quantitative and qualitative capital and liquidity requirements are essential to limiting excessive leverage and risk taking, as well as guaranteeing the solvency of the financial institutions at all times. Considerable progress was also made here in the regulation process in 2009. However, there are still a number of specific questions that have to be addressed. The supervisory authorities are faced with a big challenge. One the one hand, regulation must be tight enough to prevent future financial crises; on the other, there is the risk that, in light of the instability of current market conditions, excessive regulation will trigger a credit crunch which, in turn, will have a negative impact on the recovery of the financial system and the economy. As a consequence, it is absolutely vital to be prudent and carefully consider the advantages and disadvantages of any intended regulatory amendments.

The Financial Crisis: A summary of the key events in 2009

January

Commerzbank is partly nationalised. SoFFin, the German government's rescue fund, buys a stake of 25% plus one share for €1.8 billion and provides another €8.2 billion in the form of a silent participation (stille Einlage).

Several major international banks, including **Deutsche Bank,** report losses totalling billions of euros in the fourth quarter of 2008.

DZ-Bank is forced to raise fresh capital in order to cover losses.

Bank of America must be bailed out once again, receiving $20 billion from the US government and guarantees for bad securities to the amount of $118 billion.

The **German federal government** agrees on a second **economic stimulus package** for 2009 and 2010 to the tune of €50 billion.

The **British government** announces a second comprehensive banking bail-out in order to jump-start the issuing of credit.

February

The states of Hamburg and Schleswig-Holstein inject €3 billion of fresh capital into **HSH Nordbank** and provide guarantees to the tune of €10 billion.

US Treasury Secretary Timothy Geithner presents the key aspects of a package worth $1.5 billion to stabilise the financial system (**Private-Public Investment Program**).

Following protracted political debate, US President Barack Obama signs the bill for an **economic stimulus plan** worth almost $790 billion.

March

SoFFin provides **HSH Nordbank** with guarantees to the amount of €30 billion.

The **Federal Reserve** announces plans to buy up to $300 billion in US Treasury bonds and to boost its purchase of non-performing mortgage securities by $750 billion.

Following a catastrophic final quarter, the struggling US insurer **AIG** records losses reaching almost $100 billion in 2008.

April

An action plan to thwart the financial crisis is agreed on at the **G20 summit** in London. The centrepiece of this plan is to design a new architecture for international finance.

German Finance Minister Peer Steinbrück presents plans to create a **bad bank,** onto which German banks can offload their toxic securities.

Several large US banks comfortably returned to **profitability** in the first quarter of 2009, not least because of relaxed accounting rules.

May

BaFin extends the ban on naked **short selling.**

The **ECB** strengthens the market for **covered bank bonds** by implementing a purchase programme totalling €60 billion and aggressively pursues an accommodative monetary policy. Following the fourth interest rate cut this year, the key interest rate is just 1%.

Stress tests on the 19 largest **US banks** ordered by the government reveal additional capital requirements for ten credit institutions totalling $74.6 billion.

June

Following a takeover bid and capital increase, the state banking rescue fund SoFFin holds a 90% stake in **Hypo Real Estate.**

The first **major US banks** begin to repay the billions of dollars of state support.

July

SoFFin approves a further €7 billion in guarantees for **IKB.**

The Bundestag enacts the German **Bad Bank** Act.

Investment banking and securities trading drive profits for the major international banks in the second quarter of 2009. In contrast, **Morgan Stanley** and **Wells Fargo** suffer punishing write-downs on their exposure to commercial real estate.

August

West LB is the first German credit institution to make plans to set up a bad bank.

September

Further steps to tighten regulation of international financial markets are agreed at the **G20 summit** in Pittsburgh.

Following examples in the USA, several banks in Europe release themselves from state influence.

Ireland extends a comprehensive safety net beneath the five largest banks in the country. The state will buy mortgages and securities from these banks with a nominal value of €77 billion at a discount of at least 30% until the middle of 2010.

October

Shareholders of **Hypo Real Estate** agree to fully nationalise the bank at the AGM.

The private bank **Sal. Oppenheim** is taken over by **Deutsche Bank.**

The US real estate financier **Capmark** goes bankrupt.

Fannie Mae and **Freddie Mac,** the two US mortgage lenders currently under conservatorship, require additional billion-dollar capital injections.

The Dutch financial services group **ING** announces plans to split up.

November

Following negotiations between the federal government and **WestLB** owners on how to share the burden, the path is clear to set up a bad bank under the auspices of SoFFin.

The key US SME finance company **CIT** files for Chapter 11 bankruptcy protection.

The British government announces a second bailout for the partly nationalised banks **Royal Bank of Scotland** and **Lloyds Banking Group.**

The emirate of **Dubai** announces the suspension of debt payments by the holding company Dubai World, sending shock waves throughout international financial markets.

December

EU finance ministers agree on a new **framework for European financial markets.** The committees responsible for supervising banks, insurers and securities – CEBS, CEIOPS and CESR – are to be upgraded and given the status of EU authorities.

The **price of gold** surpasses $1,200 per troy ounce, an all-time high.

A downgrade of **Greece's** credit rating puts strain on financial markets.

The Austrian BayernLB subsidiary **Hypo Group Alpe Adria** is nationalised.

The last remaining US banks still reliant on government support, **Bank of America, Citigroup** and **Wells Fargo,** announce their intention to repay this support promptly.

BaFin publishes a circular on the requirements for **remuneration systems.**

2 Financial Markets

Recovery in a tense environment with uncertain prospects.

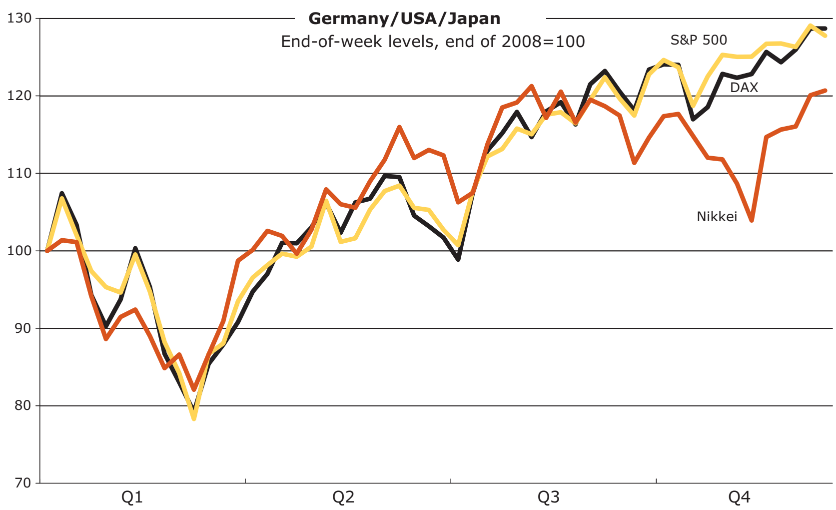
After the financial crisis spread to the real economy at the end of 2008, uncertainty and risk aversion of financial market actors overshadowed the first quarter of 2009. It was only in the second quarter that the effects of measures implemented by governments and central banks throughout both industrialised and emerging markets began to take hold. The interbank market began to thaw and the medium-term outlook for economic growth improved, leading to a rise in the relevant business climate indicators and blowing wind into the sails of stock markets. Although it was not possible for government stimulus plans to prevent an economic slump in 2009, leading economic research institutes repeatedly revised their forecasts upwards for gross domestic product growth in the course of 2009. Overall, financial markets have recovered considerably but are still filled with uncertainty given the still-fragile nature of long-term economic growth prospects. In particular, delayed effects could still cause disruption in financial markets.

Stock markets plumb new depths in March.

While the dramatic events of the previous year continued to put pressure on the stock markets until the end of the first quarter and the MSCI World Index fell to its lowest level since September 1995 with 688 points, an improved outlook for economic growth in the following two quarters resulted in significant gains on the stock markets. The positive outlook was encouraged especially by government economic stimulus plans being implemented around the globe, which above all involved supporting the automobile and construction industries. Many governments also introduced direct tax breaks in order to stimulate demand in private households. Additionally, the lower cost of raw materials also had a positive effect. Overall, at the end of the year the MSCI World Index has risen by 27% over its level at the start of the year. The Dow Jones Index grew by 18.8% in a year-on-year comparison.

Figure 2

Stock markets in comparison 2009



Source: Bloomberg

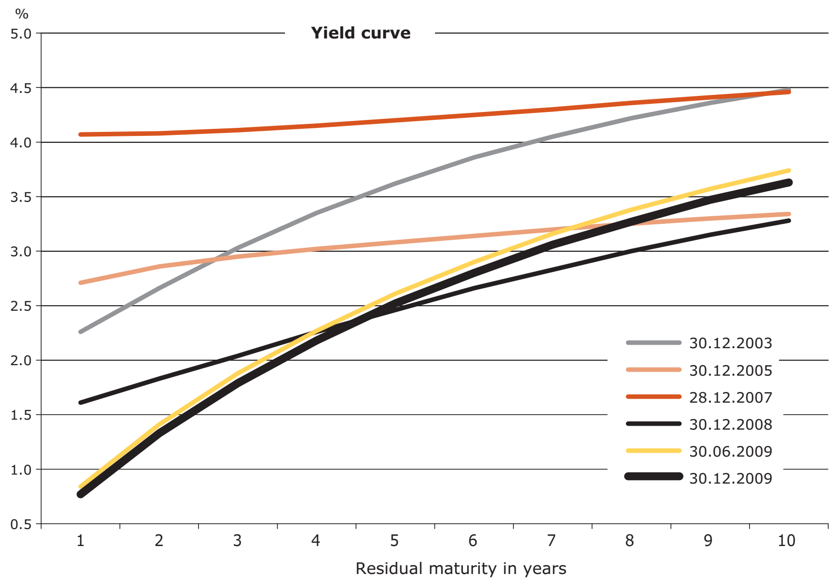
DAX performs positively throughout the year.

Over the course of the year, the DAX virtually mirrored the development of the S&P 500 Index. Although at the beginning of March it fell to its lowest level since September 2004 with 3,666 points, it made significant gains in the last three quarters of the year. In contrast to this, the Nikkei, which is largely comprised of export companies, slumped significantly in the fourth quarter as the US dollar weakened against the Japanese yen. This means that the Nikkei underperformed the DAX over the year.

Steepening yield curve.

The yield curve, which shifted downwards considerably in the previous year and steepened, became particularly steep in 2009. While maturities extending beyond five years were subject to relatively few changes, the curve for shorter maturities was significantly impacted by the monetary policy of central banks, which had successively cut their key interest rates and drastically increased liquidity. The increased attractiveness of higher yield securities due to the lower risk perception of market participants and high volume of newly issued government bonds led to moderate rises in interest rates at the upper end of the yield curve.

Figure 3
Yield curve for the German bond market*



* Interest rates for (hypothetical) zero coupon bonds without default risk.

Source: Bundesbank

Monetary policy: unconventional strategies.

While monetary policies being pursued by central banks in the preceding year were largely marked by rate cuts, a range of unconventional measures were implemented in 2009. Once large central banks such as the Federal Reserve, the Bank of England or the Bank of Japan had fully exhausted the potential to cut key interest rates, they began to support specific markets by buying up securities such as government bonds or commercial papers. The European System of Central Banks also launched a programme to purchase covered bonds, reaching a volume of almost €30 billion at the end of 2009 and enabling expenses of a total of €60 billion by

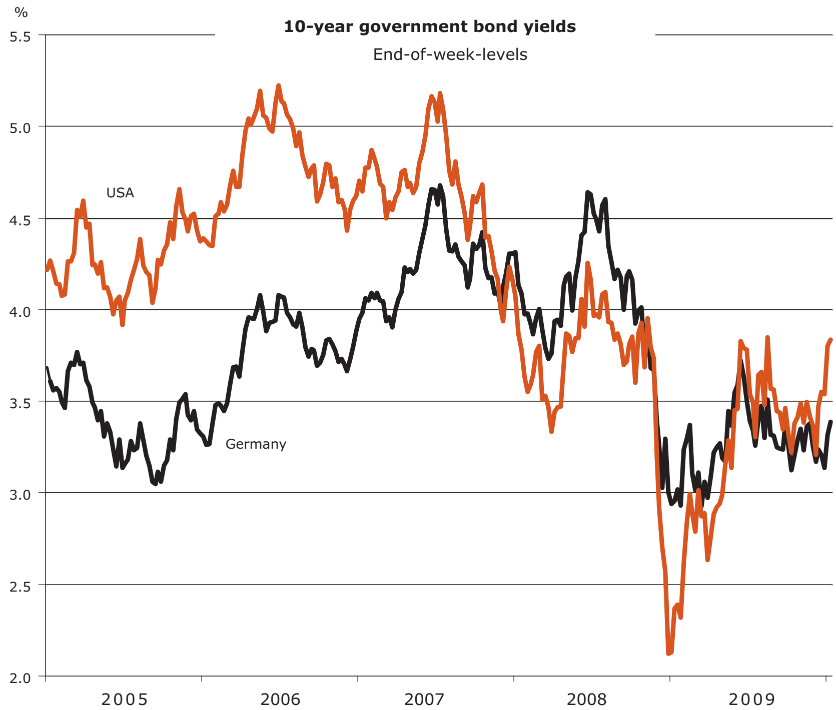
30 June 2010. Not only did the measures stimulate the securities markets, but they also had a significant impact on liquidity and refinancing potential in the banking sector. The large central banks also granted each other swap lines, which enable a central bank to borrow liquidity in a foreign currency from another central bank quickly and easily. This helped to safeguard the supply of foreign currency loans to credit institutions.

Yields of long-term government bonds stabilised in the course of the year.

Having fallen sharply at the end of the preceding year, ten-year government bond yields stabilised once again above 3% during 2009. Yields of US Treasuries and German government bonds trended in a similar fashion during the second half of the year. Growth in yields was primarily fuelled by higher inflation expectations and the lower tendency of investors to seek safe havens.

Figure 4

US and German capital market rates in comparison

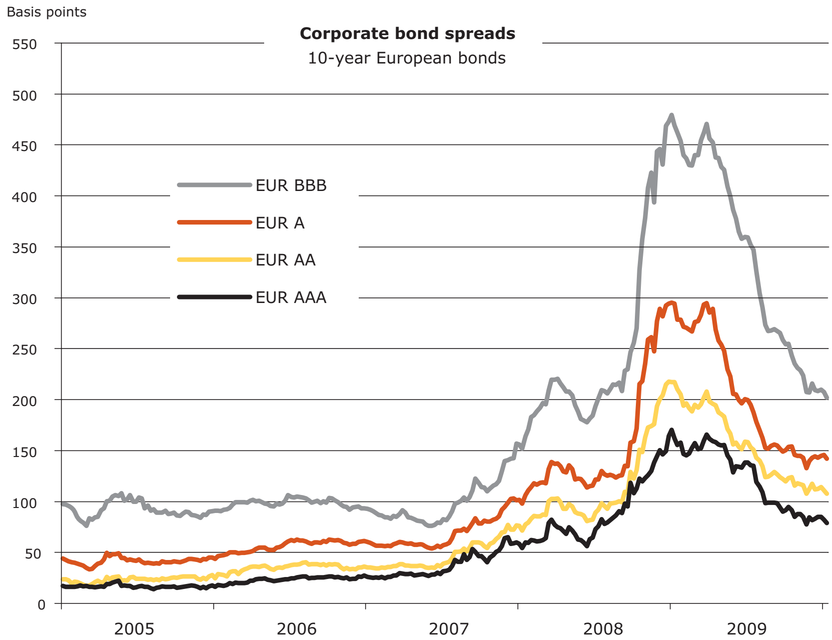


Source: Bloomberg

Spreads of European corporate bonds improve considerably.

Overall, risk premiums once again fell noticeably on the financial markets. For instance, risk premiums in the European corporate sector, which had risen sharply due to poor economic growth forecasts, fell equally sharply in the last three quarters of 2009. As a result, credit spreads of corporate bonds with an AAA rating, for example, were comfortably back below 100 basis points at the end of the year. This was primarily due to the fact that business confidence picked up. Furthermore, yields of government bonds serving as a basis for comparison increased. Increased M&A activity was also testimony to lower risk perception among investors.

Figure 5
Corporate spreads

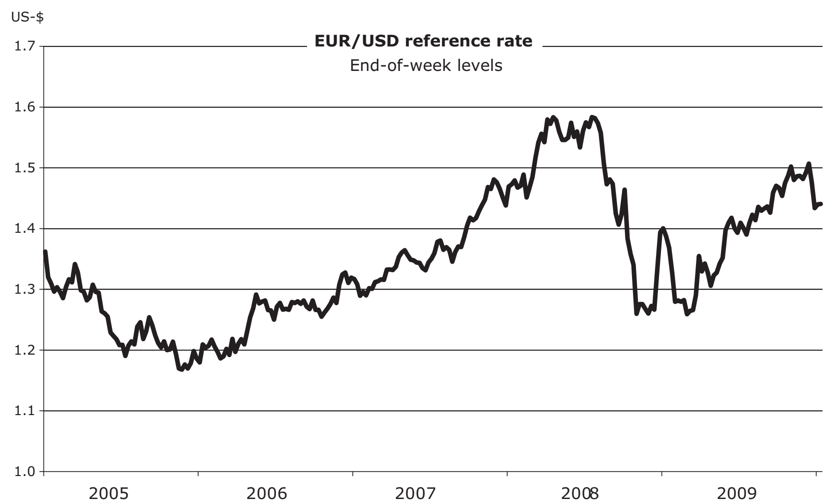


Source: Bloomberg

US dollar weakens.

After having gained significantly in value at the end of 2008 in fulfilling its traditional role as a crisis currency, the US dollar lost much of this ground in 2009. Reasons for this include the lower key interest rate compared to the euro zone and the fact that investors consider risk to be higher due to the US government deficit. In addition, the dollar weakness was fuelled by speculative carry trades with investors borrowing low-yielding currencies to invest in high-yielding currencies.

Figure 6
Exchange rate development



Source: Bloomberg

3 Banks

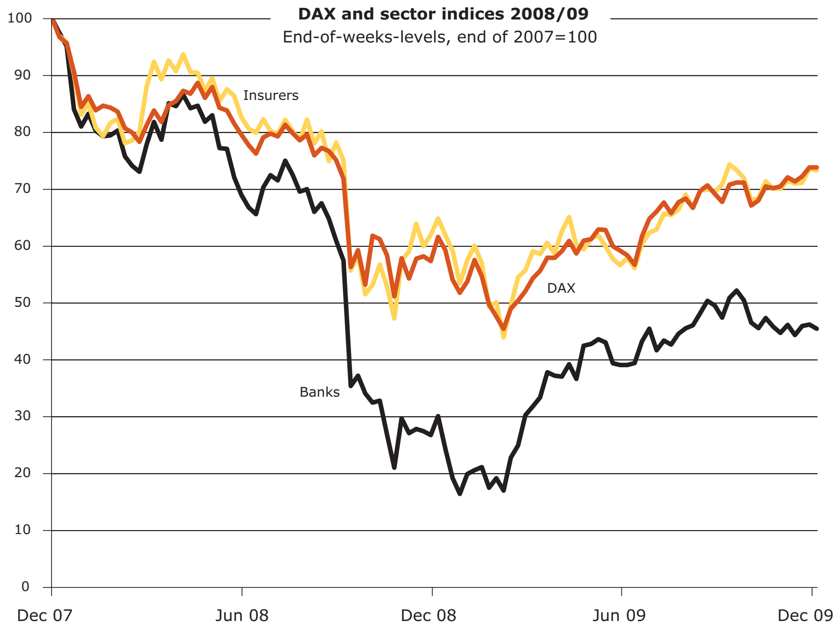
Mixed picture in the aftermath of the financial crisis.

The banking sector continued to feel the effect of the subprime crisis and the resulting global financial and economic crisis. In contrast to the preceding year, there was a more significant gap between the winners and losers of the crisis. Winners were primarily banks that had been able to limit losses thanks to comparatively good risk management during the crisis and were therefore best placed to profit from the recovery in the majority of asset classes from the second quarter of 2009. This effect was amplified to a certain extent by the disappearance of a number of key competitors from the market. By the same token, classic retail banks benefited thanks to an increase in their business volume due to the increased risk aversion of their clients. These banks simultaneously generated additional income from maturity transformation thanks to the steep yield curve. In contrast, the situation worsened for a number of banks that were already forced to avail themselves of government bail-out in 2008 or at the beginning of 2009 due to heavy write-downs on securitisation structures. They were only able to profit to a limited extent from the market recovery in 2009.

Bank shares boost the DAX.

In 2009, the situation on the stock market was the complete reverse of the preceding year. While bank shares (-70%) were a drag on performance of the DAX (-38%) in 2008, the sector index of German banks recovered markedly in 2009 with a rise of almost 70%, helping the DAX on its way to an annual growth of approximately 29%. The sector index of German insurers trended in step with the DAX.

Figure 7
Share indices for the German financial sector



Source: Bloomberg

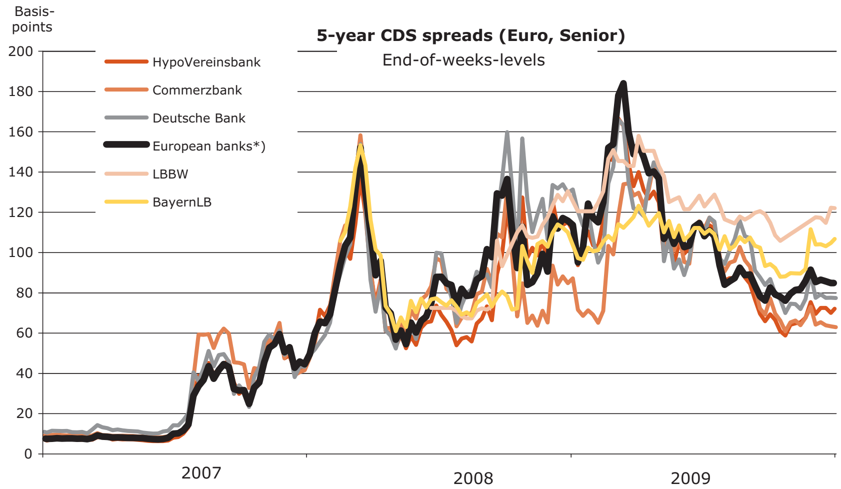
In the first quarter, the DAX fell considerably on the back of as yet undefinable risks from the global financial and economic crisis, reaching a low of 3,589 points on 9 March 2009 (intraday). Its fortunes then changed as it trended almost consistently upwards to reach 5,957 points at the end of the year. In addition to positive expectations and subsequent favourable economic data, intervention by governments and central banks helped to stabilise the stock market. Bank shares profited to a greater degree than the rest of the market as confidence in the German banking sector was restored, coupled with significant earnings growth thanks to favourable refinancing conditions and high earnings contributions from investment banking. However, the share price rally in the banking sector must be taken in context, having experienced a greater downward trend in 2008 compared to the rest of the market. Although further economic decline could be prevented and stability in the financial system partly restored, the situation at the end of the year is still marked by an air of fragility.

Volatile CDS spreads.

The continuing uncertainty hanging in the air in financial markets is reflected in the volatile premiums of credit default swaps.[1] After having risen from an all-time low of below ten basis points to 60 basis points in 2007, CDS spreads of key German banks fluctuated between 60 and 160 basis points in both 2008 and 2009. CDS spreads then trended downwards from the second quarter of 2009. This reflected both increasingly favourable expectations for economic growth and the effect of government bail-outs. In contrast to this, CDS spreads for several Landesbanks improved to a much lesser extent than those of competitors in the course of the year. It is interesting to note how sensitively CDS spreads reacted to a renewed increase in risk. This meant that uncertainty associated with the somewhat regionally concentrated debt crisis in Dubai at the end of the year entailed significant spread rises of almost 20 basis points. CDS premiums for key international competitors followed a similar course, with the majority falling below 100 basis points by the end of 2009. However, CDS spreads for UBS and a number of US financial institutions were trading at over 300 basis points at the end of March at the height of gloomy expectations of economic growth.

[1] CDS spreads are OTC market prices to assume the risk of default on a loan by a company (only the risk is traded and not the entire loan.) They are traditionally quoted in basis points. A premium of 120 basis points means that for a contract in the amount of €100 million, a premium of €1.2 million per year is to be paid (1.2% of €100 million). The greater the risk, the higher the premium.

Figure 8
Credit default swap spreads for major German banks

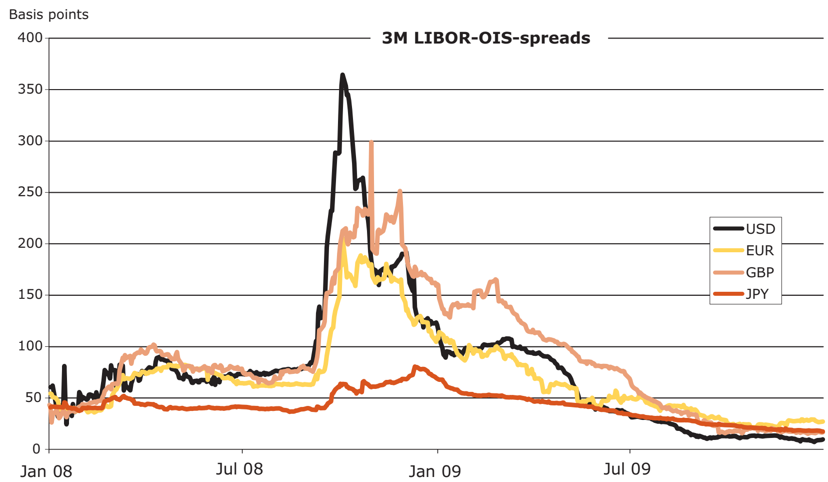


*) Unweighted average of CDS spreads for 16 major European banks
Sources: Bloomberg and calculations by BaFin.

A thawing interbank market.

While the interbank market virtually dried up at the end of 2008, the decisive action taken by central banks in 2009 led to a significant recovery in the supply of liquidity. Central money market indicators such as the O/N lending rate or the three-month LIBOR money market rate have fallen considerably from record levels seen in the fourth quarter of 2008 and are now at a level of 0.25% and 0.7% respectively (euro money market rates). This trend is highlighted in the following chart of LIBOR-OIS spreads[2].

Figure 9
Interbank market indicators – 3M LIBOR-OIS spreads



Source: Bloomberg

[2] The LIBOR-OIS spread is the difference between the 'London Interbank Offered Rate' and the 'Overnight Indexed Swap Rate'. Given the fact that the margin in basis points represents the risk premium to paid on the difference between the three-month LIBOR and the three-month revolving overnight index swap rate, the spread between the two rates is considered to be a measure of the health of the banking system.

In light of the improved financing conditions on the money market, the European Central Bank announced plans to partially phase out liquidity support measures in the course of 2009. At the end of year, however, expectations remained that the ECB would not yet increase its key interest rate as the situation on the interbank market may well have stabilised but remains fragile.

Reduction in measures to tighten lending standards.

On the back of gloomy prospects for economic growth and debtors in financial difficulties, European banks further tightened lending standards for corporate clients in the course of 2009 albeit with considerably less vigour, according to the Bank Lending Survey carried out by the European Central Bank (as at: January 2010). In contrast to the expectations of European credit institutions, a balanced survey value is expected in Germany for the first quarter of 2010. The improved liquidity situation and increasingly accommodating financing conditions accorded by banks on the money and capital markets are the first signs of a possible loosening of lending standards in the future. Credit margins for companies in the euro area continued to rise at a slowing pace in step with lending standards. A higher number of banks in Germany increased the credit margin for average loans compared to the euro area. An identical trend could also be observed for riskier loans in the third quarter of 2009. German credit institutions rolled back the credit margin increases to a significant extent in the fourth quarter of 2009. German survey values are now in line with the European average. Corporate borrowing demand in Germany continued to rise while borrowing demand in the euro area saw a generally negative yet weakening trend. The rise in demand for loans in Germany is primarily due to demand by small and medium-sized companies brought on by market share gains. Additional driving factors include debt restructuring and the tighter lending standards of other banks.

Further consolidation in banks expected.

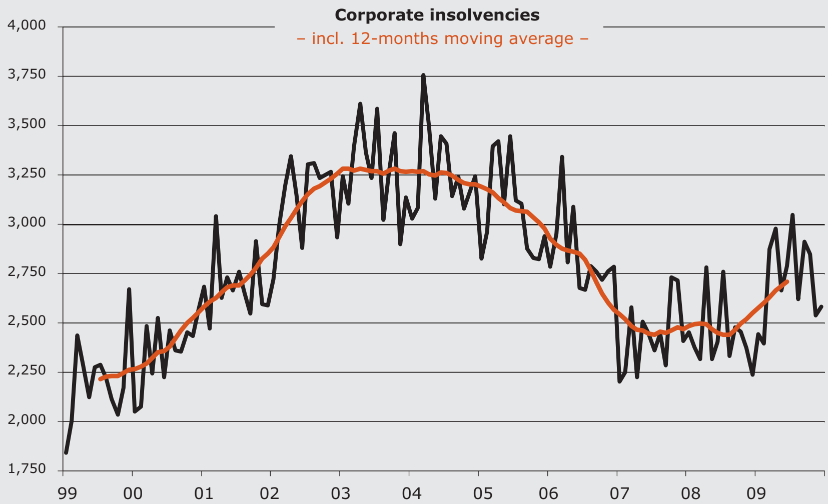
There will be further takeovers in the German banking sector over the medium term, in spite of the associated risks. The takeover of Dresdner Bank by Commerzbank in 2009 was of particular significance. The financial crisis enabled relatively strong market players to take over weakened competitors, provided their capital base permitted this. The most important example of this in Germany was the takeover of Sal. Oppenheim by Deutsche Bank. Potential losses in the lending business are likely to spur takeovers of regional retail banks particularly from 2010.

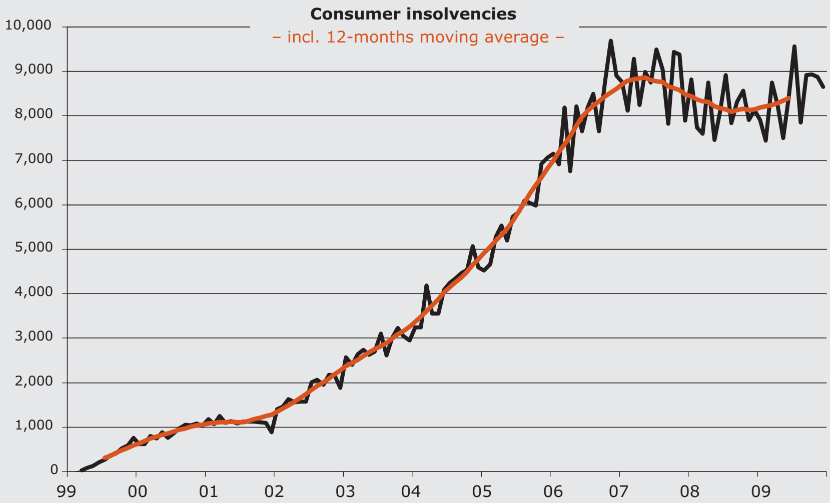
Despite considerable economic difficulties, there was no consolidation in the Landesbanks sector in 2009 contrary to statements made to this effect by the federal states concerned. This is largely due to the bailouts already made by the owners, in addition to a high degree of valuation uncertainty. It is currently unknown the extent to which requirements made by the EU Commission in several state aid cases may in fact lead to mergers or sales of *Landesbanks.*

Insolvency trend

In 2009, the number of corporate insolvencies rose again for the first time since 2003. Insolvencies rose by 12% over the preceding year to 32,687. The related estimated outstanding debt rose more than threefold in a year-on-year comparison; it increased by 230% to approx. €73.1 billion. The main reason for this was a number of large insolvencies, notably that of Arcandor, which had outstanding debt totalling €19 billion. The trend for 2010 is difficult to estimate. Despite an expected gentle upturn in economic growth, the number of corporate insolvencies may well increase as a lagging indicator of economic performance.

Figure 10
Number of insolvencies

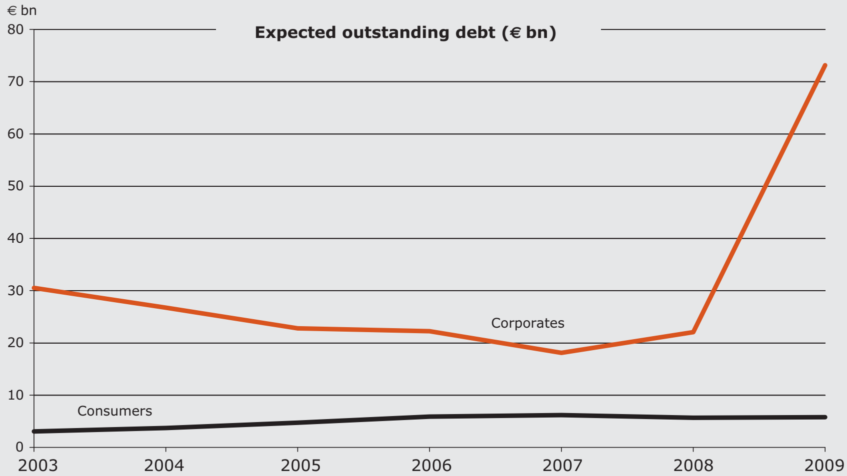




Source: Federal Statistical Office

In contrast to this, the number of private insolvencies and the associated outstanding debt increased only slightly during 2009 to 101,102 and €5.8 billion respectively. Besides tightened lending standards, a further increase may have been prevented primarily thanks to generous regulations on short-time work *(Kurzarbeit)*. The result of this may be a higher rate of private insolvencies once these regulations expire in 2010.

Figure 11
Outstanding debt



Source: Federal Statistical Office

4 Insurers

Financial and economic crisis also took its toll on insurers.

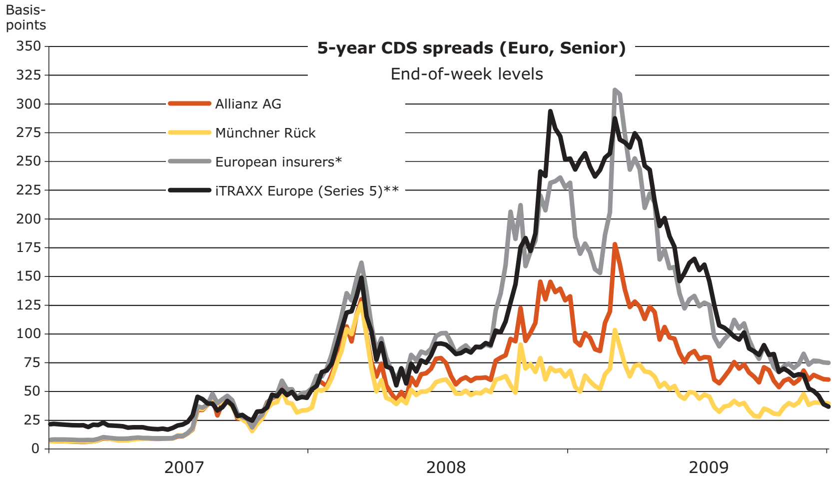
In view of their conservative investment policies, German insurance undertakings were hardly exposed to subprime risk and were therefore significantly less affected than banks at the start of the financial crisis. However, insurers were not able to shield themselves from developments on the capital markets and the consequences for the real economy. Business performance in the German insurance industry was affected by both low interest rates and the difficult economic climate. Nevertheless, the impact of the crisis on the insurance industry in 2009 was manageable.

The share index of the insurance sector slightly trailed the DAX and its performance was considerably poorer than that of the banking sector. This was due in part to the fact that the share index of the insurance sector in 2008 was considerably less impacted than that of the banking sector.

Risk premiums for German insurers fell last year.

After having risen sharply during the global financial and economic crisis, CDS spreads for insurance undertakings fell considerably in 2009. Although they soared in the second quarter of 2009 following a recovery in the first quarter of 2009, this was only temporary and the recovery then continued during the remainder of the year. Thus the market assessed the creditworthiness of German insurers in 2009 as being more favourable across the board than the European average.

Figure 12
CDS spreads of selected insurers



* Unweighted average of CDS spreads of the nine European insurers included in the iTRAXX Europe Series 5 index.

** Unweighted average of CDS spreads on the 125 most liquid European corporate borrowers with a good credit rating in the last six months before the iTRAXX Europe Series 5 index was launched in March 2006.

Sources: Bloomberg and calculations by BaFin

Rating agencies assessments rather negative in 2009.

As a result of the financial and economic crisis, several German insurance undertakings already suffered downgrades of their financial strength ratings in 2008. This trend continued in 2009. Once again the number of downgrades exceeded the number of upgrades. Additionally, the outlook for several German insurers is negative. Just how much these negative outlooks will actually translate into future downgrades largely depends on the further impact of the financial and economic crisis.

Low interest rates cut future earnings potential.

Ten-year government bond yields at the end of 2009 were around 45 basis points higher than at the end of the preceding year at 3.4%. Despite this increase, interest rates are historically low and therefore are having an impact on the earnings of life insurers from new investment in fixed-income securities. The guaranteed rate was last lowered to the current level of 2.25% in 2007. However, this reduction only applies to new policies and will therefore have a delayed impact on the rate to be earned by life insurers.

Losses from natural disasters fell considerably in 2009.

The losses incurred in 2009 resulting from natural disasters such as earthquakes, hurricanes and floods fell considerably in a year-on-year comparison. There were virtually no large-scale disasters. Although there were a number of small-to-medium natural disasters, insured losses were limited and were significantly lower than those of the preceding year. This should have a positive impact on the financial situation of reinsurers. In 2009, the financial situation of the global reinsurance industry was probably less impacted by insured losses than by the financial and economic crisis.

Table 1

Economy and financial sector overview for Germany*

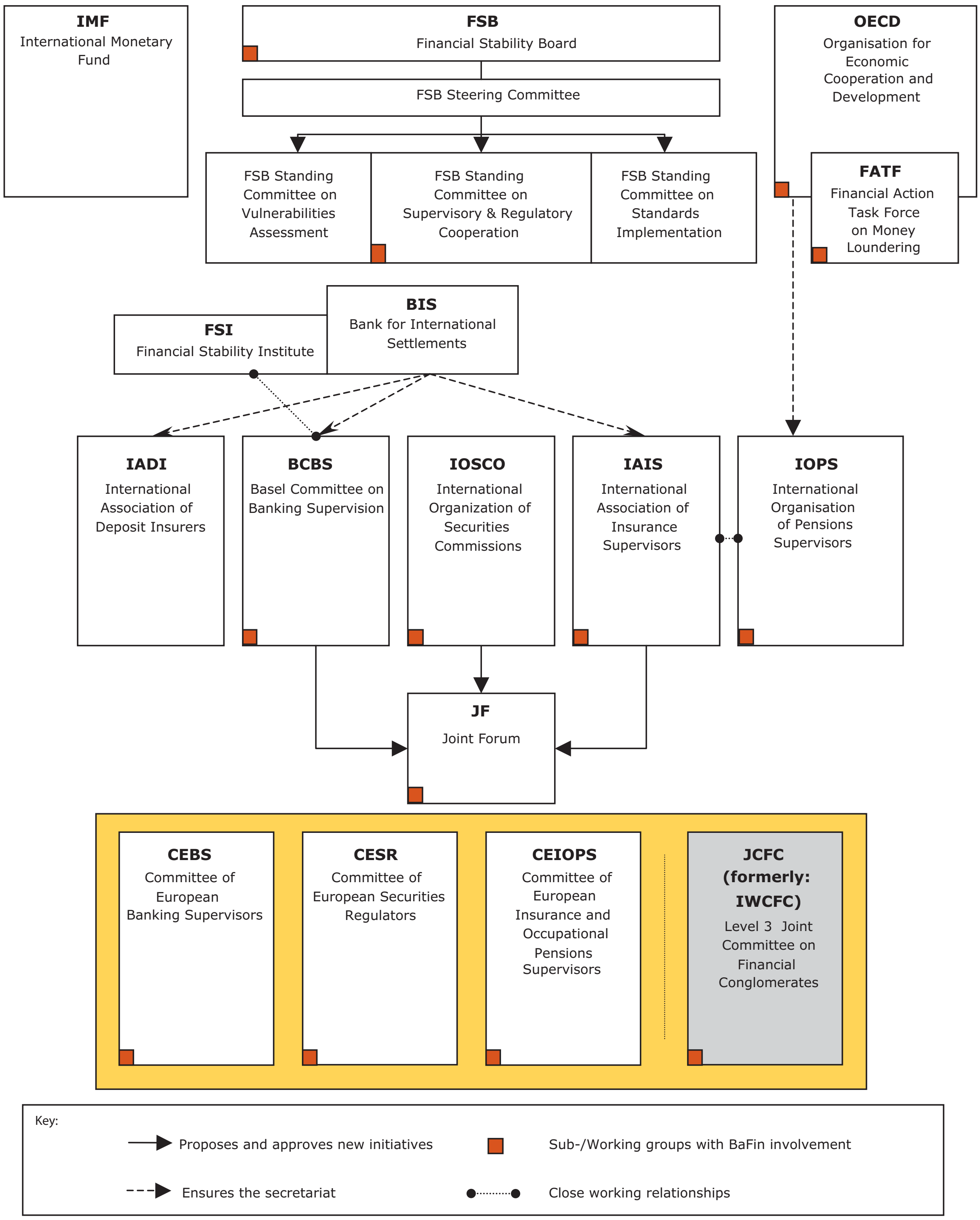
Selected economic data	Units	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP growth [1]											
Global economy	%	4.8	2.3	2.9	3.6	4.9	4.4	5.0	5.2	3.0	- 0.8
USA	%	4.1	1.1	1.8	2.5	3.6	3.1	2.7	2.1	0.4	- 2.4
Euro area	%	3.9	1.9	0.9	0.8	2.1	1.7	3.0	2.7	0.6	- 4.0
Germany	%	3.2	1.2	0.0	- 0.2	1.2	0.8	3.2	2.5	1.3	- 5.0
Corporate insolvencies	number	28,235	32,278	37,579	39,320	39,213	36,843	34,137	29,160	29,291	32,687
DAX (end of 1987=1000) [a]	points	6,434	5,160	2,893	3,965	4,256	5,408	6,597	8,067	4,810	5,957
Money market rate [2]	%	4.39	4.26	3.32	2.33	2.11	2.19	3.08	4.28	4.63	1.22
Capital market rate [3]	%	5.28	4.86	4.81	4.08	4.04	3.36	3.78	4.27	4.09	3.27
Exchange rate of the €	1 €=...$	0.92	0.90	0.95	1.13	1.24	1.24	1.25	1.37	1.47	1.39
Gross sale of fixed-income securities [4]	€ bn	659	688	819	959	990	989	926	1,022	1,337	1,534
Credit institutions											
Single institutions [a, 5]	number	2,912	2,697	2,593	2,466	2,400	2,349	2,301	2,276	2,169	2,106
Branches [a, 5]	number	56,936	54,089	50,868	47,244	45,467	47,333	40,332	39,817	39,565	
Lending volume [a, 6]	€ bn	2,187	2,236	2,241	2,242	2,224	2,227	2,242	2,289	2,358	2,358
Net interest margin [7]	%	1.14	1.12	1.20	1.16	1.18	1.17	1.15	1.12	1.09	
Net commission income	€ bn	28.1	25.3	24.3	24.4	25.3	27.8	29.9	31.7	29.6	
Administrative expenses	€ bn	77.7	81.0	78.3	77.3	75.8	78.8	81.5	81.6	78.6	
Risk provisioning	€ bn	15.9	19.6	31.2	21.8	17.2	14.1	14.0	23.6	36.6	
Cost-income ratio [8]	%	68.4	71.4	67.2	66.5	65.5	61.0	62.3	64.9	73.4	
Return on equity (RoE) [9]	%	9.3	6.2	4.5	0.7	4.2	13.0	9.4	6.6	-7.7	
Solvency ratio [a, 10]	%	11.7	12.1	12.8	13.4	13.3	13.1	13.3	12.5	14.0	15.0
Private banks											
Lending volume [a, 6]	€ bn	600	605	594	579	575	580	587	627	662	654
Net interest margin [7]	%	1.17	1.15	1.34	1.17	1.25	1.27	1.33	1.3	1.2	
Cost-income ratio [8]	%	75.4	80.4	74.2	74.0	73.5	59.8	66.0	65.5	93.7	
Return on equity (RoE) [9]	%	8.2	4.7	1.0	- 6.2	- 0.4	21.8	11.2	19.1	-15.6	
Solvency ratio [a, 10]	%	13.0	13.6	14.4	14.5	13.7	12.7	13.7	11.8	14.2	15.0
Savings banks											
Lending volume [a, 6]	€ bn	545	563	572	577	573	574	576	578	589	598
Net interest margin [7]	%	2.33	2.28	2.38	2.40	2.35	2.30	2.23	2.06	1.96	2.12
Cost-income ratio [8]	%	68.9	69.9	66.5	66.4	64.9	66.0	65.8	69.5	67.4	63.0
Return on equity (RoE) [9]	%	13.4	9.2	8,2	10.9	9.7	10.4	8.9	7.2	4.0	9.7
Solvency ratio [a, 10]	%	10.7	10.8	11.2	11.5	12.1	12.6	13.1	13.1	14.4	14.7
Cooperative banks											
Lending volume [a, 6]	€ bn	327	331	335	338	342	348	353	360	369	382
Net interest margin [7]	%	2.45	2.41	2.49	2.51	2.51	2.46	2.30	2.15	2.06	2.25
Cost-income ratio [8]	%	74.5	76.7	73.1	69.6	68.7	70.0	64.3	70.5	74.7	70.0
Return on equity (RoE) [9]	%	8.6	7.5	9.7	10.6	10.3	13.8	11.0	8.1	5.6	8.6
Solvency ratio [a, 10]	%	11.2	11.1	11.0	11.7	12.1	12.2	12.2	12.8	14.2	14.0
Insurance undertakings											
Life insurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	62.9	31.3	6.2	14.9	35.6	44.0	35.2	14.7	9.0	25.4
as a percentage of IP book value	%	11.4	5.5	1.1	2.4	5.5	6.5	5.3	2.0	1.2	3.6
Ratio of fund untis in IP [12]	%	21.4	22.5	23.0	23.3	22.0	23.2	23.1	22.7	23.5	24.3
Ratio of borrower's notes and loans in IP [12]	%	16.6	17.1	18.1	19.3	22.0	22.2	23	21.9	22.1	
Net rate of return on IP [13]	%	7.4	6.0	4.4	5.0	4.8	5.0	5.4	4.5	3.4	
Premium reserve	€ bn	445.5	476.4	502.8	520.6	536.2	551.2	566.5	586.1	599.6	
as a pecentage of balance sheet totals	%	83.7	83.7	83.8	79.4	78.8	78.1	77.3	77.6	79.7	
Surplus [14]	€ bn	20.3	13.4	5.1	9.2	9.7	14.2	14.1	13.5	6.6	
as a pecentage of gross premiums earned	%	33.1	21.5	7.9	13.6	14.1	19.5	18.8	17.8	8.6	
Eligible own funds (A+B+C)	€ bn	42.9	44.2	39.8	42.3	43.9	49.1	54.6	57.5	54.4	
Solvency margin [15]	€ bn	20.5	22.2	23.3	24.0	24.8	25.9	26.8	27.8	28.4	
Coverage of solvency margin [16]	%	209.5	199.0	170.4	176.2	177.4	190.0	203.8	206.8	191.5	
Return on equity [17]	%	12.5	7.0	3.4	5.7	5.8	9.7	9.5	8.8	7.4	
Property and casualty insurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	37.1	31.7	22.3	26.0	26.6	27.7	29.8	28.9	21.4	25.2
as a percentage of IP book value	%	38.1	31.4	21.3	23.8	22.6	22.2	22.4	20.7	15.7	18.3
Ratio of fund units in IP [12]	%	23.5	25.3	27.0	27.3	26.5	29.8	30.5	31.0	30.7	30.1
Ratio of borrower's notes and loans in IP [12]	%	13.3	13.2	13.2	14.1	16.6	18.3	15.6	19.4	20.2	
Net combined ratio [18]	%	101.0	100.2	103.2	94.7	92.2	92.6	90.6	92.7	92.0	
Eligible own funds (A+B)	€ bn	20.7	24.4	25.0	27.1	24.1	22.5	27.4	28.3	26.8	
Solvency margin [15]	€ bn	7.5	7.1	7.4	7.8	8.4	8.8	8.8	8.8	8.5	
Coverage of solvency margin [16]	%	277.1	342.7	336.9	346.0	286.3	255.3	310.7	321.6	315.3	
Return on equity [17]	%	8.7	8.9	2.8	4.2	3.0	4.5	4.6	4.1	3.6	
Reinsurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	101,8	89,2	35.8	34.3	37.2	49.9	57.7	63.6	33.7	30.6
as a percentage of book value	%	75,9	54,2	18.5	15.6	17.2	22.0	26.4	27.6	14.7	15.0
Net combined ratio [18]	%	103,8	115,3	101.6	92.8	93.5	93.8	89.2	94.1	94.1	
Eligible own funds (A+B)	€ bn	–	–	–	–	–	–	–	66.3	67.2	
Solvency margin	€ bn	–	–	–	–	–	–	–	1,146.3	1,196.4	
Gross technical provisions	€ bn	104.5	122.3	130.6	135.8	140.8	154.4	143.1	131.1	125.3	
as a percentage of gross premium income	%	265.7	278.6	244	264.4	298.5	340.0	330.3	329.7	328.4	
Net profit for the year [19]	€ bn	2.2	0.3	5.4	1.4	3.4	1.8	7.3	8.0	5.7	
Available regulatory capital [20]	€ bn	25.1	31.5	40.2	51.4	55.1	57.6	66.3	71.0	70.5	
Available regulatory capital [17]	%	8.6	1.0	13.3	2.7	6.1	3.1	11.0	11.2	8.1	

Sources: BaFin, Deutsche Bundesbank, Federal Statistical Office, Eurostat, IMF

* Annual totals or average values, unless stated otherwise.
a) As of year end.
1) Change in real GDP y-o-y.
2) 3-month Euribor.
3) Ten-year government bond yields.
4) Domestic issuers.
5) Pursuant to section 1 (1) KWG (including Postbank, investment companies and all branches of foreign banks), preliminary figures for 2009.
6) Loans to domestic enterprises and households.
7) Net interest income as a percentage of balance sheet totals.
8) Administrative expenses as a percentage of earnings from operations.
9) Net profit for the year before tax as a percentage of the average equity.
10) Liable capital in relation to risk-weighted assets (solvency ratio according to Principle I, Grundsatz I).
11) Fair values – book values of investments (IP).
12) As a percentage of total IP excluding deposits with ceding undertakings.
13) (Income from IP - expenses for IP) / arithmetical mean of IP (beginning/end of year).
14) Net profit for the year + gross expenses for premium refunds.
15) Minimum own funds free of forseeable liabilities.
16) Eligible own funds / solvency margin.
17) Net profit for the year / equity.
18) Net claims and operating expenditure / net premiums earned.
19) Corresponds to item II.14 on form 2 RechVersV.
20) Total capital less outstanding capital contributions.

III International

Figure 13
International institutions and committees



International focus

The financial crisis and its impact continued to be the overriding theme of the work of European and international supervisory bodies in 2009. The peak of the financial crisis in 2008 was signalled by the failure of the investment bank Lehman Brothers, from which point governments, central banks and supervisory authorities have continued to grapple with the task of stabilising the global financial system.

Key efforts to underpin international cooperation here were the decisions made by the G20 at the global financial summits in London, Pittsburgh and St. Andrews. These decisions covered a range of issues such as closing regulatory loopholes, improving the way in which information between supervisory authorities is shared, introducing new capital requirements for banks, new rules for executive pay, harmonising accounting standards and ensuring that every market player or product is subject to supervision.

The Financial Stability Forum (FSF) was replaced by the FSB (Financial Stability Board). The latter has seen its remit broadened immensely with a view to ensuring that international standard setters such as IOSCO, IAIS and the Basel Committee, work together with national governments, central banks and supervisory authorities on developing and adhering to universally applicable standards. German involvement in this process is assured by BaFin, the Federal Ministry of Finance and the Bundesbank, with the level 3 committees CESR, CEBS and CEIOPS performing this task at a European level.[3]

1 Financial stability

Impact of the G20 resolutions on global and European bodies

Established in 1999, the **Group of Twenty Finance Ministers and Central Bank Governors** (G20) is an informal group comprising 19 countries plus the European Union. It is a forum for cooperation and consultation with the objective of promoting international financial stability. Representatives from the International Monetary Fund (IMF) and the World Bank also attend G20 summits.

Fundamental G20 resolutions.

The financial crisis was top of the agenda at the G20 summits in London, Pittsburgh and St. Andrews, held in April, September and

[3] The documents cited in the annual report text can be found on the websites of the respective organisations (www.bafin.de » BaFin » International cooperation).

November respectively. The general course of action to be taken was already agreed upon in London in April, with the G20 drawing up far-reaching resolutions to reform financial supervision. These were then substantiated during the subsequent summits and their implementation evaluated. The overriding objective of the reforms is to strengthen both the financial markets and the regulatory framework in which they operate in order to avoid future crises. Among other issues, the summit in London focused on the shape and structure of the financial markets, together with reforms of international financial institutions: In future, there should be no financial market, actor or product that is not subject to supervision or regulation.

Furthermore the G20 agreed on the following:

- Foundation of the Financial Stability Board (FSB) to replace the Financial Stability Forum (FSF) with a wider remit to promote financial stability
- FSB cooperation with the IMF to conduct early warning exercises for macroeconomic and financial risks
- Reform of the supervisory system, in particular extending supervisory activities to incorporate any systemically relevant companies including hedge funds
- Development of stricter rules for executive remuneration
- Harmonisation of the definition of capital
- Taking action against non-cooperative jurisdictions
- Drafting a single set of accounting standards and
- Registration of rating agencies.

At its summits in Pittsburgh and St. Andrews, the G20 reiterated how critical it was to implement the financial market regulation measures agreed on at the previous summits and the importance of establishing a level playing field. Moreover, a number of resolutions were substantiated, including decisions made by the G20 in Pittsburgh on setting out standards for sound remuneration practices, building on the principles agreed on in London and which are the reasons for efforts to draft regulations on remuneration systems in Germany.

The **Financial Stability Board** (FSB) is a global body comprising high-ranking representatives of ministries of finance, central banks and supervisory authorities from the G20 countries and Spain as well as representatives of the European Commission, international standard setters (including BCBS, IAIS, IOSCO) and major financial institutions (e.g. IMF, World Bank, BIS, ECB). Based in Basel, the forum originally known as the Financial Stability Forum (FSF) was set up in 1999 largely in response to the Asian crisis and was succeeded by the FSB in April 2009. Its task – to promote stability in the financial system through supervision and the exchange of information – is performed by the Plenary, a Steering Committee, three Standing Committees and various working groups. The FSB discusses issues of fundamental systemic importance to financial stability. These issues are not necessarily directly relevant to supervision; they might only have an indirect impact. The body serves to coordinate the work of national supervisory authorities and international standard setters. In 2009, the crisis in the financial markets was the main focus of the FSB's work.

FSB promotes financial stability.

In 2009, the FSB drafted a number of progress reports on the implementation of the G20 recommendations for the G20 summits. According to these reports, the rules and principles required of FSB member states in various areas will be implemented.

Important issues in the progress reports were:

- Building high quality capital and mitigating procyclicality
- Strengthening accounting standards
- Reforming remuneration systems for managers
- Cooperation between supervisory authorities for companies active in cross-border business
- Assessing the importance of systemically relevant companies.

A further task of the FSB is to verify that member states are observing the various international standards. This is done by carrying out peer and thematic reviews. A preliminary thematic review of executive remuneration was initiated in 2009 and brought to a conclusion in March 2010. According to this review, Germany is one of the leading countries worldwide in implementing the standards. Furthermore, every FSB member state has agreed to allow examination of its observation of standards set out by the BCBS, IAIS, IOSCO, IMF and the World Bank in the course of the coming years.

Founded in 1996, the **Joint Forum** is a joint committee of the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision (BCBS). The Joint Forum comprises supervisors from 13 countries who deal with cross-sectoral supervisory issues with the idea of improving supervisor understanding of the other sectors.

The Joint Forum recommends standards for capital requirements and cross-sectoral supervisory principles.

The FSB commissioned the Joint Forum to examine the nature and scope of financial regulation in the three sectors. The key objective of the analysis was to identify systemic risks which are not sufficiently covered by existing regulatory frameworks, as well as to develop corresponding suggestions for improvement. As a result, the Joint Forum first undertook a comparison of the various international regulatory frameworks in the banking, insurance and securities sectors which, on the one hand, highlighted desirable and understandable differences but, on the other, revealed some that were open to regulatory arbitrage. To remedy these issues, the

Joint Forum has recommended introducing international standards governing minimum capital requirements in the three sectors, as well as creating common cross-sectoral principles which will lead to comparable rules for similar activities, thereby preventing arbitrage.

By the same token, the methods used to supervise and regulate financial groups were also identified as a source of systemic risks in the financial crisis, meaning that they constituted another focus of the analyses. The Joint Forum noticed that the particular challenge of group supervision was mainly in keeping track of all the activities and risks of a financial group for supervisory purposes. It is for this reason that the Joint Forum has recommended that policymakers and international standard setters revise the principles that have, up to now, governed group supervision, and improve cooperation in supervisory colleges.

Introducing minimum supervisory standards is the Joint Forum's response to the question of how much regulation is required for hedge funds, credit risk transfer products (CDS), monoliners and the origination of mortgages. There should be a minimum set of rules on managing risk appropriately for hedge funds and specific reporting requirements for hedge fund operators to supervisors. With regards to CDS transactions, there should be appropriate regulatory capital requirements. In the case of monoliners, the Joint Forum has recommended setting minimum capital, solvency and liquidity requirements. The three parent committees of the Joint Forum – the Basel Committee, IAIS and IOSCO – approved the report at the end of 2009 for it to be presented to the FSB.

IAIS paper on unregulated entities.

The IAIS is developing a guidance paper on the subject of unregulated entities. In so doing, the IAIS is honouring a request made by the G20 that, in future, every financial market player should be subject to supervision or regulation. In the paper, the IAIS concentrates primarily on non-operating holding companies and unregulated operating entities. The latter played a particularly important role in the case of American International Group (AIG), as they were responsible for bringing the company to the verge of collapse. The paper is set to be approved in spring 2010.

The IAIS develops the Common Framework.

Following a period of lengthy discussion, the IAIS gave the go-ahead for the creation of a Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) with binding solvency regulation at the beginning of 2010. The project is in response to the financial crisis and may well take a similar course to that of Basel II in the area of banking regulation. In June 2010, the IAIS intends to start work on developing a concept paper, which should then be used as a basis for deciding how to develop ComFrame further. The concept paper should be ready by the middle of 2011. In total, the setting up of ComFrame is expected to take three years, although the calibration phase can only begin after these three years have passed.

Supervision adds weight to macroprudential analyses.

One of the key lessons resulting from the economic and financial crisis is that, to ensure financial stability, additional support in the form of macroprudential supervision must be provided.

Thus, the IAIS will in future perform a higher number of macroprudential analyses, which it will then submit to the FSB. To this end, the IAIS set up a working group which was then given formal status in October 2009 under the title of the Financial Stability Committee (IAIS FSC). The IAIS FSC deals with IAIS policy in the areas of macroprudential tools, macroprudential reporting and systemically relevant financial institutions, and is therefore playing a key role in shaping future financial supervision. Macroprudential analyses are also increasingly becoming the focus of supervisory reform at a European level. A draft EU regulation provides for setting up a European System Risk Board (ESRB) which will monitor macroprudential and systemic risks within a new European supervisory structure.

At a European level, supervisors work in the three so-called Lamfalussy committees. In its position as a provider of integrated financial supervision, BaFin is represented in the **Committee of European Securities Regulators** (CESR), the **Committee of European Banking Supervisors** (CEBS) and the **Committee of European Insurance and Occupational Pensions Supervisors** (CEIOPS). The oldest of the three committees is the Committee of European Securities Regulators (CESR) based in Paris, which was established in June 2001. Following this example, the subsequent Commission's Decision of November 2003 established the Commission of European Banking Supervisors (CEBS) based in London and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) in Frankfurt. The three committees have a dual function: On the one hand, they provide advice to European bodies, such as the Commission, as part of the European legislative procedure; on the other hand, they ensure that the supervisory practices in their respective sector are uniform across Europe.

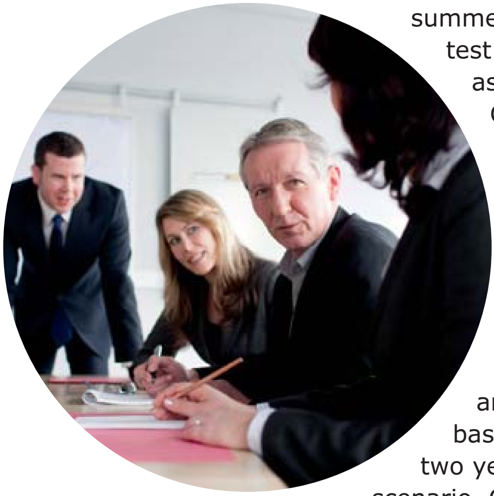
CEIOPS delivers financial stability analyses of the insurance industry.

CEIOPS has been providing the EU with successive insights into how the crisis has affected the insurance industry. Six-monthly financial stability reports represent a key tool used to provide this information, with the quality and relevance of the data contained in these reports having been improved further. In addition, special requests for information from the largest European insurance groups bolster routinely gathered figures and serve to supplement the reports. Moreover, CEIOPS was able to deliver information on current events in a timely fashion by carrying out and evaluating individual ad-hoc surveys. An example of this was the ad-hoc survey for information on the European insurance industry's exposure to the Madoff case carried out by CEIOPS at the beginning of January 2009.

EU-wide stress tests by CEBS and CEIOPS.

In order to test the resilience of the European banking and insurance sectors, stress tests were top of the agenda for the European banking and insurance supervisors CEBS and CEIOPS.

Under the aegis of CEBS, national supervisory authorities performed the first EU-wide stress tests on credit institutions in



summer 2009. The 22 banks which took part in the test represented approximately 60% of the total assets of the European banking sector. The Ecofin Council, composed of the Economics and Finance Ministers of the EU member states, commissioned CEBS to perform this EU-wide exercise. However, the final report only provided the Ecofin Council with aggregate results. Furthermore, it was agreed from the outset that even these summarised findings would not be made public. The scenario-based assessments in the stress tests cover both 2009 and 2010. CEBS took two different scenarios as a basis for simulating the profit and losses during the two years. In a somewhat more lenient baseline scenario, CEBS assumed that gross domestic product in the EU would shrink by 4% this year and by 0.1% in the following year. In the second scenario, the parameters were much tougher, with the banking supervisors estimating a fall in aggregate output of 5.2% in 2009 and 2.7% in 2010. Based on these assumptions and together with the European Central Bank, the EU Commission and national supervisors, CEBS assessed the credit and market risks facing the financial markets. CEBS is currently considering the option of conducting this test at regular intervals.

At the end of 2009, CEIOPS also initiated an EU-wide stress test in the insurance sector for the first time. The goal of this test is to determine the ability of the sector to withstand further shocks. The test involves three scenarios: An adverse scenario in which trends seen in the financial crisis continue; a recession scenario which assumes a deep, protracted recession; and an inflation scenario in which both inflation and capital market rates balloon. The results of the tests will be grouped nationally and internationally in the spring of 2010 and presented to political decision-makers.

OTC derivatives

Founded in 1983, the International **Organisation of Securities Commissions** (IOSCO) is the most important international forum for securities regulators. The Madrid-based commission is recognised as being the global standard setter in matters relating to securities. The standards and resolutions passed by IOSCO form part of national regulatory frameworks for the 181 members representing over 100 countries.

IOSCO report on unregulated markets and financial products.

IOSCO recommends that the transparency and regulation of structured products and credit default swaps (CDS), which are traded mainly over the counter, should be improved. In response to recommendations made by the G20, IOSCO set up a working group tasked with identifying regulatory gaps pertaining to unregulated markets and financial products and with submitting proposals for improvement. Published in September 2009, the recommendations for structured products and CDS made in the report strengthen current initiatives in the industry. However, these recommendations also indicate the need for regulation to improve the functioning, quality and integrity of these markets, as well as to restore investor confidence.

Suggestions to counter wrong incentives associated with structured products.

With its recommendations, IOSCO is trying to counteract wrong incentives associated with securitisations. One the one hand, this should be done by obliging issuers of structured products to disclose information, with the aim of ensuring that a constant flow of information about the performance of the underlying asset pool is upheld. Details concerning the creditworthiness of the persons with direct and indirect liability to the issuer should be disclosed, as well as the risk practices undertaken by underwriters, sponsors and originators. On the other hand, IOSCO calls for service providers, which are commissioned by the issuer to draw up analyses or perform other services that may affect the decision of an investor to buy, to be independent. Furthermore, regulators are called on to consider retaining a long-term economic exposure of originators and/or sponsors to the relevant product (skin-in-the-game requirement). Finally, protection for the investors should be improved by examining the criteria for determining how suitable a product is for certain groups of investors, while also developing tools that make it easier to understand complex products.

CDS: Counterparty default risk and transparency in the spotlight.

Central counterparties should also assist in efforts to improve the infrastructure of the CDS market. With this in mind, IOSCO recommends that these central counterparties (CCPs) have to meet a sufficient number of requirements to reduce the risks associated with clearing standardised CDS. Performing the clearing via a central counterparty means that both contract partners additionally agree to the fact that there is a third-party (i.e. the central counterparty) which acts as a contract partner for each of the two parties. The result is that the claims made by both parties are directed at the central counterparty rather than at each other. Similarly, the parties also have contractual obligations towards the CCP to fulfil. IOSCO would particularly like to ensure that CCPs maintain sufficient financial resources and observe appropriate risk management practices in order to minimise their risk of default. Additionally, transaction and market-related data should be made available to both the regulators and the market. Some of the core recommendations also pertain to the further standardisation of CDS contracts and closer cooperation between supervisory authorities with regard to information about the CDS market.

Hedge funds

International efforts to regulate hedge funds.

In future, hedge funds and their managers are to be registered with the supervisory authority. This is the recommendation proposed by an IOSCO working group in its final report on unregulated financial entities (Hedge Funds Oversight). Even though hedge funds were not ultimately responsible for the crisis, the way in which they operate can have serious implications for financial stability. As a result of the global financial crisis, the G20 also called for stricter regulation of hedge funds. In addition to registering hedge funds, IOSCO also recommends the introduction of routine regulatory requirements such as setting up an appropriate risk management system, segregating assets and establishing minimum standards for investor information. Moreover, managers will have to provide the supervisory authorities with information that is systemically important. At a European level, the EU Commission presented a draft directive on regulating "alternative investment fund managers" (AIFM draft directive) in April 2009. However, not only does the AIFM draft directive stipulate that hedge fund managers should be regulated, but it also extends this regulatory mandate to include any fund managers that have not already been covered by the UCITS Directive. Moreover, the draft ties any regulatory approval for alternative investments to certain conditions such as the suitability of the manager or capital requirements. Furthermore, sweeping requirements have been set out with regards to organisation and transparency.

Financial conglomerates

The **Joint Committee on Financial Conglomerates** (JCFC) is the permanent joint forum of European banking and insurance supervisors. Its work is to ensure that the Financial Conglomerates Directive is applied fully and comprehensively throughout the individual member states. JCFC was founded following the revised decisions establishing the level 3 committees CEBS, CEIOPS and CESR, which came into force on 23 January 2009. The Interim Working Committee on Financial Conglomerates (IWCFC), which was set up in 2006, was re-named and formalised as the Joint Committee on Financial Conglomerates (JCFC).

Revising the Financial Conglomerates Directive.

The JCFC published a number of recommendations concerning the revision of the Financial Conglomerates Directive (FCD) for consultation and submitted these to the EU Commission, taking the comments received into account. The objective of the recommendations is to eliminate a variety of practical problems associated with the existing FCD. The committee proposes to grant even small groups exemption from supplementary supervision pursuant to the FCD, provided that this is in keeping with the level of risk these groups face. This is in contrast to the existing system in which only large, homogeneous groups may be exempted from supplementary supervision in line with the FCD. However, groups that are relatively small are currently subject to supplementary supervision, even if this is totally disproportionate to the level of risk they have. In practice, there is also a problem when it comes to the definition of participation – notably the way in which "durable link" is to be interpreted. It is possible that a group consisting of just one supervised entity and one participation may, under certain circumstances, be considered a financial conglomerate. In order to establish a uniform definition of participation across the EU, the JCFC suggests two measures. Firstly, a set of guidelines on interpreting "durable link" should be drawn up. Secondly, the supervisory authorities should be granted a certain degree of discretion when identifying financial conglomerates in cases where the financial conglomerate merely comprises one supervised entity and one participation. A working group set up by the Commission is now expected to develop a proposal to amend the FCD by spring 2010.

Short Selling

IOSCO and CESR have achieved a number of early results at a global and a European level on its way to creating a uniform supervisory framework for short selling.

IOSCO publishes high level principles for the regulation of short selling.

As part of its final report on the regulation of short selling published in June 2009, IOSCO put forward a recommendation comprising four high level principles which should serve as a basis for regulating short selling. The two key principles are to establish reporting obligations for short selling with a view to providing both the market and the supervisory authorities with timely information, and to monitor closely delivery obligations for securities which have been sold short. Moreover, IOSCO recommends the introduction of regulation to ensure effective compliance and enforcement systems, as well to grant exceptions for certain types of transactions, such as market making. The overriding objective here is to safeguard the efficiency of the markets.

CESR recommends a short selling transparency system.

CESR proposes a two-tier disclosure regime for short positions in all shares admitted to trading on a regulated market – including multilateral trading facilities (MTF). This is the result of a proposal developed by CESR for net short positions, which it opened to public consultation in July 2009. Once CESR had reviewed the comments, it published a final report in March 2010. At the heart of this regulatory proposal is the intention to establish an EU-wide obligation to report and publish net short positions, provided that the market in which the shares are primarily traded is located in the EEA. To begin with, the relevant supervisory authority will have to be informed as soon as the net short position of a company's publicly issued share capital reaches a trigger threshold of 0.2%. Additional reports have to be sent once the net short position reaches, exceeds or falls below every additional 0.1%. In addition to this, once 0.5% has been reached, the position also has to be made public. Aside from short positions in shares, other positions which are recorded include those in financial instruments that are traded on the stock market and over the counter, which equate to a short position in shares (e.g. selling futures, buying put options, contracts for difference, swaps etc.). This is irrespective of whether there is a physical delivery or a cash settlement. The obligation to report and publish this information falls to the owner of the respective position. Market makers are subject to special exemptions.

Commodities

IOSCO examines the volatility of the energy markets.

A working group set up by IOSCO continues to see no evidence of any systematic manipulation of oil prices by purely financial investors. According to the report it published in March 2009, in which it refers to studies carried out by international organisations, central banks and regulators, the extreme nature of price changes has largely been the work of fundamental economic factors such as demand, inventory levels or refining capacity. This working group was set up by IOSCO in autumn 2008 in light of a highly volatile oil and agricultural commodity market. In view of the complexity of this issue, together with the importance it has for the entire economy, factors influencing the price will continue to be monitored and analysed in the future. In order to gain a complete understanding of price formation in the market and to avoid market abuse, the working group calls for more transparency with regards to OTC data, fundamental data and to large positions on the futures market, as well as for supervisory standards concerning market supervision and enforcement to be improved. IOSCO also recommends that both state and private initiatives to collect, improve and publish fundamental data should be supported in order to improve the transparency and quality of data relevant to price formation. In its closing statement at the Pittsburgh summit in September 2009, the G20 called on IOSCO directly to implement the working-group recommendations swiftly and to work together with other international organisations to create more transparency, particularly in the energy market.

Guaranteeing deposits

EU Commission continues to push for a revision of the Directive on Deposit Guarantee Schemes.

Even though the EU recently reformed the current system of guaranteeing deposits with an amendment to the Directive on Deposit Guarantee Schemes, the EU Commission has put forward radical new proposals to overhaul the regulations currently in place. First of all, it advocates expanding the mandate of national deposit guarantee schemes to include potential stabilisation measures or the orderly winding-up of troubled institutions in individual markets. This is a very ambitious drive by the Commission in view of the fact that bank supervisory authorities in the member states have varying intervention rights and that financial markets in the member states are very heterogeneous.

Moreover, the Commission is making efforts to eliminate the parallel statutory and voluntary or institutional-level deposit guarantee schemes. For BaFin, however, the existence of these parallel schemes has generally proven useful. The Commission is also in favour of implementing an EU-level (supplementary) deposit guarantee scheme to cover all member states. At the very least, however, certain issues would need to be resolved beforehand, such as what banks should be members in such a system, how such a scheme should be financed, and how the supervisory structures should be set up. Finally, the Commission is pushing to drastically shorten the time it takes for schemes to pay out to depositors after a bank failure to an even greater extent. In the view of BaFin, experience from the recent Amendment of the Directive on Deposit Guarantee Schemes ought to be gathered to enable evaluation of a potential need for an adjustment on a proven factual basis.

EU Commission plans to harmonise regulation of insurance guarantee schemes.

CEIOPS calls for a minimum harmonisation approach to be adopted with regards to insurance guarantee schemes. This is the underlying message of the recommendations made by CEIOPS to the EU Commission in June. The Commission had previously begun to examine the efficiency and appropriateness of national insurance guarantee systems already in place. In order to be able to submit suitable proposals to harmonise regulation in the form of a White Paper at a European level, CEIOPS was asked to develop recommendations. The minimum level of harmonisation now being recommended means that an EU directive merely stipulates binding minimum standards – e.g. concerning protected policies and policyholders/beneficiaries – for guarantee schemes set up in member states and leaves details such as financing and organisational issues up to the individual member states. EU members will be entitled to transcend the minimum level of protection set out in EU law. This would mean that the Federal Republic of Germany, for instance, is entitled to retain its concept of the continuity of the insurance portfolio, as is the case for Protektor, the mechanism set up by German life insurers to protect policyholders against the consequences of a life insurer becoming insolvent. The question remains whether the Commission will keep to the minimum harmonisation approach or whether it actually intends to go beyond this level of regulation.

2 European Supervisory Structure

EU puts forward proposals to restructure European supervision.

Based on the council conclusions reached in June 2009, the European Commission presented the first draft of its regulation drafts to create a new European supervisory structure in September last year. According this draft, the two cornerstones of supervisory activities shall be macroprudential supervision by the European Systemic Risk Boards (ESRB) on the one hand and, on the other, microprudential supervision by the European System of Financial Supervisors (ESFS). The ESFS will be comprised of three new European Supervisory Authorities (ESA), in addition to national supervisory authorities. These three new bodies will be created by turning CEBS into the European Banking Authority (EBA), CEIOPS into the European Insurance and Occupational Pensions Authority (EIOPA) and CESR into the European Securities and Markets Authority (ESMA). The exact details of the new financial architecture are still to be debated in the legislative process. Once this legislative process has been completed, the new structure for European financial supervision will be set up as of 1 January 2011.

ESRB is tasked with monitoring the stability of the entire financial system.

The key area of responsibility for the newly founded ESRB is to perform macroprudential supervision, i.e. to supervise macroprudential and systemic risks in the European financial system. If this body identifies any such risks, it will then be in the position to issue both blanket and specific warnings to the European Union, its member states or the three European supervisory authorities. Moreover, it can also recommend an appropriate course of action to eliminate the risks, where necessary. Despite the fact that neither the warnings nor the recommendations must be heeded, a so-called act-or-explain mechanism ensures that these cannot simply be ignored. Those who do not follow the recommended course of action must justify this decision with clear and detailed reasons. The ESRB will be shaped by the central banks and, in any case, will be closely tied to the ECB. The General Board, made up of voting members and simple observers, will make the decisions. The ECB will ensure the secretariat to the ESRB.

ESFS assumes responsibility for microprudential supervisory activities.

The three European supervisory authorities constitute the focus of microprudential supervision and, therefore, of the ESFS. The current L3 committees will be formalised as EU supervisory authorities with legal personality and considerably larger budgetary and personnel resources than was the case for the former committees The Commission’s plan is to have the ESFS act as a network comprising the three European supervisory authorities EBA, EIOPA and ESMA and the national supervisory authorities. ESA decisions are to be made by the Board of Supervisors consisting of high-level representatives from all European supervisory authorities. In addition to this, a Management Board will be set up which will be responsible for organisational decision-making. Moreover, the three authorities will each have their own independent chairperson. Ongoing supervisory activities are to remain the responsibility of national authorities. The European authorities will perform harmonisation tasks including those to develop technical standards as well as to make binding decisions in cases of a difference of opinion between national supervisory authorities, for instance. Moreover, it will also be the job of the new ESAs to facilitate and coordinate both the flow of information and cooperation between the national supervisory authorities

3 Own funds and liquidity

New regulatory capital structure

With its seat at the Bank for International Settlements (BIS), the **Basel Committee on Banking Supervision** (BCBS) was founded in 1974 by the central banks of the G10 members. A total of 27 countries are represented by central banks and banking supervisory authorities. The Basel Committee develops supervisory standards and recommendations for banking supervision and is also tasked with improving cooperation between national supervisory authorities.

BCBS puts forward proposals to reform the regulatory capital structure.

In December, the Basel Committee on Banking Supervision responded to G20 recommendations by publishing a consultative document on raising the quality of regulatory capital, simplifying the definition of capital and considerably improving transparency in this area. The new regulations lead to a number of significant simplifications in the area of tier 1 and tier 2 capital. Tier 3 capital should be abolished. On the basis of the consultative document, the Committee carried out an impact study in the first half of 2010, the results of which will help shape the final version of the regulations set to be passed at the end of 2010. The fully calibrated standards will then come into force by the end of 2012 taking into account the economic recovery and subject to appropriate transition and grandfathering arrangements.

Common equity regulations take account of special German requirements.

Work had originally begun by concentrating primarily on raising the quality of tier 1 capital with a view to safeguarding the loss absorbency of tier 1 capital, the most important criteria for tier 1 capital instruments, in the long term. However, in the course of the year, the Committee then decided to put forward a proposal to reform the entire regulatory capital structure. The focus here is on common equity which, according to the Basel Approach, may only consist of subscribed capital and disclosed reserves for public limited companies. However, the German representatives in the Basel Committee succeeded in ensuring that allowances are made for the special requirements of non-public limited companies, such as cooperative banks or savings banks. This means that the respective capital contributions by silent partners in non-incorporated companies continue to be counted as common equity. General speaking, there is a catalogue of 14 criteria for common equity instruments; these criteria will safeguard the high quality of this capital category in the long term.

Minimum level of common equity still to be decided.

In future, the majority of deductions from regulatory capital will be from common equity. Nevertheless, common equity will still have to make up the predominant part of the total amount of tier 1 capital after these deductions. Given its significance concerning the future capital requirements for banks, the exact level of this predominant part, i.e. the proportion of common equity compared to total level of tier 1 capital, will be determined once the impact study has been analysed. There will also be a catalogue of quality-assuring criteria for the remaining tier 1 capital instruments (tier 1 additional going concern capital), although the Committee has proposed striking the inclusion of so-called innovative instruments. Tier 2 capital, the characteristics of which have up to now “overlapped” with those of tier 1 capital (as is the case for the German participation right (Genussrecht)), will be reduced to just long-term subordinated debt instruments (gone concern capital) in line with the proposals. The most recent addition to the current three-part capital structure, tier 3 capital, will be completely eliminated.

Revising the Capital Requirements Directive

EU regulates hybrid financial instruments.

The first ever set of EU regulations on hybrid capital were passed in July 2009 by the Council of the European Union and the European Parliament in the form of a new Capital Requirements Directive (CRD II). The EU Commission had already decided in 2008 to integrate the 1998 Basel Accord on Hybrid Capital into EU law, in order to iron out member-state differences in recognising hybrid financial instruments as part of tier 1 capital. Moreover, in order to achieve a higher degree of convergence of supervisory practices. EU legislators also commissioned CEBS to draft a set of guidelines.

CEBS guidelines on the eligibility of hybrid instruments as tier 1 capital.

CEBS published a set of guidelines on the eligibility of hybrid instruments as tier 1 capital in December 2009. The guidelines substantiate the provisions of the Capital Requirements Directive and should help to ensure a largely uniform supervisory standard. This includes, for instance, the way in which processes to call or redeem a hybrid tier 1 capital instrument are designed. The guidelines focus on the key criteria for the eligibility as tier 1 capital instruments, which include permanence, flexibility of payments and loss absorbency, and provide additional detail on these requirements. The pressure of the ongoing financial crisis has meant that these eligibility criteria have been tightened. In future, hybrid financial instruments must be better able to absorb losses. It must be possible for the issuing bank to defer coupon payments and for these to be automatically cancelled based on the solvency situation of the bank. In addition to this, prior approval by the supervisory authority will in future be required when redeeming hybrid tier 1 capital instruments on the market.

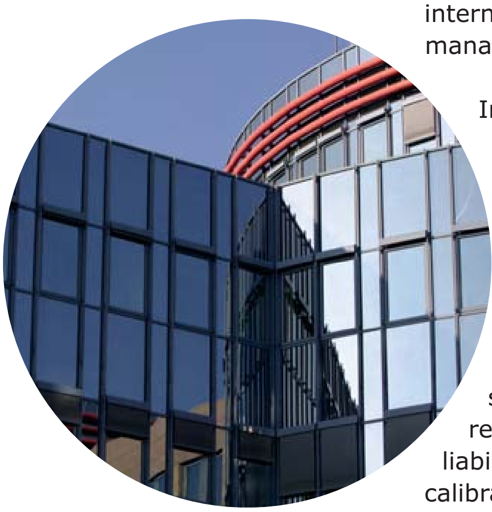
CEBS consultation on common equity guidelines.

As in the case of the guidelines for hybrid tier 1 capital instruments, eligibility as common equity is also linked to the criteria of permanence, flexibility of payments and loss absorbency. CEBS presented a consultative draft of corresponding guidelines on the inclusion of capital instruments into common equity within the meaning of the Capital Requirements Directive in December 2009. The permanence criterion can only be met if investors do not have a right to repayment of their capital under such instruments and banks do not have the option to redeem such instruments. The German representatives at CEBS, however, managed to secure an exception to this by continuing to allow members of cooperative and mutual banks to return their shares. Nevertheless, the institution and/or the supervisory authority must still be able to reject or to forbid the return of these in case of insufficient solvency. In future, the redemption of common equity instruments will be subject to prior approval by the supervisory authority. Pursuant to the requirements for the flexibility of payments, it will no longer be permitted to give the investor a right to claim distributions, nor to make up for cancelled coupon payments – prohibition of accumulation. Additionally, it will no longer be allowed to agree fixed coupon payments. All common equity components must take a proportional share of any losses as they occur pari passu with each other, and in the event of insolvency must rank pari passu with each other. They must not be provided with guarantees, pledges or other credit enhancements that legally or economically enhance their seniority. Alongside these points, the guidelines also set out requirements for the legal status of the provision of funds. The capital must be equity capital contributed by the bank shareholders or other legal owners, and be recognised under the relevant accounting standards.

Liquidity risk management

Basel Committee develops quantitative liquidity risk standards.

Numerous banks around the world struggled to shore up their liquidity during the financial crisis. As a result of this, there was an international drive in 2009 to expand on regulations governing the management of liquidity risk.



In order to ensure that internationally active banks are able to survive serious liquidity crises, the Basel Committee has developed two standards to serve as the cornerstone of a global framework to improve liquidity risk management. The first standard, a short-term measure (liquidity coverage ratio), is designed to ensure that, in a scenario defined by the supervisory authority, a group of institutions has enough highly liquid assets to cover the defined outflow of liquidity for a period of at least 30 days. The second standard, net stable funding ratio, is more long term, as it requires the refinancing of long-term, illiquid assets with long-term, stable liabilities. Both of these standards are being analysed and calibrated as part of an impact study. The plan is to finalise these in 2010 and thus implement the relevant G20 recommendations.

CEBS guidelines on liquidity buffers.

CEBS has developed a set of recommendations on the composition and appropriate size of a liquidity buffer. The liquidity buffer should largely be made up of assets which can be converted into liquidity at any time without losing much value. This would help to ensure that liquidity outflows arising within the first week can be covered by assets, which are both highly liquid and eligible for central bank borrowings. Outflows of liquidity over the following weeks can also be covered by other liquid assets. Both crises involving just the institution and those affecting the entire market should be taken as a basis for determining the size of an institution’s required liquidity buffer. The CEBS recommendations were published in December 2009 and are due to be incorporated in the national law by the EU national supervisory authorities in the first half of 2010.

4 Accounting

Revising IAS 39

The **International Accounting Standards Board** (IASB) is the highest body responsible for developing and issuing financial reporting standards. Members of the IASB include auditors, analysts and professionals. Standards developed by the IASB in the form of International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS) are valid around the world and have been endorsed by the European Union.

First revision phase of IAS 39 complete.

In November 2009, the international standard setter for accounting standards, the London IASB, completed the first phase of revision of IAS 39 with the publication of IFRS 9. Phase 1 was mainly concerned with defining new regulation on the classification and measurement of financial instruments. The result of surely the most significant change to the still-valid IAS 39 is that the IASB has reduced the number of measurement categories from four to two. This means that, in future, there will be just one category of financial assets and liabilities that have to be measured at fair value and one category measured at amortised cost. In view of the absence of impact studies and the lack of regulation on the future treatment of financial liabilities, BaFin doubts that this change will address the political requirement of effecting a reduction in the measurement at volatile fair values, as defined by the G20 and the EU. This is due to the fact that distinguishing criteria – on the one hand that the instrument is managed on a contractual yield basis and on the other, that it has basic loan features – foment uncertainty particularly in structured products and embedded derivatives with regards to future classification. It must be assumed that these products would be largely carried at fair value. In this way, the IASB may well actually extend the system of fair value accounting, in contrast to the political requirements of the G20.

Furthermore, BaFin sees problems in the accounting rules associated with strategic equity investments. The new IFRS 9 standard stipulates that these must be recorded at their fair value. However, changes in value are not to be recognised in profit or loss, but directly in equity. This eliminates the option to recycle gains or losses to profit or loss on disposal, which exists for the IAS 39 available-for-sale category. Both BaFin and long-term minded investors see this as discrimination and call for improvements.

Second revision phase of IAS 39 at the drafting stage.

An exposure draft for phase two of revising IAS 39 has been published for public comment by the end of June 2010. In this draft, the IASB puts forward a number of proposals on the way impairment losses are recognised on financial assets measured at amortised cost. The aim is to reshape the risk provisioning model in response to the G20 resolutions agreed on in Pittsburgh and the corresponding work done by the FSB. The core issue here is that the expected cash flow method should be used. The reason for this is to avoid procyclical measurement in contrast to the incurred loss model currently used by IAS 39. Moreover, the overstatement of interest revenue before a trigger event occurs would be mitigated. During the second phase, the IASB has been working together with a working group set up by the Basel Accounting Task Force.

EU postpones endorsement of IFRS 9.

In the first half of 2010, the IASB is set to present a revised draft of the standard as part of phase 3 (hedge accounting). The EU Commission has for now postponed a fast-track endorsement of IFRS 9, not least in view of the fact that drafts for the third phase are still missing. A decision on the endorsement will only be taken once it is possible to assess the total impact of all three phases on the accounting of financial instruments. The postponement has presented the IASB with the opportunity to make further adjustments to address a number of open issues. At the same time, the EU is able to take into account amendments to corresponding US accounting standards when deciding on the endorsement. The US standard setter FASB plans to present a fully revised standard in the first half of 2010.

IAIS criticises revised IFRS 9.

The IAIS Subcommittee on Accounting criticises the fact that shares must be recognised at fair value through other comprehensive income (OCI) and that recycling of gains and losses between profit or loss and OCI will be prohibited. This could result in insurance undertakings reducing their investments in equity instruments, which would have a negative impact on share prices and therefore on efforts to overcome the financial crisis.

Analyses of financial instruments

CESR analyses the reclassification of financial instruments.

In the third quarter of 2008, the IASB made it easier to reclassify financial instruments with an amendment to IAS 39. The companies concerned now have the opportunity to undertake reclassification out of the “available for sale” and “fair value through profit and loss” categories in the third and fourth quarterly financial statements of 2008, as a result of rare circumstances. CESR analysed the extent to which companies have made use of this relaxation in the rules. A sample of 100 European financial groups – 74 banks and 14 insurers – was selected. The key findings of the analysis are as follows:

- While only 48% of the groups surveyed made use of the reclassification option in the third quarter of 2008, this share rose to 61% in the fourth quarter.
- In total, financial instruments worth around €550 billion were reclassified. Of this sum, approximately €270 billion from the “available for sale” category were reclassified and approximately €140 billion from the “fair value through profit and loss” category. The remaining amount came under other kinds of reclassification.
- It was primarily banks that took advantage of the reclassification option, with just two of the 14 insurers doing the same. This

leads to the conclusion that insurance undertakings had classified fewer instruments in the fair value categories due to the long-term nature of their business model.
- An analysis of the disclosure of reclassifications revealed that around 60% of companies do not provide any information on how these measures affect profitability. There were a number of other shortfalls noted in further disclosures.

CESR study on the disclosure of financial instruments.

A number of companies listed on the stock exchange do not adhere to all disclosure requirements. This is the conclusion of CESR, which analysed the degree to which disclosure requirements are adhered to as part of financial instrument accounting practices. For the analysis published in November 2009, CESR reviewed the 2008 annual financial statements of 96 banks and insurers listed on European stock exchanges – 22 of these companies were also included in the Financial Times Stock Exchange Eurotop 100 Index. The primary objective was to verify compliance with IFRS 7 (Financial Instruments: Disclosures) and certain additional recommendations. The findings of the analysis revealed that, in several areas, a significant number of companies failed to comply with mandatory disclosure requirements, for example regarding the use of valuation techniques and on the relationships with special purpose entities. However, CESR's analysis also identified that a significant number of companies provided additional disclosures in line with recommendations published by various organisations such as the Senior Supervisors Group. CESR is of the opinion that, in the future, companies will improve the scope of information provided in annual financial statements in view of the importance of such information – particularly in times of a crisis.

Reporting and US acceptance of IFRS

CEBS: Uniform reporting standards.

CEBS published a set of revised guidelines on financial reporting (FINREP) in December. The idea behind the amendments to the FINREP guidelines is primarily to streamline reporting requirements in the EU. The core aspect of the guidelines is the maximum data model, according to which CEBS countries must provide a certain amount of data that neither exceeds nor falls below a defined level. The model should make it easier to compare data, given that room for discretion at a national level is eliminated. Moreover, IFRS amendments were integrated into the new guidelines. There are plans to incorporate IFRS amendments resulting from the revision of IAS 1 and IAS 39 into the new FINREP version in 2010.

Consultation on SEC roadmap completed.

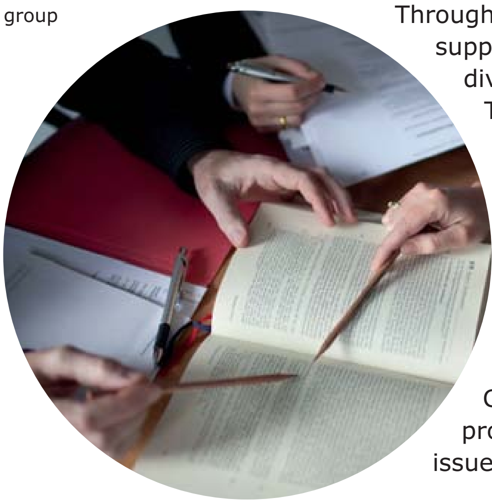
IFRS are on the verge of reaching another milestone in 2011 in efforts to establish them as the global accounting standard. In February 2009, the SEC completed the public consultation process, opened in November 2008, on a roadmap to permit the use of IFRS for US public companies, and set out plans on how it is going to proceed. According to this, the SEC will decide in 2011 on whether to accept IFRS as of 2015. The decision will be based on how much progress has been made in efforts to harmonise IFRS and US-GAAP, as well as taking into account the independence of IASB.

5 Solvency II

Solvency II Directive passed.

Solvency II paves the way for deep-rooted reform of insurance supervisory law in Europe, in particular of solvency capital regulations for insurance undertakings. Following difficult negotiations between the Economic and Financial Affairs Council (ECOFIN), the European Parliament and the European Commission in 2008 to draft the directive, they were able to reach a compromise in March 2009. The Parliament adopted this in April, with the Council acknowledging this vote in May. The result was that the directive could be passed prior to the European parliamentary elections. Solvency II must be implemented in the member states by 31 October 2012. By this time, any necessary changes to the Solvency II Directive in view of the newly shaped European financial supervisory and regulatory landscape have to be made.

Compromises on group supervision.



Throughout the negotiations, the issue of the group support regime continued to prove extremely divisive among member states and the Parliament. To prevent Solvency II from dragging on into the next legislative period purely as a result of this issue, the various parties agreed to drop the issue of the group support regime for the time being. This decision can be reviewed until 31 October 2014. Thereupon the Commission will report to the Parliament on the impact and experiences of the newly agreed group regulations. As part of this process, the Commission is then able to put forward proposals to amend the directive and to revisit the issue of the group support regime if necessary.

Implementing measures

Further proposals for implementing measures in 2009.

The directive empowers the EU Commission to enact implementing measures on certain issues. These help to make the directive more specific, thereby improving the harmony and uniformity of supervision in Europe. The four CEIOPS Solvency II working groups developed proposals to prepare for the implementing measures in 2009 and presented these to the Commission. CEIOPS submitted the most recent version at the beginning of 2010. Using this as a basis, the Commission will then present its own proposals for implementing measures to the Council as a starting point for debate and consultation. In addition to this, CEIOPS has also been developing supervisory advice to enable further harmonisation of supervisory activities in Europe. This process began at the end of 2009 and is set to continue until the first half of 2011. The key proposals of the four working groups are as follows.

The Financial Requirements Expert Group (FinReq) concentrates on four subject areas: Minimum capital requirement (MCR), solvency capital requirement (SCR), technical provisions and own funds. In 2009, a concrete formula for calculating the MCR was developed. In contrast to this, the focus of the SCR was on the ability of technical provisions to absorb losses. Two procedures are proposed to determine technical provisions; these are set to be tested in 2010 as part of QIS 5 (Quantitative Impact Studies 5). The FinReq continues to suggest that operational risk be calibrated in a different way to QIS 4 and specifies the proposals to measure health, life and non-life underwriting risk. The proposal concerning market risk now makes reference to the issue of interest rate volatility, while also refining and recalibrating individual submodules. As far as technical provisions are concerned, the proposals include calculating the best estimate, the risk margin and the risk-free interest rate term structure. Furthermore, a set of data quality standards to ensure their appropriateness, completeness and accuracy were developed.

The Internal Governance, Supervisory Review and Reporting Expert Group (IGSRR) is responsible for qualitative requirements as well as for the requirements for a company's public and supervisory reporting, and the requirements for capital add-ons. Moreover, the IGSRR is also responsible for measuring assets and other liabilities than technical provisions. In future, companies will draft a report for the supervisory authority, which will serve as a basis for the supervisory audit. This report will not be published. In addition to this, companies will publish a report on their financial situation which is to serve as a source of information for every stakeholder about the solvency level and the financial situation of the company. IGSRR developed a uniform structure for both reports and made a number of proposals for the level of detail required in the information. Furthermore, it also developed proposals pertaining to the European-wide harmonisation of the way in which capital add-ons are set and applied. Other topics for which the IGSRR has drafted implementing measure proposals include transparency and responsibility of supervisory authorities, the governance system, special purpose entities, and investments in securitised loans, as well as remuneration systems and deadline extensions in case of failure to adhere to solvency capital requirements.

The Internal Model Expert Group (IntMod) has compiled rules for the application test, calibration, statistical quality, documentation and validation of internal models. Furthermore, it details the approval of internal group models and interaction with the system of governance. The application test should demonstrate that a company's management and supervisory bodies understand what the goals of the internal model are and how it works, and that they use it during the decision-making process. In addition to this, the model must be suited to the business and cover the most significant risks. The way in which the model is designed must make it usable for decision-making processes.

In 2009, the Insurance Groups Supervision Committee (IGSC) put forward proposals to calculate and measure group solvency, while also addressing the issue of determining available capital along with its fungibility and transferability. Further to this, practical ideas were developed on the possible future shape of cooperation between European supervisors of a group in so-called colleges. There are also proposals in place now to establish detailed and harmonised supervisory reporting standards for intra-group transactions and concentration of risk, which were thrust into the spotlight during the financial crisis.

Impact study

Fifth quantitative impact study in 2010.

As part of the fifth QIS, CEIOPS developed proposals for technical specifications and passed these on to the Commission at the beginning of 2010. These proposals follow on from those of the previous QIS, but are now based on the finalised framework directive and take into account previous implementing measure proposals and developments. The study will be carried out between July and November 2010 by the Commission, with the report on the results being published in April 2011.

6 Rating agencies

New EU regulation on the supervision of rating agencies.

Every rating agency with operations in Europe is obliged to submit an application for registration by 7 September 2010 in order to be able to continue providing ratings for regulatory purposes. This is stipulated by the EU Regulation on Credit Rating Agencies, which came into force on 7 December 2009.

During the financial crisis, rating agencies came under international political scrutiny for a defining role in this crisis. Therefore it should not come as a surprise to see that governments around the world have begun drafting rules to enable the future regulation of rating agencies and to safeguard the quality of ratings. At the London G20 summit in April 2009, the participating countries agreed on the objective to legally oblige rating agencies to adhere to IOSCO code of conduct and, based on this, to implement a registration and regulatory regime for rating agencies.

Registration requirement.

The central element of the EU regulation is to require the registration of rating agencies established in the EU. Rating agencies can submit a registration application from 7 June 2010. This application must first be submitted to CESR. Following this, CESR then informs the national supervisory authority which is responsible for the registration process. As part of the registration, the rating agencies must fulfil a set of requirements which are based on the voluntary IOSCO code of conduct and which help to increase transparency and to avoid conflicts of interest. For example, rating agencies may not perform both advisory and rating activities for a company at the same time. In the past, rating agencies were often the target of fierce criticism for practices which saw the very same agency first providing issuers with advice when packaging assets for securitisation purposes and then assigning these products the highest rating. Moreover, a policy of rotation has been introduced for rating analysts. This means that they may only issue ratings for one company for a limited period of time before being moved on to another assignment within the agency.

However, not all rating agencies were simply lumped together. The special features of smaller rating agencies in particular were taken into account. If, for example, a rating agency employs fewer than 50 people and it can prove to the relevant supervisory authorities that such a mandatory rotation system for analysts would be an excessive burden, it can apply for an exemption from this regulation. At the same time, however, the rating agency must demonstrate how it intends to ensure the independence of their analysts by other means, which is the goal of this regulation.

The role of the supervisory authorities.

The tasks of registration and supervision are performed by the national supervisory authorities. Following their registration, rating agencies are then bound by strict rules governing conduct and organisation. In particular, they are obliged to implement a wide range of measures to prevent as far as possible potential conflicts of interest arising during their activities. By the same token, rating agencies will in future have to provide the supervisory authority with regular information regarding their methodologies, models and ownership structure. However, European supervisory authorities are not allowed to interfere with the actual valuation models. If rating agencies breach the rules of the EU regulation, they may be subject to sanctions or may even be stripped of their registration as a last resort. Supervision of rating agencies that are active in more than one member state is organised in Colleges of Supervisors. The decision on whether the relevant national supervision authority may participate in the colleges should depend on whether the rating agency has a branch office in the respective member state and the extent to which a member state is affected by the rating of this agency.

Rating agencies from non-member countries.

Ratings used for regulatory purposes, such as to determine regulatory capital requirements, may only come from a rating agency which has been approved in line with the EU regulation. Ratings which were issued in non-member countries may only be applied in the European Union if these ratings fulfil the EU regulation requirements. This either has to be guaranteed by an EU-registered branch office of the respective rating agency or the rating regulation and supervision in the non-member country must be considered as being of an equivalent standard by the EU Commission. The latter option is only available to small rating agencies from non-member states that are not systemically relevant. The original proposal put forward by the Commission, which categorically rejected ratings from non-member countries, was viewed by market players as having significant regulatory shortcomings. Germany supported allowing the opportunity to use ratings from non-member countries for also regulatory purposes.

Details on the content of the EU regulation.

CESR is working on a number of guidelines to provide more detail on the content and interpretation of a variety of points in the regulation. An example of this is the work to draw up the details of the registration process and a coordination arrangement between the competent authorities and CESR. Market actors were able to comment on the first draft of guidelines until the end of November 2009. These guidelines are due to be published in June 2010; further ones are to follow. In addition to this, CESR was commissioned to investigate regulatory frameworks in the USA, Japan, Canada and Australia and to report its findings to the EU Commission. Based on these findings, the Commission will decide in 2010 which regulatory frameworks are analogous to that of the EU and can therefore be deemed equivalent to the EU regulation.

7 Market transparency and integrity

MiFID and trade transparency

Post-trade transparency on the agenda for CESR and IOSCO.

CESR recommends increasing post-trade transparency on the market for corporate bonds, structured products and credit default swaps (CDS). This was the conclusion of a report published in the middle of July 2009 on post-trade transparency. CESR thinks that the new transparency regime should cover corporate bonds for which a prospectus has to be published – including the bonds admitted to trading on a regulated market – as well as corporate bonds traded on a multilateral trading facility (MTF). CESR also recommends a post-trade transparency regime for assed-back securities (ABS), collateralised debt obligations (CDO) and CDS. In light of the short-term nature of asset-backed commercial papers (ABCP), CESR does not consider it top priority to develop post-trade transparency here. CESR is in the process of defining its recommendations in detail and is set to present these to the EU Commission in July 2010 within the framework of the so-called MiFID review. IOSCO Committee for Secondary Markets was also taking time to address the issue of transparency requirements when trading structured products following the financial crisis. Together with market participants, the committee held a consultation to determine if the level of post-trade transparency was sufficient. IOSCO drafted a consultation report on this issue in September 2009. The findings are set to be published in 2010.

Impact of MiFID on secondary markets for equities.

The vast majority of equity-trading in Europe continues to take place via regulated markets and not via new competitors or OTC trading. This is one of the findings of an analysis carried out on secondary equity markets and on the impact of MiFID here. CESR published the analysis's findings and conclusions in June 2009. MiFID has led to a number of changes in the markets such as ending the concentration of trading in the hands of established stock exchanges, which has promoted the emergence of alternative trading systems and increased competition on the secondary equity market. At the same time, the nature of trading changed as a result of technological innovation. Although inroads have been made into the market share of established stock exchanges due to these changes, the majority of equities continue to be traded on the regulated markets. Another consequence of heightened competition is that direct costs for the execution of orders have fallen. Unfortunately, these cost advantages seem to have been negated by the increased cost of trading in a more fragmented environment and market volatility. Moreover, in light of the new competitive environment, the analysis has unearthed concerns of a number of market participants about whether the various execution venues are receiving equal treatment from a regulatory point of view. Furthermore, there are concerns regarding the quality and consolidation of post-trade transparency data. CESR has registered these concerns and will hold further consultations.

CESR: A new procedure to agree on pre-trade transparency waivers.

In the spring of 2009, CESR developed a sample procedure to coordinate and agree on new approvals for exemptions from pre-trade transparency (waiver). The first four assessments of such waivers, which were granted using this new procedure, were published by CESR on its website in May 2009. Since this time, more than ten additional procedures, including those associated with the planned trading regulations of a German marketplace, have been carried out. Given the scope of interpretations throughout individual member states of the pre-trade transparency waivers granted by MiFID, it was necessary to introduce a uniform procedure. Aside from ensuring a reasonable interpretation of MiFID, the primary concern was to push for uniformity in the EU to guarantee a level playing field. The new procedure leads to a non-legally binding decision by CESR within six weeks. BaFin has informed the stock exchange supervisory authorities of the Federal States responsible for ensuring pre-trade transparency for exchange transactions about the new procedure and asked for them to work together with BaFin and CESR on any waiver applications. In addition to evaluate new waiver applications, CESR is also investigating current waivers in the member states. This work is then to be incorporated into the CESR recommendations pertaining to the MiFID review.

Market integrity and market abuse

IOSCO published a report on outsourcing by markets.

In future, stock exchanges should follow a new set of principles concerning the outsourcing of services and functions. This is the conclusion of report which was published in July 2009 by IOSCO Committee on Secondary Markets chaired by BaFin. The aim of the new principles is to safeguard market integrity and to ensure appropriate risk management. To this end, third party service providers should be vetted both before a contract is concluded and on an ongoing basis, for example. The key idea here is primarily to uncover potential conflicts of interest on the part of the third party service provider. A set of security systems should be introduced to manage market disruption and crisis situations; these systems should be regularly tested. Similarly, the third party service provider should be expected to take appropriate steps to protect confidential data and information.

CESR: Additional guidelines concerning the Market Abuse Directive.

Since May 2009, market participants have been able to call on additional help to understand and interpret the Market Abuse Directive. Following the end of consultations and a public hearing, CESR published a new set of guidelines covering the issues of insider lists, suspicious transactions reports, stabilisation and buy-back programmes, as well as the two-fold notion of inside information. This additional help to understand and interpret the directive should serve as a guide for market participants to various aspects of the directive. These are an integral part of the third set of guidelines concerning the Market Abuse Directive. In this way, CESR has responded to repeated calls on the market for the provision of additional guidance.

The Market Abuse Directive has generally proven useful.

CESR members are of the opinion that many of the regulations contained in the Market Abuse Directive have proven their worth. In July 2009, CESR issued a joint response of every CESR member to a call for consultation by the European Commission on the review of the Market Abuse Directive. The definition of market manipulation was particularly well received. However, market participants also agreed on the necessity to consider making amendments in certain areas. For instance, CESR members posed the question of just how much the directive’s scope of application could be extended to other markets, for example.

EU legislative initiative on consumer protection for retail investors.

After a period of protracted preparatory work, the EU Commission published a communication in April 2009 which announced the introduction of legislation to increase the protection of retail investors when purchasing investment products. This refers to financial products that are typically sold to retail clients, allowing them to benefit from the performance of one or more assets, provided that there is a certain degree of complexity (so-called packaged retail investment products or PRIP). Investment products for retail investors of the kind mentioned above include certificates, derivatives, investments funds, open and closed real estate funds, unit-linked life insurance and structured deposits. These do not include equities and simple bonds.

The legislative initiative has two underlying objectives. Firstly, a mandatory document should be created which is easy for retail investors to understand and which provides a clear overview of key information about the investment product. This should be given to the investor before any decision is taken. The key information should give the retail investor a picture of the way in which the product works together with the opportunities and risks of the product. It should also make it possible to compare the product with other ones. Secondly, the Commission intends to harmonise as much as possible the array of different marketing provisions for such investment products spread over several directives. Specifically, this refers to requirements associated with investor advice, the way in which potential conflicts of interest when selling a product are handled and how sales commission is regulated. With considerable input from BaFin, the 3L3 committees CESR, CEBS and CEIOPS are seeing through the Commission's initiative, drawing on their practical supervisory experience.

Prospectuses and voting rights

Common positions on EU prospectus law.

The CESR expert group for prospectuses has continued work on developing the catalogue of common positions on the uniform application of prospectus law. In the most recent wave of updates to the catalogue in December 2009, common positions on 74 frequently asked questions were published. In February 2009, CESR published an updated overview of the languages accepted in individual member states when producing a prospectus, as well as of the acceptable languages which prospect summaries can be translated into in individual member states.

Amendments to the Prospectus Directive.

Following public consultation, the European Commission published a proposal to amend the Prospectus Directive. The central element of this proposal is the new regulation governing the summary of prospectus information, which in principle is based on the "key investor information" document under the UCITS Directive. The summary should be standardised in order to be able to better compare and contrast different products. Following discussions in the European Council and the European Parliament, there are plans to pass the amended Prospectus Directive in the middle of 2010 for this then to be incorporated by member states into national law.

CESR consultation on enhancing notifications of voting rights.

According to the Transparency Directive, merely being in possession of certain financial instruments, which entitle the holder to acquire shares to which voting rights are attached, means that the holder is subject to a notification obligation. Events on the financial markets and a number of cases in member states have, however, led to a debate on whether other financial instruments should be subject to voting rights notification requirements as well. By way of example, even purely cash settled instruments, such as cash settled options, can be used to exert influence over a listed issuer or allow for creeping control without the public knowing. Such options can have the same economic effect as actually holding shares or entitlements to acquire shares. Up to now, such constellations have not been subject to voting rights notification requirements pursuant to the Transparency Directive.

CESR thus launched an initiative in 2009 to coordinate discussions at a national level in several member states and to achieve the most uniform approach possible. At the same time, the Committee is of the opinion that the scope of application of the Transparency Directive should be extended to include all instruments referenced to shares that allow the holder to benefit from an upward movement of the price of these shares, i.e. that effectively create a long economic exposure to the issuer. The consultative paper was published by CESR in February 2010. The final report detailing the CESR recommendations for the EU Commission should be incorporated into the pending Transparency Directive review.

8 Corporate governance

Failures in corporate governance, such as poorly placed incentives based on an excessive remuneration and bonus policy, opaque corporate interdependence, insufficient risk management and the failure of supervisory board and investor control mechanisms played a significant role in the financial crisis, alongside many other factors. In 1999, the OECD developed a set of fundamental principles of corporate governance, which has since served as an international guideline for politicians, industry and financial supervisors. Following the work of the OECD, the BCBS also published a set of guidelines on corporate governance in the banking sector in 1999. In light of the shortcomings in corporate governance which were exposed during the financial crisis, both organisations scrutinised their fundamental principles in the reporting year, just as the Committee of European Banking Supervisors (CEBS) did.

OECD study reveals shortcomings of corporate governance.

In June 2009, the OECD carried out a comprehensive, cross-border study entitled "Corporate Governance and the Financial Crisis: Key Findings and Main Messages". The study revealed a number of shortcomings in the implementation and enforcement of its core principles on corporate governance. For this purpose, the OECD analysed the key areas of remuneration structures, risk management, supervisory board practices and the exercise of shareholder rights. It established that there was a lack of correlation between the level of remuneration and business performance, as well as an insufficient risk management system that neither considered the risks inherent to such remuneration systems nor the risk exposure of the company as a whole. Supervisory board members were often lacking the level of objectivity and independence recommended by the OECD. They were simply not in the position to be able to carry out sufficient checks of the risk management and remuneration system in the supervised company. For this reason, it is the intention of the OECD to improve the implementation and enforcement of its core principles. This should be done by providing detailed recommendations in the form of a handbook on corporate governance principles on the one hand and, on the other, through peer reviews, which should enable OECD member states to review implementation progress. Additionally, a so-called "best practice" policy should be developed together with the FSB. These recommendations are due to be presented in April 2010.

BCBS and CEBS reform their corporate governance principles.

The BCBS has begun substantiating and enhancing a number of its principles on corporate governance in the banking sector. Moreover, the entire document is undergoing a comprehensive overhaul. A working group began by assessing the extent to which the Basel Principles have been implemented in the signatory states and by analysing specific case studies. Principles are now being substantiated and enhanced to strengthen areas in which the BCBS identified particularly serious weaknesses in implementation. Above all, this includes:

- The role of the board of directors/management and supervisory boards and its working practices
- Risk management
- Complex and/or opaque corporate structures
- Transparency

The BCBS presented the revised principles for public consultation at the beginning of 2010. It is expected that these will be finally passed in September 2010.

In a similar vein, CEBS carried out a review of the way in which its guidelines on corporate governance are being implemented in EU and EEA member states, identifying any shortcomings in the implementation at a corporate level. By way of example, it was discovered that the complexity of some corporate structures often was not matched by an appropriate structure of governance. Other deficits uncovered include insufficient supervision of management by the supervisory authority and the inadequate integration of internal control functions in the company or group. Following discussions with the banking sector, consultancies and institutions, CEBS presented a report to the EU Commission at the beginning of 2010, which will be used by a CEBS working group to overhaul the guidelines in 2010.

IAIS drafts standards and guidance on remuneration.

The Governance & Compliance Subcommittee of the IAIS has drafted its "standards and guidance on remuneration", complying with an FSB resolution aimed at international standard setters to support the introduction of FSB standards for sound remuneration practices at key financial institutions. This support should be largely focused on the specific financial situation of insurance undertakings and on protecting the interests of policyholders and beneficiaries. These standards are due to be passed in 2010.

Level 3 working group examines harmonisation opportunities.

A working group set up by the 3L3 committees sees no immediate need to harmonise the regulatory framework for cross-sectorally active companies as far as internal governance is concerned. The working group compiled, analysed and evaluated the current regulations concerning internal governance. The focus of the analysis was the MiFID for the securities sector, the current Solvency II Directive for the insurance sector and the CRD for the banking sector, together with the guidelines developed by the L3 committees. The objective was to identify overlapping and potentially contradictory regulations for cross-sector companies, i.e. entities undertaking activities in the areas of banking, insurance and securities. Indeed, the working group came to the conclusion that there were certainly a number of overlaps, particularly in the case of MiFID and CRD. In spite of this fact, the group does not believe that it is a priority to harmonise the existing differences between the three sectors. In order to determine the extent to which the industry is actually affected by the existing overlaps, a "call of evidence" has been made, calling on companies and pressure groups to present their views on selected fields where overlaps have been identified and, in particular, to highlight any negative practical impact of differences. The selected areas are as follows:

- Managing conflicts of interests
- Risk management policies, processes and procedures
- Independence of risk management, compliance and internal audit with reference to their varying sector-specific requirements
- Supervisory Review Process

9 Investment funds

IOSCO recommendations on funds of hedge funds published.

Before and during any investment, fund of hedge funds managers should analyse both the liquidity of the target funds and the liquidity of the financial instruments held by these hedge funds. This is the recommendation of IOSCO made in its final report on best market practices in the field of funds of hedge funds. In addition to standards on liquidity risk, IOSCO also recommends the introduction of standards governing due diligence processes for target funds which draw on the lessons learned from the Madoff case. Before acquiring a target hedge fund, the custody procedure for assets of the target fund should be examined. This involves considering the relationship between the custodian of the assets and the manager of the target hedge fund.

In response to the subprime crisis, IOSCO has also developed a set of good practices for due diligence processes, which the investment manager should perform before investing in structured products. The central issue in the report, which was published in July 2009, is the stipulation that an investment manager should be able to understand and evaluate the structure and risk potential of a complex product before acquiring it. To this end, IOSCO recommends introducing a three-step process to exercise due diligence with structured products, in which the underlyings of the product, the structure of the product and the impact of the product on the overall portfolio of the fund must be analysed.

UCITS Directive on requirements regarding securities funds published.

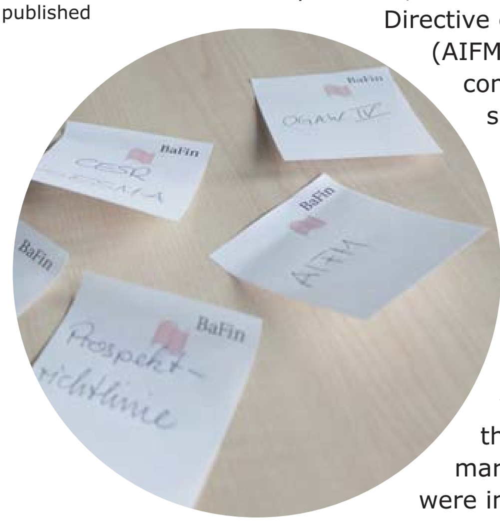
The UCITS IV Directive was published in November 2009. The key issues here are:

- The introduction of an EU passport for management companies.
- The replacement of the simplified prospectus with the “key investor information” document.
- The creation of framework conditions for merging UCITS and master feeder structures.
- The facilitation of the EU passporting notification procedure.
- The strengthening of supervisory powers and of cooperation between supervisory authorities.

The UCITS IV Directive empowers the EU Commission to adopt implementation measures (level 2 measures). In October 2009 at the behest of the EU Commission, CESR gave advice on measures to implement the EU management company passport and the key investor information document. Together with the EU management company passport, the advice includes standards for internal organisation and managing conflicts of interest, rules of conduct and regulations on risk management in management companies. The CESR proposals concerning the key investor information document include details on its content, form and presentation. CESR put forward further proposals regarding the merging of UCITS, master-feeder structures and notification procedures at the end of December 2009. The UCITS IV Directive has to be incorporated into national law by member states by July 2011.

Draft directive on alternative investment funds published

In April 2009, the EU Commission published a proposal for a Directive on Alternative Investment Fund Managers (AIFMs). The aim of the draft directive is to create a comprehensive and effective regulatory and supervisory framework for AIFMs at the European level. Alternative investment funds (AIF), as defined by the draft directive, refer to any funds which are not covered by the UCITS IV Directive. However, according to the current draft directive, it is of no relevance if the AIF is domiciled within or outside the European Union, if it belongs to the open-ended or closed-ended type or which legal structure it has. This would mean that a significant share of the grey capital market would then be regulated if this directive were incorporated into national law.



10 Occupational retirement provision

The **International Organisation of Pension Supervisors** (IOPS), based in Paris, was founded on 12 July 2004. IOPS is an organisation similar to the IAIS which is responsible for the area of occupational retirement provision. The objective of IOPS is to set international standards in the supervision of occupational retirement schemes, to promote international cooperation and to act as a global forum for the exchange of information.

IOPS develops methods to measure supervisory performance.

IOPS has published a working paper on measuring the performance of pension supervisory authorities. This first details four pillars which stand for good supervisory governance and therefore constitute the basis for good supervisory work: independence, accountability, transparency and integrity. Moreover, IOPS members recommend the combined use of various instruments to measure performance in order to be able to determine the notoriously difficult-to-measure performance of supervisory authorities as well as possible. Recommended action includes effectiveness measures, looking at outcomes against the authority's high-level objectives, or economy measures for operating activities, in order to be able to compile statistics on various activities.

IOPS guidelines for supervisory intervention, enforcement and sanctions passed.

IOPS passed guidelines on supervisory intervention, enforcement and sanctions at a meeting in Rio de Janeiro in October 2009. The guidelines detail specific intervention rights that are required or should be utilised by the supervisory authorities to intervene, enforce and sanction.

Joint working paper by IOPS and the OECD to improve supervisory activities.

Supervision should be proportional, flexible and risk-based. This is the conclusion of a joint working paper by IOPS and the OECD. These two organisations conducted an evaluation of international guidelines, best practices and member recommendations to improve occupational retirement provision, with a view to analysing the responses to the economic and financial crisis. In the course of this work, IOPS and the OECD also came to the conclusion that occupational retirement schemes must improve both their corporate governance and risk management in order to avoid investing in excessively risky assets or in assets which are not completely understood.

IOPS and CEOIPS put risk management rules under the spotlight.

An IOPS working paper on pension funds' risk-management framework examines what sort of risk-management framework occupational retirement schemes should have in place. Drawing on the experiences of occupational retirement schemes and other financial sectors, such frameworks are broken down into four main categories: Management oversight and culture, strategy and risk assessment, control systems, and information and reporting. Ways in which supervisory authorities can check that such systems are operating are also considered.

According to a report by CEIOPS, there is a broad spectrum of risk management rules present in EU member and EEA signatory states. In its report, CEIOPS details which risk management rules occupational retirement schemes have to observe in each country, and how the supervisory authorities review and check adherence to these rules. The majority of countries have at least implemented a general regulation regarding risk management, such as the documentation of the risk management strategy. In more than half of the countries reviewed, special risk management regulations, in particular those concerning market, credit and operational risk, have been introduced. Eleven countries have obliged occupational retirement schemes to provide information to beneficiaries, which goes beyond the requirements set out by the Pension Fund Directive. The supervisory authorities regularly review risk management regulations by carrying out on-site inspections.

Budapest protocol revised by CEIOPS.

In October 2009, CEIOPS adopted the revised Budapest protocol. Two key changes were made here: On the one hand, CEIOPS provided support to ensure cooperation between the responsible authorities in the EU member and EEA signatory states, in case of difficulties arising due to the different definitions of cross-border activities in the respective countries, for instance. On the other hand, European supervisory authorities have strengthened consumer protection regarding occupational retirement schemes by regulating cooperation between the competent authorities in case of complaints made by future beneficiaries and members with cross-border relevance – as is the case with the Siena Protocol. The Budapest Protocol is a multilateral MoU, which regulates collaboration of the competent authorities for occupational retirement schemes in the EU and the EEA operating cross-border activity.

Development of cross-border occupational retirement schemes.

The number of cross-border occupational retirement schemes increased from 70 to 76 between June 2008 and June 2009. As in previous years, CEIOPS reported on the development of the cross-border activities of occupational retirement schemes within the EU and EEA in 2009. Ten of the 76 schemes extended their activities abroad for the first time; in contrast, four schemes pulled the plug on their cross-border activities. The reasons for this about-turn are manifold. In one case, the member states concerned were unable to reach agreement on whether supervisory or social security law is to be applied when calculating the minimum guarantee level. In line with this trend, the number of home member states fell from nine to seven, while the number of host member states rose from 21 to 22. When making a comparison, it should be noted that there are varying definitions of what constitutes cross-border activities in EU member and EEA signatory states.

11 Colleges and bilateral cooperation

A core objective of supervisory authorities is to improve the supervision of banking groups with cross-border activities. The most important instrument in place to perform this task are the **supervisory colleges.** A college represents a structure to facilitate cooperation between home country and host country supervisors of a cross-border banking or insurance group, which also includes regular meetings between the supervisors of this group. The aim of the colleges is to coordinate supervisory activities and enhance the exchange of information between the relevant authorities, thereby increasing the efficiency of international supervisory activities. Working groups promote and coordinate both the setting up of new colleges and the ongoing work of existing colleges at a global and a European level. A key aspect here is the exchange of experiences given that colleges have been in place in some countries for a number of years while, in other countries, they are just being set up. For three German banking groups, for which Germany is the home country supervisor, there are supervisory colleges at a European level: Deutsche Bank, Commerzbank and Bayerische Landesbank. Further colleges will be added in the course of 2010.

FSF calls for colleges for systemically relevant companies.

In response to the financial market crisis, G7 finance ministers agreed to the erstwhile FSF (now FSB) action plan to set up colleges of supervisors. The goal is to monitor the global risks associated with internationally active financial companies in close bilateral and multilateral cooperation – inside and outside Europe – with the supervisory authorities concerned. The FSB created a list of systemically relevant companies for which colleges needed to be set up. Immediate action had to be taken to set up the colleges for the key banks and insurance undertakings with cross-border activities, such as the Deutsche Bank and Allianz groups, by 31 March 2009. The FSB is now calling for the setting up of smaller "core colleges" with only the most important respective supervisory authorities, in order to ensure a swift and uncomplicated exchange of information.

BCBS and EU develop rules for colleges further.

During the reporting year, the BCBS founded a global college working group which works closely together with the FSB. The group is tasked with drafting guidelines for the future cooperation of supervisory authorities, which also set out the principles for cooperation and coordination in colleges. In order to achieve this, the working group first obtained an overview of the structures and practices of the existing colleges. The working group will pass these good practice principles to the FSB upon completion. At a European level, work associated with colleges is at an advanced stage: The revised Capital Requirements Directive, which will come into force at the end of 2010, stipulates the need to establish colleges for any banking group with a subsidiary or significant branch in another EU member state. Moreover, it requires CEBS to develop guidelines for the practical work of the colleges and therefore, by extension, for the tasks defined in the Capital Requirements Directive. CEBS put forward a corresponding draft in December.

IAIS draws up guidelines for supervisory colleges.

The IAIS details 13 core characteristics of a supervisory college in its guidance paper on the use of supervisory colleges on insurance undertakings with cross-border activities. According to the guidelines passed in October 2009, a supervisory college should be organised in accordance with the nature, scale and complexity of the group it oversees. To be most effective, it should generally be established as a permanent, integral part of the group-wide supervision process. It is vital that appropriate agreements on the exchange of confidential information between the members of the supervisory college are in place. The IAIS and FSB are convinced of the key role supervisory colleges can play in preventing and overcoming crisis situations. For this reason, the IAIS guidelines should also be incorporated into the upcoming work on cross-sector supervisory colleges for financial conglomerates.

Further cooperation agreements for the supervision of branch offices in the securities sector.

BaFin has concluded a number of agreements on standing requests of assistance, with the supervisory authorities in Ireland, Finland and Luxembourg. A standing request for assistance refers to a request for administrative assistance from the respective foreign supervisory authority to assume certain supervisory powers for branches located in the host country. In the case of a branch of a French bank in Germany, BaFin actually agreed on a Common Oversight Program with the French Autorité des Marchés Financiers (AMF), which was advisable in view of the key market position the bank has in the German retail banking sector. In contrast to a standing request for assistance, a common oversight program provides a framework for close cooperation between the supervisory authorities concerning the supervision of the branch involved. In a similar vein, BaFin also agreed on another common oversight program with the Italian Commissione Nazionale per le Società e la Borsa (CONSOB) with regards to the branch of a German credit institution in Italy.

12 Memoranda of Understanding

Multilateral IAIS MoU signed.

BaFin, the Financial Supervisory Commission from Taiwan and the Bermuda Monetary Authority (BMA) were the first members to sign the IAIS Multilateral Memorandum of Understanding (MMoU) in June 2009. With this MMoU, the IAIS intends to improve cross-border cooperation between insurance supervisors. By signing the MMoU, the members agreed to a number of issues including regulations governing the exchange of information on cross-border activities of insurers, reinsurers and insurance groups; they also came to an understanding on a set of minimum standards to protect the confidentiality of this information. In the meantime, other organisations have since signed the MMoU including the Australia Prudential Regulation Authority (APRA), the Autorité de Contrôle des Assurances et des Mutuelles (ACAM, France), De Nederlandsche Bank (DNB, the Netherlands), the Finanzmarktaufsicht (FMA, Austria) and the Insurance Supervisory Commission (Romania). A total of eight members have thus already signed up to the agreement; a further 20 IAIS members have signalled their interest in joining the agreement and are currently undergoing the three-stage application process.

Applications to sign the IOSCO MMoU.

An IOSCO resolution obligates every IOSCO member to apply to join the IOSCO MMoU by the beginning of 2010. As a result, securities regulators from a whole host of countries applied to join in 2009. Having already signed the MMoU in 2003, BaFin was involved in reviewing the incoming applications and also provided technical support to an applicant in one case. By signing the agreement, the supervisory authorities commit themselves to exchanging information on the cross-border pursuit of capital market offences. The MMoU has since established itself as the international standard for the exchange of law enforcement information between securities regulators.

Table 2
Memoranda of Understanding (MoU) 2009

Banking supervision		Securities supervision		Insurance supervision	
Argentina	2001	Argentina	1998	Australia	2005
Australia	2005	Australia	1998	Californien (USA)	2007
Austria	2000	Brazil	1999	Canada	2004
Belgium	1993	Canada	2003	China	2001
Brazil	2006	China	1998	Croatia	2008
Canada	2004	Croatia	2008	Czech Republic	2002
China	2004	Cyprus	2003	Dubai	2006
Croatia	2008	Czech Republic	1998	Estonia	2002
Czech Republic	2003	France	1996	**Florida (USA)**	**2009**
Denmark	1993	Hong Kong	1997	Hong Kong	2008
Dubai	2006	Hungary	1998	Hungary	2002
Estonia	2002	Italy	1997	Korea	2006
Finland	1995	Jersey	2000	Latvia	2001
France	1992	Luxembourg	2004	Lithuania	2003
Great Britain (BE/FSA)	1995	**Monaco**	**2009**	Malta	2004
Great Britain (BSC)	1995	Poland	1999	**Maryland (USA)**	**2009**
Great Britain (SIB/SROs)	1995	Portugal	1998	**Minnesota (USA)**	**2009**
Greece	1993	Qatar	2008	Nebraska (USA)	2007
Hong Kong	2004	Russia	2001	**New Jersey (USA)**	**2009**
Hungary	2000	**Russia**	**2009**	New York (USA)	2008
Ireland	1993	Singapore	2000	Qatar	2008
Italy (BI)	1993	Slovakia	2004	Romania	2004
Italy (BI-Unicredit)	2005	South Africa	2001	**Singapore**	**2009**
Jersey	2000	Spain	1997	Slovakia	2001
Korea	2006	Switzerland	1998	USA (OTS)	2005
Latvia	2000	Taiwan	1997		
Lithuania	2001	Turkey	2000		
Luxembourg	1993	United Arab Emirates	2008		
Malta	2004	USA (CFTC)	1997		
Netherlands	1993	USA (SEC)	1997		
Norway	1995	USA (SEC)	2007		
Phillipines	2007				
Poland	2004				
Portugal	1996				
Qatar	2008				
Romania	2003				
Russia	2006				
Singapore	**2009**				
Slovakia	2002				
Slovenia	2001				
South Africa	2004				
Spain	1993				
USA (FDIC)	2006				
USA (FedBoard/OCC)	2003				
USA (NYSBD)	2002				
USA (OCC)	2000				
USA (OTS)	2005				
USA (SEC)	2007				

MoU with US insurance supervisory authorities.

BaFin has agreed on closer cooperation with four American insurance supervisory authorities: the Minnesota Department of Commerce (MDOC), the New Jersey Department of Banking and Insurance (DOBI), the Florida Office of Insurance Regulation (FLOIR) and the Maryland Insurance Administration (MIA). The signatories agreed to permit on-site inspections of branches or subsidiaries in the respective host country. Furthermore, the bilateral agreement makes provisions for the exchange of information which is relevant for the supervisory and regulatory tasks of the respective authorities.

MoU with Singaporean supervisory authority.

BaFin and the Monetary Authority of Singapore (MAS) agreed on the possibility of audits in the host country as part of an MoU. In addition to supervising insurance undertakings, the MoU also makes provisions for supervising credit institutions and financial services institutions. BaFin and MAS also agreed on measures to streamline the exchange of information, which should provide particular support in crisis situations and in which the Bundesbank is involved.

MoU with securities regulators from Monaco and Russia.

BaFin has also signed two MoUs with securities regulators from Monaco and Russia. The MoU between BaFin and the Commission de contrôle des activités financières (CCAF) regulates the cooperation of both supervisory authorities in the field of market supervision, in particular in pursuing cases of insider trading or market manipulation. By the same token, the MoU with the Federal Financial Markets Service of Russia (FFMS) should help to promote cooperation between the two supervisory authorities in the field of market supervision.

13 Technical cooperation

BaFin also advised and supported foreign supervisory authorities in their efforts to set up a new supervisory system during the reporting year.

Cooperation with China.

In the year under review, there were once again a number of visits paid to BaFin by delegations from the Chinese supervisory authorities and employees of Chinese financial institutes to garner information and attend seminars. In May, a BaFin employee held a lecture in Beijing on the issue of securities supervision. Cooperation is set to continue in 2010.

Good relations with Ukraine, South Korea and Russia.

Cooperation with the Ukrainian financial supervisory authority continued to be strengthened in 2009. A delegation from the Ukrainian insurance supervisory authority came to Bonn in February to obtain information on a range of selected supervisory issues. Similarly, representatives from the Ukrainian securities supervisory authority visited BaFin in September to exchange information. In return, BaFin representatives visited Kiev in October. It is planned to establish even closer ties between the German and Ukrainian supervisory authorities in 2010.

Good relations with the South Korean financial market regulators were maintained in 2009. In June and October, employees of these authorities completed an internship in the securities and insurance sectors lasting several weeks.

In a similar vein, cooperation with Russia continued, with a delegation from the Russian insurance supervisory authority attending seminars at BaFin. Conversely, a BaFin employee also participated in a further training event for Russian insurance supervisors in Moscow.

Support for Serbia, Armenia, Moldova and Bosnia-Herzegovina.

Good relations were maintained and extended with the Serbian insurance supervisory authorities. In November, a four-person delegation from Serbia came to obtain information on a range of selected issues related to supervisory activities. Likewise, representatives of the Armenian insurance and securities supervisory authorities also paid visits to obtain and exchange information.

Contact with the National Commission of Financial Markets (NCFM) of Moldova was also developed further in the year under review. In October and November, employees of these authorities completed internships in the securities and insurance sectors lasting several weeks. Initial talks were held on the subject of financial services supervision with representatives from Bosnia-Herzegovina, while consultations were held at both the national bank and in the country's parliament.

New relations with Africa.

For the first time, representatives from the Tanzanian capital market supervisory authority and stock exchange visited BaFin in Frankfurt.

BaFin helped to organise a conference on regional integration in South Africa, the goal of which is to establish closer cooperation and, in the long term, to create a common market for the Southern African Development Community (SADC). The SADC is an organisation of 15 countries in southern Africa, which are working towards creating a common market in 2015. BaFin highlighted its experiences from the European common market, with particular reference to an integrated capital market and the single passport concept (European passport for cross-border activities).

Dr. Thomas Steffen,
Chief Executive Director of
Insurance Supervision

IV Supervision of insurance undertakings and pension funds

1 Basis for supervision

1.1 Act on Strengthening the Supervision of the Financial Market and Insurance Sector

The financial market crisis prompted the need for improvements to the powers of intervention available to the financial market and insurance sector supervisory authorities. On 13 October 2008, the German federal government announced that it would be proposing amendments to supervisory law to improve the powers of intervention at the disposal of the supervisory authorities in times of crisis as part of a package of measures designed to stabilise the financial markets. The Act on Strengthening the Supervision of the Financial Market and Insurance Sector *(Gesetz zur Stärkung der Finanzmarkt- und der Versicherungsaufsicht* – FMVAStärkG)[4] is not intended to pre-empt the current reform plans at European and international level. Consequently, it was limited to those objectives that are deemed to be particularly important, such as improving preventative measures, the provision of better information to the supervisory authorities in the form of additional disclosures, improved rights of intervention in crisis situations and making the responsible individuals more accountable.

The most important amendments to the Insurance Supervision Act *(Versicherungsaufsichtsgesetz* – VAG) are described in brief below:

Monitoring of supervisory board members

New regulations include notification requirements, substantive requirements and measures.

The new regulations governing the monitoring of supervisory board members include notification requirements (primarily sections 5 (5) no. 9, 13d no. 12 VAG), material requirements (mainly section 7a (4) VAG) and measures (mainly sections 87 (8), 121c (6) VAG). They affect all of the types of undertakings that are subject to supervision pursuant to the VAG, with some differences as far as the details are concerned: primary insurance and reinsurance undertakings, pension funds, insurance holding companies, insurance special purpose vehicles and mixed financial holding companies.

[4] Federal Law Gazette (BGBl.), I 2009, p. 2305.

Supervisory board members have to be reliable and qualified (section 7a (4) sentences 1 and 2 VAG). Furthermore, only five supervisory board mandates at companies subject to supervision by BaFin are permitted as a general rule; more than five mandates are permitted if the companies belong to the same insurance or corporate group (section 7a (4) sentence 4 VAG).

The regulations governing the monitoring of supervisory board members in the VAG correspond largely to those set out in the Banking Act *(Kreditwesengesetz* – KWG). BaFin published a – cross-sectoral – guidance notice on 3 March 2010 containing information on qualification and notification requirements in particular.

Limit on the number of management mandates

Limits in cases of multiple mandates.

The supervisory authorities have long tolerated multiple mandates in insurance groups within certain limits, because the VAG does not allow all insurance classes to be offered by a single legal entity – a principle known as the segregation principle *(Spartentrennungsgrundsatz)*. For some time, however, there have been certain managers with a total of more than ten management mandates within a group.

Under the new regulations, managers will only be allowed to hold two mandates in principle (section 7a (1) sentence 5 VAG). Only mandates at primary insurance and reinsurance undertakings, pension funds, insurance holding companies and insurance special purpose vehicles will count towards this limit. The Supervisory Authority can opt to approve more mandates if the companies involved belong to the same insurance or corporate group (section 7a (1) sentence 6 VAG).

The legislature felt that the provision set out in the draft bill stipulating a maximum of five mandates was too rigid. The grounds for the law *(Gesetzesbegründung)* mention the fact that a larger number of mandates is not a problem if, for example, the individual involved is to be responsible for a narrowly defined area, e.g. personnel or IT.

For the time being, the new regulation does not apply to multiple mandates that were already in place when the amendments came into force, i.e. on 1 August 2009. In such cases, a transitional period shall apply until 31 December 2010 (section 123f VAG).

Insurance holding companies

Exception for holding companies repealed.

The exception in the legal definition of an insurance holding company has been repealed. Under this provision, companies that could prove that they did not exercise any management function were not classified as insurance holding companies within the meaning of section 1b VAG (section 1b (1) sentence 2 VAG (old version)). The amendment came in response to a need for fast action to be taken by supervisory authorities in times of crisis. In the past, companies were able to challenge administrative acts *(Verwaltungsakte),* subjecting them to supervision (section 2 VAG) on the grounds that they did not exercise any management function. This meant that BaFin's hands were tied until the courts had passed a res judicata judgment. There is also a need to prevent a situation in which financial risks are shifted to holding companies that are not subject to supervision, not only if the latter exercise a management function.

As far as the other amendments to section 1b VAG are concerned, the following is worth highlighting: Measures have been taken to make sure that holding companies not only ensure appropriate risk management at group level as the superordinated entity, but that, as such, they also have a proper business organisation (section 64a in conjunction with section 1b (2) half-sentence 1 VAG).

Prohibition of non-insurance business

Further details as regards what constitutes non-insurance business.

The prohibition of non-insurance business (section 7 (2) VAG) only applies to primary insurance undertakings. The regulations that apply to reinsurance undertakings are less stringent (section 120 (1) sentence 3 VAG). Section 7 (2) VAG is based on European directive requirements that will continue to apply under Solvency II.

The prohibition of non-insurance business was detailed further to improve legal certainty. The new section 7 (2) sentence 4 VAG clarifies the purpose of the prohibition, namely to protect policyholders and (indirectly) the insurance undertakings from the additional financial risks associated with non-insurance business.

The new section 7 (2) sentence 3, half-sentence 1 VAG bans borrowing in principle. In doing so, the legislature put an end to a difference of opinion between the insurance industry, which sees the borrowing ban as an unreasonable restriction, and the supervisory authorities, which point to the financial risks and the insurance industry's function as a financial intermediary, accumulating funds from surplus agents and channelling them to deficit agents. The grounds for the law state that exceptions may be considered within narrow limits, for example for companies in need of short-term liquidity assistance, or for short-term overdraft facilities. This largely corresponds to the current supervisory practice. Special regulations apply to certain forms of hybrid capital, which are eligible as own funds within precisely defined limits (section 7 (2) sentence 3 half-sentence 2, section 53c (3c) VAG).

Risk concentrations at group level

Notification duty pursuant to section 104i VAG.

The superordinated group entity must disclose all significant risk concentrations at insurance group level to the Supervisory Authority on a quarterly basis (section 104i VAG). This regulation is required because the information that the supervisory authorities receive on group solvency, for example, paints an insufficient picture of a group's real risk situation.

The new provision is based on section 104r VAG – a regulation containing a similar notification duty for financial conglomerates.

Reporting requirement for securitisations

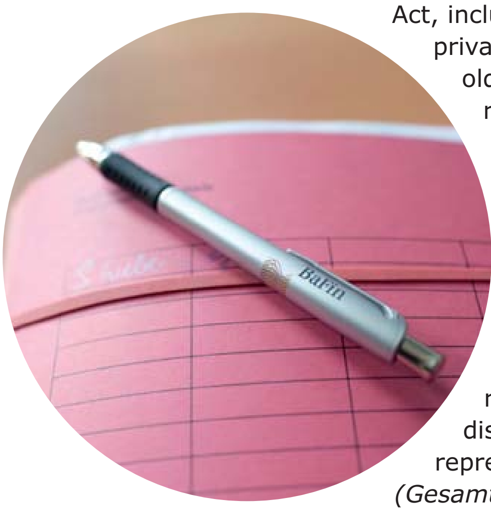
The Act on Strengthening the Supervision of the Financial Market and Insurance Sector has also extended section 13d VAG to include a new reporting requirement in no. 11. This provision stipulates that primary insurance and reinsurance undertakings must report any direct and indirect securitisation of claims risks or other risks to BaFin insofar as a special purpose vehicle is involved. In order to increase the transparency of such transactions and the insurers' risk position, the disclosure must include the prospectus, the contractual provisions underlying the risk transfer and a list of the risks for the insurance undertaking that have been identified as being associated with the transaction.

1.2 Structural reforms to pension rights adjustments

New structures for pension rights adjustments.

The Act on Structural Reforms to Pension Rights Adjustments *(Gesetz zur Strukturreform des Versorgungsausgleichs* – VAStrRefG) came into force in early September 2009. The Act sets out provisions governing pension rights adjustments in Art. 1 Act on Pension Rights Adjustments *(Gesetz über den Versorgungsausgleich* – VersAusglG).

The aim of the pension rights adjustments is to split the entitlements acquired during marriage between the divorced spouses and to resolve problems that have arisen when adjusting pension rights in the past. Entitlements, within the meaning of the Act, include claims under occupational pension schemes and private retirement savings plans that offer protection for old-age or invalidity. This means that the new regulations affected both *Pensionskassen* and pension funds, as well as life insurance undertakings. As the pension vehicles, the undertakings have to calculate the proportion of the entitlement that is attributable to the period of time spent as a married couple and then submit a proposal for the adjustment value to the family court.



The implementation of the statutory requirements raised a large number of practical questions that were discussed in a joint working group comprising representatives from the German Insurance Association *(Gesamtverband der Deutschen Versicherungswirtschaft e.V.*

– GDV) and from industry. The main basis for the discussions was a draft prepared by the GDV which, following extensive and controversial discussions, resulted in an agreement being reached on a system for splitting entitlements. The undertakings affected can now use this system to submit changes to the operating plan for the parts of their portfolios that are subject to approval. BaFin also held talks with the "pension rights adjustments working group" of the German Actuarial Society *(Deutsche Aktuarvereinigung e.V.* – DAV) on this issue.

Section 15 (5) VersAusglG was supplemented to include a provision stating that entitlements under occupational pension schemes give rise to an entitlement from the pension rights adjustment fund *(Versorgungsausgleichskasse),* unless the person entitled to compensation chooses another pension vehicle in cases in which an external split *(externe Teilung* – a situation in which a pension entitlement is created with a pension vehicle other than that with which the individual liable to pay the compensation has an entitlement) is agreed. The pension rights adjustment fund is a Pensionskasse within the meaning of section 118a VAG which is formed solely for the aforementioned purpose, and does not perform any other business activities. The legislature has set out specific regulations for pension rights adjustment funds in the Act on Pension Rights Adjustment Funds *(Gesetz über die Versorgungsausgleichskasse* – VersAusglKassG) to take account of the special characteristics of these undertakings. The pension rights adjustment funds shall be set up as mutual societies with life insurers as their founding members.

1.3 Regulations and circulars

BerVersV and BerPensV

Amendments to reflect BilMoG.

In the second half of 2009, BaFin revised the Regulation on the Reporting by Insurance Undertakings to the Federal Financial Supervisory Authority *(Verordnung über die Berichterstattung von Versicherungsunternehmen gegenüber der Bundesanstalt für Finanzdienstleistungsaufsicht* – BerVersV) and the Regulation on the Reporting by Pension Funds to the Federal Financial Supervisory Authority *(Verordnung über die Berichterstattung von Pensionsfonds gegenüber der Bundesanstalt für Finanzdienstleistungsaufsicht* – BerPensV). The amendments are scheduled to come into force in May 2010, and will be applied for the first time to the annual financial statements for the financial year starting after 31 December 2009. Most of the amendments to the BerVersV and BerPensV were required to reflect the Act to Modernise Accounting Law *(Bilanzrechtsmodernisierungsgesetz* – BilMoG). This is because the provisions governing the internal accounting of insurers and pension funds vis-à-vis the Supervisory Authority are based largely on financial accounting rules. The BerVersV is also affected by isolated amendments to the Insurance Contract Act *(Versicherungsvertragsgesetz* – VVG), in particular the introduction of policyholder participation in valuation reserves pursuant to sections 153, 211 VVG. BaFin also felt the need to expand the concept of an "administrative offence" set out in section 25 BerVersV to include quarterly statements *(Nachweisungen)*. As well as amending the wording of the regulations, the forms and statements that undertakings have to use for reporting purposes were also revised.

Requirements for remuneration systems in the insurance sector

Amendments to existing remuneration principles.

BaFin published the new Circular 23/2009 (VA) on 21 December 2009. The background to this new circular is as follows: In September 2009, the countries that attended the G20 summit in Pittsburgh decided to reform the existing remuneration structures to make the financial sector more stable. They made a commitment to implement the Financial Stability Board (FSB) standards for remuneration systems. These standards are directed at financial institutions, meaning that they also apply to insurance undertakings. The BMF called on BaFin to implement the new remuneration standards as soon as possible, initially at circular level. Consequently, BaFin issued a circular on the requirements to be met by remuneration systems in the insurance sector at the end of the year under review. The new circular was necessary in order to supplement and enhance existing principles and to ensure uniform procedures in the banking and insurance supervision areas. The circular is to be transposed into a regulation in the course of 2010.

The publication of the new circular meant that an old circular published by the former Federal Insurance Supervisory Office (BAV) and part of the MaRisk VA[5] were repealed. The requirements contained therein were incorporated into Circular 23/2009 (VA), meaning that they continue to apply unchanged for the vast majority of insurance undertakings. The FSB standards have now been incorporated, although these new standards will only apply to major companies in most cases. The undertakings themselves are responsible for performing a self-assessment, taking certain parameters into account, to determine whether or not they fall into the group that has to observe the standards. The only consequence for other undertakings is that they have to observe the requirements at group level and adjust any employment law agreements to the extent that this is possible.

Monitoring compliance with the Minimum Refund Regulation

New statement for minimum allocation.

BaFin has made Statement 612 available to the affected undertakings in Circular 12/2009 (VA). This statement replaces Statement 611 on the calculation of the allocation amount, which did not collect all of the relevant data for determining the minimum

[5] Circular 3/2009 (VA).

allocation pursuant to the new Regulation on the Minimum Refund in Life Insurance *(Verordnung über die Mindestrückerstattung in der Lebensversicherung* – ZRQuotenV).

The new statement had to be completed for the first time for the annual financial statements for financial year 2008, and has to be submitted to the Supervisory Authority, as part of internal profit breakdowns, by the end of July of the year following the relevant financial year. As well as the relevant amounts from the different sources of profit, the statement also documents a possible reduction in the minimum allocation amount, which must, however, have been approved by BaFin in advance.

2 Ongoing supervision

2.1 Authorised insurance undertakings and pension funds

The number of insurance undertakings subject to supervision by BaFin fell further in 2009 to 615 (previous year: 626), 596 of which were actively conducting business and 19 of which were not. The description of 2009 business development includes the public-law insurance undertakings subject to supervision by the individual federal states (9 of which were actively conducting business and 1 of which was not). A sector breakdown is provided in the table below:

Table 3

Number of supervised insurance undertakings (IU) and pension funds [6]

	IU with business activity			IU without business activity		
	Federal supervision	State supervision	Total	Federal supervision	State supervision	Total
Life IU	96	3	99	10	0	10
Pensionskassen	153	0	153	0	0	0
Death benefit funds	41	0	41	0	0	0
Health IU	51	0	51	0	0	0
Property & casualty IU	217	6	223	6	1	7
Reinsurance undertakings	38	0	38	3	0	3
Total	**596**	**9**	**605**	**19**	**1**	**20**
Pension funds	29	0	29	0	0	0

[6] The data does not include small mutual societies (kleinere Versicherungsvereine auf Gegenseitigkeit) which operate on a mainly regional basis and are subject to supervision by the individual federal states (see BaFin statistics for 2008 – primary insurance undertakings and pension funds, p. 8, table 5).

Commencement and relinquishment of insurance business

Life insurers

2009 saw one German life insurer subject to supervision by BaFin cease business operations altogether. One company from a signatory state to the Agreement on the European Economic Area (EEA), Liechtenstein, set up a branch office (BO). Furthermore, 22 foreign life insurance undertakings from the EEA registered for the cross-border provision of services (CBS) in Germany (previous year: 21). A number of service providers expanded their business activities.

Table 4
Registrations made by EEA life insurers

Country	CBS*	BB**
France	6	
Ireland	4	
Italy	2	
Liechtenstein		1
Luxembourg	3	
Netherlands	2	
Poland	1	
UK	3	
there of Gibraltar	1	

* Cross-border provision of services within the meaning of section 110a (2a) VAG.
** Business via branches within the meaning of section 110a (2) VAG.

Health insurers

At 51, the number of health insurance undertakings remained unchanged as against the previous year.

Property and casualty insurers

In 2009, BaFin authorised four property and casualty insurers to conduct property and casualty business. 14 property and casualty insurers (6 of which are branch offices) ceased business operations altogether. Foreign property and casualty insurers from the EU established two branches, one from Belgium and one from Latvia. 24 insurance undertakings from the EEA registered to start providing services in Germany (previous year: 42). Furthermore, a number of insurance undertakings previously authorised to provide services registered expansions of their business operations. Compulsory insurance is still only offered on a small scale, and is usually limited to motor vehicle liability insurance. A number of insurance undertakings ceased provision of services in Germany in 2009, too.

Table 5

Registrations made by EEA property and casualty insurers

Country	CBS*	BB**
Belgium		1
Cyprus	1	
Czech Republic	1	
Denmark	2	
France	3	
Hungary	1	
Ireland	1	
Italy	1	
Latvia		1
Luxembourg	1	
Malta	4	
Netherlands	1	
Poland	1	
Romania	1	
Spain	1	
Sweden	1	
UK	4	

* Cross-border provision of services within the meaning of section 110a (2a) VAG.
** Business via branches within the meaning of section 110a (2) VAG.

Reinsurers

In the year under review, BaFin did not grant authorisation to any reinsurer. Foreign reinsurers from the EU set up three branch offices, with the companies in question based in the EU member states of Ireland, Luxembourg and Spain. Four companies ceased to operate as independent German reinsurers in the same period.

Pensionskassen and pension funds

In 2009, BaFin granted authorisation to three pension funds, and one pension fund merged with another.

This means that BaFin currently supervises 153 *Pensionskassen* and 29 pension funds. At the end of the reporting year, one authorisation process for a Pensionskasse was still pending.

In the year under review, one institution for occupational retirement provision with its registered office in another EU member state (Austria) and three institutions for occupational retirement provision with their registered offices in another signatory state to the EEA Agreement (Liechtenstein) registered with BaFin.

2.2 Interim reporting

2.2.1 Crisis on the financial markets

Insurers are not to blame for the global financial crisis, but rather have been helping to stabilise the markets to date. Nevertheless, the insurance sector is also a key institutional investor, meaning that it was unable to escape the consequences of the global financial crisis entirely unscathed – a fact that applies not only to companies with global operations. Many insurers were hit by hefty write-downs on investments, for example because of the slump in share prices. The sustained period of low interest rates is also putting companies under pressure: Low interest rates are choking investment income, and could even put companies' long-term ability to fulfil contractual guarantees at risk.

Otherwise, German insurers have so far proven to be fairly robust in the face of the crisis. One reason for this relative resilience lies in Germany's stringent investment regulations, which provoked some criticism before the crisis broke out. Investments using restricted assets, for example, are subject to stringent requirements as far as diversification is concerned, meaning that the German insurance industry was largely steered away from dangerously high risk concentrations. Another advantage of Germany's insurance undertakings is that they have a relatively low proportion of equities in their portfolios compared with their competitors in other European countries. BaFin continues to collect information on the risk situation of major insurance groups and selected insurance undertakings on a regular basis. These reports suggest that the stability of the German insurance system is not at risk.

2.2.2 Business trends

Life insurers

In the area of direct life insurance, new policies with the first premium paid were down by 7.9% in 2009 from 6.47 million to 5.96 million new contracts. The underwritten amount of new insurance policies fell by 0.5% compared with the previous year to €218.5 billion (2008: €219.6 billion).

The share of mixed endowment insurance as a proportion of new contracts rose slightly year-on-year, from 14.4% to 14.7%. The proportion of term insurance rose as against the previous year from 28.2% to 29.2%. The share of annuities and other life insurance fell from 57.4% to 56.2%, while endowment insurance remained constant at 8% of the underwritten amount on new insurance policies. Term insurance increased its share of the underwritten amount on new insurance policies from 32.4% to 34.0%. Annuities and other life insurance fell as a proportion of the total underwritten amount from 59.7% to 58.6%, bucking the prior-year trend.

Early withdrawals (surrender, conversion into paid-up policies and other early withdrawals) fell from 3.6 million contracts to 3.4 million contacts. At €120.3 million, the total underwritten amount accounted for by these early withdrawals was higher than in previous years (€113.8 million in 2008 and €108 million in 2007). There was a decline in early withdrawals from endowment policies compared with the previous year: 9.1% in terms of policy numbers and 3.5% with respect to the underwritten amount.

The number of direct life insurance policies totalled 90.8 million contracts at the end of 2009 (-1.9%), with a total underwritten amount of €2,527.8 billion (+1.4%). The share of mixed endowment policies fell from 47.3% to 45.5%, and from 36.4% to 33.9% in terms of the total underwritten amount, continuing the downward trend seen in the previous years. At 14.4% in terms of policy numbers and 21.8% with respect to the underwritten amount, term insurance remained virtually constant as regards year-on-year development. Annuities and other life insurance policies continued their positive development, increasing their proportion of policies from 38.2% to 40.1% and their share of the total underwritten amount from 42.4% to 44.3%.

Gross premiums written in direct insurance business rose from €75.3 billion to €80.7 billion. The share of endowment policies slid further from 41% to 37.2%, while the share of annuities and other life insurance policies continued to climb from 53.5% to 57.7%.

Health insurers

Gross premiums written in the direct health insurance business increased by 3.5% to €31.4 billion in 2009. The number of insured natural persons rose by 3.4% to total 34.8 million.

Property and casualty insurers

The gross premiums written in direct insurance reported by property and casualty insurance undertakings in 2009 were virtually unchanged as against the previous year at €58.6 billion (previous year: €58.2 billion).

Gross claims expenditure for claims relating to the year under review fell by 1.4% to €20.3 billion (previous year: €20.5 billion), while gross claims expenditure for claims relating to previous financial years remained stable at €13.6 billion. Gross provisions for individual claims from the year under review were set up in the amount of €14.7 billion (as against €14.9 million in 2008) and the gross provisions set up for individual claims from previous years totalled €45.8 billion compared with €45.2 billion in 2008.

With gross premiums written totalling €19.5 billion, motor vehicle insurance was still by far the largest class of insurance, even though the premium volume was down by 3.3% on the prior year. Gross expenditure for claims in the year under review was down by 3.2% year-on-year, and payments relating to claims from previous years also dipped slightly by 0.8%. All in all, gross provisions for individual claims from the year under review and for outstanding claims from previous years were down by 4.4% and 1.5% year-on-year respectively.

In the area of general liability insurance, property and casualty insurance undertakings collected total premiums of €7.6 billion (-1.6%). A total of €1 billion (-1.9%) was paid out for claims from the year under review, while €2.2 billion (-1.3%) was paid out for previous years' claims. Gross provisions relating to individual claims, which are particularly important in this insurance class, fell by 3% (+0.9%) to €2.2 billion with regard to outstanding claims from the reporting year and rose by 4.2% (+2.9%) in relation to outstanding claims from previous years to total €13.2 billion.

In the area of fire insurance, the undertakings in question collected gross premiums of €1.7 billion (-1.0%). Gross expenditure for claims in the year under review fell by 1.2% to €485 million.

Viewed together, the comprehensive residential buildings insurance and comprehensive household insurance classes collected premiums totalling €7.1 billion (+1.8%). Expenditure for 2009 claims was down 7.0% on the previous year, while provisions for individual claims increased by 7.2% Expenditure for claims from previous years was up by 1.4%, while the provisions for claims relating to previous years were 13.8% higher than the 2008 level.

Premiums from general accident insurance totalled €6.3 billion (previous year: €6.4 billion). Gross expenditure for 2009 claims was unchanged at €0.3 billion. The provisions set up for outstanding insurance claims from the year under review were up by 3% as against the previous year.

Pension funds

The development of new pension fund business is directly linked to the financial performance of the potential sponsoring companies. With the global financial crisis lurking in the background and given the liquidity shortages at potential sponsoring companies, the development of non insurance-based business (nicht versicherungsförmige Leistungszusagen) pursuant to section 112 (1a) VAG, in particular, is likely to have been more subdued on the whole. Defined contribution plans with a defined benefit underpin are largely financed by way of salary sacrifice by employees. All in all, gross premiums written came in at €2.9 billion, as against €2.5 billion in the previous year.

2.2.3 Investments

Slight increase in investments made by German insurers.

Following the dramatic turbulence on the financial markets in 2008, 2009 was characterised by a recovery on the global stock markets and historically low interest rate levels in the euro zone. This meant that insurers were confronted with a complex situation on the capital markets.

The total investments made by all German insurers, including reinsurance undertakings, increased by 1.8% as against 2008 to €1,323 billion (2008: €1,299.9 billion). The book value of all investments made by German primary insurers came in at €1,119 billion as at 31 December 2009, an increase of 3.2% (previous year: 1,084 billion). The investments made by health insurers rose considerably, namely by 7.4% or €11.4 billion to total just shy of €164 billion. The lowest rates of investment growth were reported by property and casualty insurers at 0.9% or €1.2 billion to total €138 billion, followed by life insurance undertakings with an increase of 2.6% or €18.2 billion to €707 billion.

There has been no drastic change in the investment pattern shown by primary insurers compared with the previous year. In terms of total assets, the most substantial investment fluctuations within the various main asset classes compared with the previous year came in at two percentage points at the most.

Primary insurers continued to focus their investments on fixed-income securities and note loans. Covered bonds, municipal bonds or other bonds were the largest single item among the investments made by primary insurance undertakings. Listed bonds, loans to EEA states, note loans and registered bonds issued by credit institutions accounted for around one third of the total assets of primary insurers.

Furthermore, around one quarter of total assets were invested in investment funds. The volume of investments means that this proportion is largely determined by life insurance undertakings. Health and property/casualty insurers, on the other hand, invested 18% and 30% of their total assets in investment funds respectively. Within this category, 95% of the investments made by primary insurers were destined for German funds, as in the previous year. Within the funds, the emphasis in all insurance classes was once again clearly on fixed-income securities.

Table 6

Investments 2009

Investments of all Insurance undertakings	As at 31.12.2009		As at 31.12.2008*		Change in 2009	
	in Mio. €	in %	in Mio. €	in %	in Mio. €	in %
Real property and equivalent rights and shares in property companies	25,748	1.9	25,722	2.0	+ 26	+ 0.1
Fund units, shares in investment stock corporations *(Investmentaktiengesellschaften)* and investment companies	293,775	22.2	289,325	22.3	+ 4,450	+ 1.5
Loans secured by mortgages and land charges	58,170	4.4	60,039	4.6	- 1,869	- 3.1
Securities loans and loans secured by bonds	797	0.1	967	0.1	- 170	- 17.6
Loans to EEA states, their regional governments or local authorities, international organisations	105,543	8.0	82,233	6.3	+ 23,310	+ 28.3
Corporate loans	11,451	0.9	12,659	1.0	- 1,208	- 9.5
ABS	910	0.1	1,120	0.1	- 211	- 18.8
Policy loans	5,369	0.4	5,797	0.4	- 428	- 7.4
Covered bonds, municipal bonds and other bonds issued by credit institutions	265,901	20.1	253,014	19.5	+ 12,887	+ 5.1
Listed bonds	120,951	9.1	113,379	8.7	+ 7,572	+ 6.7
Other bonds	11,777	0.9	10,999	0.8	+ 778	+ 7.1
Subordinated debt assets	22,780	1.7	23,489	1.8	- 710	- 3.0
Participation rights *(Genussrechte)*	8,590	0,6	11,109	0.9	- 2,519	- 22.7
Debt register claims *(Schuldbuchforderungen)* and open market instruments	1,173	0.1	801	0.1	+ 372	+ 46.5
Listed shares	15,391	1.2	15,790	1.2	- 399	- 2.5
Unlisted shares and partnerhip interests excl. private equity holdings	121,269	9.2	133,408	10.3	- 12,139	- 9.1
Private equity holdings	7,166	0.5	6,568	0.5	+ 597	+ 9.1
Investments at credit institutions	214,101	16.2	218,973	16.8	- 4,871	- 2.2
Investments made under the opening clause	16,271	1.2	15,609	1.2	+ 662	+ 4.2
Other investments	15,836	1.2	18,846	1.4	- 3,009	- 16.0
Total investments	**1,322,971**	**100.0**	**1,299,850**	**100.0**	**+ 23,121**	**+ 1.8**
Life IU	707,370	53.5	689,147	52.1	+ 18,223	+ 2.6
Pensionskassen	107,986	8.2	104,189	7.9	+ 3,797	+ 3.6
Death benefit funds	1,813	0.1	1,647	0.1	+ 165	+ 10.0
Health IU	163,856	12.4	152,508	11.5	+ 11,348	+ 7.4
Property/casualty IU	137,971	10.4	136,801	10.3	+ 1,170	+ 0.9
Reinsurance undertakings	203,974	15.4	215,557	16.3	- 11,583	- 5.4
All IU	**1,322,971**	**100.0**	**1,299,850**	**100.0**	**+ 23,121**	**+ 1.8**
Primary Insurers	1,118.996	84.6	1,084,293	83.7	34,704	+ 3.2

* The 2009 figures are based on interim reporting and are merely preliminary figures. This means that the figures quoted may vary from those published in the previous year.

Pension funds

Investments for the benefit of pension funds which bear the investment risk rose from €719 million to €843 million in 2009, which corresponds to relative growth of 17.2% (2008: +12.3%). As at the balance sheet date, the net hidden reserves in the investments made by pension funds stood at around €13 million. In 2009, several pension funds are likely to make use of the valuation option provided in section 341b of the Commercial Code *(Handelsgesetzbuch* – HGB), which allows certain securities to be classified as fixed assets.

The investments made for the benefit of employees and employers who bear the investment risk climbed from €12.7 billion to €16.3 billion in the year under review. These investments consist primarily of fund units. The financial crisis clearly left its mark on the accounting measurement of these assets last year, resulting in impairment losses. The recovery on the capital markets meant that the fair values of the investments made by pension funds also started to edge up again.

All pension funds subject to supervision by BaFin were able to cover their technical provisions in full.

2.3 Solvency

Still healthy solvency in all insurance classes.

Preliminary estimates suggest that, on the whole, primary insurers and reinsurers performed well in terms of meeting the minimum capital requirements in 2009.

Life insurers

Solvency in the life insurance industry remained solid in 2009. In the forecast statement as at 15 October 2009, all life insurers were able to demonstrate that they would meet the solvency requirements as at 31 December 2009. Following the marked decline in the solvency coverage ratio in 2008, the ratio stabilised in the year under review, and is expected to come in at 188% of the minimum requirement.

Health insurers

All health insurance undertakings also comply with the solvency requirements according to the scenario-based forecast. At 227%, the solvency coverage ratio for this sector is expected to be up slightly on the prior-year value of 224%. The sector still has a good level of own funds.

Property and casualty insurers

In the property and casualty sector, the coverage ratio was virtually unchanged as against the prior year at 317%, meaning that it clearly exceeds the minimum capital requirements. Although business volumes were down on the whole and reinsurers contributed a greater portion of claims expenditure, the solvency margin was still up compared with 2008. Own funds were strengthened despite the financial crisis thanks to capital injections made by shareholders and retained earnings.

Reinsurers

The solvency of reinsurers subject to supervision in Germany totalled €68.8 billion at the end of 2008. At the same point in time, the solvency margin came in at €6.4 billion, while the coverage ratio was up slightly again from 1.074% auf 1.079%.

The substantial own funds result, as in the past, from the distinctive fact that several major reinsurers in Germany also exercise the holding function in an insurance group or financial conglomerate. A considerable proportion of these companies' own funds is necessary for the financing of the holding function, and not to cover reinsurance activities. If the figures are adjusted for the holding companies, the average coverage ratio of the reinsurers subject to supervision in Germany still comes in at 277% (2007: 261%), far higher than the amount required.

Pensionskassen

Estimates suggest that the solvency coverage ratio of the Pensionskassen stood at approx. 124% at the end of 2009. All in all, company solvency has improved. The estimates show that three Pensionskassen will be unable to satisfy the solvency requirement as at 31 December 2009. Measures to resolve the coverage shortfall have been developed with the companies in question, and solvency plans have been approved for two of the companies. One company had already been prohibited from acquiring new business some years ago.

Pension funds

As a result of the scope of business of the 28 pension funds, the minimum guarantee fund was, in most cases, decisive in terms of determining the minimum capital requirements in each case. The solvency margin required pursuant to section 1 of the Regulation Concerning the Capital Resources of Pension Funds *(Verordnung über die Kapitalausstattung von Pensionsfonds* – PFKAustV) was greater than the respective minimum guarantee fund amount for only four pension funds. In the year under review, the eligible own funds held by pension funds were sufficient.

2.4 Stress test

Fundamental change to stress test scenarios.

In 2009, BaFin conducted a stress test as at the balance sheet date of 31 December 2008. A rules-based approach was adopted for the stress test scenarios as far as the assumed share price losses were concerned: a fundamental change. The discount increases in the event of an increase in share prices, reflecting the increased potential for a rebound reaction. The discount is reduced if share prices fall, because the potential for a rebound reaction is also reduced. The EuroStoxx 50 share index is taken as a basis. The idea behind this move was to counteract procyclicality and put a damper on any exaggerated tendencies.

As at the reporting date of 31 December 2008, the discount for the equities only scenario, based on the index level, came in at 16%, while the combined scenarios (equities/bonds and equities/property) were subject to a haircut of 12% for the equity share. The discount for bonds was unchanged at 5%, and the discount for properties also remained the same at 10%. The bonds-only scenario remained unchanged with a discount of 10%.

In order to take account of the increasing importance of unit-linked insurance, the additional mathematical provision in the unit-linked business with guarantees now has to be taken into account in the stress test if the fair value of the fund units is lower than the present value of the guarantees (calculated based on a fixed technical interest rate).

Two life insurers...

95 life insurance undertakings submitted a stress test. BaFin exempted three companies from the duty to submit a stress test due to the low-risk nature of their investments, although one company voluntarily submitted the stress test. 93 life insurance undertakings reported positive results in all four stress test scenarios. The two companies that returned slightly negative results have also been able to restore their risk-bearing capacity in the meantime.

...one health insurer,...

BaFin included 44 health insurance undertakings in the stress test evaluation, and exempted seven companies from the duty to submit a test due to the low-risk nature of their investments. One health insurer's stress test values were negative. Measures were initiated to restore the company's risk-bearing capacity, with the result that the interim stress tests submitted by this company returned positive figures again. All of the other companies can be assumed to have sufficient assets to cover their technical provisions and statutory capital requirements even in the event of hefty price slumps/increases in interest rates.

...seven property and casualty insurers...

BaFin asked 185 property and casualty insurers to submit their stress test results. 41 companies were exempted from the duty to submit results.

178 property and casualty insurers reported positive stress test results. Five companies reported negative results in all four scenarios, while two produced a negative result in two scenarios. This was once again due, primarily, to the step-up of target values that was required by the stress test model. In particular, there was an above-average increase in the provision for claims outstanding due to company-specific special effects such as major losses, declining premiums, changes to reinsurance relationships or increases in reserves. Nevertheless, even those companies with negative stress test results can be assumed to have sufficient risk-bearing capacity as things stand at the moment.

...and twelve Pensionskassen reported negative stress test results.

BaFin exempted 23 of the 153 Pensionskassen subject to its supervision at the end of 2008 from their obligation to submit stress tests due to the low-risk nature of their investments. 118 of the 130 Pensionskassen required to submit stress tests reported positive results in all four stress test scenarios. At the twelve Pensionskassen with negative results, the coverage shortfall tended to be small. These companies took measures to restore their risk-bearing capacity in the course of the year under review.

2.5 Composition of the risk asset ratio

As at 31 December 2009, all primary insurance undertakings reported on their total investments. The companies had to submit a breakdown of investment types in accordance with the schedule of investments set out in section 1 (1) of the Investment Regulation *(Anlageverordnung* – AnlV), as well as a breakdown by the particular risks involved.[7]

The following assessments are based on the data for life, health and property/casualty insurers, as well as *Pensionskassen*. The book value of all restricted asset investments of these classes totalled €1.08 trillion at that date, compared with €1.04 trillion in the previous year.

Insurance undertakings can invest up to 35% of their restricted assets in investments associated with higher risks. In particular, these risk investments include equity investments, participation rights, subordinated debt assets and hedge funds. They also include what is known as the residual value of a fund and an increased potential market risk of investment funds. As at the reporting date, the risk asset ratio for all primary insurers came in at 11%.

[7] Section 2 (2) AnlV; Statement 670.

Table 7
Composition of the risk asset ratio

Type of investment pursuant to section 2 (1) no. ... AnlV, version dated 21.12.2007	Restricted assets									
	Life IU		Health IU		Property/casualty IU		Pensionskassen		Total for all four classes	
	Absolut in € m	Share in %	Absolut in € m	Share in %	Absolut in € m	Share in %	Absolut in € m	Share in %	Absolut in € m	Share in %
Total investments*	686,752	100.0	16,380	100.0	120,842	100.0	107,306	100.0	1,076,280	100.0
Thereof:										
Securities loans (no. 2), to the extent that equities (no. 12) are the object of the loan	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Subordinated debt assets and participation rights *(Genussrechte)* (no. 9)	17,051	2.5	5,033	3.1	2,920	2.4	2,193	2.0	27,197	2.5
Fully paid-up equities admitted to trading on an organised market (no. 12)	4,013	0.6	310	0.2	559	0.5	24	0.0	4,905	0.5
Non-listed fully paid-up equities, shares in a German private limited company (GmbH), limited partner and silent partner interests within the meaning of the HGB (no. 13)	9,416	1.4	2,118	1.3	2,156	1.8	422	0.4	14,111	1.3
Units in funds (nos. 15-17, incl. hedge funds), provided that they – contain fully paid-up equities and participation rights admitted to trading on an organised market in the EEA	18,194	2.6	2,842	1.8	6,880	5.7	6,881	6.4	34,797	3.2
– cannot be clearly assigned to other investment types; fund residual value and non-transparent funds	13,609	2.0	1,691	1.0	2,623	2.2	1,861	1.7	19,784	1.8
Investments in high-yield bonds	6,388	0.9	698	0.4	1,029	0.9	664	0.6	8,779	0.8
Increased fund market risk potential**	3,221	0.5	341	0.2	334	0.3	76	0.1	3,971	0.4
Investments linked to hedge funds (partly in categories other than the AnlV nos. set out above)***	2,563	0.4	563	0.3	443	0.4	772	0.7	4,340	0.4
Total investments subject to the 35% risk asset ratio	74,454	10.8	13,596	8.4	16,943	14.0	12,893	12.0	117,886	11.0

* Including cash at credit institutions excluding liabilities from mortgages, land charges (Grundschulden) and capital annuity charges (Rentenschulden).
** This refers to a market risk potential exceeding 100%, which has to be included in the calculation of the risk asset ratio as set out in section 3 (3) sentence 1 AnlV.
*** These values are approximations.

Source: Sector totals as at 31 December 2009 for life, health and property/casualty insurers, as well as Pensionskassen, from Statements 670 and 673, Circular 11/2005 (VA).

Average sector equity ratio stood at 3.7%.

Without taking the residual value into account, the equity ratio of the companies averages 3.7% of their restricted assets, below last year's value of 4.9%. This figure varies from class to class, from 2.0% for health insurance undertakings to 6.4% for Pensionskassen.

The risk asset ratio also includes investments in hedge funds or other direct and indirect investments that relate to hedge funds. Direct investments in hedge funds are minimally contained in units of funds. Most hedge fund investments, however, are 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 classified in the schedule of investments in accordance with their cash instrument, but must be fully included in the risk asset ratio in accordance with section 3 (3) AnlV. They account for 0.4% of the risk asset ratio.

Subject to certain conditions, insurance undertakings are also permitted to invest up to 5% of their restricted assets in high-yield investments. These investments, which account for 0.8%, are also included in the 35% ratio.

Non-transparent funds and all fund investments that could not be classified under other types of investment are attributed to what is known as the residual value. Within the risk asset ratio, this position reached a level of 1.8% of the restricted assets for all classes. The residual value ranged from 1.0% for health insurers and 2.2% for property and casualty insurers.

In accordance with the Investment Act (Investmentgesetz – InvG) or corresponding provisions of another country, the use of certain derivatives can mean that a fund entails leveraged potential market risk. This increased potential market risk of a fund is also included in the risk asset ratio pursuant to section 3 (4) AnlV.

Table 8

Proportion of total investments in selected asset classes

Type of investment	Total assets									
	Life IU		Health IU		Property/casualty IU		Pensionskassen		Total for all four classes	
	Absolut in € m	Share in %	Absolut in € m	Share in %	Absolut in € m	Share in %	Absolut in € m	Share in %	Absolut in € m	Share in %
Total investments*	707,370	100.0	163,856	100.0	137,971	100.0	107,987	100.0	1,117,184	100.0
There of:										
Investments in private equity holdings (in restricted assets pursuant to section 2 (1) no. 13 AnlV)	4,685	0.7	815	0.5	915	0.7	209	0.2	6,624	0.6
Directly held asset-backed securities and credit-linked notes pursuant to C 1/2002	4,064	0.6	562	0.3	479	0.3	460	0.4	5,566	0.5
Asset-backed securities and credit-linked notes held via funds pursuant to C 1/2002	5,324	0.8	754	0.5	1,728	1.3	487	0.5	8,293	0.7
Investments in hedge funds and investments linked to hedge funds (in restricted assets pursuant to C 7/2004)	3,337	0.5	614	0.4	730	0.5	844	0.8	5,525	0.5

* Including cash at credit institutions excluding liabilities from mortgages, land charges (Grundschulden) and capital annuity charges (Rentenschulden).

Source: Sector totals as at 31 December 2009 for life, health and property/casualty insurers, as well as Pensionskassen, from Statements 670 and 673, Circular 11/2005 (VA).

Alternative investments still account for only a small portion of investments.

The table shows that the proportion of total investments accounted for by alternative investments has barely changed as compared with the previous year. Only the proportion of asset-backed securities und credit-linked notes held directly or via funds fell from 0.6% to 0.5% and from 0.9% to 0.7% respectively.

2.6 Risk-oriented supervision

Internal Models Working Group (AKIM)

Under Solvency II, insurers will have two risk-based methods available to them to determine their regulatory capital requirements. In the future, insurers will be able to use not only the standard approach, but also an internal model that is recognised by the supervisory authorities in order to calculate the own funds that they require.

The "Internal Models Working Group" (AKIM) that was set up in 2006 allows interested company representatives to discuss such internal models. Two rounds of discussion were held in the working group in 2009. Debate focused on the approval process for the calculation of the solo SCR (solvency capital requirement) and the group SCR, the MCeV (market consistent embedded value) and the preliminary examination phase as regards the information to be presented at this stage.

The GDV internal models working group also met with BaFin representatives on numerous occasions between October 2008 and June 2009. The participants developed a common understanding as to how the framework directive is to be interpreted, and the results are to be published in two GDV brochures. BaFin is also preparing guidance notices to provide clearer information on the approval process.

Preliminary examinations of internal models.

November 2009 saw the European Council and Parliament pass the framework directive on Solvency II. Furthermore, CEIOPS issued its technical advice on the level 2 implementing measures for consultation. According to the timetable, Solvency II will have been implemented in the member states by the end of 2012. As soon as the directive was passed, a number of insurers informed BaFin that they were willing to apply for the approval of an internal model as soon as the directive came into force.

The framework directive states that no longer than six months should elapse between the filing of the application and the granting of approval. Given this tight deadline, a pre-application phase is to be introduced prior to the actual application phase. This will allow BaFin to get an initial impression of the complex facts underlying the internal model before the actual application is filed. In 2009, BaFin held talks with around 30 interested insurers to see whether or not, and how, these companies could be admitted to a preliminary examination phase. To date, there are three major insurance groups with an internal model that is already advanced enough for the pre-application phase. BaFin started the first set of preliminary examinations on these companies in 2009. Several rounds of talks were held with other companies to clarify unresolved issues concerning the approval process.

BaFin audit teams performed on-site preliminary examinations.

This meant that, in the year under review, BaFin audit teams spent an average of between seven and 14 weeks on companies' premises for supervisory consultations and on-site inspections. At one insurance group, BaFin started by evaluating the market and credit risk module. A one week-long pre-visit also took place. As the year progressed, a further three preliminary examinations were performed on site, each taking two weeks. In early 2009, BaFin also spent a prolonged period assessing the risk management system of another insurance group. They also looked into the investment management business area of the company in question.

The first part of the preliminary examination of the credit risk model was performed at another insurance group in September 2009. This examination was performed not only by BaFin employees, but by representatives of seven supervisory authorities from five European countries (France, Italy, Netherlands, Romania, Czech Republic). The foreign supervisory authorities used the pre-visit as an opportunity to gain an insight into model examinations as well as into the company's risk management system. Another preliminary examination of the credit module was performed in December 2009, also involving representatives from other European countries. The cooperation with the representatives from other European countries ran smoothly at all times.

Improved exchange of information between European supervisory authorities.

The involvement of European supervisory authorities in the preliminary examination process will increase in 2010. The existing Coordination Committees will be transformed into "Colleges", with more formal consultation procedures being put in place. This has improved the exchange of information between the various supervisory authorities involved in supervising an insurance group.

The European authorities responsible for supervising insurance groups meet at varying intervals, for example quarterly or once a year. How often they meet is decided based on the individual insurance group in question.

For the period from 2010 to 2012, the affected insurance groups have been consulted on the order of the next set of preliminary examinations based on a rough plan. Talks are planned with another nine insurance undertakings in 2010. Depending on the progress of development work on the internal model, a more detailed plan for further preliminary examinations will then be set in 2011.

Risk classification

BaFin allocated insurance undertakings to risk classes.

BaFin allocates the companies it supervises to risk classes, which it then uses to determine how intense its supervisory activities should be. Insurers are allocated to classes using a two-dimensional matrix that takes into account the systemic relevance and quality of the company. As far as life insurers, Pensionskassen, death benefit funds and pension funds are concerned, systemic relevance is measured based on the companies' total investments. For health insurers, property and casualty insurers and reinsurers, gross premiums earned are the decisive factor. Systemic relevance is measured based on a three-tier scale (high, medium and low).

A company's quality is assessed based on its

- financial position and performance,
- growth and
- management quality.

The first two criteria are marked based on insurance-specific ratios, while management quality is assessed using qualitative criteria. The valuation system tallies up the marks awarded for the sub-criteria to form an overall mark on a four-tier scale ranging from A (high quality) to D (low quality).

BaFin last performed a risk classification as at 31 December 2009:

Table 9
Risk classification results 2009

Undertakings in %		Quality of the undertaking				
		A	B	C	D	Total*
Systemic relevance	high	0.9	5.0	2.7	0.0	8.6
	medium	3.0	13.7	2.7	0.2	19.6
	low	8.8	43.7	15.9	2.0	70.4
	Total*	12.7	62.4	21.3	2.2	100.0

* Total contains 1.4% companies with no classification.

As in the previous years, BaFin did not allocate any insurance undertakings with high systemic relevance to the low-quality category. More than two thirds of the insurance undertakings that are subject to supervision by BaFin have only low systemic relevance. This relatively high proportion means that company quality follows a normal distribution pattern, resulting in a high concentration of quality categories B and C.

Impact of the financial crisis on BaFin's risk assessment.

The risk classification process takes into account both the general economic situation and the specific circumstances affecting the insurance sector. Obviously, a negative economic climate has an impact on the risk assessment performed by BaFin. Experience has shown that the effect of the crisis on companies has varied depending on their market impact. This means that in 2009, insurance undertakings with a low market impact were initially assigned more D ratings than in the previous year. In the course of the year, however, the proportion of companies scoring a "D" fell again.

Deterioration in investment-intensive insurance classes.

As was to be expected, the financial crisis had more of an impact on companies with a large investment portfolio and that compete directly with their peers in terms of their investment result. As far as life insurers and death benefit funds are concerned, the proportion of companies with A and B ratings fell by between eight and nine percentage points in each case. At the same time, the proportion of companies that were awarded a C rating rose by seven to eight percentage points. The ratings awarded to pension funds and Pensionskassen also deteriorated. The proportion of companies with a "very good" rating declined in 2009, whereas the number of companies with B and C ratings rose by ten percentage points.

As far as property and casualty and health insurance undertakings are concerned, there were only minor changes in quality as against the previous year, with 78% of companies still assigned to the A or B category. There were no major changes for reinsurance undertakings either.

As has been the case over the past few years, there was no major change in company allocations to the three market impact categories.

On-site inspections

No change in market impact.

When planning its on-site inspections and supervisory inspections, one of the things that BaFin takes into account are the results of the risk classification process. This risk-oriented supervisory approach meant that 2009 was to focus primarily on assessing insurance undertakings and pension funds with a high risk potential that had not been subject to any on-site inspections in the recent past. BaFin cancelled some of these inspections again, however, to allow it to react to changes in the risk assessments of other insurance undertakings with on-site inspections at short notice. The inspections that were originally planned for 2009 but were not carried out are now to be performed in 2010. BaFin performed 60 on-site inspections at insurance undertakings, slightly more than in 2008.

The following risk matrix shows a breakdown of the inspections by risk class.

Table 10

Breakdown of on-site inspections in 2009 by risk class

<table>
<tr><th colspan="2" rowspan="2">On-site inspections</th><th colspan="4">Quality of the undertaking</th><th rowspan="2">Total</th><th rowspan="2">Under-takings in %</th></tr>
<tr><th>A</th><th>B</th><th>C</th><th>D</th></tr>
<tr><td rowspan="3">Systemic relevance</td><td>high</td><td>1</td><td>7</td><td>6</td><td>0</td><td>14</td><td>24.14</td></tr>
<tr><td>medium</td><td>2</td><td>4</td><td>2</td><td>1</td><td>9</td><td>15.52</td></tr>
<tr><td>low</td><td>4</td><td>19</td><td>11</td><td>1</td><td>35</td><td>60.34</td></tr>
<tr><td></td><td>Total</td><td>7</td><td>30</td><td>19</td><td>2</td><td>60</td><td>100.00</td></tr>
<tr><td></td><td>Under-takings in %</td><td>12.07</td><td>51.72</td><td>32.76</td><td>3.45</td><td>100.00</td><td></td></tr>
</table>

* Total figure includes two on-site inspections at companies with no classification.

2.7 Risk reports

Sector evaluation of 2009 risk reports.

The statutory provisions set out in the VAG stipulate that insurance undertakings have to ensure risk-oriented corporate management in preparation for Solvency II. This includes, among other things, preparing risk reports for the company's management team, a copy of which has to be submitted to BaFin. Companies are not allowed to prepare special reports that are only intended for BaFin. 2009 was the first year in which all companies were subject to the obligation to submit these reports.

Frequency of reports and scope

Frequency of risk reports varies considerably.

The frequency of the risk reports varied considerably, although more than 50% of all companies, irrespective of their size and insurance class, opted for quarterly publication. Other frequencies are insignificant at large insurance undertakings, whereas small and medium-sized insurers are more likely to submit reports on an annual basis. The following table shows a detailed breakdown of the frequency of reports by company size, based on BaFin's risk classification:

Table 11
Frequency of risk reports

Frequency	Risk-classification small in %	medium in %	large in %
monthly	4	2	0
quarterly	59	58	82
every 4 months	1	1	0
semi-annually	6	9	0
annually	22	20	13
unclear	8	10	5
Total	**100**	**100**	**100**

When the risk reports were assessed, it became evident that in some cases, more than four months elapsed between the date as at which the report was drawn up and its submission to the management board. This period is too long, because the risk situation can change considerably within a four-month period.

All in all, the scope of the risk reports is appropriate.

The management team as a whole is responsible for a company's risk strategy. At most insurance undertakings, a member of the management board is responsible for risk management. This member's department usually prepares the risk report as a means of providing the entire management board with information. All in all, the insurance undertakings opted for an appropriate scope for their risk reports. 25% of the reports had fewer than ten pages, while more than 50% had 20 pages or more. Some of the risk reports contained a brief summary of the main results.

Report presentation

Some reports largely comprised tables and diagrams. While this form of presentation is very compact, it does not always make the report easy to understand. Furthermore, it produces a report of a quantitative nature, which does not always accurately reflect risks that are largely based on expert assessments, e.g. reputational or legal risk.

Other reports consisted (almost) exclusively of text describing individual risks. While this form of presentation is easier to understand, it makes it difficult to pinpoint specific pieces of information. These reports were also more aimed at a qualitative risk analysis that is not suitable for the content of the report. Therefore most of the reports used a mixture of the two presentation forms: Risks that are easy to quantify, such as market risk, were described in text, with the most important ratios being shown in tables or graphics. Additional information such as time series, sensitivity analyses, etc. could be found in an appendix, along with any risk inventory. Risks that are subject to more of a qualitative assessment are usually set out in text form.

Special features of Group reports.

Pursuant to section 55c (2) CAG, insurance groups are allowed to draw up a group report only. Most groups made use of this option. Nevertheless, group reports should also look at the risk situations of the group subsidiaries, which was not always the case in the reports submitted in 2009.

Components

Overview of market environment.

When a company assesses its own risk situation, a comparison with its market environment is often helpful. As a result, some risk reports provided a brief summary of the development of representative market data for the last four quarters. Both business and risk strategies must be aimed at achieving realistic objectives, meaning that the market environment plays a role in the assessment. This information is particularly important in times of crisis.

Risk management organisation.

A large number of risk reports provided an overview of the company's risk management system. First, they described the basic principles that form the basis for the risk management system, including the reporting processes. Second, they named the individuals responsible for key types of risk.

Risk strategy and risk-bearing capacity.

Some risk reports provided a brief outline of the company's risk strategy, which was sometimes followed by an analysis of its risk-bearing capacity. The latter is designed to show, for one thing, what proportion of the own funds available within the company is required for covering its risks. but also the amount of own funds exceeding this level. Both parameters allow readers to assess how much risk the insurer can still take.

Risks

Reports are to assess the typical risks facing a company's own classes of insurance.

Since the MaRisk VA stipulates that companies have to manage all material risks, some companies logically report only on risks that are allocated to the categories "material" or higher. Nevertheless, companies are advised to provide information on at least all of the typical risks affecting their own class of insurance when preparing their reports. This ensures that the management is informed of typical risks. Most companies also reported on all identified risks, some in the form of an enclosed risk inventory, others by including the risks as points in a diagram.

Most of the risk reports provided information on the risk situation allowing for any risk limitation measures that have been taken. Nevertheless, the reports did not reveal how efficient these measures are, because only a few companies presented an overview of the situation both before and after the measures were taken.

Only a handful of dependency analyses.

Not all risks are independent of each other, i.e. one event can result in various different risks materialising. In a worst-case scenario, a combination of these risks can jeopardise the very existence of a company, even if taken individually, the risks are certainly within the realms of control. This is why dependency analyses play a very important role in risk management and strategy. Nevertheless, only a very small number of risk reports included such analyses, in most cases within the market risk module.

Limit system

Companies generally also reported on the utilisation of the main limits. They did so by using triggers in the form of a traffic-light system. The most common trigger in 2009 was the solvency capital requirement, along with other ratios, some of which were not particularly risk-sensitive. The threshold values for amber and red warning lights depend to a considerable degree on the desired utilisation of risk-based capital, meaning that no sector standard can be identified at present. In terms of escalation, it is normal for limit utilisation levels that fall within the red category to be reported to the head of department at the very least. Lower-level employees generally deal with amber warnings.

Where limits were breached, irrespective of the warning level, the risk reports generally started off by referring to the causes. They then described how the company reacted. These measures were often designed to remedy the breach as soon as possible.

Key ratios

Key ratios not used very often for risk management purposes.

Although the MaRisk VA explicitly states that key ratios should be used for risk management purposes, only very few risk reports used them. Most reports stated the solvency coverage ratio. Furthermore, some companies calculated the solvency capital requirement pursuant to QIS 4 or an internal risk model, and expressed this risk-based capital as a proportion of their own funds. These companies included the major insurance groups, whose risk management is based almost exclusively on this key ratio at all levels. The results of the BaFin stress tests were also found in many risk reports. Class-specific ratios, for example the cancellation ratio in life insurance or the combined ratio in the non-life segment, were included far less often.

2.8 Group supervision

At the end of 2009, BaFin was involved in supervising a total of 31 insurance groups with cross-border activities. The significance and size of the groups varied considerably, from globally active insurance and reinsurance groups to very small companies. BaFin assumed the role of the authority responsible for group supervision for 16 out of these 31 groups. This means that it was responsible for coordinating the supervisory authorities involved, and for organising and hosting the supervisory conferences known as “colleges”. In 2009, BaFin convened supervisory college meetings for six of these 16 companies with major holdings abroad. These meetings focused on exchanging supervisory information on group solvency, risk concentrations and transactions within the group. Other issues that were discussed included the planning of the internal model approval process under Solvency II, coordinating emergency action plans, performing risk assessments for new products and boosting the efficiency of transnational supervisory structures. In the case of the 20 groups for which BaFin did not assume the group supervision role, it attended all nine supervisory colleges organised by foreign group supervisors.

Transnational exchange of information will become even more important with Solvency II.

In the financial crisis, the conferences already established have shown just how important supervisory colleges are for cross-border supervision. The transnational exchange of information between the individual authorities responsible for supervising a given insurance group is set to become even more important when the Solvency II framework directive comes into force. From then on, insurance supervisory authorities will have to meet up at least once a year in supervisory colleges.

BaFin's objective for the groups for which it performs the group supervision role is to organise a supervisory college meeting at least once a year even before Solvency II comes into force. If this is not possible or would not be appropriate, the authorities will exchange information electronically.

Supervision of insurance groups with cross-border activities.

The focus of supervisory activity had already been shifted from individual companies to group level when the EU Directive on the supplementary supervision of insurance undertakings in an insurance group was passed[8]. In 2000, the European supervisory authorities signed the Helsinki Protocol, an agreement on the principles that were to apply to the exchange of information. The German supervisory authority played an active role in this development from the outset, because improved cooperation was an absolute must to ensure that the legitimate interests of policyholders could be protected on the European common market as well.

In order to address globally active German insurers, too, BaFin now also incorporates supervisory authorities from non-EU/EEA states like Japan, Switzerland or the US in its exchange of information. This process is, however, always governed by special agreements due to confidentiality requirements and secrecy obligations.

[8] D 98/78/EC dated 27 October 1998, OJ EU no. L 330 dated 5 December 1998, p. 1.

2.9 Developments in the individual insurance classes[9]

Life insurers

Situation has eased thanks to stock market recovery.

The life insurance undertakings subject to supervision by BaFin generated gross premiums written in direct insurance totalling around €80.4 billion in 2009, which equates to a year-on-year increase of around 7.2%. The value of the investment portfolio increased by approximately 2.7% to around €702 billion. The financial situation of these life insurers was stable in the year under review. The substantial recovery on the stock market and low interest rates had a favourable impact on the valuation reserves. In all investments, the sector had net hidden reserves totalling approx. €25.3 billion at the end of the year, based on preliminary figures. This corresponds to around 3.6% of total investments, compared with 1.5% in the previous year.

All life insurers withstood the adverse scenario of the forecast statements.

In the year under review, BaFin asked life insurance undertakings to prepare two forecast statements as at 30 June and 15 October. These forecasts simulated the impact of unfavourable developments on the capital market on the company's earnings situation, providing an additional risk-oriented supervisory tool in addition to the BaFin stress tests. In the forecast statements, the companies had to simulate the impact of a 20% drop in share prices, and a rise in interest rates to the tune of 50 basis points, on their net income for the year. The forecast statements showed that all of the life insurers assessed would have been able to meet their obligations even in the event of unfavourable scenarios.

Net investment return of 4.2%.

The preliminary figures put the average net investment return at 4.2% in 2009, up on the prior-year figure of 3.4%.
In the second forecast statement, BaFin also asked companies to declare their bonuses for 2010. The arithmetic mean of total bonuses declared for endowment policies for 2010 was down slightly year-on-year from 4.2% to 4.1%.

Forecast statement on interest rate guarantees in the life insurance segment

In the autumn of 2009, BaFin for the first time collected data from life insurance undertakings aimed specifically at assessing the extent to which interest rate guarantees can be met in the long term. At the moment, companies have to ensure an average annual return of 3.4%. The move aroused much interest among other European supervisory authorities as well.

In order to assess whether or not life insurers are able to meet their interest rate obligations, BaFin asked them to submit

[9] The 2009 figures are merely preliminary figures. They are based on interim reporting as at 31.12.2009.

standardised forecast statements on three capital market scenarios. As well as one baseline scenario, BaFin stipulated two pessimistic scenarios which included, in particular, an immediate slump in interest rates. The forecast period ran until 2018.

The forecast statements showed that the companies would be able to survive financially even if the pessimistic scenarios materialised.

Partial collectivisation of the free provision for bonuses and rebates.

At the end of 2008, the GDV, in consultation with BaFin, commissioned a legal opinion on the partial collectivisation of the free provision for bonuses and rebates *(freie Rückstellung für Beitragsrückerstattung* – RfB). The background: Back in 1994, the Third EU Directive resulted in the strict separation of the existing insurance policies at the time (today's old policies) and new business in the future (today's new stock). The old stock remained subject to regulation, meaning that the basis for calculation was stipulated by law. As far as the provision for bonuses and rebates was concerned, this resulted in a loss of its compensatory function in some cases, because certain inheritance mechanisms between generations of policyholders were disabled. The intention is to restore this compensatory function by partially collectivising the free provision for bonuses and rebates.

The aforementioned legal opinion concludes that, while the partial collectivisation of the free provision for bonuses and rebates is impossible based on the current legislation, an amendment to the legislation would be permissible from a constitutional law point of view, and is also necessary in view of the facts.

A joint working group comprising the GDV and BaFin is to implement this in consultation with the Federal Ministry of Finance (Bundesministerium der Finanzen – BMF). The working group believes that one possible solution would be to create a new group of policies in the internal accounts and allocate amounts from the free provision for bonuses and rebates for the relevant parts of the portfolio to this group based on rules that are still to be defined. These funds would then be collectively available to the relevant parts of the portfolio within a framework that is also still to be finalised. Once the technical issues have been clarified, BaFin will propose the necessary amendments to the legislation to the BMF.

Extended obligations for life insurers and their appointed actuaries.

In the amendment to the VAG as a result of the Act on Strengthening the Supervision of the Financial Market and Insurance Sector, the legislator has extended the obligations incumbent upon life insurers and their appointed actuaries.

In their proposals for suitable policyholder bonuses, the appointed actuaries now also have to take into account whether the company is in a position to fulfil its liabilities under the insurance contracts at all times. The management board must submit this proposal to BaFin without delay, stating whether or not, and if so why, it intends to deviate from the proposal. This means that BaFin receives this information immediately after the passing of the

management board resolution at the latest, allowing it to intervene before the turn of the year if need be.

The appointed actuaries also have to use a report to show the management board that their proposal is appropriate. The management board has to submit this report to BaFin, and there are plans to set out regulations governing the content of, and deadlines for, the report in a regulation.

A working group of the DAV, which also includes BaFin employees, has developed a draft for this regulation. BaFin assumes that the final regulation will be more or less in line with this draft.

The draft stipulates that the report has to be submitted as soon as the annual financial statements have been prepared. In terms of content, it should include two sections: In the first section, the report should show that the proposed bonus does not pose a risk to the fulfilment of liabilities under the life insurance contracts at all times, i.e. that it is not too high. In the second part, the report should show that the distribution of the bonus shares within the portfolio is appropriate, i.e. that the bonus is distributed fairly.

Private health insurance

Moderate new business with forecasted premium growth of 3.5%.

The 51 private health insurers supervised by BaFin collected premiums totalling around €31.4 billion in 2009, which equates to a year-on-year increase of around 3.5%. Against the backdrop of the ongoing debate on the reform of the healthcare system, the market for private health insurance remained difficult. Furthermore, since early 2007, salaried employees who are voluntarily insured in the statutory health insurance system have only been able to switch over to the private health insurance system if their income has been above the statutory income limit for compulsory insurance for three consecutive calendar years. Consequently, new business for comprehensive health insurance, in particular, was only moderate – as in previous years. The premium growth was due primarily to premium adjustments.

Improved earnings and reserve situation expected.

In 2009, health insurance undertakings boosted their investment portfolio by 7.7% to total approx. €164 billion. The year under review was characterised by the impact of the crisis on the financial markets, although the situation on the capital markets eased notably as the year progressed. Share price recoveries had a positive effect on the earnings of the health insurers. BaFin expects to see far lower write-downs on investments. At the end of 2008, the net hidden reserves in the investments totalled €3.3 billion and rose considerably, namely by approx. 90% in 2009 to €6.3 billion.[10]

[10] This data is based on Statement 671 pursuant to Circular 11/2005 (VA), which has to be submitted during the year. The data is of a merely preliminary nature as it does not yet reflect write-ups or write-downs.

One out of 40 health insurers was unable to withstand the prescribed scenarios.

As at 30 June 2009, BaFin asked 40 health insurance undertakings to prepare a forecast statement and report the results. Eleven companies were exempted from the requirement to submit their forecast statement due to their low-risk investment portfolio or the fact that they offer non-substitutive health insurance.

The forecast statements provide an additional risk-oriented supervisory tool in addition to the BaFin stress tests. These forecasts simulated the impact of unfavourable developments on the capital market on the company's earnings situation. In the 2009 forecast statement, BaFin defined four different scenarios based on market developments. Two scenarios dealt exclusively with the impact of share price risks on the company's earnings, while the other two also included interest rate risks.

Only one small health insurer was unable to withstand the scenarios prescribed because it had insufficient own funds to fulfil the minimum guarantee fund requirement. The company has now, however, furnished proof showing that it has sufficient own funds, meaning that it, too, complies with the solvency regulations.

All of the other health insurance undertakings were able to withstand the assumed scenarios in financial terms.

Net investment returns likely to exceed 4% in 2009.

The forecast statements suggest that there will be a slight improvement in net investment income due to the somewhat less tense situation on the capital markets. Preliminary figures point towards net investment returns of just over 4% for the industry.

All of the health insurance undertakings were able to meet their guaranteed rate obligations in all four scenarios. In only a small number of cases, net investment income was not quite sufficient to finance the technical interest rate for the mathematical provision. Nevertheless, the companies had access to a sufficient volume of other surplus funds (e.g. safety loading) to ensure that the required funds could be allocated to the ageing provision.
The basic rate that was introduced as of 1 January 2009 gives people that were not previously insured an opportunity to obtain insurance cover for illness.

The basic rate replaces the standard rate that was launched in 1994. Older private insurance policyholders had the option of switching to this rate if their income was below the upper earnings limit *(Beitragsbemessungsgrenze)*. As with the standard rate, premiums for the basic rate coverage may not exceed a statutorily defined limit – €570 at present. In return, policyholders receive benefits similar to those offered by the statutory health insurance system.

In June 2009, the Federal Constitutional Court *(Bundesverfassungsgericht* – BVerfG) ruled that the introduction of the basic rate was in line with the constitution.[11] Nevertheless, the

[11] Judgment of 10 June 2009, case ref.: 1 BvR 706/08.

court stipulated that the legislature would have to monitor the situation to ensure that the basic rate did not trigger premium hikes in the comprehensive health insurance segment, which would eat away at the main private health insurance business. BaFin will also be keeping a close eye on developments in the basic rate segment in the future.

The basic rate is also available to individuals who have no health insurance at present. In addition, all private insurance policyholders who took out a health insurance policy after 1 January 2009 can switch to the basic rate at any time, taking part of their ageing provision with them. What is more, private insurance policyholders who took out a health insurance policy after 1 January 2009 can demand that their insurer surrenders part of their ageing provision if they switch to another company in the future.

For those policyholders who already had private health insurance prior to 2009, the legislature provided a window for changing to the basic rate from January to June 2009. Within this period, they had the option of moving to the basic rate offered by their own, or by another insurer. After this period, this group cannot switch to the basic rate until they reach the age of 55 as a general rule. Policyholders who switch to the basic rate of another insurer cannot switch again to another rate, maintaining the ageing provision they brought with them, until they have spent 18 months in the basic rate.

8,200 policyholders covered by the basic rate at present.

Only a very small number of policyholders made use of their right to switch within the six-month period.

In actual fact, the response to the basic rate has been subdued to date. Out of a total of around 8.6 million people with comprehensive private health insurance, only approx. 8,200 individuals are insured under the basic rate, approx. 7,100 of whom previously had no insurance.

Deductibles in the basic rate.

Various problems arose in connection with the basic rate in the year under review. Since the standard rate had provided for a deductible of €306, insurers moved policyholders over to the basic rate with a €300 deductible. In some cases, reducing the deductible in the basic rate to €0 would not have resulted in higher premiums for policyholders, because premiums in the basic rate are subject to a €570 cap and this level had already been reached in the relevant cases. The insurance undertakings failed to inform their clients that the abolition of the deductible would therefore have been free for them. BaFin has written to several insurance undertakings on this matter and has asked them to issue statements.

Flat-rate risk surcharge for policyholders changing rate.

In 2007, one health insurance undertaking launched a new rate on the market and closed its old rate for new business. The insurer imposes a flat-rate risk surcharge on policyholders wishing to transfer from the old rates to the new rate. According to the insurer, this is designed to compensate for the difference in premiums resulting from the different calculation approaches and the more stringent risk assessment for the new rates.

BaFin had prohibited the insurer from imposing the surcharge on policyholders with no medical history at the time the policy was taken out who would have had to pay risk surcharges when changing to the new rates. The company brought action before the Administrative Court of Frankfurt am Main against this prohibitory injunction. The court had granted the claim on the grounds that the flat-rate risk surcharge did not impair the right to change rate because the policyholders were not in a worse position after the change.

BaFin filed an appeal against the judgment before the Federal Administrative Court *(Bundesverwaltungsgericht* – BVerwG). The Supervisory Authority is of the opinion that the flat-rate risk surcharge basically undermines the right to change rate as set out in the VVG: Older policyholders no longer have any incentive to switch rate if the change does not allow them to save on premiums. Moreover, the idea runs contrary to the supervisory law principle of equal treatment if existing clients that would be best risks even in the new rate have to pay higher premiums after switching than the best new business risks.

Mortality as a trigger.

Under the old legislation, the most recent mortality tables only had to be introduced immediately in the event of a premium rate adjustment triggered by claims development. The new statutory provisions increase the scope of circumstances that entitle insurers to recalculate premiums. Now, the publication of new mortality tables can be an independent trigger of a premium adjustment. This means that – in order to avoid huge increases in premiums that could result in cases where several circumstances triggering adjustment collide – a change in expected mortality is also permitted as a trigger for a premium adjustment. This was made possible due to an amendment to the VVG and the Calculation Regulation *(Kalkulationsverordnung* – KalV).

Property and casualty insurers

Considerable increase in claims expenditure with only marginal premium growth.

Business development among property and casualty insurers was still satisfactory in 2009 in the face of the financial and economic crisis. Despite what was marginal premium growth on the whole, premium income declined in the motor vehicle insurance segment, an area that has traditionally been a significant one for this class of insurance. This trend was caused by sustained intense price competition and by policyholders opting to move to lower-cost rates and lower no-claims classes. With the exception of the slight drop in premiums in the credit insurance sector (a development that was to be expected), all other non-life classes generally reported a slight increase in premium income.

Claims expenditure, however, was up considerably year-on-year, an increase that is attributable to developments in the legal expenses, transport, credit, suretyship and fidelity liability insurance segments. The moderate claims development witnessed in other areas was unable to fully compensate for this effect.

The estimated combined ratio for the entire underwriting business is likely to have increased year-on-year but is expected to remain well below the 100% mark. With only minor changes in premiums, this produced a far lower underwriting profit compared with the previous year.

Reinsurance

2009 was largely spared severe natural and other major catastrophes, meaning that there were fewer claims than in 2008. This brought global economic losses in 2009 down to approx €35 billion (previous year: €144 billion). Compared with the above-average drop in economic losses, insured losses totalled around €16 billion (previous year: €32 billion), a trend that is attributable to the fact that a larger number of moderate natural catastrophes occurred with what was a higher degree of insurance coverage on the whole.

Winter storm Klaus, which hit northern Spain and the south-west of France in January 2009, was the most expensive single event, involving approx. €2.4 billion in insured losses. The earthquake in Italy caused total economic losses to the tune of around €0.4 billion. The biggest loss event in Germany was the collapse of the Cologne city archive building in March 2009, which caused estimated economic losses of around €0.4 billion.

As far as financial year 2009 is concerned, preliminary sector estimates expect Germany’s reinsurers to achieve gross premiums of just short of €40 billion, with own funds of just under €70 billion.

In 2009, too, BaFin received a number of enquiries on the admissibility of reinsurance business offered in Germany by primary and reinsurance undertakings with their registered offices in a third country.[12]

Pensionskassen

Slight decline in premium income.

According to the forecast statements as at 15 October 2009, premium income for the Pensionskassen subject to competition *(Wettbewerbspensionskassen)* that have been established since 2002 is down on 2008. This shows that the market is now becoming saturated. As regards the Pensionskassen, which are predominantly financed by employers, the development in premium income depends on the workforce of the sponsoring company. The premium income of these Pensionskassen has also fallen, according to the forecasts.

The value of the investment portfolios of the 153 *Pensionskassen* subject to supervision by BaFin increased by around 4% in 2009 to around €107 billion.

[12] See also BaFin statistics 2007/2008 – reinsurance undertakings.

In addition to the investment risks, which the stress tests take into account, *Pensionskassen* are also subject, in particular, to the risk of longevity on the part of their policyholders. This could mean that *Pensionskassen* will have to adjust their bases of calculation and boost their mathematical provision over the next few years. The ongoing phase of low interest rates is making it more difficult for companies to generate the surpluses they need to finance these adjustments, because new investments only offer relatively low returns.

Forecast statement shows improved financial situation at Pensionskassen on the whole.

BaFin requested forecast statements for Pensionskassen as at 30 June and 15 October 2009, asking the companies to forecast their result for the financial year based on four equity and interest rate scenarios. BaFin asked 135 Pensionskassen to submit forecast statements. 18 companies were exempted from this requirement due to the low-risk nature of their investments. The forecasts showed that the financial situation of Pensionskassen improved on the whole in 2009. The positive development on the stock markets considerably reduced the level of hidden liabilities in equities, and the companies were able to generate higher surpluses again.

Pension funds

In 2009, new business was characterised by the assumption of existing benefit commitments in non-insurance based pension plans. As at the end of the year, the total portfolio included 673,483 individuals with benefit entitlements, 260,211 of whom were current beneficiaries. The pension funds paid out a total of €763 million in benefits. They had generated gross premiums of €2.891 billion by the end of the year, with a large proportion of single premiums.
Investments made for the benefit of employees and employers who bear the investment risk totalled €16.3 billion. The performance of these investments means that the capital that exceeds the minimum mathematical provision to be set up in each case has fallen considerably at several pension funds. If the value of these investments falls below the amount of the minimum mathematical provision, which is not guaranteed by the pension fund, the sponsoring company has to make supplementary contributions. In the year under review, no such supplementary contributions were imposed by any pension funds.

Forecast statements show stable financial situation.

As in previous years, BaFin requested the submission of forecast statements as at 30 June 2009. The scenarios for the end of 2009 included the situation on the capital markets as at the observation date and a negative equity scenario, as well as scenarios that combined the first two scenarios with a rise in interest rates. All of the pension funds were able to withstand the four assumed scenarios as at the reference date. In particular given what is generally a low equity ratio at pension funds, only a few pension funds have any hidden liabilities in the investments for own account reported at cost. The financing of future write-downs in the amount of these hidden liabilities would be guaranteed by the sufficient surplus coverage of the solvency margin at the affected pension funds alone.

V Supervision of banks, financial services institutions, and payment institutions

1 Basis for supervision

1.1 Act on Strengthening the Supervision of the Financial Market and Insurance Sector

Sabine Lautenschläger,
Chief Executive Director
of Banking Supervision

As a consequence of the financial market crisis, the legislature strengthened the powers of intervention of the Financial Market and Insurance Sector Supervisory Authority with the Act on Strengthening the Supervision of the Financial Market and Insurance Sector, which came into force on 1 August 2009.[13] BaFin thus receives intervention rights that apply considerably earlier than before. The aim was to increase the preventive powers of the Supervisory Authority, improve the Supervisory Authority's information, strengthen intervention rights in crisis situations and emphasise the responsibility of supervisory bodies' members.

Monitoring of members of administrative or supervisory bodies.

A significant component of the law are the new minimum requirements for the members of administrative or supervisory bodies of institutions (section 36 (3) *Kreditwesengesetz* – KWG). These requirements refer to the trustworthiness as well as the qualification of administrative and supervisory board candidates. They are supplemented by relevant reporting requirements and powers granted to BaFin to implement measures. As a support, BaFin has published a guidance notice on the monitoring of members of administrative and supervisory bodies on its website.[14]

The requirements for trustworthiness do not differ fundamentally from the administrative practice relating to managers. Thus there should not be any facts that could give rise to doubt about the applicant's personal trustworthiness. Facts that could give rise to doubt are for example economic crimes – such as embezzlement or fraud – or violations of public policy embodied in business, commercial, competition or tax law.

The grounds for the law contain relatively detailed information concerning qualification requirements. It states that administrative or supervisory board members must be qualified to understand the transactions performed by the institution or financial holding company, to assess their risks and where necessary to enforce changes in the management of the company's business. Adequate

[13] Federal Law Gazette (BGBl.), I 2009, p. 2305.
[14] www.bafin.de » Publications » Guidance notices.

qualification requires the ability to understand economic and legal processes of the specific institution's or financial holding company's daily business activities. Only through qualification can administrative or supervisory board members actively support the company's development and perform their monitoring and control functions.

Increased capital requirements through capital add-ons.

The KWG gives BaFin the possibility to raise the capital requirements by demanding a higher solvency ratio in accordance with the Solvency Regulation *(Solvabilitätsverordnung* – SolvV). Thus far, raising capital requirements was only possible if the Supervisory Authority could prove that the risk profile of a specific institution was worse than that of the vast majority of other institutions. This was difficult to prove in practice. The Supervisory Authority can now react more flexibly to an institution's risk profile with the revised section 10 (1b) KWG. This provision stipulates four standard cases in which setting capital add-ons is to be considered. These include the case of an institution assuming risks that the SolvV does not take into account at all or not fully, or the case in which an institution's risk-bearing capacity is no longer guaranteed. Capital add-ons may also be necessary to create an anticyclical risk buffer. The same applies in the case of newly formed entities or comprehensive restructurings and reorganisations of business activities to cushion against the higher start-up risk.

Section 11 (2) KWG – additional liquidity buffer.

Similar to the case with capital requirements, the Supervisory Authority has, in accordance with section 11 (2) KWG, the power to raise the liquidity requirements. It can now take action earlier and more effectively than heretofore in order to counteract liquidity risks at individual institutions.

Measures in cases of inadequate own funds or inadequate liquidity.

In accordance with section 45 (1) KWG, the Supervisory Authority may take measures concerning an institution whose own funds or liquidity fails to satisfy the requirements of the KWG. The legislature has expanded these powers to implement measures in two ways. Firstly, measures in accordance with section 45 KWG no longer require that capital or liquidity requirements not be met. Rather it is now sufficient that an institution's net assets, financial position and results of operations suggest that it cannot meet these requirements at all times. Secondly, the existing prohibition of profit distribution was supplemented so that now not only withdrawals and the distribution of profits but also any payments on own funds components may be prohibited or limited if they are not completely covered by the net income for the year. An exception applies for longer-term subordinated liabilities (section 10 (5a) KWG). In particular, this enables BaFin to prohibit interest payments on what are known as hybrid capital components, for example, on silent contributions or profit-participation certificates if these may only be made through liquidation of reserves.

Measures in the case of organisational deficiencies.

In accordance with section 45b KWG, BaFin has the right to order a higher own funds ratio if an institution has no proper business organisation. Different to the practice up until now, it is no longer necessary that the institution fail to comply with an order to establish a proper business organisation (section 25a (1) sentence

8 KWG). BaFin can now already set a capital add-on due to a deficient business organisation while issuing such an order. BaFin may also impose a capital add-on instead of or in addition to the other risk reduction measures listed in subsection 1, such as restricting business activities or prohibiting loans. Moreover, it is also stressed that the capital add-on means raising the own funds ratio and not necessarily maintaining additional own funds. It is thus clearer that an institution is not obliged to enlarge its capital base but rather is free, for example, to also reduce its risk assets.

Measures in cases of danger.

In accordance with section 46 (1) KWG, BaFin may avail itself of a variety of different measures in order to address the danger of an institution no longer being able to satisfy its obligations to its creditors. With the new sentence 2, BaFin also has the option of prohibiting or limiting payments to group companies if these transactions are detrimental to the institution (ring-fencing). Moreover, it may declare that payments are only permissible under certain conditions. This measure can be helpful above all if the parent company of a German institution with its registered office in a third country experiences a crisis situation and then attempts to drain liquidity from the German subsidiary. Due to the international reciprocity of such measures, which can be expected in the medium term, and the potentially associated problems of German institutions with foreign subsidiaries, BaFin must exercise particular care in weighing interests in such situations.

Reporting requirements for modified equity ratio.

The Act on Strengthening the Supervision of the Financial Market and Insurance Sector also introduced the obligation to report changes in a modified equity ratio (section 24 (1) no. 16 and (1a) no. 5). A modified equity ratio is a non-risk-sensitive key figure, like a "leverage ratio". It is used to measure the institution's ratio of equity to debt, that is, total assets plus the off-balance sheet liabilities and the assumed costs of transforming off-balance sheet liabilities into balance sheet items *(Wiedereindeckungsaufwand für Ansprüche aus außerbilanziellen Geschäften)*. Significant changes in the leverage ratio can alert the Supervisory Authority to higher risks in the business policy.

1.2 Act on the Further Development of Financial Market Stabilisation

Financial Market Stabilisation Act and SoFFin.

On 23 July 2009, the Act on the Further Development of Financial Market Stabilisation *(Gesetz zur Fortentwicklung der Finanzmarktstabilisierung)* came into force.[15] It supplements the existing package of measures of the Financial Market Stabilisation Act *(Finanzmarktstabilisierungsgesetz* – FMStG), which along with the Act on the Establishment of a Financial Market Stabilisation Fund *(Finanzmarktstabilisierungsfondsgesetz* – FMStFG) also includes establishing the Financial Market Stabilisation Fund

[15] Federal Law Gazette (BGBl.), I 2009, p. 1980.

(Sonderfonds Finanzmarktstabilisierung – SoFFin) in October 2008. The aim of the FMStFG and all measures based on it was to restore confidence in the financial system and to stabilise the financial sector. To this end, the FMStG makes different instruments available to SoFFin, which enable financial institutions to strengthen their capital base and avoid liquidity shortages on a temporary basis. The Financial Market Stabilisation Agency *(Finanzmarktstabilisierungsanstalt* – FMSA) administers SoFFin.

Further Development of Financial Market Stabilisation (Bad Bank Act).

The Act on the Further Development of Financial Market Stabilisation paved the way for forming what are referred to as "bad banks". In concrete terms, the act offers banks two different models: The special purpose vehicle model and the consolidation model.

Special purpose vehicle model relieves burden on bank balance sheets.

With the special purpose vehicle model, the bank can form a domestic special purpose vehicle, or SPV, to which it can transfer structured securities with a certain discount. This discount is normally 10% of book value. The special purpose vehicle finances the purchase of securities by issuing bonds guaranteed by SoFFin to the bank. Banks can cleanse their balance sheets using this SPV model, by freeing up funding sources to grant new loans to the economy.

Consolidation model enables restructuring.

The consolidation model is also aimed at relieving the balance sheets of participating banks. However, the possibility to transfer assets is not limited to structured securities but extends to practically all risk positions including the business areas that are contrary to the bank's future strategic orientation. This enables banks to restructure themselves so that they can concentrate on their core banking business in the future. There are two varieties of the consolidation model: At federal level, the law provides for forming liquidation agencies within the FMSA. This model is referred to as the "agency within the agency" *("Anstalt in der Anstalt"* – AidA) model. At state level, it is possible to form liquidation agencies under state law. The focal point of the new regulations is that owners of the transferring credit institutions are directly liable for all the agencies' losses. In accordance with FMStFG, the liquidation agencies are only subject to limited BaFin supervision.

1.3 New regulations on providing investment advice

Investor protection improved.

The law that went into force on 5 August 2009 newly regulating legal relationships under bonds from global issues and improving enforceability of investor claims based on incorrect advice[16] gives investors two main improvements: Firstly, the period of prescription for damage claims due to incorrect advice has been adapted to the standard period of prescription contained in the Civil Code

[16] Federal Law Gazette (BGBl.), I 2009, p. 2512.

(Bürgerliches Gesetzbuch – BGB). Now, the three-year period of prescription does not begin until the damage is noted and not upon conclusion of a contract as was the case until now. Secondly, since 1 January 2010, investment services enterprises are obliged to prepare and hand out a written record of any investment advice. If it is not possible to give the client a copy of the record of the consultation before transaction conclusion, for example of a telephone consultation, the client has a one-week right of rescission in the case of an incomplete or incorrect record. The new documentation obligation is aimed at further improving the quality of investment advice by more quickly identifying any misunderstandings between advisor and client and enabling BaFin to more easily detect deficiencies. Such records should also enable investors to more easily prove the content of a consultation in case of a dispute.

BaFin examines compliance with new regulations.

As of the first quarter 2010, BaFin has examined what changes institutions are implementing in their business models in reaction to the new regulations on recording investment advice. Additional topics for auditing for the coming year will be staff training and the question of whether or not it is now easier to track what investment advice was provided in each individual case.

1.4 New type of financial services requiring a licence – investment management

Definition of a new type of financial services closes legal gap.

Another form of improving investor protection has been the introduction of investment management as a new financial service requiring a licence.[17] Thus the legislature has reacted to providers that wanted to avoid BaFin supervision by indirectly investing funds collected from clients in financial instruments – for example via shares in companies. Prior to now, BaFin interpreted this type of activity as principal broking services requiring a licence because investors acquiring profit-participation certificates or fund units were partaking in a collective of investors. In conducting this activity, the companies were thus purchasing and selling financial products in their own name but for the account of others. However, a change in case law confirmed by the BVerwG, disallowed this classification.[18]

BaFin circular and guidance notice on investment management as a new type of financial services defined by the legislature.

In a circular dated 30 March 2009, supplemented by a guidance notice dated 8 December 2009, BaFin detailed the new definition of financial services, investment management, distinguishing it in particular from activity that does not require a licence in the first

[17] Art. 2 of the Act on the Further Development of the Pfandbrief Act (Gesetz zur Fortentwicklung des Pfandbriefgesetzes), Federal Law Gazette (BGBl.), I 2009, p. 607.
[18] See 2008 Annual Report, p. 203 et seq.

place.[19] For example, the term "collective of investors" does not require there be a connection between the investors under company law. It is sufficient if they have been individually acquired for investment management and only their funds and financial instruments are collectively managed. The term "collective of investors" thus also includes, in particular, the offers aimed at the public at large and using either models based on company law, such as the trust limited partner model, or bonds or participation rights to pool investor funds for investment in financial instruments.

Grandfathering provision.

There is, however, a grandfathering provision: In accordance with section 64l KWG, an institution that had a licence for principal broking services, proprietary trading or portfolio management on 25 March 2009 is deemed as having been granted the licence for investment management at this time. Moreover, products that were issued between 1 July 2005 and 23 September 2008 in compliance with prospectus law are not subject to the investment management licence requirement. This means that all products for which a prospectus has been published by the date stated fall under the grandfathering provision.

1.5 Act to implement EU regulation on credit rating agencies

Credit rating agencies subject to supervision for first time.

As a result of the new EU Rating Regulation,[20] credit rating agencies will be subject to governmental supervision for the first time. The centrepiece of the European regulation is what is referred to as the registration procedure, according to which a credit rating agency is granted a licence valid throughout the EU to carry out rating activities after the requirements have been met. All rating agencies wishing to issue credit ratings within the European Union must go through the registration procedure from June 2010 onwards. Rating agencies initially file for registration with the Committee of European Securities Regulators (CESR). The committee then notifies the national supervisory authorities, which are ultimately responsible for conducting the registration process and oversight. After registration, rating agencies are subject to strict rules of conduct and organisation. In particular, they are obliged to implement a wide range of measures to prevent as far as possible potential conflicts of interest arising during their activities.

With the draft of a law to implement the EU Rating Regulation, the German legislature has now supplemented the new EU regulation and set out important details for supervision in Germany.[21] The law is to go into effect in early summer 2010. BaFin will be responsible for oversight of rating agencies in Germany until this responsibility

[19] Circular 7/2009 (WA), www.bafin.de » Veröffentlichungssuche (available in German only).
[20] R (EC) no. 1060/2009, OJ EU no. L 302 dated 17 November 2009.
[21] www.bundesfinanzministerium.de » Gesetze » Ausführungsgesetz zur EU-Ratingverordnung (13 January 2010) (available in German only).

is transferred to the European Securities and Markets Authority (ESMA), which is to be created with effect from 1 January 2011. At the same time, the implementation act expands the schedule of fines under the Securities Trading Act *(Wertpapierhandelsgesetz* – WpHG) in order to be able to sanction violations of the EU Rating Regulation as administrative offences. In four cases, the range of administrative fines runs up to €1 million, for example, if a rating agency issues a rating despite a conflict of interest or a lack of reliable information. BaFin may impose administrative fines of up to €200,000 for the other violations.

Registration begins in June 2010.

The first registration applications may be filed starting from 7 June 2010. Agencies already operating must have filed their application for registration by September 2010 at the latest. The approval decision must be made within 125 working days at the latest. Approximately 20 to 30 rating agencies are expected to require registration, alone ten of which are in Germany.

1.6 Act to Modernise Accounting Law

The Act to Modernise Accounting Law came into force.

The Act to Modernise Accounting Law *(Bilanzrechtmodernisierungsgesetz* – BilMoG) came into force at the end of May 2009.[22] This marks the conclusion to the commercial law reform, following a three-year discussion. The aim was to position the Commercial Code *(Handelsgesetzbuch* – HGB) as a full-scale and permanent alternative to the IFRS (International Financial Reporting Standards) for non-capital market oriented companies by improving the quality of information of financial statements prepared in accordance with the HGB. The focus was also on implementing EU regulations as well as relieving companies (deregulation). And not least, lessons learned from the financial market crisis found their way into the BilMoG.

Application from 2010.

The BilMoG is to be applied for the first time to financial years that begin after 31 December 2009. However, there are exceptions in terms of the amendments resulting from the Audit Directive and the Directive Amending other Council Directives on Accounts of Certain Types of Companies. These are to be applied for the first time to annual and consolidated accounts for the financial year beginning after 31 December 2008.

The supervisory focus is primarily on accounting of financial instruments.

Supervision is focused primarily on the impact on banks' accounting of financial instruments. The practice of what is referred to as fair value accounting will increase in this respect. The law now requires credit institutions to carry assets held for trading at fair value less a risk discount.

Moreover, stricter recognition requirements will apply for derivatives, which, in accordance with the new regulations, must be

[22] Federal Law Gazette (BGBl.), I 2009, p. 1102.

included on the balance sheet. Furthermore, 10% of the net income from assets held for trading are to be allocated to the special item "fund for general banking risks" as an anticyclical risk buffer. The newly regulated consolidation of special purpose vehicles represents an important harmonisation with IFRS, as well. These consolidation rules are in line with SIC 12 under IFRS. It should be noted, however, that for now consolidation for supervisory purposes follows the prevailing regulation.

The BilMoG's impact on supervisory reporting requirements for banks was another focal point of BaFin. One such example is currency conversion and its impact on calculating an institution's solvency ratio. Deferred taxes and internally generated intangible assets also raised some questions concerning reporting under the monthly balance sheet statistics and the Monthly Returns Regulation *(Monatsausweisverordnung* – MonAwV).

1.7 New remuneration rules

BaFin circular implements remuneration standards.

On 21 December 2008, BaFin published two circulars implementing the standards for remuneration systems in the banking sector (Circular 22/2009) and in the insurance industry (Circular 23/2009), developed by the Financial Stability Board (FSB). In April 2009, the FSB published its Principles for Sound Compensation Practices, which were already incorporated into the new version of the Minimum Requirements for Risk Management *(Mindestanforderungen an das Risikomanagement* – MaRisk), dated 14 August 2009. At the G20's request, the FSB then developed detailed implementation standards for its principles for major banks and insurance undertakings, and published them on 25 September 2009 (Principles for Sound Compensation Practices – Implementation Standards). The FSB expected governments to immediately and rigorously implement these standards. BaFin has thus initially implemented the new remuneration regulations for Germany in the form of circulars. However, during the course of 2010, the new standards will be transposed into a regulation (Remuneration Regulation – *Vergütungs-Verordnung*). The planned regulation will maintain the substantial underlying message of the circular, subject to further international developments.

Scope of application and proportionality.

Circular 22/2009 (BA) is directed at both credit and financial services institutions (section 1 (1b) KWG) as well as branch offices of foreign institutions (section 53 (1) KWG). Despite what appears at first glance to be a quite extensive scope, in its practical implementation, the circular makes a distinction regarding key requirements. The general requirements of section 3 apply to all institutions and to the remuneration systems for all employees. The general requirements, however, do not present any major challenge for the institutions. Rather they are intended – irrespective of regulatory requirements – to be part of day-to-day business practice in the institutions' own interest.

The special requirements in section 4 are considerably more differentiated. This is largely about variable remuneration of managers and risk takers, the remuneration committee and comprehensive disclosure requirements. The individual institutions are themselves responsible for performing a risk analysis (self-assessment) to determine whether or not these requirements are to be implemented. Key criteria are the institution's business and remuneration structure as well as the complexity, risk profile and international nature of its business activities. The analysis must be plausible, comprehensive and clear to third parties. If the self-assessment is negative, it is not necessary to apply any of the special requirements. The self-assessment instrument is to take account of Germany's heterogeneous institutional structure, ensuring that the majority of German institutions are not disproportionately burdened (principle of proportionality).

General requirements of remuneration systems.

In accordance with the general requirements applicable to all institutions and staff, remuneration systems must be established in line with the goals set out in the strategies. This means that the remuneration systems must be structured in such a way as to avoid negative incentives for managers and employees to take excessive risks. A negative incentive, for example, might be when the total remuneration depends significantly on the variable remuneration.

An additional focus is on institution control units, which include back office, risk control and internal audit functions. A negative incentive for these functions might be created, for instance, if the amount of remuneration were based on the same key parameters as those of the organisational units they control. Having such parallel structures can result in conflicts of interest that affect the control functions properly performing their duties.

In accordance with the general requirements, moreover, the institutions' administrative and supervisory bodies must be informed of the remuneration systems at least annually, so that they can judge whether or not they are appropriate. Moreover, the chairman of the administrative or supervisory body shall be granted a corresponding right to information from the management. The remuneration systems must be reviewed for their appropriateness at least once a year and modified if necessary.

Special requirements of remuneration systems.

If, due to its business or remuneration structure or complexity, risk profile and the international nature of its business activities, an institution determines in its risk analysis that it must also meet the special requirements set out in the circular, the institution must perform an additional self-assessment to determine whether it has any risk takers. The criteria may include an organisational unit's size, type of business activity, business volume, amount of risks, and earnings as well as the employee's activity (e.g. as trader) and position, and the amount of remuneration an employee has received thus far, and a highly competitive job market situation. The self-assessment must cover all the institution's organisational units. The same special requirements apply to the remuneration of such an institution's risk takers as to the remuneration of its managers – for whom no self-assessment is necessary at all.

Remuneration of managers and risk takers.

In accordance with the special requirements, fixed and variable remuneration of managers and other risk takers must be appropriately balanced. A risk taker's dependence on variable remuneration is a de facto obstacle to reducing or even eliminating variable remuneration. On the other hand, the portion of variable remuneration must also be high enough for an incentive to be generated at all. The appropriate balance should ensure that substituting fixed for variable remuneration components does not annul the incentive effect. Guaranteed variable remuneration components are permitted only in the context of hiring new staff and for no longer than one year. The institution is also not allowed to offset the risk orientation of remuneration through hedging or other counter-measures.

Requirements for variable remuneration.

Depending on the position, responsibilities, amount of variable remuneration and risk exposure that a risk taker can generate, at least 40% of variable remuneration shall be paid on a deferred basis over a period of at least three years – pro rata temporis and linked to the sustainability of positive performance. This means, that a "malus" performance system should be in place by which the deferred variable remuneration components can be offset or even fully eliminated. In order to avoid problems relating to labour law, there shall be no entitlement to the deferred variable remuneration during the deferral period.

Moreover, at least 50% of the deferred compensation must be based on the institution's sustainable performance. The institution's performance can be tracked, for example, through share-based remuneration – real or virtual equity compensation – or key figure-based remuneration, as long as it is not cash-based.

Remuneration committee responsibilities.

Institutions to which the special requirements apply must also form a committee to monitor the appropriateness of the remuneration systems. The responsibilities of this committee are monitoring as well as designing and developing the remuneration system. The committee should be able to identify any remuneration system deficiencies early on so that management can promptly counteract any negative developments. The committee does not normally have any decision-making competencies unless management allows otherwise. The organisational guidelines must include the remuneration committee's responsibilities and its placement within the organisational structure.

In addition to employees of the human resources department, the remuneration committee must also include representatives of the organisational units that originate business and of the control units. This means employees from front and back office, trading and settlement, and risk control functions. The internal audit function is to also be involved within the scope of its responsibilities. Committee membership should be balanced so that the committee can perform its duties in the interest of the institution.

At least once a year, the remuneration committee must prepare a report on the structure, status, and development of the institution's remuneration systems and present it to management and the administrative or supervisory body. The remuneration committee is to submit an ad hoc report on any significant changes in the remuneration system or other events relevant to the remuneration system. Moreover, the chairman of the administrative or supervisory body shall have a direct right to information from the remuneration committee.

Disclosure.

The disclosure obligations stated in Circular 22/2009 (BA) refer, for one thing, to presenting and assessing the structure, monitoring and development of remuneration systems as well as the composition, functions and organisational integration of the remuneration committee. Secondly, they require information on managers and risk takers with regard to the aggregate amount of remuneration, broken down by fixed and variable remuneration as well as the number of beneficiaries. The institution shall publish the information on its own website or in another appropriate medium.

1.8 Further development of MaRisk

International regulatory initiatives as a basis.

The risk management requirements for institutions which are set out in the MaRisk were detailed and expanded in part in 2009. BaFin published the current version of MaRisk following a public consultation in August 2009 in its Circular 15/2009 (BA). International regulatory initiatives resulting from the financial crisis were the main reason for the revision. For example, FSB recommendations from April 2008 also focused on improving the institutions' risk management. The Capital Requirements Directive (CRD) also contains new risk management requirements. For example, the requirements for liquidity risk management have been considerably expanded.

Need for adjustment in a number of areas.

The revised version of MaRisk also reflects international risk management standards as well as experience gained in supervisory and auditing practice. As the German supervisory framework already had a comprehensive set of regulations in place with MaRisk before the crisis, many changes supplement and substantiate existing requirements. In particular, the areas of stress testing and liquidity risk management as well as management of risk concentrations demonstrated a need for adjustment. In this respect, the institutions must perform stress tests for all material risks based on the risk factors identified in each case. They must also take risk concentrations into account, in particular. Moreover, banks must manage and monitor their liquidity risks in such a way that they recognize early on that liquidity shortages are developing. The institutions must appropriately include potential losses due to risk concentrations in risk management. The new MaRisk also contain more stringent requirements for group-wide risk management. They now also explicitly require that a strategy be developed for the entire group. Moreover, institutions must now guarantee their risk-bearing capacity for the group as a whole not only on an individual institution basis, as was the case in the past. MaRisk now also put greater emphasis on the interaction of management and supervisory board. It now requires managers to grant the supervisory or administrative board a direct right to information from the internal audit function in future so that the supervisory body can better perform its monitoring function.

Principles-based approach underlying MaRisk is maintained.

The changes do not affect the MaRisk's principles-based approach. MaRisk continue to contain several opening clauses which enable simplified and more flexible implementation depending on the size of the institution, its core business activities and its risk profile. These give especially small institutions the scope they need to implement the requirements. The principle of proportionality anchored in section 25a KWG is thus retained.

1.9 Additional amendments to supervisory law

Amendment to the Building Societies Regulation

Standardised maximum amount of €30,000.

The amendment to the Building Societies Regulation *(Bausparkassenverordnung* – BSpKV) prompted by BaFin came into force in May 2009. In particular, the collective and non-collective ceilings for unsecured loans *(Blankodarlehen)* and loans issued against a commitment not to encumber or sell the property *(Darlehen gegen Verpflichtungserklärung)* have been standardised. There is a now a €30,000 ceiling. This standardised maximum amount should now make granting smaller residential construction loans – most notably for maintenance and modernisation – less bureaucratic and easier. The amendment should also benefit energy-related renovations, which are becoming increasingly important.

New calculation for the "Fonds für bauspartechnische Absicherung".

Furthermore, the procedure under which allocations to the fund dedicated to long-term positions of the home savings collective *(Fonds für bauspartechnische Absicherung)* are calculated (section 8 BSpKV) was also revised. This additional statutory risk provision instrument is designed to guarantee the granting of building loans. The purpose of amending the calculation procedure is to adequately reflect new rate trends in the building society sector in the calculation of the allocation amounts.

Official interpretation of marketing

In February 2010, BaFin published a circular on marketing by investment services enterprises.[23] It thus provides the institutions with a guideline in order to ensure the new regulations are observed in the most uniform way possible, and establishes a clear basis for communication between providers and clients.

[23] Circular 1/2010 (WA).

Marketing communication must be comprehensible.

The new rules are based on the key principles of fairness, clarity and presentation that does not mislead. Clients should be able to see at first glance the benefits and rewards as well as disadvantages and risks of the products or services advertised in the marketing communication. For example, information must be sufficient and presented in such a way that it is comprehensible to the client group addressed. BaFin considers this to mean the following: The necessary scope and depth of product descriptions must be geared to the average knowledge of the target group. Furthermore, the more complicated a product or service (including its risks) is, the more explanations the related product information must contain. Furthermore, the information must not only be sufficient in scope but also presented in a way that is comprehensible for the average member of the client group addressed. That means, among other things, that the way in which the information is worded must be all the more straightforward and generally comprehensible the less knowledgeable and experienced the addressed clients can be assumed to be.

Marketing communication must be identifiable as such.

The rules generally apply to all information that investment services enterprises make available to clients, regardless of whether or not it is of a marketing nature. Marketing information shall be clearly identifiable as such. However, an institution only has an obligation to clearly label the information as marketing information if the marketing nature of the information is otherwise not identifiable. Since the statutory provisions are based solely on the premise that the investment services enterprise must provide clients with information it does not matter whether the information originally comes from the investment services enterprise. For this reason, information which is initially provided to the investment services enterprise by a third party and which is then made available to clients by the investment services enterprise also falls under the scope of application of the provisions. This also affects sales materials of an asset management company which is not directly affected by the new guidelines itself as it is no investment services enterprise.

2 Ongoing solvency supervision

2.1 Authorised banks

The number of institutions subject to supervision has fallen once again.

The number of authorised banks in Germany has fallen once again. BaFin supervised 2,008 credit institutions and securities trading banks at the end of the year under review; that number was 2,048 at the end of 2008. BaFin distinguishes between four groups of institutions among the banks under its supervision: lending institutions, institutions belonging to the savings bank sector, institutions belonging to the cooperative sector and other institutions. The lending banks include, among others, the major commercial banks, private banks and foreign bank subsidiaries. In addition to the Landesbanks, the savings bank sector also includes the public and the "free" savings banks. The institutions are assigned to the savings bank or cooperative bank sector primarily on the basis of their economic ties. For this reason, DZ Bank and WGZ Bank are assigned to the cooperative sector. "Other institutions" includes building societies, Pfandbrief banks and securities trading banks, as well as both the federal and state development banks *(Förderbank)*.

Table 12
Number of banks by type of institution

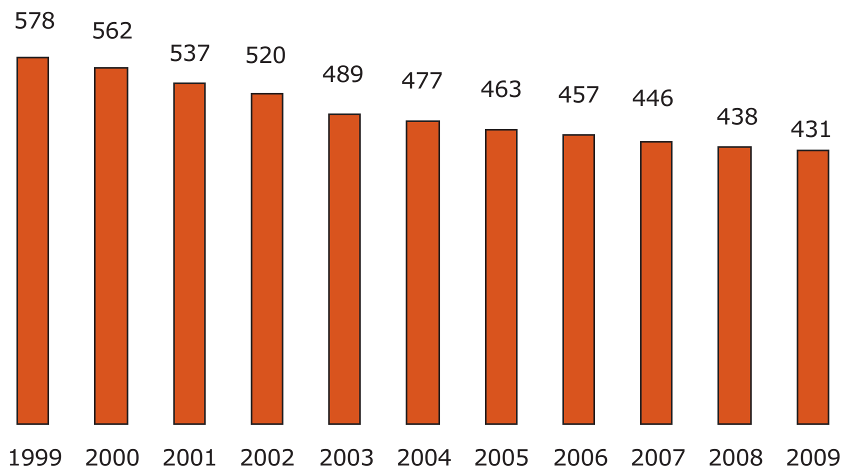
Type of institution	2009	2008
Lending banks	204	183
Institutions belonging to the savings bank sector	441	448
Institutions belonging to the cooperative sector	1,208	1,247
Other institutions	155	170
Total	**2,008**	**2,048**

The savings bank consolidation process continues at a moderate pace.

As in the past years, the savings bank sector's consolidation process continued at a moderate pace in 2009. There were 431 savings banks at the end of 2009. In 2008, there were still 438 – a decrease of just under 1.6%.

Figure 14

Number of savings banks

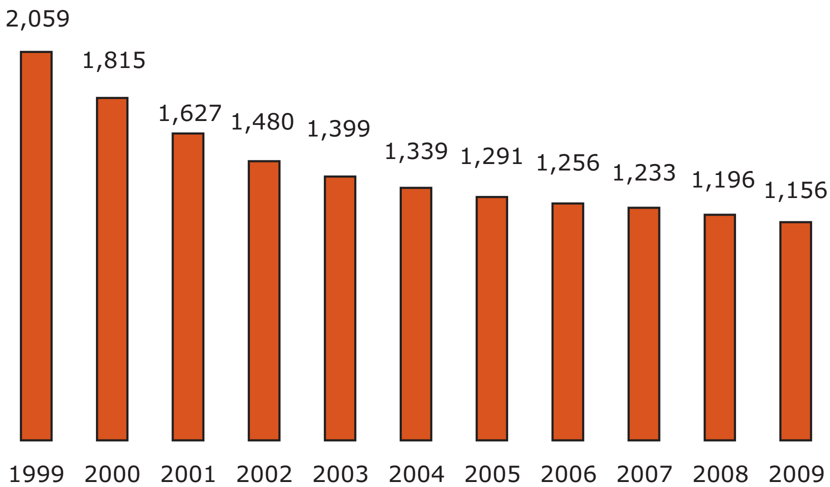


Consolidation pace in cooperative sector accelerates.

At the end of 2009, BaFin supervised in the cooperative sector a total of 1,156 primary institutions, two central institutions, eleven quasi-central institutions und 47 housing cooperatives with a savings scheme *(Wohnungsbaugenossenschaften mit Spareinrichtung)* which also form part of the cooperative sector. Thus the number of primary institutions was reduced by 40 or 3.3% (previous year: 37 institutions or 3.0%). Moreover, the pace of consolidation in the cooperative sector has slightly increased once again compared to previous years.

Figure 15

Number of cooperative sector primary institutions



24 building societies and 66 Pfandbrief banks in Germany.

In the building society sector, Vereinsbank Victoria Bauspar AG merged with Wüstenrot Bausparkasse AG in 2009. This leaves Germany with a total of 24 building societies. The number of banks issuing Pfandbriefe rose to 66 in the year under review despite the restructuring of the HRE Group (previous year: 62). As Pfandbriefe are considered secure investment instruments, institutions will maintain interest in obtaining a Pfandbrief licence.

Table 13

Foreign banks in the Federal Republic of Germany*

As at 31 December 2009

Country	Subsidiaries of banks	Subsidiaries of non-banks	Branches	EU branch offices**	Representative offices
Andorra	–	–	–	–	0
Australia	–	1	1	2	–
Austria	1	–	–	17	6
Azerbaijan	–	–	–	–	1
Bahrain	–	–	–	1	–
Belarus	–	–	–	–	1
Belgium	2	1	–	2	1
Bermuda	–	1	–	–	–
Brazil	–	–	1	–	2
Canada	–	1	–	–	–
China, People's Republic	–	–	4	–	2
Cyprus	–	1	–	–	–
Czech Republic	–	–	–	–	1
Denmark	–	1	–	3	2
Egypt	1	–	–	–	–
Estonia	–	–	–	–	0
Finland	–	–	–	1	–
France	8	2	–	24	11
Greece	0	1	–	2	–
Hungary	–	–	–	2	–
Iceland	–	–	–	0	–
India	–	–	1	1	–
Iran	1	–	3	–	–
Ireland	–	–	–	3	1
Israel	–	–	–	–	2
Italy	5	2	–	5	2
Japan	0	4	3	3	3
Jordan	–	–	–	1	–
Latvia	–	–	–	1	1
Lebanon	–	–	–	1	–
Liechtenstein	0	1	–	–	–
Luxembourg	4	2	–	10	2
Mongolia	–	–	–	–	1
Netherlands	5	2	–	22	–
Norway	–	–	–	1	–
Pakistan	–	–	1	–	–
Philippines	–	–	–	–	3
Poland	–	1	–	1	–
Portugal	–	–	–	–	6
Russia	1	–	–	–	4
Singapore	–	1	–	–	–
Slovenia	1	–	–	–	–
South Korea/Rep.	2	–	–	–	2
Spain	1	–	–	2	6
Sweden	1	0	–	2	–
Switzerland	4	8	–	2	2
Tajikistan	–	–	–	–	1
Turkey	4	–	–	–	5
United Kingdom, UK	3	6	–	29	2
USA	6	9	4	22	–
Total	**50**	**45**	**18**	**160**	**70**

* The change in recognition method made in the year under review yields results that deviate significantly from 2008. For this reason, 2008 figures are not stated.

** Country assignment is made on the basis of the group parent company's country of domicile.

2.2 Economic development

After the financial crisis caused by the US subprime crisis spilled over into the real economy at the end of 2008, uncertainty and risk aversion among financial market participants were still high in the first quarter 2009. The support measures implemented by the governments and central banks of many industrialised countries and emerging markets did not take effect until the second quarter; the almost frozen interbank market only began a gradual thaw.

Good risk management helps to limit loss.

As in 2008, the consequences of the global financial and economic crisis were again reflected in the performance of banks. However, in the year under review those banks that managed to limit their losses during the crisis thanks to a good risk management system counted among the winners. It is these banks that most clearly benefited from the recovery that set in in the majority of asset classes in the second quarter 2009. Traditional retail banks also benefited from this effect. They increased their business volume due to the increased risk aversion of their clients while simultaneously generating additional income from maturity transformation thanks to the steep yield curve. In contrast, those banks that most frequently counted among 2009's losers were those that were already forced to avail themselves of government bail-out in 2008 or at the beginning of 2009 due to heavy write-downs on securitisation structures. These banks only benefited to a limited extent from market recoveries during the course of the year.

Situation of Pfandbrief banks

At the start of 2009, the Pfandbrief market also remained strongly affected by the financial crisis. Despite the fact that the Pfandbrief is normally crisis-proof in contrast to many other refinancing instruments – it has never experienced default in its long history – its issue activity saw a sharp decline as well. The Pfandbrief also suffered from the backlash of turbulence on the securitisation market. It should be noted however that the Pfandbrief was one of the last instruments to be hit by the financial crisis and that it recovered very quickly.

Pfandbrief market recovered early – with high spreads at the start.

This recovery began comparatively early in 2009; in the first quarter the Pfandbrief market already exhibited a clear upward trend in issue volume. Even *Jumbo Pfandbriefe,* mean issues with a volume of at least €1 billion, could be placed again from February 2009 onwards. However, initially spread levels were unusually high for the Pfandbrief market (up to 100 basis points). Numerous domestic and foreign government-backed issues as well as the high emission volumes of government bonds were responsible, in part, for these premiums. In comparison to other covered bonds, however, the risk premiums for Pfandbriefe remained rather low during the crisis. Risk premiums for mainly British but also Spanish and to a lesser degree for French covered bonds amounted in part to several times the spread premium for German Pfandbriefe. As of mid-2009, the new issue volume noticeably increased, relieving Pfandbrief issuer liquidity. At the same time, the very high risk premiums for Pfandbrief issues declined significantly, which had a positive impact on earnings of Pfandbrief institutions.

2009 issue volume of €110 billion.

The institutions issued a total Pfandbrief volume of around €110 billion in 2009, of which more mortgage Pfandbriefe were issued than public-sector Pfandbriefe. Of the new issues during the period under review, around €58 billion was attributable to mortgage Pfandbriefe (including ship Pfandbriefe) and around €52 billion to public–sector Pfandbriefe. In previous years, Pfandbrief issuers still sold, in part, significantly more public-sector Pfandbriefe than mortgage Pfandbriefe. The new development is largely due to the fact that Pfandbrief banks' traditional low-margin government financing business has been in a phase of consolidation for a number of years now. Some issuers have thus nearly withdrawn completely from this business area and are focused on the mortgage lending business, which is typically more profitable.

Pfandbrief even more secure in the future.

The fear that the plethora of government-backed bonds could permanently undermine the Pfandbrief's attractiveness proved to be unfounded. Thanks to capital market recovery the number of these issues declined significantly, so that the high competitive pressure that accumulated in the meantime also decreased and is likely to decrease even further in the future if refinancing markets continue to ease up. As a secure, simple and transparent product, the German Pfandbrief thus appears to be well equipped to weather future challenges. The amendment to the Pfandbrief Act *(Pfandbriefgesetz* – PfandBG) to be passed in 2010 will also boost the Pfandbrief as it will raise the Pfandbrief's level of security even higher than it already is.

SoFFin is now sole shareholder of HRE.

At the end of September 2008, the Hypo Real Estate Group (HRE) found itself caught in a huge liquidity squeeze threatening its very existence, which could only be held at bay by a joint rescue package from the German financial industry and the German federal government with a total volume of €102 billion (€50 billion liquidity facility and €52 billion in SoFFin guarantees). In December 2009, the total volume of guarantees, which were restructured several times in the course of 2009, was fully converted into SoFFin guarantees, which now amount to €95 billion, taking repayments into account. In addition to measures to secure liquidity, SoFFin also undertook a series of corporate actions to recapitalise HRE. To this end, SoFFin performed a capital increase at HRE, raising the equity base by around €6 billion in several steps. Since the squeeze-out of minority shareholders in October 2009, SoFFin is now also the sole shareholder of Hypo Real Estate Holding AG. The EU Commission has declared the recapitalisation measures to be temporarily compatible with EC Treaty state aid rules, pending final formal approval of the restructuring plan.

HRE and DEPFA merge to become Deutsche Pfandbriefbank AG.

As part of restructuring the group, DEPFA Deutsche Pfandbriefbank AG merged with Hypo Real Estate Bank AG; the newly created Pfandbrief bank, which now functions as the strategic core bank of the group, operates under the name of Deutsche Pfandbriefbank AG. The restructuring plan for the HRE group still provides for transferring assets to a liquidation agency *("Anstalt in der Anstalt"*

– AidA). SoFFin supports this project, which is also pending EU Commission approval.

Investigation committee for HRE Group

At the end of April 2009, the *Bundestag* set up an investigation committee to clarify "whether orders, instructions, misjudgements, public statements, failures or other acts contributing to, or exacerbating the irregularities at Hypo Real Estate Holding AG (HRE) or resulting in a heavier burden being placed on citizens that could have been avoided (...)" were given, made, or committed in the area subject to the responsibility of the Federal Ministry of Finance *(Bundesministerium der Finanzen* – BMF), including SoFFin and BaFin as well as the Bundesbank.

The resolution to set up the committee contained investigation mandates concerning four main topics and a total of 15 sub-topics for a period spanning several years. This period covers the time before HRE was spun off from HypoVereinsbank in 2003 to the day the resolution to set up the committee was adopted in April 2009. In terms of content, the investigation mandate is directed, among other things, at the question of whether the structures existing between the BMF, the Bundesbank and BaFin from 2007 to September 2008 were suitable for appropriately ensuring an adequate reaction to systemic risks at HRE. Moreover, it dealt with the questions of whether the Federal Minister of Finance was himself adequately informed of HRE's liquidity problems, what the content of discussions in mid-2007 to involve financial holding companies was, and whether any findings of fault had already been detected before HVB was spun off.

The committee issued a total of 125 orders to hear evidence in order to substantiate the object of the investigation, 47 of which affected BaFin. BaFin President Jochen Sanio, Chief Executive Director of Banking Supervision Sabine Lautenschläger-Peiter and three other employees of BaFin, along with many other individuals, were invited to testify. Internally, the investigation committee not only affected Banking Supervision but also Insurance Supervision, Securities Supervision and BaFin's cross-sectoral area; these areas all had to collect documents for presentation to the investigation committee on the BMF. BaFin staff from all areas spent a total of more than 14,000 working hours on this activity.

The investigation committee concluded its work by publishing an assessment report dated 18 September 2009 (BT-Drs. 16/14000), to which the reporting members of the German parties FDP, *die Grünen,* and die *Linke* submitted a dissenting opinion. The assessment report determined the following:

- "Rescuing Hypo Real Estate was necessary; there was no alternative. It secured the German financial market, which was in acute danger at the time."

- ”The German federal government negotiated the rescue package in a professional manner and to the advantage of taxpayers. Tying the private financial industry so closely to the risks of granting guarantees was a world first.“
- ”The instability that made the rescue package necessary in the first place resulted exclusively from the Lehman insolvency – a wrong decision made by the US government which nobody could have predicted – and the impacts on the HRE subsidiary bank DEPFA plc after the interbank market dried up around the globe. Until the Lehman insolvency occurred, there were no measures the BMF could have better ordered be taken than the Supervisory Authority could have taken acting independently.“
- ”The Supervisory Authority exhausted all the legal possibilities and courses of action concerning HRE, and closely supported its development.“
- The report also had this to say about the Supervisory Authority: ”The hearing of evidence provided no basis to suggest that the BMF was not regularly and sufficiently informed by the Supervisory Authority.“

The situation of private, regional and specialty banks

The private, regional and specialty banks also felt the consequences of the financial market crisis, in yet another difficult year. However, only some of these banks were directly affected. This was largely dependent on the extent to which an institution held certain government bonds or subprime papers in its portfolio. The majority of institutions, however, were indirectly affected by the crisis. Many of the banks were confronted with the task of setting up the additional risk provisions necessary while simultaneously earning a profit, in the midst of a difficult economic environment.

Scrapping premium helps Autobanks only to a limited extent.

As specialty banks, the Autobanks are under pressure both due to the financial crisis and the crisis in the automotive sector. For many Autobanks, 2009 was marked by the initial positive effects of the scrapping premium as well as refinancing problems and the rising costs of risk. The main refinancing sources of many Autobanks – interbank credit lines and receivables sales via securitisation transactions – largely broke away. The refinancing gaps had to be filled from other sources, such as group financing. The scrapping premium exacerbated this problem in part, initially generating positive new business but also increasing the need for refinancing at the same time. The Autobanks that secured their liquidity via deposit business did so by means of very customer-friendly terms, thus generating a level of demand that in part taxed the banks’ organisational capacity to the limit. Due to a lack of appropriate investment opportunities the additional liquidity also decreased earnings in part. Earnings were also burdened by rising risk costs due to an increasing number of car dealer insolvencies.

Situation of the Landesbanks

Support measures for some Landesbanks vital.

As in previous years, development on the financial markets also took its toll on the Landesbanks. While some Landesbanks survived the crisis because of lower exposure in structured securities, deteriorated securities ratings entailed higher capital requirements for other institutions, which then along with impairment losses pushed these institutions to the brink of their economic existence. Some banks only avoided acute danger to their existence through corporate action and guarantees of billions of euros on the part of their respective shareholders as well as other guarantees totalling billions from SoFFin. However, those Landesbanks that received support from their public-law shareholders continue to face extensive restructuring tasks.

Restructuring of WestLB

At the end of March 2008, WestLB transferred a securities portfolio of around €23 billion to a special purpose vehicle. In May 2009, the European Commission approved as state restructuring aid North Rhine Westphalia's assumption of a first loss position in the amount of €5 billion (junior tranche). The Commission made its aid decision on the basis of a restructuring plan and, as expected, subject to extensive requirements. The bank group must focus on three core businesses in the future; it must close locations in Germany and abroad as well as withdraw from certain business activities and considerably reduce business volume. Moreover, the ownership structure must change by the end of 2011 and a bidding process must be undertaken to this end.

WestLB then applied to SoFFin for several stabilisation measures in order to implement the Commission's requirements. In a first step, SoFFin has agreed at the end of September 2009 to guarantee a €6.4 billion portfolio. However, the owners had to assume a proportional counter-guarantee of €4 billion in return. The European Commission approved this measure in October 2009 as rescue aid for two months.

In a second step, WestLB will transfer portfolios of around €85 billion by 30 April 2010 at the latest (retroactively as of 1 January 2010) to the first AidA ("bad bank") formed in Germany. To this end, it transferred the first sub-portfolio of around €6 billion to this liquidation agency set up as a public-law institution on 11 December 2009. The liquidation agency is expected to receive €3 billion in equity from WestLB as well as a €1 billion guarantee from its old owners to cover potential losses. Moreover, SoFFin is participating in the WestLB core bank with a silent contribution of €3 billion, which it can convert to shares from 1 July 2010 onwards.

The European Commission gave preliminary approval to this measure at the end of December 2009 for a six-month period on grounds of financial stability. It also initiated a formal investigation at the same time. In its preliminary approval, the Commission refers to Germany's commitment to adapt the restructuring plan to meet the Commission's goals. To this end, the remaining banking business is to be sold in line with the original restructuring plan, appropriate burden sharing ensured and any distortions of competition limited.

EU instituted state aid proceedings against several Landesbanks.

In addition to the case of WestLB, the European Commission also initiated state aid proceedings for other relief measures – at HSH Nordbank, at BayernLB and LBBW – some of which are not yet concluded. The European Commission placed extensive requirements for these cases as well, which thus far concern scope and focus of future business activities as well as revision of their business models. For example, these include significantly reducing total assets, as well as risk-weighted assets, and decreasing foreign business activities. The restructuring expense burdens the Landesbanks' operating results. Nonetheless, Landesbanks' earnings rose considerably over the past year. It should be noted however that the changes made to simplify IFRS-based accounting that went into force at the beginning of 2009 prevented the banks from further significant impairment losses, which had a one-off positive effect on the annual results.

Restructuring of HSH Nordbank

HSH Nordbank's financial, earnings and risk situation in 2009 continued to be shaped by the consequences of the financial and economic crisis. The crisis of confidence on the financial markets impaired HSH Nordbank's liquidity to the extent that its very existence was threatened, resulting at the end of 2008 in the bank availing itself of SoFFin guarantees of €17 billion, which were extended at the beginning of 2010 until 31 December 2010.

In February 2009, HSH Nordbank presented a strategic plan to restructure the bank. The focal point of the plan was a capital increase by around €3 billion in June 2009. Moreover, the shareholders issued a second-loss guarantee of €10 billion for major loan and securities portfolios of the HSH Nordbank group. This thus restored the group's regulatory as well as its economic risk-bearing capacity, which were temporarily no longer intact due to those risks that caused loss to the bank.

The recapitalisation measures of the federal states Hamburg and Schleswig-Holstein – as shareholders of HSH Nordbank – are deemed state rescue aid under EU law. As a result, the EU Commission announced at the end of November 2009 the institution of state aid proceedings. At the beginning of September, HSH Nordbank submitted a restructuring plan to the Commission, to which changes have meanwhile been made. The negotiations for final approval of state aid continue.

HSH Nordbank's new business model focuses on its core competencies, such as ship financing and the use of established regional client relationships. In addition, the bank intends to decrease total business activities by nearly 50% and close the majority of its international locations. The "Restructuring Unit" set up at HSH Nordbank at the end of December 2009 assumed responsibility for the liquidation of non-strategic portfolios that will no longer belong to the core bank in future.

The former chairman of the Deutsche Bank management board Hilmar Kopper was elected as chairman of the supervisory board. Furthermore, the new supervisory board no longer includes any senators or ministers from the affected federal states Hamburg and Schleswig-Holstein. The management board also underwent a significant change in 2009. The supervisory board revoked the management board appointments of Jochen Friedrich and Peter Rieck in November 2009 and appointed Constantin von Oesterreich (Chief Risk Officer) and Dr. Martin van Gemmeren (Restructuring Unit) as the new members of the HSH Nordbank AG management board.

Situation of the savings banks

Savings banks benefit from steeper yield curve.

As only a few savings banks invest heavily in problematic financial products, they were not that strongly affected by the turbulences on the financial markets. Savings banks focus primarily on lending and deposit business and are thus particularly dependent on maturity transformation income. In 2009, savings banks thus benefited considerably from the increasing spread between short and long-term capital market rates resulting in higher margins. The steeper yield curve thus had a very favourable impact on the institutions' net interest income and earnings. Savings banks generate more than two thirds of their profit from deposit and lending business. For this reason, savings banks' earnings power will continue to strongly depend on maturity transformation in the future.

Loan loss provisioning charges lower than expected.

Impairment losses on securities were not an issue for the savings banks in the year under review; in some cases, there were even write-ups. Provisions for loan losses decreased despite the recession and the negative impact expected on savings banks' corporate clients was more moderate than initially forecast. However, due to the delayed after-effects of the economic downturn, higher loan defaults are expected for 2010.

Situation of the building societies

The financial crisis did not affect the building societies very strongly either, which is evidenced by the continued low loan default rate and the low level of write-downs on investments. Moreover, the building societies, which refinance their non-collective business on the capital market, benefited from lower refinancing costs at the end of the year.

Wohn-Riester boosts building societies' business.

As expected, 2009 fell short of the record year 2008 in terms of new business as anticipatory effects due to upcoming changes in the home building subsidy had generated additional demand in 2008. However, positive development was also seen in 2009 through extension of the state-incentivised private pension scheme *(Riester-Rente)* to loan agreements for the purchase or construction of residential property *(Wohn-Riester)*. Demand for building society savings contracts *(Bausparverträge)* qualifying as Riester plans offered since November 2008 was so high that it has in part exceeded market participant expectations.

Quelle Bauspar AG

To protect Quelle Bauspar AG client rights, the other private building societies jointly assumed 100% ownership of the institution in the year under review. To this end, shares were transferred into a company especially formed for this purpose, which is owned by all other private building societies. This move enables the contractual obligations to Quelle Bauspar AG clients to continue to be met; their legal claim to building loans remains intact.

Quelle Bauspar AG, on the other hand, has ceased new home financing business. Quelle Bauspar AG was legally independent from the retail and leisure travel group Arcandor and its subsidiary Quelle. However, the threat loomed that the institution would face difficulties due to its name-based identity.

Situation of securities trading banks, exchange brokers and electricity traders

Performance depends on business orientation.

Following heavy revenue declines in past years, those securities trading banks and exchange brokers active in fixed-income trading particularly benefited in 2009 from financial market recovery. In contrast, the environment for corporate finance, primarily for SMEs, only stabilised very slowly compared to the previous year. As was the case in past years, performance of individual securities trading banks and exchange brokers was strongly dependent on their respective business orientation. Only those institutions that prepared themselves in a timely manner for the constantly changing market conditions continued to show improved performance in the year under review. In addition to the generally weak market situation, the consolidation trend resulting from the reorganisation of exchange trading – above all in Frankfurt am Main – and the establishment of further multi-lateral trading facilities also made itself felt. This competitive pressure forces the institutions to consolidate into bigger units, adapt their service to customer needs by offering additional banking services and develop into full-service banks with a focus on securities business.

EEX trading volume stabilises.

The trading volume of the European Energy Exchange (EEX) stabilised in the year under review, despite the absence of a number of significant trading participants and the decline in energy prices. However, these volumes continue to constitute only part of total electricity transactions. The interest in financial products continues to be relatively weak, lagging behind market participant expectations. Due to the loss of confidence in the wake of the financial crisis, however, there is increasing interest in settlement of OTC transactions via exchanges.

2.3 Risk classification

Risk classification and systemic relevance.

In risk classification, two marks, which are based on the findings and assessments for each institution, are assigned to every institution subject to oversight. The first mark ranging from A to D rates the individual bank's quality. This classification has no relationship to ratings awarded by rating agencies. Even class D institutions are not necessarily in default in a banking supervisory sense. The Supervisory Authority gives the second mark for systemic relevance, an approximate assessment of the theoretical influence a hypothetical distress of the respective bank would have on the financial sector. Criteria include size, intensity of interbank relationships and degree of international activity. Systemic relevance, which has been defined in the Supervision Guideline BaFin issued in consultation with the Bundesbank, refers to an institution's supervisory significance. Therefore, the Bundesbank and BaFin use systemic relevance as an indicator for determining supervisory intensity for the institution in question as well as for determining division of responsibilities between them and establishing the related processes.

Evaluation of systemic consequences due to distress only possible on a case by case basis.

It is not easy to determine beforehand whether an institution will experience systemic consequences resulting from distress and what measures would be required. Systemic consequences cannot be evaluated until once they have actually occurred. In order to assess them, market reactions must be taken into account in addition to a careful examination of the institution's economic ties. It is possible that there may be no other alternative than to support institutions not classified as systemically relevant within the meaning of the Supervision Guideline, in the interest of maintaining financial stability.

Mergers impact risk classification.

BaFin has classified the systemic relevance of credit institutions and securities trading banks since 2004. There have scarcely been any changes in the past five years resulting from a decrease or increase in importance of the institutions. Bank mergers have the biggest influence on classification. For bank groups, each subsidiary of a group is classified separately, so that changes in the group of consolidated companies have also resulted in slight variations. This is compounded by a more strongly differentiated classification of building societies. While the building societies as a whole continue to be highly systemically relevant, individually they are classified differently depending on the importance of each specific building society.

Risk classification as basis for supervisory action.

Classification of an institution is made by the Bundesbank on the basis of a comprehensive risk profile. An institution's risk profile reflects its risk situation and capital resources, its risk management and its organisational and management quality. BaFin makes the final decision. The Bundesbank and BaFin determine how intense their supervisory activities should be based on these classifications. The Supervisory Authority considerably intensifies its activities with rising systemic relevance of institutions. Oversight is focused on the related analyses of risks and their potential impact on the institution's risk-bearing capacity. As a result, BaFin and the Bundesbank closely cooperate in this regard.

The institutions' quality and systemic relevance classifications can be clearly seen in a matrix.

Table 14
Risk classification results 2009

Institutions in %		Quality of the institution*				
		A	**B**	**C**	**D**	**Total**
Systemic relevance	**high**	0.2 %	0.5 %	0.9 %	0.2 %	1.8 %
	medium	2.8 %	3.3 %	2.1 %	1.2 %	9.4 %
	low	35.0 %	38.1 %	12.5 %	3.2 %	88.8 %
	Total	38.0 %	41.9 %	15.5 %	4.6 %	100.0 %

* Including the financial services institutions that are authorised to obtain ownership or possession of funds or securities from customers or execute transactions or trade in financial instruments for their own account.

Classification during the financial crisis.

Overall, the German banking sector stood its ground quite well in the third year of the financial crisis as well. At the end of 2009, savings banks and cooperative banks, above all, posted stable results, also from a supervisory point of view. Consequently on a positive note, the banking sector's quality classification was stable overall. The financial crisis clearly affects banks with medium and higher systemic relevance. Over half of banks with high systemic relevance are classified as a source of concern (quality C) or problematic (quality D). More victims of the global financial crisis can again also be found among the institutions with medium systemic relevance.

2.4 Supervisory action

Three types of special audits.

In its special supervisory audits, the Supervisory Authority distinguishes between those requested by banks, those initiated by the Supervisory Authority, and scheduled audits. In the first case, BaFin only conducts the audit at the request of an institution; in the second case it does so based solely on the Supervisory Authority's need to adequately address an issue. The third case comprises those audits the Supervisory Authority conducts based on a statutorily prescribed audit schedule. This is particularly the case for audits of Pfandbrief cover, which the PfandBG requires be performed regularly at two-year intervals.

Special audits requested by banks and special audits initiated by the Supervisory Authority.

Special audits requested by banks are, in particular, acceptance audits of the institutions' internal risk measurement procedures, e.g. of rating systems in the lending business in accordance with IRBA (Internal Ratings Based Approach), advanced measurement methods of operational risks in accordance with the AMA (Advanced Measurement Approach) or the internal procedures to measure liquidity risks. Special audits initiated by the Supervisory Authority are performed either for a specific reason – e.g. to follow-up on information contained in the auditor's report – or also as a kind of routine random audit. Such audits can provide the Supervisory Authority with its own, detailed insight into the institution's risk situation.

Administrative court confirms BaFin practice of routine audits

With a *res judicata* judgment dated 29 October 2009[24], the Frankfurt am Main Administrative Court ruled that despite the KWG's differentiated supervisory instruments, BaFin is not prevented from routinely auditing institutions' business activities at appropriate intervals. This can even be taken from the Act itself (section 44 (1) sentence 2 KWG). Performing routine audits enables BaFin the maximum level of monitoring. Thus BaFin is entitled to avail itself of the remaining supervisory instruments for supplemental monitoring, and only in the periods between routine audits.

The court may only examine an audit order under two aspects: Firstly, it may examine whether performing routine audits is part of BaFin's administrative practice at all. This fact was sufficiently proven in this case. Secondly, it must examine whether individual routine audits are performed at appropriate intervals. The audit order also took this criterion into account.

[24] Case ref.: 1 K 704/09.F.

Taking such a clear stand, the court stressed the major significance of routine audits as a supervisory instrument. It highlighted the fact that in the auditing practice, there are no rules of privilege such as size of a bank. Thus all banking sectors are subject to the same degree of supervision. Moreover, the court also declared that the legality of the audit order is not affected by the amount of the costs anticipated either.

The court's decision draws on established case law, e.g. that of the Federal Administrative Court. Ultimately, the only barrier for effective supervision is the ban on arbitrariness anchored in constitutional law.

More special audits in 2009.

Due to the persistent financial crisis, the Supervisory Authority was forced to expand its audit activities in 2009. Out of a total of 258 special audits (previous year: 244), 187 audits were initiated by the Supervisory Authority, compared to 163 the year before. 43 more were performed at the request of banks (previous year: 61) and 28 statutorily required audits of cover assets (previous year: 20).

Fewer valuation audits – focus on MaRisk.

The number of pure valuation audits among audits initiated by the Supervisory Authority dropped back to just eleven. The Supervisory Authority not only examined valuation methods and lending business results (traditional lending-related special audits – *Kreditsonderprüfungen*/KSP) but also performed more valuations of financial products in the trading book (impairment-related audits – *Werthaltigkeitsprüfungen).* The Supervisory Authority initiated 124 special audits again focusing on the institutions' implementation of organisational and risk management duties (section 25a KWG), which the Supervisory Authority has specified in detail in the MaRisk, in the year under review, compared to 125 such audits in the previous year.

Table 15

Number of special audits

	2009	**2008**
Impairment-related special audits*	11	23
Section 25a (1) KWG (MaRisk)	164	125
Organisation	8	5
Cover assets	28	20
Other	4	10
Market risk models	4	5
IRBA (credit risk measurement)	28	45
AMA (operational risk measurement)	8	8
Liquidity risk measurement	2	3
Other risk measurement	1	0
Total	**258**	**244**

* These audits were referred to as lending-related special audits until the 2008 annual report.

The following table shows the breakdown of audits by type of institution. It is of note in the table that only 8.1% of cooperative sector banks were audited. The considerably higher percentage of audits of lending banks, other institutions and savings banks reflects, for one thing, the higher systemic relevance of these institutions as reflected in the risk matrix. For another thing, the requested IRBA and AMA audits as well as the statutorily required cover asset audits are having an effect for these types of institutions. Both types of audit were hardly performed in the cooperative sector.

Table 16

Breakdown of 2009 special audits by type of institution

	Lending banks	Savings bank sector	Cooperative sector	Other institutions
Impairment-related special audits	3	2	5	1
Section 25a (1) KWG (MaRisk)	30	41	81	12
Organisation	2	4	2	0
Other	0	11	2	1
Cover assets	1	19	1	7
Market risk models	1	1	2	0
IRBA (credit risk measurement)	13	7	4	4
AMA (operational risk measurement)	8	0	0	0
Liquidity risk measurement	1	0	1	0
Other risk measurement	1	0	0	0
Total	**60**	**75**	**98**	**25**
in %*	**29.4 %**	**17.0 %**	**8.1 %**	**16.1 %**

* In terms of the total number of institutions of the respective type.

The types of institution listed in the table also comprise their respective central institutions; the Landesbanks belong to the savings bank sector, while DZ Bank and WGZ Bank belong to the cooperative sector. The former mortgage banks, building societies, institutions with special functions and guarantee banks belong to Other institutions. This also includes some other specialty banks as well as the financial services institutions that are authorised to obtain ownership or possession of funds or securities from customers or execute transactions or trade in financial instruments for their own account.

Risk-orientation of special audits.

Combining the audit figures with the classifying risk matrix gives an idea of how risk-oriented the special audits were. The following table contains only those audits initiated by the Supervisory Authority. Of course, the risk classification of the institutions subject to supervision is only relevant for this type of special audit.

Table 17

Breakdown by risk class of 2009 special audits initiated by the Supervisory Authority

Special audits		Quality of the institution*				Total	Institutions in %**
		A	B	C	D		
Systemic relevance	high	0	2	14	4	20	55.6 %
	medium	4	12	15	9	40	21.4 %
	low	27	53	37	10	127	7.2 %
	Total	31	67	66	23	187	9.4 %
	Institutions in %**	4.1 %	8.0 %	21.4 %	25.0 %	9.4 %	

* Including the financial services institutions that are authorised to obtain ownership or possession of funds or securities from customers or execute transactions or trade in financial instruments for their own account.

** Percentage of the institutions audited in the respective quality or relevance class (e.g. 4.1% of all class A institutions were audited in the year under review).

Audit focus on problematic institutions...

The more critical BaFin classifies the quality of an institution, the greater its need to take an in-depth look at that bank's actual situation. The percentage of audits initiated by the Supervisory Authority thus rose to 25.0% of the problematic institutions classified as D. The percentage of banks with a high systemic relevance audited (55.6%) was even more significant. It reflects a further shift in the banks' classification in the risk matrix.

...but good institutions are also audited.

The Supervisory Authority also audits, at least on a random basis, institutions classified as "good"; this also occurred in the year under review. However, a special audit was performed for only one in every 25 of those institutions classed as A (green).

Audit of internal risk models at credit institutions.

At the end of 2009, a total of 14 credit institutions (previous year: 15) had BaFin certification that their internal market risk model meets the supervisory requirements on calculating capital requirements (model banks). The decrease in the number of model banks is not due to fewer requests but to a merger. Five institutions selected the full use of internal market risk models. This means that the model is used for measuring all market risk types with the exception of what are referred to in the Solvency Regulation as "other market risk positions".

Only 14 backtesting exceptions left.

The number of backtesting exceptions declined considerably in the year under review to 14 (previous year: 120). This decline is mainly based on the models meanwhile taking market volatility, which rose strongly in the previous year, into account. Moreover, market volatility did not rise further in 2009 but generally fell again instead.

Audits are based on backtesting results.

In the first six months of 2009, BaFin audited primarily credit institutions that had demonstrated a large number of backtesting exceptions the year before. In some cases a considerable need for supervisory action was identified. Due to their construction, risk models are based on historical information, for which reason unforeseen structural breaks require quickly adapting the model to the new conditions. Appropriate risk management using market risk models is thus only possible if the models are continuously developed and supplemented by other instruments such as stress tests. This was exactly what was not being done, in part, at some credit institutions. Another frequent finding at some institutions in the year under review was their insufficient reaction speed: They took too long to identify risks in the process of becoming material and to include them in the respective model or to eliminate other deficiencies that had been detected.

In individual cases deficiencies resulted in higher capital requirements.

Due to the in part substantial deficiencies and delays in rectifying them, BaFin had to raise capital requirements at some institutions by as much as 30%. Only in this way could BaFin ensure that the risk positions included in the risk model were appropriately backed by own funds. At the same time, BaFin demanded fundamental improvement be made to the risk models at the credit institutions in question. It monitors the rectification of deficiencies in close cooperation with the Bundesbank.

Table 18

Risk models and factor ranges

Year	New applications	Applications withdrawn	Rejected	Number of model banks	Minimum add. factor*	Maximum add. factor*	Median
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	0.2
2007	0	0	0	15	0.0	1.0	0.2
2008	1	1	0	15	0.0	1.0	0.2
2009	0	0	0	14	0.0	2.5	0.3

* Does not take the additional factor component into account due to backtesting exceptions (section 318 (2) SolvV).

Findings of supervisory law violations and sanctions imposed.

In addition to the purely on-site audits, BaFin also directs enquiries concerning individual business matters to the institutions under supervision. As a result of audits and enquiries, BaFin also determined various violations of the KWG with differing degrees of severity in the year under review. It thus implemented a number of supervisory steps. There were a total of 152 supervisory law violations identified and sanctions imposed in 2009 (previous year: 78). The following table shows the breakdown of these sanctions and violations by type of institution.

Table 19
Findings of supervisory law violations and sanctions imposed

Type of institution	Severe violations	Measures against managers	Administrative fines	Measures in cases of danger (pursuant to section 46 KWG)
Lending banks	26	5	0	0
Savings bank sector	36	2	1	0
Cooperative sector	69	3	0	0
Other institutions	10	0	0	0
Total	**141**	**10**	**1**	**0**

New supervisory approaches

Capturing systemic risks and integration in supervisory practice. The development of the financial market crisis has shown how important integrating findings of systemic relevance into practical banking supervision is. The momentum of the global financial markets constantly generates new products and thus new risks that could cause domino effects. The traditional supervisory approach, which is based on the individual institution or the group of institutions, should thus be supplemented by systemic elements. That requires, for one thing, that information with systemic relevance can be promptly captured via the supervisory reporting system; that is, the Supervisory Authority should receive the information it requires from institutions without requesting it, on the basis of standardised forms. Identifying systemic relationships is, however, just one side of the coin. The other side is that this systemic information must also be linked to ongoing supervision of institutions and groups of institutions in a meaningful way. For this reason, BaFin set up a banking supervision risk committee at the end of September 2009.

Risk committee to support ongoing supervision

The new committee is responsible for preparing and structuring information on the market environment for better use by the Supervisory Authority. This new approach no longer looks at the individual institution in isolation but rather within its market environment, which is determined by macroeconomic developments on the one hand and findings from cross- and peer group comparisons with other institutions on the other hand. The objective of the committee is to recognise negative developments earlier and to be able to react to them more promptly. The BaFin risk committee meets monthly.

Its main duty lies in strengthening risk identification. To this end, it collects and evaluates information that is relevant for groups of institutions or the entire financial sector. It draws on information from banking supervision, the basic issues sections and auditing practice. Moreover, the committee also takes into account information from BaFin and Bundesbank units that deal with market developments. Cross-comparisons, in which peer groups are formed and analysed, are another important element in the risk identification process.

Based on its risk assessment, the risk committee develops suggestions for action to be taken by the respective BaFin sections so that this information and evaluations can be taken into account in their risk assessment of each individual institution. The risk committee's recommendations for action can also extend to determining supervisory focal points or to proposing regulatory environment changes. The risk committee is supported by a secretariat, which summarises and prepares the environmental information received and then reports it to the risk committee members.

In mid-December 2009, the expanded risk committee, which consists of senior representatives from BaFin and the Bundesbank, commenced its work. The regular cooperation on this joint committee, which meets quarterly, represents one more step taken to closer collaboration between BaFin and the Bundesbank.

A bank's business strategy is the starting point for supervisory analysis.

The institutions' strategic alignment shows how under the conditions of their macroeconomic environment and limited internal resources (financial, personnel-related or technical/organisational) they intend to generate sufficient earnings to sustainably ensure their future viability. The Supervisory Authority thus places great importance on an institution's business strategy for supervisory purposes and has also correspondingly anchored this in internal guidelines – for example, on preparing supervisory risk profiles. Moreover, there are relevant regulatory rules concerning institutions' strategies (section 25a KWG, MaRisk), which are the object of the audit of annual accounts, and banking operation audits.

A closer look at business strategies.

The Supervisory Authority will address the topic of strategy in more detail in the future. BaFin is currently developing guidelines for dealing with particularly risky business strategies. Such guidelines should particularly take earnings aspects into account. For example, earnings concentrations in certain business areas could be critical. Business strategies that do not appear to be viable given the instruction's resources or which would mean a sudden change in the strategic focus normally clearly indicate a problematic situation. BaFin, however, only evaluates institutions' business strategies in terms of their soundness. The respective institution's managers and supervisory board are responsible for its business orientation.

Assessment of risk-bearing capacity.

The supervisory review process (second pillar of Basel II) focuses on the assessment of an institution's risk-bearing capacity. In this respect, the Supervisory Authority relies on criteria resulting from market risk, IRBA, AMA and MaRisk audit practice. Moreover, internal working groups at the Supervisory Authority address and develop important aspects of risk-bearing capacity such as available financial resources, risk concentrations, diversification effects and stress testing.

Cross-comparisons are an additional important component in assessing risk-bearing capacity. In autumn 2009, the Bundesbank thus conducted two risk-oriented random checks on behalf of BaFin, the findings of which will then be integrated into supervision of the individual institutions. Cross-comparisons not only give BaFin an overview of the institutions' range of practices. The differences that are determined in such comparisons also offer an opportunity to eliminate any deficiencies at the institutions. The comparisons also enable the Supervisory Authority to judge the advantages and disadvantages of individual internal models.

Harmonisation and cooperation to prevent regulatory arbitrage.

As the room for discretion in implementing international regulatory rules results in different national-level rules, what is referred to as "regulatory arbitrage" can thus not be entirely avoided. However, BaFin does everything in its power to promote international harmonisation of supervisory rules and to contribute to uniform implementation. Findings from audits, business strategies and risk-bearing capacity concepts of the institutions play an important role at national level in combating regulatory arbitrage. Furthermore, analyses that cover a number of institutions help to identify loopholes and to take measures to eliminate them through regulatory initiatives, for example.

Collaboration in supervisory colleges increases.

BaFin is also involved in an international effort to regularly meet with other national supervisory authorities, in what are called "colleges", to further optimise coordinating supervision of cross-border undertakings and thus also to address the issue of regulatory arbitrage. This collaboration with foreign supervisory authorities, particularly within Europe, was further intensified in 2009. For example, BaFin participated as host supervisor, in supervisory colleges for eleven European banking groups, spanning a total period of 36 conference days. After the colleges, the supervisors frequently opted to get in touch with personal contacts they made in the college process "directly" by phone or e-mail to clarify issues arising in day-to-day supervisory practice. The formal framework for the college collaboration is typically defined by multilateral agreements on cooperation and coordination, which are based on CEBS regulations. Detailed discussions and negotiations with foreign supervisory colleagues preceded conclusion of the respective agreements.

Supervision of foreign institutions

BaFin as host supervisor.

BaFin not only exercises its supervisory powers for cross-border institution groups within the European regulatory framework on banking supervision as a home supervisor but also in the role of host supervisor. In the year under review, BaFin acted as "host supervisor" for 167 institutions.

Limited supervisory powers for EU/EEA branch offices.

In addition to the opportunity via the "EU Passport" to conduct business in Germany as a cross-border service provider, EEA institutions very frequently avail themselves of the option of maintaining a branch office within the meaning of section 53b KWG in Germany. At the end of 2009, 80 EU/EEA branch offices were registered with BaFin. These branch offices are only subject to limited host supervision by BaFin of compliance with liquidity requirements. They do not have separate legal personality and completely depend on the directives and instructions of foreign head offices. Because they lack legal personality they do not prepare their own annual financial statements either. Moreover, branch office managers are not subject to KWG requirements for managers (manager qualification).

BaFin is vested with the supervisory instruments under section 53b (3) – (5) KWG that it may also apply to institutions operating in Germany. However, it cannot initiate or intervene in procedures that often follow, such as insolvency or liquidation of an institution. This power is vested only in the Supervisory Authority of the country in which the respective enterprise is domiciled. Thus, after ordering a measure to avert danger, BaFin is dependent on the actions taken by the home supervisor. The legislature's balancing act between the legal framework at European level (home country supervision and the principle of treating a credit institution and its branch offices as a single entity), on the one hand, and the need for effective supervisory instruments to avert danger under national law, on the other, results in BaFin's hands being partially tied in the area of limited host supervision.

No limitation on supervision of foreign bank subsidiaries.

BaFin is not subject to any restrictions concerning its supervisory activity of legally independent subsidiaries. Managers of foreign bank subsidiaries generally have sufficient powers to independently steer their institutions, also through the financial market crisis, on a stand-alone basis. Nevertheless, a number of institutions are tightly integrated into group structures. In some cases, this created a burden on the German units in the year under review. For example, a deterioration in liquidity and loan portfolio was observed at a number of bank subsidiaries. This was only partially due to a deterioration in the financial situation of external borrowers. Rather, many of these bank subsidiaries were heavily involved within the group in lending the parent company funds or refinancing themselves to a large extent within their own group. In cases in which the foreign parent company experienced difficulties, this negatively impacted the liquidity of the respective subsidiary. In a number of cases, BaFin thus used its right to information in accordance with section 44 KWG and required these bank subsidiaries to report on their liquidity status at frequent intervals.

Kaupthing Bank hf., German branch

On 22 June 2009, BaFin lifted its payment and disposal stoppage (moratorium) on Kaupthing Bank hf., German branch. The moratorium that had been in place since 9 October 2008 served to secure the bank's remaining assets. Prior to that the Icelandic Minister of Economic Affairs made a binding statement on behalf of the entire Icelandic government that payment to German depositors would be made in accordance with Icelandic law and European legal requirements. For this reason, the interests of the subsidiary's German clients were no longer in danger. The moratorium was thus no longer necessary.

Repayments to German depositors started at the end of June 2009. The Icelandic government made clear that Kaupthing Bank hf. remains under the control of the Icelandic Financial Supervisory Authority FME during the winding up process. Kaupthing Bank hf. and the Icelandic authorities were and are solely responsible for winding up the bank in accordance with Icelandic law. The same also applies to payment of deposits as is stipulated in European legal provisions for such cases.

On its German website, Kaupthing Bank hf. published general information and details of the repayment procedure for German clients. The bank also explained on its website how clients can assert their claims to interest payments. In November 2009, the bank concluded winding up its operating business in Germany. The deadline for filing claims in accordance with Icelandic insolvency law ended on 30 December 2009.

2.5 IRBA and AMA approval procedures

Counterparty risk

A total of 450 IRBAs at 49 institutions.

At year-end 2009, 49 institutions and groups of institutions calculated their capital requirements for counterparty risks based on internal rating systems and rating procedures for securitisation positions (IRBA). Two institutions also use the Internal Model Method to calculate counterparty risk. Of the 49 IRBA institutions, 20 are lending banks and 14 are Other institutions. Another eleven institutions are savings banks and four cooperative banks. Since 1 January 2008, around half of all IRBA institutions have received approval to use the Advanced IRBA. In its approval procedure, the Supervisory Authority confirmed the suitability of a total of around 450 internal rating systems and rating procedures for securitisation positions.

28 suitability and follow-up examinations.

BaFin and the Bundesbank performed 28 suitability and follow-up examinations in the year under review. Follow-up examinations are intended to ensure that deficiencies in IRBA systems determined in the approval examination are promptly rectified.

Operational risk

Survey on operational risk management of German BIA institutions.

BaFin und the Bundesbank conducted a study in 2009, in which they examined operational risk management at the institutions that use the basic indicator approach (BIA). The results of the study can be accessed on the BaFin website. The BIA is largely used by smaller and medium-sized institutions. Participation in the study was voluntary. All participating institutions classified operational risks as significant and implemented specific measures to identify, assess, monitor and manage them. The management systems focus on systematically gathering and evaluating information on operational risks and losses incurred, and preparing it for use as a decision-making basis. The participating institutions consistently use loss databases. A significant number of the institutions already rely on external loss data for loss analysis. Using external data can result in a significant improvement in risk management, as weaknesses in procedures and systems, potential human error and external threats can be identified before they cause considerable loss in the own institution. As operational risk management is a comparatively recent discipline, it is likely that risk identification and assessment systems will be further refined in future.

A total of 14 AMA institutions.

In 2009, four more institutions received approval to use the Advanced Measurement Approach (AMA). Thus 14 institutions and groups of institutions used a total of 15 advanced measurement approaches at the end of the year. BaFin served as "home supervisor" for the approval procedures in seven cases and as "host supervisor" in eight. The 14 institutions and groups of institutions that are entitled to use AMA are mainly lending banks, while one belongs to Other institutions. Two institutions are savings banks and one is a cooperative bank.

64 institutions use a standardised approach.

64 institutions used a standardised approach in the year under review, of which one institution was approved to use an alternative indicator in the standardised approach. Use of the standard approach continued to lag behind BaFin expectations. In earlier surveys, around 130 institutions had stated they intended to use the standardised approach. However, the other institutions now use the basic indicator approach instead.

Audits at AMA institutions.

The Supervisory Authority performed follow-up examinations at some AMA institutions in 2009. A variety of different procedural improvements were determined in these examinations. However, in particular the allocation procedure and validation as well as business environment and internal control factors continued to show room for improvement. BaFin outlined the framework for model changes and, if necessary, an audit of them, in a guidance notice entitled "Model Change Policy" dated 20 January 2009.

Liquidity risk

Approval of institutions' internal liquidity risk models.

The Regulation on the Liquidity of Institutions *(Liquiditätsverordnung* – LiqV) which came into force in January 2007 enables institutions to demonstrate adequate liquidity based on their own internal risk measurement and management procedures (risk models), which are first subject to examination by BaFin (section 10 LiqV). In 2009, BaFin continued the approval procedures begun in 2008 and approved one institution's internal risk model for supervisory purposes. However, no further institutions applied for approval of internal risk models in the year under review.

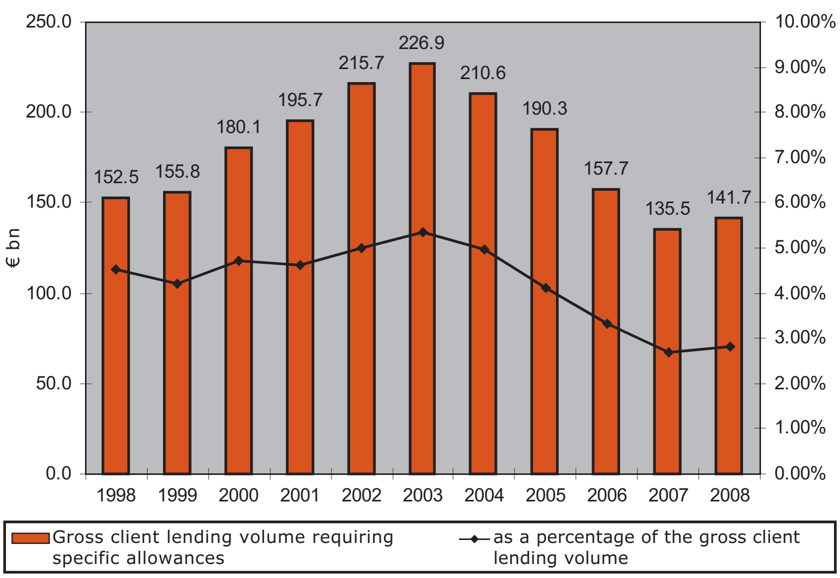
2.6 Non-performing loans

Volume of non-performing loans rose again for the first time.

As expected, gross client lending volume requiring specific allowances evaluated by BaFin rose in 2008. This aggregate key figure is derived from the audit reports of the annual financial statements of the individual banks. An approximate total volume of non-performing loans (NPL) in German credit institutions' portfolios can be determined on this basis. In 2008, the German banking sector suffered a rise in NPL for the first time in four years. The volume of receivables requiring specific allowances rose by 4.6% over the prior year to €141.7 billion. At the same time the proportion of NPL to total gross client lending volume also rose slightly to currently 2.8%. The increase in absolute NPL volume results in particular from the increased number of problem loans in the Landesbank sector, which has been hard hit by the financial crisis. In contrast, the major banks as well as the savings banks and cooperative banks were able to keep their NPL volume largely stable in 2008.

Figure 16

NPL market potential*



* The audit reports of the 2009 annual financial statements were not yet all available to BaFin at the time of printing.

The financial crisis has increasingly spread to the real economy. As typically more lagging indicators, corporate insolvencies and loan defaults can be expected to continue to rise, which will lead to increased risk provisioning and a greater need for valuation allowances on bank balance sheets. For this reason, we can expect to see the more difficult economic conditions reflected in a further increase in NPL volume.

2.7 Securitisations

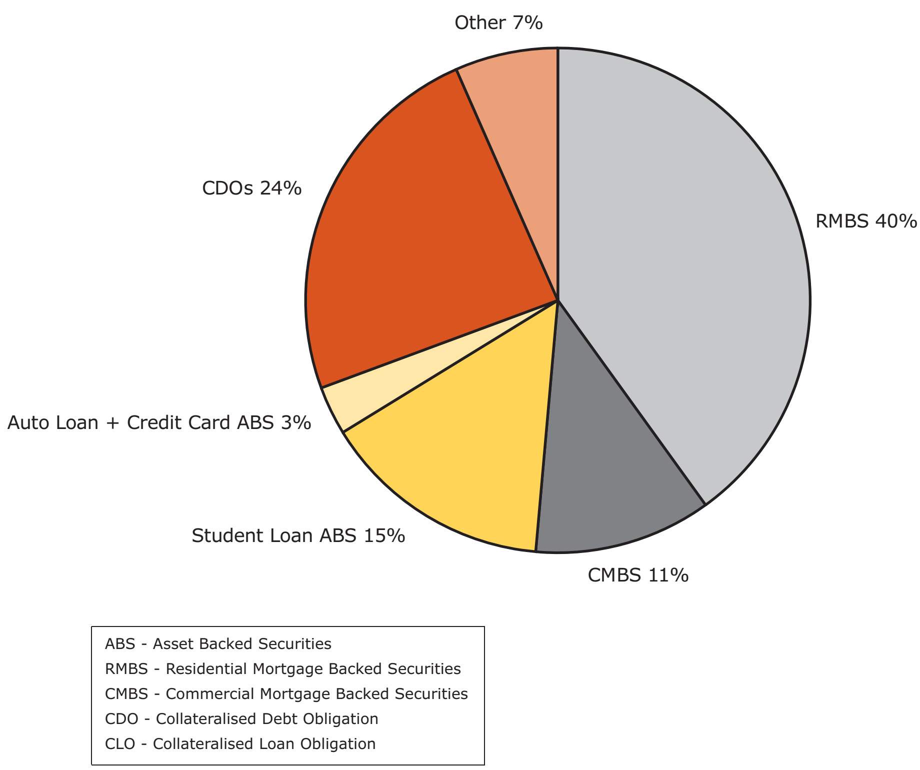
Securitisation volume of major German banks.

17 selected major German banks held securitisation positions totalling €213 billion (carrying amounts) on their books at the end of 2009. The carrying amounts declined slightly in the second half of 2009, which is largely due to maturities and repayments as well as individual sell-offs. The figure given above is unheeded exposure, i.e. the net exposure is less. The following figure shows the breakdown of exposures by individual asset classes.

Figure 17

Securitisation positions by asset class

(Selection of 17 major German banks as at 31 December 2009)



Source: Bundesbank, BaFin

Around half of the exposures are mortgage backed securities, of which the majority are residential mortgage backed securities (RMBS). However, the risk structure of the positions held is very heterogeneous. For example, existing RMBS contain US subprime papers as well as the comparatively robust AAA tranches backed by central European residential mortgages.

Securitised loans by region.

Just under one fourth of the positions consist of collateralised debt obligations (CDO), of which approximately one half are collateralised loan obligations (CLO). Another significant exposure of 15% is in student loan ABS (asset-backed securities), which are mostly US government-guaranteed student loans. Securitised consumer loans (auto loan and credit card ABS) and other securitisations are of lesser importance.

A breakdown of the underlying loans by region shows that the largest share of exposure is to US borrowers (46%). Marked differences can be seen however in a breakdown by asset class. While US exposure in some segments, for example student loan ABS, is very high (99%), RMBS averages 46%. For commercial mortgage backed securities (CMBS), exposure to the USA was 33% and to the UK 27%.

Rating structure.

Nevertheless, 63% of securitisation positions are rated "AAA" with only 10% rated as non-investment grade. The large number of rating downgrades in the past years however also resulted in a significant increase in German banks' capital requirements.

2.8 Financial services institutions

710 financial services institutions under supervision.

Earnings of financial services institutions remained stable in 2009, following a decline in 2008.

At the end of 2009, a total of 710 financial services institutions were under BaFin supervision (previous year: 722), including 73 German branches of foreign companies (previous year: 82).

182 of the financial services institutions under supervision engaged in investment and contract broking and providing investment advice (previous year: 191). 508 had a licence for portfolio management (previous year: 509). Two financial services providers were authorised to obtain ownership or possession of funds or securities from customers (previous year: 4).

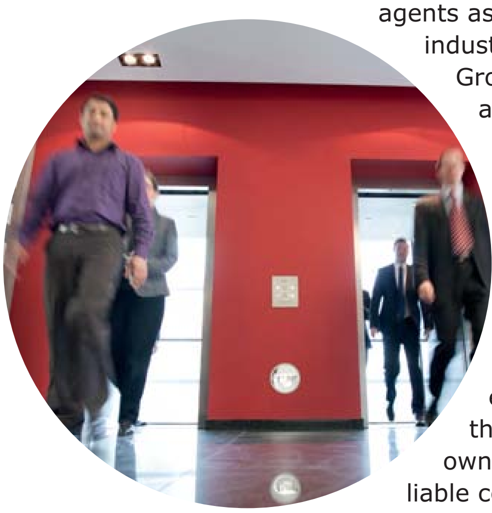
43 licence applications.

In 2009, 43 companies applied for a licence to provide financial services (previous year: 125). Eleven financial services institutions applied for an expansion of licence scope (previous year: 31). Thus the number of applications fell back to the normal number prior to 2008. The extraordinarily high number of applications in 2008 was due to a new rule stipulating that the provision of investment advice requires a licence.

Tied agents

Fewer tied agents.

The number of tied agents declined in 2009 by a good one fifth to approximately 40,000 (previous year: approximately 50,000). The number of liable companies of approximately 190, in contrast, rose slightly (previous year: approximately 180). The majority of tied agents are registered with credit institutions (approximately 27,000 agents). The year under review saw a drop in the number of tied agents as a result of mergers in the German credit industry. By way of example, within the Allianz Group, only some of the original 33,000 tied agents working for Dresdner Bank AG were transferred to Oldenburgische Landesbank AG. Of the five institutions with the most agents (just under 35,000), four are credit institutions and only one is a financial services institution. Around 13,000 agents cooperate with financial services institutions.



Tied agents must disclose their status to existing and potential clients at the beginning of the business relationship. If a tied agent has its own website, the agent's activity is attributed to the liable company.

Tied agents may not commence their activity until after the liable company has electronically notified BaFin. Notification may only be made via the electronic notification procedure. In addition to the Smartcards used thus far, the option of using server certificates has also been available since summer 2009.[25]

The company must first check whether the tied agents are qualified and reliable. Before the tied agent can commence its activity, it may be necessary in the case of pre-incorporated companies *(Vorgesellschaften)* – for example, a GmbH i.G. – for entries to be made in the commercial register. Any inclusion of tied agents in the institution's internal control system and internal audits must be transparent for BaFin.

Cooperation

Working group meeting with the Bundesbank...

Agenda items of the 22nd working group meeting of BaFin and the Bundesbank included the new type of financial services requiring a licence, investment management, which was introduced in 2009, and the new requirements for supervisory and administrative boards in accordance with section 36 (3) KWG. Participants also discussed questions concerning the audit of the Compensation Scheme of German Securities Trading Companies *(Entschädigungseinrichtung für Wertpapierhandelsunternehmen –* EdW) in accordance with the Deposit Guarantee and Investor Compensation Act *(Einlagensicherungs- und Anlegerentschädigungsgesetz –* EAEG).

[25] www.bafin.de » Companies » Reporting and publishing platform (MVP).

...and the annual consultation with the IdW.

In their annual consultation, BaFin and the WpHG working group of the Institute of Public Auditors in Germany *(Institut der Wirtschaftsprüfer* – IdW) exchanged their experience in auditing investment services enterprises. One focus was auditor reporting on compliance with organisational requirements when institutions work with a great number of tied agents. They also discussed new WpHG rules, which will impact future audit practice, such as the record of investment advice.

Auditing associations workshop.

In December 2009, BaFin organised a workshop on auditing the investment services business of cooperative and savings banks audited by their respective auditing bodies or associations; the workshop was attended by auditors of the auditing bodies of savings bank and giro associations *(Sparkassen- und Giroverbände)* and the cooperative auditing associations *(genossenschaftliche Prüfungsverbände)*. In this forum as well, another topic in addition to savings and cooperative bank audit findings in 2009 was the record of investment advice and how its practical implementation can be appropriately examined in the coming audit season.

Supervision of leasing and factoring

899 companies receive licence by act of law.

Since December 2008, companies that engage in finance leasing or factoring are, as financial services institutions, subject to BaFin supervision. By notifying BaFin, financial services institutions are deemed to have been granted a licence for these business activities (section 64j (2) KWG). For medium-sized and large companies notification must be received by the end of January 2009. The deadline for small companies was extended to the end of 2009. This enabled 899 companies to obtain a licence thus far. For a number of other companies the result of the examination is still pending on whether they actually engage in finance leasing or factoring subject to licensing.

KWG "light" and anti-money laundering supervision launched.

Supervision of finance leasing and factoring institutions is based on the provisions of the KWG and the Money Laundering Act *(Geldwäschegesetz* – GwG). Under the limited supervision in accordance with the KWG ("KWG light"), finance leasing and factoring institutions do not have to meet all requirements. They are exempted, for example, from capital requirements and Solvency and Liquidity Regulation requirements. Moreover, in the interest of gently introducing the new regulatory regime for finance leasing and factoring institutions, BaFin and the Bundesbank are practicing supervision with reasonable discretion. For example, institutions are not rebuked if they did not submit their 2008 annual financial statements in accordance with the strict rule for preparation of institutions' annual financial statements under commercial law. With the same objective in mind, the obligation for institutions to report loans of over one million euros has been postponed and institutions are permitted to report such loans based on present value instead of residual (book) value as of the beginning of 2010.

BaFin and the Bundesbank have also set significant future supervisory cornerstones for the sector. For example, they have published an accompanying letter on MaRisk and have agreed on how money laundering prevention at leasing institutions has to be implemented.

Risk-oriented supervision

In 2009, BaFin concluded its revision of the criteria for risk classification of financial services institutions. This revision was necessary after the Act Implementing the Markets in Financial Instruments Directive *(Finanzmarktrichtlinie-Umsetzungsgesetz* – FRUG) significantly expanded institutions' conduct of business obligations at the end of 2007. The risk matrix now also contains assessment fields on marketing, best execution or information on kick-backs. BaFin found deficiencies particularly in the sub-categories client information, marketing, organisational requirements, and record-keeping requirements, as well as quality of management and organisational structures. Depending on the severity of the deficiencies, BaFin has already ordered co-audits, determined main points of emphasis for the annual examination or scheduled special audits at the institutions affected.

BaFin determined risk classes for a total of 646 financial services institutions. In the "medium" or "low" class, it assesses the impact of special risks in the financial services provider's business area; these include selling particularly high-risk products, usage of a large number of tied agents, the number of clients or a strong international orientation of business activities. Risk classification based on systemic relevance is not performed as financial services institutions have no systemic risks comparable to those of credit institutions.

Table 20
Risk classification results 2009

Institute in %		Qualität des Instituts				
		A	B	C	D	Summe
Systemrelevanz	hoch					
	mittel	3.7 %	5.0 %	1.7 %	0.2 %	10.6 %
	niedrig	43.0 %	39.3 %	5.6 %	1.6 %	89.4 %
	Summe	46.7 %	44.3 %	7.3 %	1.7 %	100.0 %

Audits and measures

Informative supervisory consultations.

In the year under review, BaFin accompanied a total of 57 audits at financial services institutions and held 110 supervisory consultations with managers or board members of financial services institutions. Co-audits and supervisory consultations can focus on solvency as well as market supervision issues.

45 licences terminated; two licences revoked.

45 licences of financial services institutions terminated in 2009, the majority of which were returned. BaFin revoked the licences of two financial services institutions.

The Supervisory Authority revoked the licence of one financial services institution as it not only fell below the €50,000 minimum amount of initial capital required but also violated the duty to report insolvency. It also violated reporting requirements, notification obligations and KWG submission deadlines on a number of occasions as well the ban on cold calling on one occasion.

In the other case, BaFin revoked an institution's licence because all managers had resigned and the company failed to notify the Supervisory Authority of the new managers.

Two licences returned after consultation.

BaFin held consultations with one financial services institution with regard to the intended revocation of the institution's licence. This was largely due to organisational deficiencies and violations of notification and reporting obligations. It also violated supervisory regulations on numerous occasions. In the end, it was not necessary for BaFin to revoke this institution's licence as the institution itself returned it after the consultations with BaFin and prior to BaFin's decision to revoke the licence.

Another financial services institution that provided investment advice and/or portfolio management services for several hedge funds also voluntarily returned its licence after its consultation with BaFin. The company not only failed to comply with the agreed investment policy but was also suspected of having committed fraud and embezzlement. The investment decisions for the hedge funds were made by a single employee, who invested the money under false pretences in funds he himself controlled, charged management fees and privately used the airplanes and real estate properties acquired by the funds. Insufficient and ineffective internal control procedures at the institution facilitated this practice.

Suspension of voting rights ordered.

BaFin ordered suspension of voting rights of a shareholder with an indirect stake in an institution. This person was in custody awaiting trial for suspected fraud in another case, thus rendering his reliability questionable.

One warning issued.

In one case, BaFin warned the manager of a financial services institution after he did not meet his notification and reporting obligations concerning his financial situation and net assets or his obligations to audit the investment services business for a longer period of time despite multiple reminders.

Compensation case determined.

BaFin determined a case of compensation at one financial services institution in 2009 after it gained knowledge of the fact that the former manager had been sentenced for embezzlement of client funds. The institution had a licence to provide financial services until 2007 and was a member of the EdW. The institution had concluded asset management agreements with its clients and was authorised to purchase financial instruments after consulting them. However, the manager breached this agreement by transferring client funds to his own accounts and to those of third parties in order to use them for private purposes. The EdW will now decide on the actual existence and scope of the individual client claims to compensation for loss.

2.9 Payment institutions

New supervision of payment services.

The Payment Services Supervision Act *(Zahlungsdienste-aufsichtsgesetz* – ZAG) came into force as of 31 October 2009, and assigned supervision of the new payment institutions category to BaFin – along with the Bundesbank. Some of these activities now defined as payment services were already subject to BaFin supervision under the KWG as giro business, money transmission services or credit card business before the ZAG came into force.

Transitional period until April 2011.

Deposit-taking credit institutions and e-money institutions are permitted to provide payment services without any special licence. Banks not licensed to provide all types of banking business, financial services providers and other enterprises must be licensed as a payment institution to do this. Payment institutions do not belong to the deposit guarantee scheme but they must separate client deposits accepted for payment services and hold them in bankruptcy-remote custody. In accordance with the provisions of the Payment Services Directive, payment services that commenced before 25 December 2007 may continue to be provided until April 2011 without the licence required by the law. Companies that take advantage of the transitional period do not have to meet the supervisory requirements for payment institutions, including protection of client funds. Banks with a licence for giro business received the licence as a payment institution by act of law. The licence as payment institution generally entitles to provision of payment services in other EEA states as well.

By the end of the year under review, twelve companies had applied for a licence as a payment institution.

3 Market supervision

3.1 Credit institutions and financial services institutions

Credit institutions

Focuses: Selling Lehman certificates...

WpHG supervision of credit institutions focused mainly on the brokering of Lehman certificates. Following the Lehman collapse in 2008, many investors continued to file complaints with BaFin in 2009, citing false advice from their bank. The statements made by investors filing complaints were often completely inconsistent with the records prepared by the institution in question and the statements obtained from the advisors. Certain institutions only kept a digital record – in accordance with the rules valid at the time – of the statements made by their clients concerning their investment goals, financial situation, knowledge and experience and did not hand out a copy of this record to the client. In such cases, the client only found out what his advisor had documented during the consultation when the bank responded to his complaints. Other institutions chose a different way. Not only did the advisor at one institution give his client a copy of the documentation he had prepared, he also had the client countersign it. But even in such cases the clients filing the complaint typically contested the documentation they had countersigned stating that the information did not apply. Only a civil court will be able to make a binding decision for the client and his bank on which statements indeed accurately reflect what occurred.

...and compliance.

Another focus of WpHG supervision of savings and cooperative banks as well as Landesbanks was the issue of compliance. With the implementation of FRUG, more importance will be attached to compliance for investment services enterprises than has been the case thus far. The term compliance itself should be understood in a functional way and describes the task of monitoring and assessing the policies and procedures that an investment services enterprise implements in order to meet WpHG requirements. Therefore, BaFin pays special attention in supervising institutions to whether or not they have a permanent, effective and independent compliance function in place. In 2009, BaFin closely observed to what extent compliance functions had sufficient personnel and equipment.

Circular on tasks and status of compliance function

In 2009, BaFin prepared and consulted on the content of a draft circular on the tasks and status of the compliance function as well as additional organisational requirements in accordance with section 31 et seq. WpHG.[26] While the general part of these Minimum Requirements for the Compliance Function (MaComp) regulates, among other things, the scope of application and the goals and responsibility of management, the special part consists of various modules that substantiate the individual provisions of section 31 *et seq.* WpHG.

With this new circular, BaFin aims to strengthen the status of the compliance function in companies. The planned circular specifies, for example, the professional requirements for compliance function employees and their competences. Moreover, processes are listed in which the compliance function is to typically be involved, such as the "New Product Approval Process". The draft also contains provisions on the relationship between compliance and internal audit.

Moreover, circulars that already exist or that are still in the consulting phase, such as for monitoring personal account dealing of employees and marketing, are to be integrated into the special part. Final publication is planned for spring 2010.

Six special audits in accordance with section 35 WpHG.

In 2009, BaFin ordered a special audit at six credit institutions, due to special circumstances. These investment services enterprises had actively sold larger quantities of Lehman certificates as part of their standard retail business with private clients. The portion of guarantee certificates, i.e. certificates for which the issuer promises redemption of at least the nominal amount at maturity, varies from institution to institution. Three institutions did not sell any or sold only a very small quantity of guarantee certificates from Lehman Brothers but the other three institutions actually focused on such certificates that typically target more risk averse investors. The cases in which redemption below the nominal amount was made depending on the development of the underlying asset were mainly market-standard certificate types such as those also launched by other issuers and actively sold to retail clients by other institutions.

The special audits were intended to clarify whether the institutions complied sufficiently with WpHG requirements for investment advice. The audits focused not only on consultation meetings that served as the basis for the purchase of Lehman certificates but also on cases in which a client contacted his advisor for advice on his Lehman certificate after the subprime crisis had broken out. Additional points of emphasis for the audits were the reasons for including Lehman certificates in the investment programme, sales measures and target group selection. Of further interest was the

[26] Consultation 17/2009.

age structure of clients affected, the share of client assets invested in the Lehman certificate, whether the client purchased the Lehman certificate by phone and what funds the client used to finance the purchase. To this end, BaFin asked the auditor to randomly examine and take a closer look at such cases in which the client had already lodged a complaint with his bank – i.e. cases in which the auditor had to take into account the statements made by the client in his complaint in addition to the record prepared by the bank.

However, the audits did not reveal any systematic or frequent violations of WpHG requirements in the sale of Lehman certificates. The weak points identified by the auditors were of a general nature and thus did not affect the sale of Lehman certificates in particular. The revenue this generated for the institutions was also within the range of revenue they achieved selling investment funds or other certificates. The significance of Lehman Brothers as a sales partner largely depended on whether the institution followed a more open approach in selecting its cooperation partners or whether it tended to give more priority to its own products or those of other savings or cooperative banks. The audits did not identify any extraordinary sales activities or incentives concerning Lehman certificates.

As far as issuer creditworthiness is concerned, the institutions audited based their decision primarily on rating as they do for inclusion of other issuers' certificates in their investment programme. The development of CDS spreads, that is, the insurance premiums that institutional investors pay to hedge against default, generally had no impact on the decision. For this reason, advisors generally did not provide information on the development of this risk indicator in recommending Lehman certificates or in those cases in which the client sought advice from his bank after the subprime crisis had broken out.

CDS spreads

A credit default swap (CDS) is a credit derivative whereby the protection buyer makes a series of payments to the protection seller in exchange for a payoff should a predefined credit event occur (e.g. failure to pay). Unlike for a total return swap, the protection seller is only obliged to pay if the specified credit event occurs. CDS spreads react very quickly to changes in the market, so for some time now they have played a key role in the evaluation of credit risks. For example, CDS spread widening usually precedes a possible rating downgrade or even the review of a rating.

The majority of Lehman's clients at all institutions were older than 60, thus a little older than the average securities account holder. This was primarily due to the fact that particularly clients in this age group held disposable assets to invest in securities. Advisors largely documented more defensive, risk-averse investment strategies for only a small proportion of their clients. However, examinations also showed that in a considerable number of cases, clients financed their purchase of Lehman certificates via deposits such as maturing term deposits with the institution. The proportion of securities portfolios made up of Lehman certificates was generally between 10% and 50%. The vast majority of Lehman certificates were not sold via telephone.

BaFin discovered at some institutions that the defined risk exposure for the client's investment strategy was exceeded in many of the Lehman certificate purchase cases examined. One institution specially noted the exceeded risk exposure in the record of investment advice provided to the clients. However, in their complaints, the clients stated that they had not requested an increase in the risk exposure themselves, but had followed the recommendation of their advisor. At another institution, the defined risk exposure was exceeded because the Lehman certificates sold were included in the risk exposure calculated in the IT system the same way as all certificates without capital protection, but the advisors considered them less risky products due to their specific structure.

It became clear that not all institutions were still offering standard investment strategies in consultation meetings whereby the institution would only acquire securities with fixed income, capital preservation at maturity and only very slight price fluctuations during the term. In fact, the investment strategies defined by the institutions as having the lowest risk also allowed investments which could lose considerable value during the term. Some of the lowest risk investment strategies provided for substantial equity exposure for longer investment horizons. This approach was also reflected in the allocation of the certificates to risk classes at some institutions. For example, some institutions allocated guarantee certificates to the lowest risk class regardless of the extent of possible price fluctuations during the term, purely because of the set redemption of a minimum of the nominal amount at maturity. Other institutions refrained from such a blanket classification of guarantee certificates, and only allocated those with shorter terms to the lowest risk class.

Some institutions reacted to the Lehman collapse by taking into account both the rating and other risk factors such as CDS spreads when including certificates in their offer. One institution plans to prevent defined risk exposure being exceeded in future by taking into account a smaller proportion of the sales revenue included in the advisor's sales target in such cases.

Increased focus on portfolio structure in future.

The Supervisory Authority will attach more importance to portfolio structures in its regular audits in future. This is because it identified that although the institutions had provided their advisors with well-structured sample portfolios to aid them in their investment advice, deviations from these sample portfolios did not constitute a breach of internal guidelines, and were generally not particularly subject to in-house checks or action. As a result, the client portfolios contained considerable proportions of certificates although the sample portfolios only provided for a small quantity of certificates.

BaFin will pay particular attention to the fact that the requirement for records of investment advice in place since 1 January 2010 provides more transparency both for the Supervisory Authority and for retail clients in this respect. The record keeping obligations in place until the end of 2009 were not fully suitable for indicating the actual course and content of consultations.

Certificate selling also focus of regular audits in accordance with section 36 WpHG.

Against the backdrop of the Lehman collapse, BaFin also focussed on the sale of certificates in the regular examination of a further nine credit institutions. In addition to special audits, credit and financial services institutions are subject to an annual audit obligation with a view to their conduct and organisational requirements. These annual examinations should focus on the whole process – from the inclusion of a certificate in the investment programme right through to it being recommended.

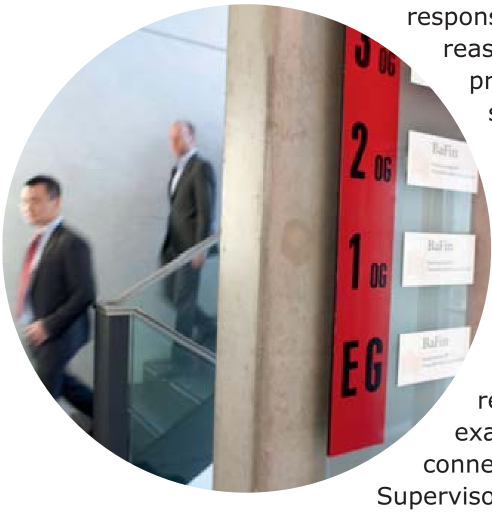
The audit reports already available indicate considerable differences in the specific structure of the product selection process. While some institutions include compliance staff every time marketing begins for a certificate, others do not involve them at all, or only if marketing the certificate involves a completely new business activity. Furthermore, initial reports and the special audits show that the reasons or forecasts underlying the selection of a certain security for active sale are very difficult to identify on the basis of organisational guidelines and records prepared by the institutions. Finally, the reports make it clear that, at least in standardised retail business with private clients, only current issues are recommended with a view to earning a sales commission. Neither a value calculated using mathematical finance nor the probability of the most favourable scenario for the investor are usually provided in such cases. Some institutions try to prove that the investments offer an adequate risk/reward profile by obtaining offers from several issuers and, thus, creating a competitive situation. Only a few institutions research into whether the selection of a certain certificate was the right decision, i.e. whether the client's investment generated the targeted returns.

Once BaFin has received all audit reports, it will decide whether and how the general organisational requirements are to be substantiated, in terms of, for example, the product approval process, and in particular the involvement of the compliance function. It is not least in the interests of the institutions themselves to have clear and transparent organisational guidelines, as civil courts also expect banks to assess any investment products that are to be recommended to clients with due care. Clients should be able to trust that the bank recommending the purchase of a particular security has examined it with such due care and found it to be a good product.

Financial services institutions

Special audits in accordance with section 35 WpHG for lead brokers.

BaFin conducted special audits also for lead brokers in 2009 as there were suspicions of systematic price manipulation by some market participants using the open market in Frankfurt.[27] Designation of a lead broker is one of the requirements for including equities in the open market and lead brokers are also responsible for price determination in the open market; for these reasons, BaFin checked their role in relation to the suspected price manipulations, as well as whether they had taken sufficient steps to identify suspicious transactions and report them to BaFin. BaFin wanted to know in particular the relationships the institutions had to the issuers for whom they acted as lead brokers on the open market, and to the shareholders for whom they traded the securities in the open market. The WpHG also obligates investment services enterprises to notify BaFin of any facts giving rise to suspicions of market manipulations or insider trading. The lead brokers involved had not reported suspicious activity at any time. BaFin also examined the treatment of conflicts of interest particularly in connection with personal account dealing of employees. The Supervisory Authority wanted to know whether the securities trading banks or their employees had accepted securities as payment or were holding securities in their portfolios for which the prices are determined by the institutions. Conflict of interest can arise if lead brokers hold securities they sponsor, particularly as the lead brokers have a statutory obligation to remain neutral when determining prices for the securities. BaFin sent requests for information to a large number of lead brokers back in August 2008, but this failed to produce exhaustive information.



Serious organisational deficiencies identified.

The special audits revealed considerable deficiencies in the organisation of the audited companies. The process for dealing with conflicts of interest and regulation of personal account dealing of employees often failed to comply with statutory provisions. Some institutions had accepted payment for lead broker services also in the form of shares in the respective companies. Managing directors had also received shares at par value from the companies to be listed. For the most part, securities trading banks had not made any organisational arrangements in order to meet the obligation to report suspicious activity. The institutions were often also in breach of the principle of segregating assets. Some were found to be holding client funds in their own collective accounts. Institutions often kept client securities in their own escrow accounts for long periods, thus not holding them in custody in a form which would give the client an equal legal status in accordance with the Safe Custody Act (*Depotgesetz* – DepotG). Some of the lead brokers had not fully documented internal regulations and company-specific circumstances. BaFin is currently looking into which supervisory law measures are to be taken based on the results of the special audits.

[27] See chapter VI.2.2.

Advance payment of charges ban

There was previously no court ruling as to whether sales provisions in accordance with investment law also applied to financial services providers and credit institutions which market funds. The HessVGH's decision of September 2009 was based specifically on the assumption that institutions or companies not subject to supervision in accordance with section 1 (1) no. 2 InvG but which are involved in selling (domestic) investment funds are also to observe the product-related provisions of the Investment Act.[28] The court thus rejected a complaint from a company which had previously been banned by BaFin from using fund rules which stipulated that when a savings plan agreement was concluded, 80 to 90% of the first months' saving instalments would be used to cover costs. BaFin saw this as a breach of the advance payment of charges ban (section 125 InvG). The ban states that when selling investment units over a period of several years, investment companies can use no more than a third of the agreed payments for the first year to cover costs; the remaining costs must be evenly spread over all subsequent payments. The court stressed in its decision that there was no reason why the provisions of the InvG should not be applied to cases in which investment units are not offered directly by the asset management company managing the fund, but by credit institutions, financial services providers or other companies. Even in the draft stages of the InvG, it stated that companies not subject to supervision under the InvG, but involved in selling investment funds were to observe the product-related provisions of the InvG. However, the HessVGH ultimately left this legal question open. It stated that the WpHG also requires client interests to be protected when performing investment services, and that for this purpose, at least the legal motive behind section 125 InvG should be taken into account. The huge advance payment of charges of 80% or even 90% implying a considerable deviation from the one-third rule set out in the InvG, was not compatible with client interests within the meaning of section 31 (1) no. 1 WpHG, and therefore not permitted.

Audit exemptions

234 institutions exempt from annual WpHG audit.

BaFin exempted 234 credit and financial services institutions from the annual audit obligation in accordance with section 36 WpHG (previous year: 46). Of these exemptions, 208 were credit institutions, including 28 savings banks and 179 cooperative banks. A further 26 exemptions were granted to financial services institutions.

The substantial increase in the number of exemptions was a result of the changes to the discretionary criteria at the beginning of 2009 regarding audit exemptions. Firstly, the upper limit for the number of securities accounts maintained by an institution to qualify for a

[28] Case ref.: 6 B 2322/09.

one-year exemption was raised from 750 to 1,000. Secondly, financial futures transactions at institutions with up to 500 securities accounts no longer rule out a two-year exemption. Only if the financial futures transactions represent a significant proportion of the investment services provided can an exemption period of just one year be considered, due to the institution's increased information and duty of care obligations towards the client. The changes to discretionary criteria have meant that cooperative banks in particular, but also savings banks, have enjoyed examination exemptions – a relief for the institutions concerned.

BaFin also exempted 202 credit institutions from examinations of their safe custody business (previous year: 13).

Administrative offence proceedings

Two administrative fines imposed.

BaFin instituted ten new administrative offence proceedings against banks and financial services institutions in 2009 (previous year: 5). Four such cases were pending from the previous year. In two cases, administrative fines of up to €6,000 were imposed for breach of the cold calling ban. One case was dropped. Eleven cases were still open at the end of 2009.

3.2 Rules of conduct for analysis of financial instruments

Financial analyses systematically evaluate and present information on companies, sectors or markets and provide recommendations for certain investment decisions. However, these recommendations do not take into account the personal risk situation of a specific investor; they are aimed at a larger non-specific group of persons.

Credit and financial services institutions

At the end of 2009, BaFin was supervising 419 credit and financial services institutions which prepared their own analyses or purchased them from third parties and made them available to their clients or the public (previous year: 463). The focus was on credit institutions; only a few financial services institutions prepared or published analyses.

No serious deficiencies found.

Auditors also check compliance with the provisions for financial analysis as part of their annual audit of the institutions' investment services business. BaFin evaluates the audit reports and, if necessary, requests further information from the auditors or institutions. In cases where violations of supervisory law were found, most institutions remedied these before the end of the audit. No serious deficiencies were found in 2009.

In addition, BaFin examined the preparation and presentation of various financial analyses in individual cases. If weak points were identified in these examinations, such as conflicts of interest not being disclosed in full, BaFin requested the institutions in question to make adjustments. In response, the institutions for example established additional internal control measures.

BaFin also answered several questions relating to the interpretation of section 34b WpHG. These were largely in connection with new business models or restructuring of existing companies. In several cases, tied agents also wanted to prepare and present financial analyses. However, this would require notification in accordance with section 34c WpHG, even if the agent is operating under the liability umbrella of a licensed credit or financial services institution (section 2 (10) KWG).

Independent analysts

A total of 135 independent entities which notified BaFin of their analysis activity in accordance with section 34c WpHG were also subject to supervision (previous year: 123). The size of these companies varied from small investment newsletter publishers to large analyst companies well known in the market. The first six months of 2009 saw more activities terminated than commenced, but this switched around in the second half of the year. Unlike credit and financial services institutions, independent analysts are not subject to annual external audits. In order to monitor compliance with qualification, transparency and organisational requirements, BaFin thus obtains information on an ad hoc basis and requests documentation.

Investment newsletters back in focus.

As in 2008, BaFin continued to observe more purchase recommendations from investment newsletters for commodity shares traded thin and only on the regulated unofficial market. Conflicts of interest arise if the persons making the recommendation either hold the recommended instruments themselves or if the analysis has been paid for by a third party. The person making the recommendation must disclose this in both cases. In many of the cases BaFin investigates, the investment newsletter publisher is based outside of Germany but targets investors in Germany. This often makes investigations time-consuming and complicated. Some of the investment newsletter publishers under investigation abandoned their operations before the investigation was complete. In other cases, investigations gave rise to suspicions of involvement in market manipulation by the investment newsletter publishers. In such instances, BaFin initiated examinations and informed the public prosecutor's office.[29]

[29] See chapter VI.2.4.

Media

The financial crisis saw an increase in economic reporting in the media. The constitutionally guaranteed protection of press freedom led to an exception for journalists who prepare financial analyses themselves or publish analyses prepared by third parties in accordance with section 34b (4) WpHG, provided that such journalists are subject to comparable self-regulation including effective controlling mechanisms. BaFin therefore does not supervise journalists who can prove that effective self-regulation comparable to the WpHG requirements applies to them.

BaFin informed a Croatian delegation of this regulatory framework in March 2009, as relevant European legislation was being implemented there at the time. It also explained the special rule for journalists during visits to various media associations, news agencies and journalists.

Administrative offence proceedings

New administrative offence proceedings initiated in one case.

BaFin initiated new administrative offence proceedings in 2009 due to suspicions of a breach of rules of conduct in the analysis of financial instruments. It dropped the administrative offence proceedings still pending from the previous year.

VI Supervision of securities trading and investment business

1 Basis for supervision

1.1 Prohibition of naked short sales and transparency regime

Karl-Burkhard Caspari, Chief Executive Director of Securities Supervision

After 31 January 2010, BaFin's general decrees dated 19 and 21 September 2008 on the prohibition of naked short sales in eleven financial stocks expired. BaFin had imposed the prohibition at the height of the financial crisis and had extended it on several occasions. A naked short sale is when the seller sells shares that he does not actually own at the time of the transaction or does not have an undisputed right to be transferred ownership of shares in the same class. Investors were, however, at all times able to execute covered short sales.

The decrees were allowed to expire because the situation on the financial markets had improved to such a degree in the months preceding the decision that there was no need to further extend the prohibition. The volatility of shares in credit institutions, stock exchange operators, insurance undertakings and other companies in the financial sector had fallen back down to, or even below, the level seen before the financial crisis came to a head.

The share prices of the companies affected – with the exception of the special case of Hypo Real Estate – had also recovered again in the months before BaFin made its decision. Given the largely stable market situation, naked short sales would not be able to influence the share prices of protected stocks enough to cause any substantial disruption on the market. Nor did they pose any risk to financial stability anymore, because, at the time the prohibition expired, the stabilisation measures taken by the federal government meant that the stocks in question were not facing the sort of liquidity bottlenecks that could be exacerbated by massive short-selling. In addition, the prohibition was no longer required in order to help stabilise the financial markets in the long term.

Transparency obligation introduced.

In order to take account of the ongoing abstract risks, however, transparency provisions had to be put in place for short sales. This prompted BaFin to introduce a transparency obligation for net short-selling positions in ten selected financial stocks in early March 2010.[30] This is a less severe measure than a prohibition in terms of

[30] www.bafin.de » Supervisory legislation » Orders Securities supervision » General Decree on the introduction of a transparency obligation for net short-selling positions of the Federal Financial Supervisory Authority (BaFin) of 4 March 2010.

the degree of intervention, but nevertheless allows a targeted course of action for risks to proper securities trading and financial stability.

The regime provides for a two-tier transparency system: First, net short-selling positions which reach or exceed 0.2% of the shares in issue of one of the companies specified must be notified to BaFin. As soon as the level of a net short-selling position reaches, exceeds or falls below the thresholds by a further 0.1%, a further notification must be submitted. As of 0.5%, the position is also published anonymously on the BaFin website.[31] This gives BaFin far better information, enabling it to take fast, targeted action against short sales early on if these transactions pose a risk to proper securities trading and the stability of the financial system. What is more, issuers and market participants can also obtain better information on trading activities thanks to the publication, making the accumulation of large-scale short-selling positions more difficult and helping to prevent undesirable developments.

The decree came into force at 0 hrs on 25 March 2010 and shall be valid until midnight on 31 January 2011 in the first instance. As far as the net short-selling positions and the thresholds that are subject to reporting requirements are concerned, the decree is based on the proposals published by the Committee of European Securities Regulators (CESR) on 2 March 2010 for a pan-European short selling disclosure regime, which BaFin played a key role in developing.

1.2 Reporting requirement for regulated unofficial market instruments

With the transposition of the MiFID into German law, credit institutions and financial services providers were no longer obliged to report transactions in "pure" regulated unofficial market securities. This means that BaFin no longer had direct access to this data when supervising the regulated unofficial market (Freiverkehr) for signs of insider trading and market manipulation. In order to take account of this substantial loss of data, the legislature has once again incorporated a reporting requirement for regulated unofficial market instruments into the WpHG with Article 6 of the Act on Strengthening the Supervision of the Financial Market and Insurance Sector.[32] This requirement now applies to instruments that are traded on a German regulated unofficial market, but that are not admitted to trading on a regulated market within the EEA ("pure" regulated unofficial market securities).

[31] www.bafin.de » Databases & lists » Overviews.
[32] Federal Law Gazette (BGBl.), I 2009, p. 2305.

1.3 Investment Accounting and Valuation Regulation

With the Investment Accounting and Valuation Regulation *(Investment-Rechnungslegungs-und Bewertungsverordnung* – InvRBV) of 16 December 2009, BaFin provided more detailed information on the financial accounting requirements that apply to asset management companies *(Kapitalanlagegesellschaften)* and investment stock corporations *(Investmentaktiengesellschaften)* for the first time.[33] The InvRBV sets out the content, scope and presentation of reports on investment funds, and also sets out regulations on how assets should be valued.

To date, only a small number of older official BaFin announcements have been available on the valuation and accounting regulations that apply to funds *(Sondervermögen)* and investment stock corporations *(Investmentaktiengesellschaften)*. Not least as a result of the financial crisis, an increasing number of interpretation questions are being asked relating to accounting practices at funds and investment stock corporations, and the valuation of assets.

The InvRBV now provides more legal certainty as far as the valuation of, and periodic reporting on, investment funds are concerned. Furthermore, BaFin’s regulation sets out uniform requirements for the sector, making reports easier to compare and allowing increased transparency for investors.

1.4 Supervisory practice

One of the ways in which BaFin substantiates its administrative practice is by way of circulars or interpretation decisions presented in the form of Q&As. In 2009, BaFin published a large number of these documents on its website to allow companies that are active on the capital market to be able to judge what view BaFin takes on certain matters.

Circular on transmission requirements to the company register

In May 2009, BaFin published a circular summarising which information that is relevant from a capital market perspective listed companies and other issuers of financial instruments have to transmit to the company register to be stored there.[34] These include, inter alia, voting right and ad-hoc disclosures, directors’ dealings, financial reports or prospectuses.

[33] www.bafin.de » Supervisory legislation » Regulations.
[34] Circular 11/2009 (WA).

Circular on the reporting requirement for regulated unofficial market instruments

In response to the reintroduction of a reporting requirement for "pure" regulated unofficial market instruments in November 2009, BaFin published a circular explaining, among other things, the reporting requirements for various market participants.[35] The new reporting requirement, for example, applies not only to German reporting parties, but also to foreign trading participants. The question as to whether they have their registered office within or outside of the EEA is irrelevant in this respect. Foreign reporting parties, however, only have to submit reports on regulated unofficial market instruments if the transactions in these instruments were executed on the market where they are admitted to trading.

Custodian bank circular

In early 2010, BaFin consulted on a circular on the duties and obligations of custodian banks pursuant to sections 20 et seq. of the Investment Act (InvG).[36] Custodian banks play a key role in protecting investor interests. While it is primarily the asset management company that decides how fund assets are to be invested, the custodian bank is responsible for the issue and redemption of fund units, payment and settlement, and holding the fund assets in custody and performing various control functions. In the circular, BaFin now sets out, among other things, detailed information on the content and timing of assessments to be performed by custodian banks on transactions that require their consent. The circular also contains precise information on how custodian banks have to check the settlement instructions issued by the asset management company and provides in-depth models for investment limit monitoring. The technical and organisational implementation of these detailed regulations is likely to be the most important change from the custodian banks' point of view. The circular is scheduled for publication in the summer of 2010.

MaRisk for management companies

BaFin also consulted on a circular defining the Minimum Requirements for the Establishment of a Proper Business Organisation and in particular for the Risk Management of Asset Management Companies and Investment Stock Corporations (InvMaRisk).[37] The fact that asset management companies lost their status as credit institutions as a result of the Act Amending the Investment Act *(Investmentänderungsgesetz* – InvÄndG) of December 2007 meant that the original Minimum Requirements for

[35] Circular 19/2009 (WA).
[36] www.bafin.de » Unternehmen » Konsultationen (only available in German).
[37] www.bafin.de » Unternehmen » Konsultationen (only available in German).

Risk Management *(Mindestanforderungen an das Risikomanagement)* no longer formally applied to asset management companies either. BaFin, however, continued to use the MaRisk for the banking sector *mutatis mutandis* to interpret the organisational duties set out in section 9a InvG.

In order to take account of the specific business model of management companies, BaFin has now developed Minimum Requirements for the Risk Management of Asset management companies and Investment Stock Corporations, based on the regulations set out in the MaRisk for the banking sector. As well as setting out specific requirements for risk management systems, the circular also contains requirements for outsourcing and for internal audit. This circular is also scheduled for publication in the summer of 2010.

Further publications

In addition to the draft versions of the custodian bank circular and the InvMaRisk, BaFin published three other circulars on the InvG: On the authorisation procedure pursuant to sections 7 et seq. InvG, on the criteria for exemption from the auditing requirement pursuant to sections 19f (2) sentence 2 InvG and on the requirements for outsourcing portfolio management to a company that has its registered office in a third country pursuant to section 16 (2) sentence 4 InvG.[38]

BaFin also published Q&As on eligible assets, on borrowing pursuant to section 53 InvG, on foreign UCITS and on the scope of application of the InvG.[39]

[38] Circular 10/2009 (WA), 16/2009 (WA), 18/2009 (WA).

[39] Administrative practice regarding the explanation of certain definitions set out in Directive 2007/16/EC and CESR/07-044 (eligible assets) dated 15 October 2009; Q&As on section 53 InvG – borrowing, dated 1 December 2009; Q&As on notification of distribution pursuant to section 132 InvG and on the distribution of foreign EC investment units dated 24 August 2009; Q&As on the scope of application of the InvG pursuant to section 1 sentence 1 no. 3 InvG and on Circular 14/2008 (WA).

2 Monitoring of market transparency and integrity

2.1 Trading platforms

Multilateral trading facilities

Three MTF subject to supervision.

In the year under review, three multilateral trading systems were subject to supervision by BaFin. The significance of alternative trading facilities, however, is constantly on the rise. Multilateral trading facilities (MTF) are gaining more and more market share for securities transactions, which means increasingly tough competition, particularly vis-à-vis organised markets as well. BaFin monitors developments on the markets very closely. In particular, it was responsible for assigning new or modified trading facilities to categories and assessing whether or not the systems described could be classified as MTFs. If this is the case, the systems are subject to a licensing requirement pursuant to the KWG (institutional supervision) and the WpHG (supervision of system operations). These investigations are always particularly extensive, because below the surface, there are often significant differences between individual trading facilities that could be decisive for their categorisation.

Foreign trading screens

BaFin grants a licence to the Chicago Mercantile Exchange.

In 2009, stock exchanges from third countries once again showed a keen interest in remote memberships. By way of example, BaFin authorised the Chicago Mercantile Exchange Inc. (CME), USA, to set up trading screens in Germany. This means that a total of four operators from foreign markets are now authorised to give German trading participants direct electronic access to their markets.

Foreign stock exchanges from non-EU states require a licence if they want to grant domestic trading participants (remote members) direct market access via trading screens. This is because foreign stock exchanges are only permitted to set up trading screens in Germany if they are subject to the same sort of monitoring that applies under German law and if their supervisory authorities cooperate with BaFin. The exchange of information between supervisory authorities is important if cases of cross-border insider trading and market manipulation are to be pursued. Furthermore, it allows BaFin to check whether or not investment services enterprises *(Wertpapierdienstleistungsunternehmen)* that operate for clients on foreign markets using trading screens are complying with their rules of conduct.

2.2 Market analysis

In 2009, BaFin analysed 441 cases of suspected market abuse (2008: 440). In 77 analyses, it was recommended that the matter be investigated further (2008: 66) – in 28 cases due to insider trading (2008: 37) and in 49 cases (2008: 29) due to market manipulation.

Further increase in the number of suspicious transaction reports.

In most cases, analyses are attributable to suspicious transaction reports from banks, notices from stock exchange trading surveillance units, enquiries submitted by the criminal prosecution authorities and letters from companies and investors (750; 2008: 1,300). There was a marked increase in the number of suspicious transaction reports from banks and financial services providers (194; 2008: 114). Most suspicious transaction reports from banks related to equities (164; 2008: 67), while a smaller number related to warrant transactions (8; 2008: 30). Foreign supervisory authorities reported 27 suspicious transactions to BaFin (2008: 17).

Increase in volume of reports.

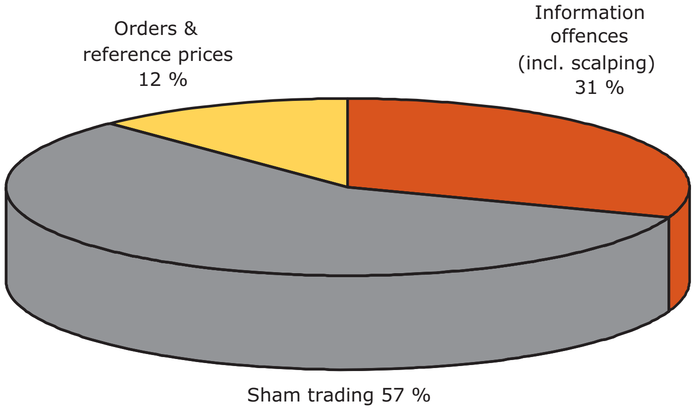
Reports on all securities transactions play a key role in allowing BaFin to pinpoint cases of insider trading and market manipulation. In 2009, banks and financial services providers reported a total of 992 million transactions (2008: 859 million), i.e. 3.9 million reports per trading day (2008: 3.4 million). The increase in the volume of reports is most likely attributable primarily to the fact that since November 2009, regulated unofficial market transactions have also been subject to a reporting requirement again, as well as to the fact that trading activity has increased slightly again on the whole.

Focal point of report analysis: market manipulation.

There has been a marked shift in the focus of BaFin's report analysis activities towards market manipulation. Sham actions, such as matched trades, were the focal point of these activities in 2009 (28; 2008: 16). The shift from insider trading to more market manipulation analyses is likely to be due to the fact that the current market environment makes it more difficult for potential insiders to exploit their insider information to their advantage.

Figure 18

Positive manipulation analyses by issue

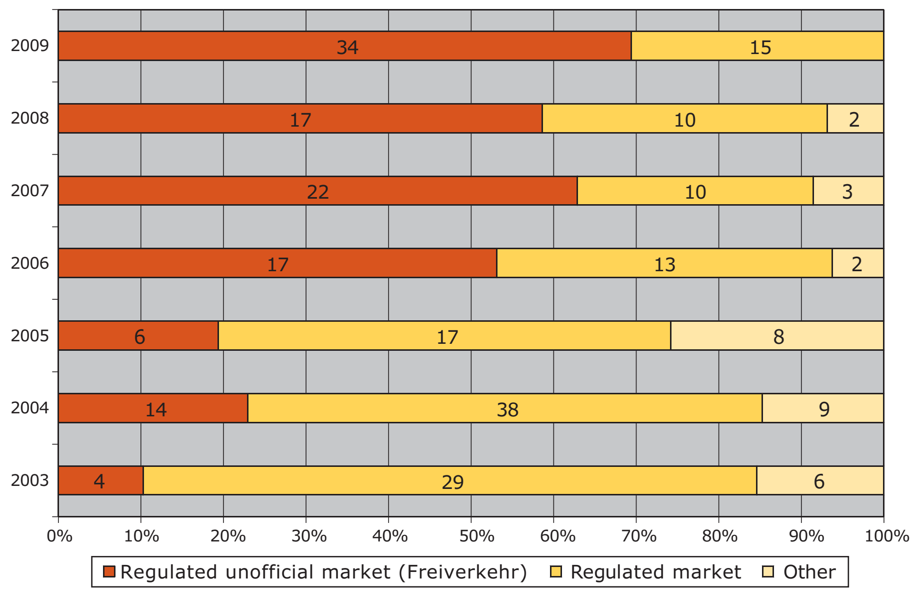


Regulated unofficial market manipulation still on the rise.

34 manipulation analyses (69%) related to regulated unofficial market instruments, particularly to illiquid foreign financial instruments (2008: 59%). One common problem is the double function performed by lead brokers *(Skontroführer):* On the one hand, these securities trading banks *(Wertpapierhandelsbanken)* apply for equities to be admitted to trading on the regulated unofficial market, while on the other, they usually also set the prices of the financial instruments they are responsible for. BaFin conducted special audits at these lead brokers and in some cases, it identified considerable organisational defects. By way of example, it was often the case that the internal company regulations on conflicts of interest, employee transactions and the safekeeping of assets did not meet the statutory requirements. BaFin is currently looking into which regulatory measures are to be taken based on the results of the special audits.[40]

Figure 19

Positive manipulation analyses by segment



BaFin issues warning on securities orders placed without authorisation.

BaFin also picked up on cases of attempted market manipulation involving regulated unofficial market instruments as a result of securities orders placed without authorisation in the year under review. These mainly related to illiquid foreign equities, primarily from the US and Switzerland, which are traded on the regulated unofficial market. Presumably with the aim of influencing prices, individuals pretended to be clients on the phone and instructed the bank to buy selected financial instruments via the corresponding client securities account. In April 2009, BaFin issued a warning, advising clients not to give account, securities account or personal data out to callers claiming to be investment advisors, brokers or

[40] See chapter V.3.1.

BaFin employees.[41] It also informed the banking associations involved and asked them to make banks aware of the problem and to urge them to be more careful when identifying callers. Because the banks stepped up the checks they perform to identify callers, many of the telephone orders issued by unauthorised individuals were not executed in the first place.

Deutsche Börse AG imposes more stringent requirements for open market trading.

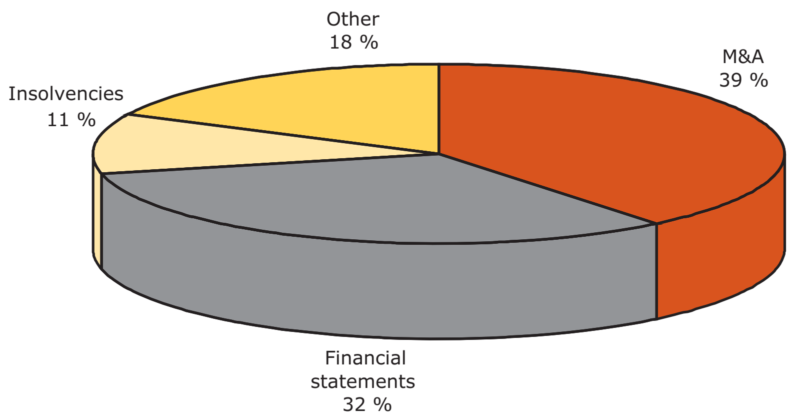
In 2009, Deutsche Börse AG stepped up the criteria for admission to the open market. In addition to the reintroduction of the reporting requirement, this was another measure taken to help combat market abuse in this segment. Now, financial instruments can only be admitted to the open market if they are already being traded on a stock exchange that is recognised by Deutsche Börse AG. Deutsche Börse AG has published a list of recognised trading venues on its website. In the case of equities and depository receipts that are not yet admitted to trading, the applicant must prove that the issuer has share capital of at least €250,000 that has been fully paid-up in cash. This must be confirmed by an authorised lawyer or auditor and an approved prospectus must be submitted. Alternatively, the applicant has to submit a form containing more detailed information on the security and the issuer.

Proportion of takeovers subject to insider analyses on the decline.

Fewer mergers and acquisitions were the subject of insider analyses. Whereas in 2008, every second insider analysis related to takeover activity, this figure dropped to only around 40% in 2009 (11). This is likely attributable to the fact that the M&A market is weaker on the whole. By contrast, more analyses focused on periodic results (9), which triggered 32% of all insider analyses (2008: 22%). Almost all insider analyses (89%) dealt with financial instruments that are traded on the regulated market. The role of the regulated unofficial market, on the other hand, was virtually insignificant in this respect.

Figure 20

Positive insider analyses by issue



[41] www.bafin.de » Veröffentlichungssuche » Verbrauchermitteilungen (Wertpapieraufsicht; only available in German).

2.3 Insider trading

BaFin filed complaints against 78 individuals for insider trading.

In the year under review, BaFin opened 30 new cases (2008: 44), and filed complaints against 78 individuals for suspected insider trading (2008: 67). It referred a total of 28 cases to the public prosecutor's office (2008: 27). In 37 cases, BaFin found no evidence of insider trading (2008: 54).

At the end of the year, 27 cases, some of which dated back to previous years, were still pending (2008: 62).

Table 21
Insider trading investigations

Period	New investigations	Investigation results			Pending investigations
		Dropped	Referred to public prosecutor's office		
	Insiders	Insiders	Cases	Individuals	Total
2007	42	29	20	64	99
2008	44	54	27	67	62
2009	30	37	28	78	27

Courts sentence eleven individuals.

Eleven people were convicted of insider trading in 2009 (2008: 6), seven of whom were convicted after summary proceedings *(Strafbefehlsverfahren;* 2008: 3). 53 cases were dropped by the prosecutors (2008: 96), 14 of which after an out-of-court settlement *(Geldauflage;* 2008: 12).

Table 22
Prosecutors' reports on closed insider proceedings

Period	Total	Dropped	Dropped after out-of-court settlement	Res judicata court decisions			
				Decisions made by the court	Convictions after summary proceedings	Convictions following full trial	Acquittals
2007	82	65	14	0	3	0	0
2008	102	84	12	0	3	3	0
2009	53	28	14	1	7	3	0

Cooperation with foreign countries.

BaFin cooperates with foreign supervisory authorities to pursue cases of insider trading. In the year under review, it received 17 enquiries from abroad (2008: 33), most of which came from the Netherlands and France. Vice versa, BaFin contacted foreign authorities, particular those in Switzerland and the UK, 40 times (2008: 63).

Details on some of the completed cases are set out below.

Deutsche Telekom AG

Most severe case of insider trading to date.

In the period from November 2004 to August 2006, an investor relations manager at Deutsche Telekom AG passed insider information on to his friend, an entrepreneur, on five occasions. The information in question included forecast revisions, a planned dividend distribution, the Telekom/T-Online conversion ratio range and the acquisition of a stake by Blackstone.

Before this information was published, the entrepreneur purchased call and put options on Deutsche Telekom and T-Online International using both his own accounts, and accounts of close relatives held in Germany, Luxembourg and Switzerland. By investing a total of around €3.6 million, he had generated total proceeds of approx. €6 million within only a few days, with price gains of more than €2.4 million. The Telekom employee received a cut of around €70,000 in cash via a bank safe in Luxembourg.

In March 2009, in what was the most severe case of insider trading to be brought to court to date, the Regional Court *(Landgericht* – LG) of Bonn sentenced the Telekom employee to a suspended prison sentence of 15 months and 50 hours of community service for the unauthorised dissemination of insider information. The court sentenced the entrepreneur to three years in prison for insider trading on 34 counts. The Regional Court also ordered that profit totalling €48,000 and around €760,000 respectively be forfeited. The judgment against the entrepreneur is not yet *res judicata*.

Freenet.de AG

On 9 August 2004, freenet.de AG released its quarterly and half-yearly figures by way of an ad hoc disclosure, announcing a considerable drop in sales and earnings. Shares in freenet.de lost around 25% after the disclosure was published.

In July 2004, two members of the company's executive bodies had already sold a total of 124,300 shares in freenet.de using converted stock options for a total sale price of around €2.36 million.

In January 2009, the Regional Court of Hamburg imposed a fine on the two accused individuals, payable in 300 daily instalments of €1,000 and €500 respectively. The court also ordered that the accused forfeit the proceeds from the sale, after taxes, totalling €705,352 and €699,838 respectively.

After the accused filed an appeal, the Federal Court of Justice (Bundesgerichtshof - BGH) confirmed the verdict of guilty, but repealed the Regional Court's judgment with regard to the penalty[42], on the grounds that the Regional Court of Hamburg had calculated the advantage that the accused had gained as a result of the insider trading, based on the difference between the initial

[42] Decision of 27 January 2010, case ref.: 5 StR 224/09.

trading price that day and the low on the same day, multiplied by the number of shares. The BGH is of the opinion, however, that the advantage should be based on the price that would have resulted had the market been aware of the insider information that was concealed. It stated that this required a calculation based on an estimate that looks not only at the specific trading day, but involves a long-term assessment of share price performance. Another criminal division of the Regional Court of Hamburg that is responsible for handling commercial cases will now have to make a new decision on the penalty.

Walter AG

On 20 April 2005, Walter AG announced that the squeeze-out price for the transfer of shares held by minority shareholders to Sandvik Holding GmbH had been set at €75.50.

Between 18 and 20 April 2005, an external project employee had bought 1,050 shares in Walter worth €57,750 via a Swiss account. His buy transactions were the only ones to be executed in Germany, on the Frankfurt Stock Exchange on 18 and 19 April 2005, and allowed him to generate share price gains of €21,525.

In October 2009, the Düsseldorf public prosecutor's office suspended the investigation proceedings *(Ermittlungsverfahren)* pursuant to section 153a (1) of the Code of Criminal Procedure *(Strafprozessordnung* – StPO) after an out-of-court settlement of €40,000.

Thielert AG

On 5 October 2006, the German Association for the Protection of Shareholders *(Schutzgemeinschaft der Kapitalanleger e.V.* – SdK) announced that it had received a criminal complaint against responsible individuals at Thielert AG due to document forgery, accounting fraud and prospectus and investment fraud.

A manager at Thielert AG had already been aware of the criminal complaint a few days previously. On 29 September 2006, he issued a stop loss order for all of the Thielert shares in his securities account. When he then sold the 16,214 shares in Thielert on 5 October 2006, he generated proceeds of around €308,066 and managed to evade a loss worth around €29,509.

The Local Court *(Amtsgericht* – AG) of Hamburg-Blankenese dropped the proceedings against the accused, who pleaded guilty, in August 2009 pursuant to section 153 a (2) StPO after an out-of-court settlement of €35,000.

Linos AG

On 14 July 2006, Optco Akquisitions GmbH published an announcement stating that it would be offering shareholders in Linos AG a takeover price of €16 per share. This represented a premium of around 20% on the last share price prior to the announcement.

The regional head of a Linos subsidiary had known of the planned takeover since mid-May 2006 by virtue of his position. He passed the inside information on to his mother, and transferred €5,000 into her account. On 4 July 2006, his mother then purchased 948 shares in Linos at a price of €10.44, and sold them after the announcement was made on 14 July 2006 at a price of €15.70. By investing €9,897, she therefore generated a profit of €4,986.

In December 2008, the Local Court of Landshut issued a penal order *(Strafbefehl)* imposing a fine on the regional manager, payable in 90 daily instalments of €100. His mother was also fined, with the amount payable in 60 daily instalments of €30. The court also ordered that the proceeds from the sale totalling €4,986 be forfeited. The penal orders have had res judicata effect since January 2009.

D+S europe AG

On 15 April 2008, Pyramus S.a.r.l. announced that it wanted to make shareholders in D+S europe AG a cash offer of €13 per share. It stated that the bidder had already secured 27% of the voting rights in the company. The price of shares in D+S europe then rose by 30% from €10.03 to €13.

The managing director of a D+S europe AG subsidiary had purchased a total of 3,000 shares in D+S europe for €29,597 on 10 and 11 April 2008. He sold these shares on 16 April 2008 for €38,700, generating a profit of €9,103. After the accused admitted to the offence, the Lübeck public prosecutor's office dropped the case after an out-of-court settlement of €26,000 in July 2009.

2.4 Market manipulation

Number of market manipulation investigations doubled.

In 2009, BaFin investigated twice as many cases of suspected market manipulation as in the previous year (77), launching 150 new investigations. In 54 other cases, public prosecutor's offices or police authorities asked for BaFin's help in ongoing investigation proceedings (2008: 37).

113 of the new formal investigations launched were based on notifications from the stock exchange trading surveillance units of German stock exchanges. In terms of content, they related to trading-supported manipulation, e.g. reference market

manipulation, wash sales or matched trades. Another focal point were investigations initiated by public prosecutor's offices or police authorities.

BaFin asked foreign supervisory authorities for support in 60 cases of market manipulation (2008: 43), most of which related to clients who had executed suspicious transactions on a German stock exchange via a foreign institution. Foreign authorities made enquiries with BaFin in twelve cases (2008: 14).

BaFin files complaints against 120 individuals.

In 60 of the cases investigated, BaFin found evidence pointing towards market manipulation (2008: 32), and filed complaints against 120 suspects with the competent public prosecutor's offices as a result (2008: 64). In four other cases, the evidence pointed towards an administrative offence; such cases are passed on to BaFin's administrative fines section for further processing. There was no evidence of any violation in 115 cases, in which BaFin then closed its investigations (2008: 42). 71 cases were still pending at the end of the year (2008: 100).

Table 23
Market manipulation investigations

Period	New investigations	Investigation results						Pending investi-gations
		Dropped	Referred to public prosecutor's office or BaFin administrative fines section					
			Public prosecutor's office		Admin. fines section		Total (cases)	Total
			Cases	Individuals	Cases	Individuals		
2007	61	41	22	49	4	8	26	97
2008	77	42	32	64	0	0	32	100
2009	150	115	60	120	4	6	64	71

Focus once again on scalping.

Scalping was once again a focal point of market manipulation activity in 2009, particularly on the regulated unofficial market. BaFin investigated numerous cases and reported them to the public prosecutor's office. Scalping refers to a process in which an offender owns shares that he advertises in a positive light or recommends to potential investors without indicating his conflict of interest in an appropriate and effective manner. In the cases investigated by BaFin, the offenders first of all purchased shares in a new or renamed company at a low price and then arranged for them to be admitted to trading on the regulated unofficial market. They then used large-scale advertising campaigns to market the shares using investment newsletters, spam e-mails or, more recently, also by telephone. This triggered substantial increases in the share price and trading volume of the company in question, which the offenders exploited to sell the shares they had purchased at a low price with a profit. If the shares were no longer marketed, the share price plummeted in most cases. A number of investigation proceedings have already resulted in charges being brought, while some have not yet been concluded.

Suspected market manipulation involving corporate bonds.

Another focal point in the year under review was investigating price fluctuations affecting corporate bonds at the end of 2008. Marked price fluctuations had prompted the trading surveillance unit of the Frankfurt Stock Exchange to file complaints on the grounds of suspected market manipulation in April 2009. The complaints related to 374 corporate bonds. The closing share price at the end of the year is very significant for the securities market, because the prices reached on this cut-off date are often used to value investments or for accounting purposes. BaFin investigated all of the cases in detail, but was unable to identify any prohibited market manipulation. The initially suspicious price movements were often caused by fluctuations on the reference markets. According to the exchange rules that apply to them, lead brokers must take these fluctuations on the reference markets into consideration when they set their prices. One example of a reference market that was used in a large number of cases was the US system known as TRACE (Trade Reporting and Compliance Engine). The price jumps were also attributable to orders placed by private investors who wanted to purchase bonds or realise losses before the launch of the flat-rate withholding tax *(Abgeltungsteuer).*

In more than 200 cases, however, BaFin uncovered evidence suggesting that lead brokers had used the price addenda "Geld (G)" (bid) and "Brief (B)" (ask) in an unauthorised manner, and involved the responsible Exchange Supervisory Authority. This authority is responsible for determining whether or not this sort of price determination violates the exchange rules. The Frankfurt Stock Exchange has since amended its rules. Now, prices that vary considerably can only be set after consultation with the trading surveillance unit. A number of price addenda have also been deleted.

14 convictions for market manipulation.

In 2009, German courts convicted 14 individuals of market manipulation (2008: 5). Nine convictions were made following a full public trial (2008: 3) and five after summary proceedings *(Strafbefehlsverfahren;* 2008: 2). 27 cases were dropped by the prosecutors (2008: 17), nine of which were settled after an out-of-court settlement (2008: 5).

BaFin launched six new administrative offence proceedings on the grounds of attempted market manipulation, with seven cases still pending from the previous year (2008: 8). It levied administrative fines of up to €3,500 in three cases. BaFin dropped two cases (2008: 1), meaning that eight cases were still pending at the end of the year (2008: 7).

Table 24

Prosecutor's and court reports, and reports by BaFin's administrative fines section concerning closed market manipulation proceedings

Period	Total	Decisions made by public prosecutor		Res judicata court decisions in criminal proceedings				Decisions in administrative offence proceedings	
		Dropped	Dropped after an out-of-court settlement	Dropped after an out-of-court settlement	Convictions after summary proceedings	Convictions following full trial	Acquittals	Dropped	Final administrative fines
2007	18	11	0	0	2	2	0	3	0
2008	23	12	5	0	2	3	0	1	0
2009	46	18	9	0	5	9	0	2	3

Details on some of the cases that have been concluded are set out below.

RussOil Inc. et al.

In July 2009, the Berlin public prosecutor's office filed complaints against an author, television presenter and the publisher of various stock market information services on the grounds of suspected market manipulation. The individual is said to have recommended equities on a total of 49 occasions from September 2005 to June 2007 without disclosing his own financial interest in the stock. After the accused invested in the companies, he recommended the corresponding shares for purchase in investment newsletters and e-mail hotlines. The recommendations pushed up both the share prices and the trading volume of the stock in question. The accused then sold the shares he had previously purchased from his securities account with a profit.

The Local Court of Berlin has already issued orders to attach assets worth a total of €85 million.

Gontard & Metallbank AG

Highest penalty in history imposed.

Several offenders had driven up the share prices of various insolvent companies, including Gontard & Metallbank AG, by disseminating incorrect press releases in a targeted manner. These press releases related to issues such as alleged restructuring plans or takeover offers. Before publishing the press releases, they had purchased millions of the largely worthless securities, allowing them to benefit from the rise in the share prices.

The Regional Court of Hamburg sentenced one of the self-proclaimed investors to five and half years in prison in February 2009. Three years and nine months of the sentence were for market manipulation, while one year and nine months were imposed for an accounting crime. The court sentenced several other accused individuals to suspended sentences of up to two years.

These are the highest penalties to be imposed in a market manipulation case to date. Where the accused filed an appeal against the judgment, the BGH confirmed the verdict of guilty, but reduced the profit to be forfeited to around €753,000.[43]

Nomia Equity AG

In order to manipulate the stock exchange price of an illiquid share, the sole member of the management board of a holding company issued buy and sell orders with high limits using both his private securities account and a company securities account. These orders were executed against each other on the stock exchange, pushing the share price up. With the price at this inflated level, he then sold a large package of shares on the OTC market to his accomplice, a fund manager, for the fund managed by the latter. The member of the management board of the holding company generated proceeds of around €1.5 million at this fund's expense.

In February 2009, the Regional Court of Würzburg sentenced the fund manager to two years in prison for embezzlement *(Untreue)* and a fine payable in 360 daily instalments of €80. The member of the management board of the holding company was sentenced to a year and nine months in prison for market manipulation and being an accessory to embezzlement, as well as to a fine payable in 270 daily instalments of €150. The court suspended both sentences.

2.5 Ad hoc disclosure and directors' dealings

Ad hoc disclosure

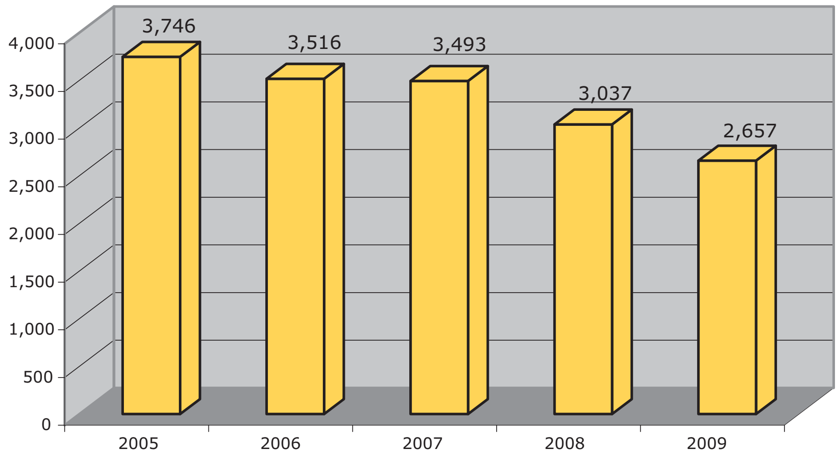
2,657 ad hoc disclosures.

Listed companies published 2,657 ad hoc disclosures in the year under review, bringing the number of mandatory disclosures down further in 2009 (2008: 3,037). This is likely to be attributable to the fact that there were fewer corporate transactions that were subject to reporting requirements. The number of listed companies also fell. Numerous issuers were delisted as a result of a squeeze out, and there were only very few new IPOs.

[43] Decision of 27 January 2010, case ref.: 5 StR 254/09.

Figure 21

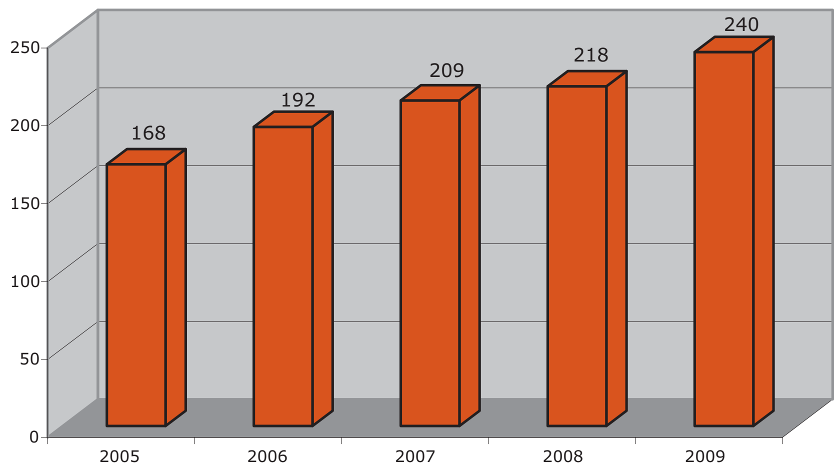
Ad hoc disclosures (2005 – 2009)



Listed companies exempted themselves from the ad hoc disclosure obligation 240 times in 2009 (2008: 218), meaning that the trend towards more exemptions witnessed in recent years continued. Companies can obtain an exemption from the ad hoc obligation as long as this is necessary to protect their legitimate interests, provided that there is no reason to expect that the public will be misled and if the company is able to guarantee that the inside information will remain confidential.

Figure 22

Exemptions (2005 to 2009)



New Issuer Guidelines set out details on the ad hoc disclosure requirement.

BaFin revised its Issuer Guidelines to describe and provide details on when and how companies have to publish ad hoc disclosures. In these Guidelines, BaFin addresses particularly relevant aspects of the disclosure requirement that were not set out in the first issue, published in 2005. By way of example, they explain when interim business figures have to be published in an ad hoc disclosure: If the issuer has not previously published a forecast, it has to publish an ad hoc disclosure on interim figures if these deviate considerably from the prior-year figures or from market expectations, or signal a break with the business trend to date. If, on the other hand, the issuer has published a forecast and if the interim results are in line with these expectations, no ad hoc disclosure has to be published.

If an annual forecast has been published and the interim figures deviate from the market expectations, they may be subject to the ad hoc disclosure requirement even if the original annual forecast still applies. If full year or interim results are subject to a publication requirement, the ad hoc disclosure must be made without delay – i.e. irrespective of any pre-defined publication dates, press or analyst conferences or stock exchange trading hours.

Eight administrative fines imposed.

BaFin opened 22 new proceedings on the grounds of suspected violations of the ad hoc disclosure requirement (2008: 20), with 42 cases still pending from previous years (2008: 52). BaFin imposed eight administrative fines of up to €200,000 for violations of reporting requirements (2008: 5). It dropped 14 cases (2008: 22) and 42 cases were still pending at the end of 2009.

OLG decision on the disclosure obligation when a member of the management board leaves the company

In administrative offence proceedings in 2009, the Frankfurt am Main Higher Regional Court *(Oberlandesgericht* – OLG) commented on when inside information is deemed to have arisen if a member of the management board leaves a listed company before his/her contract expires. The court took the view that insider information has arisen, meaning that the company is subject to a disclosure obligation, as soon as the Board member's intention has become a matter of fact, this intention has been communicated to another key decision-maker at the company and has the potential to influence prices. It stated that the company's interests are taken into account in the sense that in such cases, the company has the option of temporarily exempting itself from the disclosure obligation.

In 2007, BaFin had imposed an administrative fine of €200,000 in this case. The company filed an objection against the fine assessment order and the Local Court of Frankfurt am Main acquitted the company in 2008. The public prosecutor's office then filed an appeal against this decision with the Higher Regional Court, which repealed the decision and remanded it to the Local Court.[44] The company, however, withdrew its objection before the Local Court made a new decision. This means that BaFin's administrative fine decision is now *res judicata.*

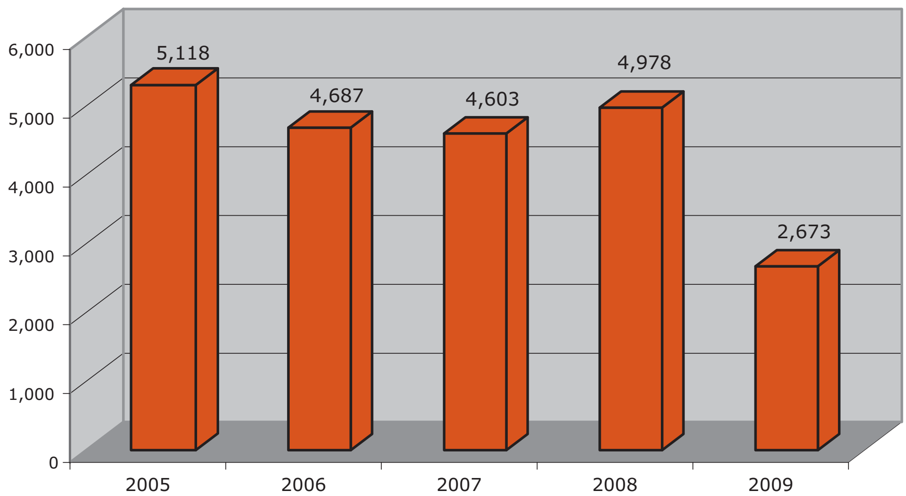
[44] Case ref.: 2 Ss OWi 514/08, www.lareda.hessenrecht.hessen.de.

Directors' dealings

Directors' dealings disclosures on the decline due to flat-rate withholding tax.

Members of the Executive and Supervisory Boards of listed companies, as well as their relatives, reported 2,673 securities transactions executed for their own account (2008: 4,978), more than half the number reported in the previous year. This is likely to be due not only to the general market environment, but also to the flat-rate withholding tax (Abgeltungsteuer) that was introduced as at 1 January 2009. The introduction of this tax prompted many company insiders to execute transactions they had been planning anyway before the close of 2008.

Figure 23
Directors' dealings disclosures (2005 to 2009)



Four administrative offence proceedings launched.

BaFin launched four administrative offence proceedings for possible breaches of notification and disclosure requirements for directors' dealings (2008: 7), with nine other cases still pending from the previous year (2008: 9). BaFin imposed an administrative fine of €2,000 in one particular case (2008: 2). In one other case, the Local Court of Frankfurt am Main acquitted the company in question of the allegation after an objection was filed. Eleven cases were still pending at the end of 2009 (2008: 9).

2.6 Voting rights and informational obligations vis-à-vis security holders

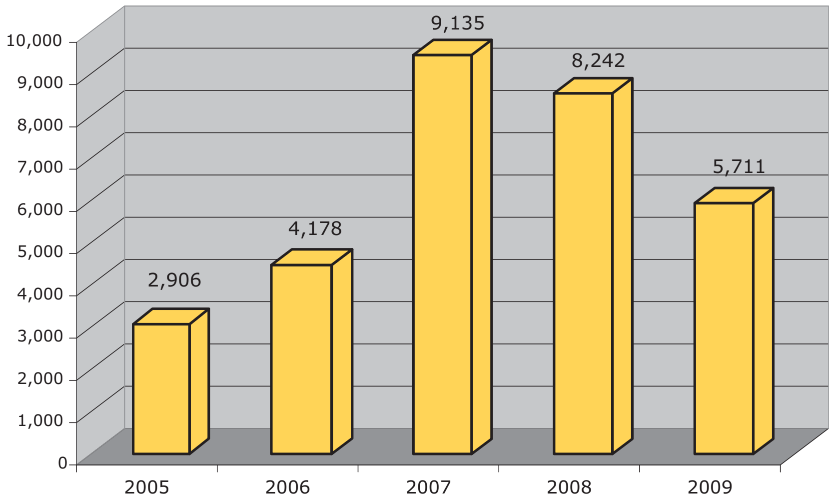
Voting rights

Fewer changes in voting rights subject to reporting requirements.

In 2009, there were fewer changes to the shareholder structure of listed companies that were subject to reporting requirements. BaFin received 5,711 reports on voting rights (2008: 8,242) and 98 reports on financial instruments (2008: 31). Issuers reported 373 changes in their voting capital (2008: 494).

Figure 24

Reports on voting rights (2005 to 2009)



Here, too, the sharp decline is most likely explained by the crisis on the financial markets and the fact that fewer companies were admitted to trading on a regulated market in 2009 (947, 2008: 1,026). Two REITs were listed on German stock exchanges.

Changes as a result of the Risk Reduction Act.

The Risk Reduction Act *(Risikobegrenzungsgesetz)* has resulted in major changes to transparency requirements. Since March 2009, voting rights pursuant to sections 21, 22 WpHG and voting rights that can be acquired via financial instruments have had to be added together. This means that, without being subject to a reporting obligation, individuals can hold up to 2.99% of the voting rights directly and 2% of the voting rights via financial instruments at the same time. Under the old legislation, the thresholds stood at up to 2.99% of the voting rights directly and 4.99% of the voting rights via financial instruments.

In May 2009, an additional obligation was also introduced for individuals subject to reporting requirements who reach or exceed the 10% threshold or higher threshold values. In such cases, the individual subject to the reporting requirement must disclose to the issuer, within 20 trading days, what the purpose of the acquired interest is and where the funds used to acquire the interest originate from. A disclosure also has to be made if the objectives pursued with the interest change. This does not include cases where thresholds are exceeded due to offers under takeover law, or by domestic management and investment companies and foreign management and investment companies under Directive 85/611/EEC. Issuers then have to publish the disclosures as they would with a report on voting rights.

The new reporting requirements were one of the issues discussed at BaFin's annual information event for issuers.

21 administrative fines for violations of reporting requirements.

In 2009, BaFin launched 342 proceedings due to disclosures or publications that were not made at all, were not made by the applicable deadline, were not made correctly or were not made in full (2008: 228). Another 251 cases were still pending from previous years (2008: 38). BaFin imposed administrative fines of up to €30,000 in 21 cases (2008: 4). It dropped 103 cases (2008: 11) and 469 cases were still pending at the end of 2009 (2008: 251).

Attribution of voting rights held by minors

In October 2009, the Administrative Court *(Verwaltungsgericht –* VG) of Frankfurt am Main ruled that voting rights held by children below the age of 18 are to be attributed to both parents pursuant to section 22 (1) sentence 1 no. 6 WpHG.[45] The plaintiff and his three children, all of whom were minors, each held 1% of the shares in a company. In 2007, the plaintiff first of all acquired an additional 1%, after which one of his children reached the age of 18. In BaFin's view, this meant that he first of all exceeded the 5% threshold, and then fell below the threshold value again. BaFin asked the plaintiff to publish a corresponding report on voting rights, which he was not prepared to do. He claimed that his children's voting rights could not be attributed to him, because he had agreed with his wife, who also had custody rights, that she would be solely responsible for the children's shares.

The court did not deem this internal agreement between the plaintiff and his wife to be decisive to the question of attribution, stating that the plaintiff could not be discharged of his statutory duty of care for his children's property in this manner.

The plaintiff's application to be granted leave to appeal against this decision was rejected by the Administrative High Court of the state of Hesse, and a legal evaluation confirmed the decision made by the Administrative Court of Frankfurt am Main in full.[46] The decision is therefore *res judicata.*

Informational obligations vis-à-vis security holders

In order to ensure that investors can exercise the rights to which they are entitled on the basis of securities held by them, issuers of securities that are admitted to trading on the stock exchange must observe numerous informational obligations. If, for example, they intend to change their legal basis, they must inform BaFin accordingly. This can include planned changes to articles of association or legal bases that affect the rights of the security holders and are subject to a decision by the general meeting. In 2009, companies reported 458 planned changes of this nature (2008: 342).

3,083 reports were made by issuers on changes to the rights attached to the securities admitted to trading, new bond issues and

[45] Case ref.: 1 K 390/09.F (3).
[46] Case ref.: 6 A 2932/09.Z.

the publication of significant information in third countries. (2008: 30,197). The marked decline in the number of these publications in 2009 is due to the fact that they only have to be made for bonds that are admitted to trading on an organised market. This restriction has applied since the summer of 2008 and was designed to bring the legislation into line with the regulations that apply in other EU/EEA member states.

BaFin launched 21 administrative offence proceedings because issuers failed to make disclosures or publications pursuant to sections 30a et seq. WpHG by the applicable deadline, failed to make them correctly or in full, or failed to make them at all.

3 Prospectuses

3.1 Prospectuses for securities

Slight decline in the number of approval processes.

In 2009, BaFin examined 2,480 prospectuses, registration documents and supplements to check that they were complete, comprehensible and contained no contradictory information, i.e. were coherent (2008: 2,688). It refused to grant approval in three of these cases (2008: 7). The financial crisis meant that there were fewer issues, a trend that had already started to emerge in the second half of 2008.

Table 25
Approvals in 2008 and 2009

	2008	2009
Equities/IPO/capital increnses	97	88
Derivative products	251	148
Bonds	215	197
Registration forms	40	28
Supplements section 16	2,078	2,016
Total	**2,681**	**2,477**

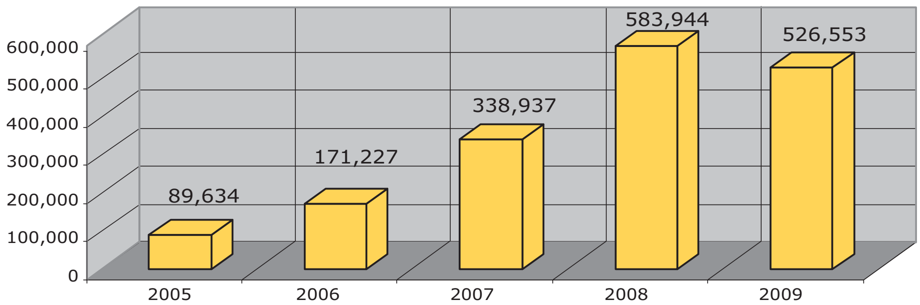
The number of supplements remained relatively constant at 2,016, meaning that there was no considerable increase like that witnessed in previous years. At 88, the number of prospectuses for IPOs, admission to the regulated market and capital increases was down slightly year-on-year due to the market environment. This decline was not, however, as pronounced as in previous years. Issuers also submitted fewer prospectuses for derivative products and bonds (345). In 28 cases, they made use of the option of incorporating the information on the issuer contained in the base prospectus in a separate document – the registration document.

Lower total issue volume.

After the total issue volume doubled in both 2007 and 2008, it fell slightly in 2009 (526,553). The issue volume comprises full prospectuses, final terms and supplements based on the old legislation.

Figure 25

Total issue volume (2005 to 2009)



For each new issue under a base prospectus, final terms are filed with BaFin. The crisis prompted a decline in this respect, too.

Increasing trend towards "EU passport".

In 2009, the "EU Passport" once again proved to be popular with issuers. BaFin issued notifications for 2,721 prospectuses and supplements for other European countries (2008: 2,473). More than 50% of the certificates of approval were once again destined for Austria (1,334). Many issuers from EU member states, however, once again had their prospectus notified for the German market (1,358; 2008: 1,217). Almost half of these notifications came from Luxembourg (706).

Table 26

Outgoing and incoming notifications in 2009

	Outgoing notifications	Incoming notifications
Austria	1,334	36
Belgium	59	6
Denmark	26	–
Finland	25	–
France	83	29
Ireland	–	90
Italy	118	–
Liechtenstein	63	–
Luxembourg	742	706
Netherlands	66	172
Norway	23	–
Poland	14	–
Sweden	51	6
United Kingdom	39	306
Other	78	7
Total	**2,721**	**1,358**

Fifth workshop on prospectus law issues.

BaFin organised its fifth workshop for market participants, which was attended by 130 issuers and lawyers. The main topic addressed was the Prospectus Directive, although the workshop agenda also included practical issues such as the legislation governing supplements or cases involving a complex financial history.

Targeted research on the Internet and in printed media.

As in previous years, BaFin scoured the Internet and printed media for offers that did not meet the statutory requirements. It focused first and foremost on how the offers were advertised. BaFin also checked whether securities were being offered without a prospectus. It identified 34 violations in the course of its research. In the majority of cases, the advertisements and offers failed to include the necessary reference to the base prospectus and the final terms. BaFin pointed this out to the issuers and made sure that they resolved the deficiencies.

Information on exchange offers

In 2009, BaFin found out that a group of individuals was still using the electronic Federal Gazette *(Bundesanzeiger)* to post a large number of offers for the conversion of shares in companies controlled by them. Most of these shares are not traded on the stock exchange. The offers were aimed at holders of shares, certificates and fund units of larger institutions who had been unsettled by the financial crisis. In late 2008, BaFin had already published a note to consumers advising all investors to carefully check both the party making the offer and the economic substance of the investment before accepting it.[47]

In principle, every company is free to make exchange offers to the holders of securities in another company. What is more, the credit institutions responsible for managing the securities accounts have a contractual obligation to pass such offers on to their clients.

Where the provisions of the Securities Acquisition and Takeover Act *(Wertpapiererwerbs- und Ubernahmegesetz* – WpÜG) apply to these offers, an offer document must be prepared and its publication must be approved by BaFin. In the case of securities that are either not traded on the stock exchange, or are only admitted to trading on the regulated unofficial market of German stock exchanges, however, the provisions set out in the WpÜG do not apply.

A public exchange offer typically constitutes a public offer of securities to which the provisions set out in the Securities Prospectus Act (Wertpapierprospektgesetz – WpPG) apply. The exchange offers identified by BaFin fall under an exemption set out in the WpPG, which stipulates that the prospectus requirement can be waived if the sale price (or the exchange value) of all of the securities being offered is less than €100,000 over a period of twelve months.

Six new administrative offence proceedings.

BaFin launched six new administrative offence proceedings (2008: 6), with ten further cases still pending from previous years (2008: 8). BaFin imposed an administrative fine of €2,000 in one particular

[47] www.bafin.de » Veröffentlichungssuche » Verbrauchermitteilungen (Wertpapieraufsicht; only available in German).

case (2008: 3). It dropped three cases (2008: 1) and twelve cases were still pending at the end of 2009 (2008: 10).

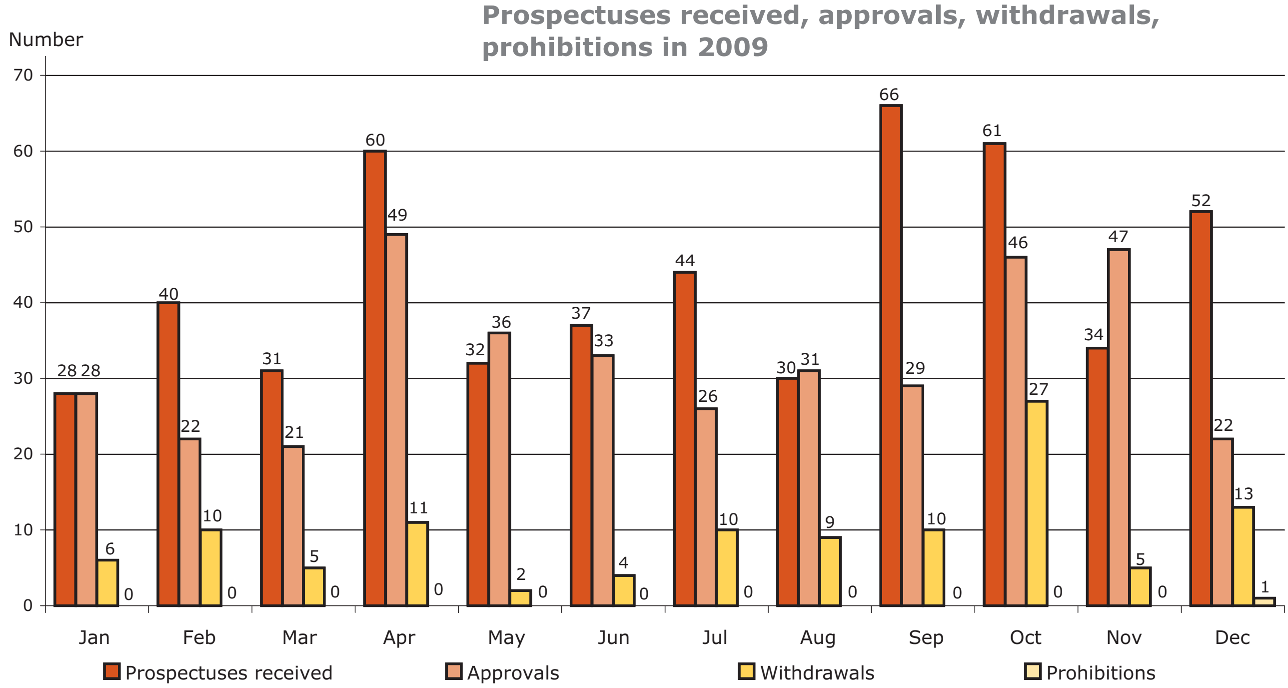
3.2 Prospectuses for non-securities investments

Considerable decline in prospectus volume due to financial crisis.

In 2009, the financial crisis resulted in a considerable decline in the number of prospectuses submitted for non-securities investments, such as shares in companies, registered bonds, shares in trust assets or other closed-end funds. BaFin examined a total of 515 prospectuses (2008: 773). It approved the publication of 390 prospectuses (2008: 708) and prohibited one offer. In 112 cases, the offerors withdrew their applications themselves (2008: 92).

Figure 26

Prospectuses received, approvals, withdrawals, prohibitions in 2009

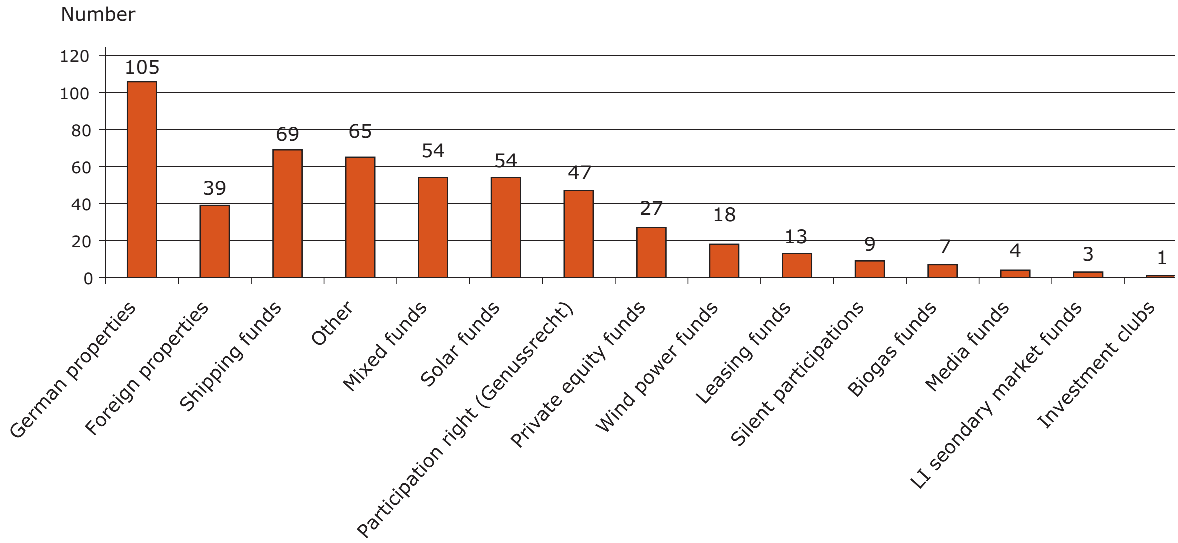


The funds offered were designed to raise equity totalling €9 billion, significantly less than in 2008 (€15.7 billion).

Property and renewable energy particularly popular.

As far as the fund type is concerned, real estate funds accounted for the lion's share by far, at around 29% (2008: 20%). 21% invested in domestic, and 8% in foreign property (2008: 10% in each case). Solar funds designed to finance photovoltaic facilities (PV facilities) in Germany, Spain and other southern European countries also gained in popularity (10%, 2008: 4%). The Renewable Energy Act *(Gesetz für den Vorrang erneuerbarer Energien* – EEG) promotes energy generation using sources such as the sun, wind, water, biomass and geothermal energy. Private individuals, usually from a specific region, often join forces to establish a civil-law partnership under German law *(Gesellschaft bürgerlichen Rechts* – GbR), and then buy and operate PV facilities *(citizens' solar facilities)* in a joint effort. These are usually installed on large and unshaded roof areas on public buildings that are lent by local or district authorities. It is always only the company in which the investors invest, and not the landlord, that is required to publish a prospectus. Shipping funds declined in 2009, accounting for only 13% of total funds compared with 35% in 2008.

Figure 27
Prospectuses by fund type in 2009



Supplements to prospectuses at an all-time high.

Never before did offerors submit as many prospectus supplements as they have been doing since the crisis broke out (644; 2008: 547). These are required, by way of example, if the management team changes or current annual financial statements have to be submitted. The market situation means that it takes much longer for issues to be placed on the market. The longer the offer period, the more likely it is that new circumstances or legal changes will arise, requiring the offeror to make this information available to investors in a supplement.

Annual workshop on prospectuses.

BaFin also provided information on how supplements have to be structured at its annual workshop on prospectus-related issues. In addition, this regular event once again addressed the issue of how to describe risks in prospectuses. The new activities subject to a licence under the banking supervisory system, investment management, factoring and finance leasing, also featured on the agenda. In this respect, it is important that market participants know that there can be a licensing requirement pursuant to section 32 KWG in addition to the requirement to prepare a prospectus.

Many investments are offered and advertised on the internet – and not always in line with the statutory requirements. In early 2009, BaFin therefore performed internet research to track down public offers of non-securities investments without a prospectus as part of a targeted campaign. It also looked for cases of unauthorised advertising or advertising without any reference to the prospectus.

BaFin recorded a total of 84 suspicious cases. In 79 cases, it suspected that the non-securities investments were being offered in an unauthorised manner. Three cases related to deliberately misleading advertising. In two other cases, the advertisements failed to refer to the prospectus.

Focal point of Internet Surf Week: citizens' solar facilities and investment clubs.

Most of the cases were offers relating to citizens' solar facilities and investment clubs. These usually have the legal form of a German civil-law partnership (GbR), and also of German limited partnerships, meaning that they are subject to the requirements set out in the Act on the Prospectus for Securities Offered for Sale *(Verkaufsprospektgesetz* – VerkProspG) as a general rule. The fact that civil-law partnerships are relatively straightforward to set up gives offerors huge advantages. This type of partnership often, however, implies disadvantages that investors joining the GbR underestimate, including a risk of financial ruin. All members of a GbR have unrestricted liability for the debt and liabilities of the company with their entire private assets. In the worst-case scenario, investors can go bankrupt.

BaFin ultimately identified 16 unauthorised offers and one case of unauthorised advertising. All of the offerors affected then withdrew the unauthorised public offers and unauthorised advertising and amended their websites.

Three administrative fines imposed.

BaFin launched five new proceedings due to possible breaches of the VerkProspG (2008: 10), with ten further cases still pending from previous years (2008: 3). BaFin imposed three administrative fines totalling up to €9,174, including skimmed profits of €2,174. It dropped three cases (2008: 2) and nine cases were still pending at the end of 2009 (2008: 10).

4 Corporate takeovers

Fewer offer procedures once again.

BaFin authorised a total of 18 offers (2008: 39) in 2009, eleven in the first (2008: 17) and seven in the second half of the year (2008: 22). This puts the number of approved offers well down on the average for the last few years. The negative developments on the financial markets and the associated difficulties regarding financing corporate takeovers continued to have an impact on the takeover market. BaFin's job is to ensure sufficient transparency for corporate takeovers, as well as to make sure that offer procedures are implemented quickly and that all shareholders are treated equally.

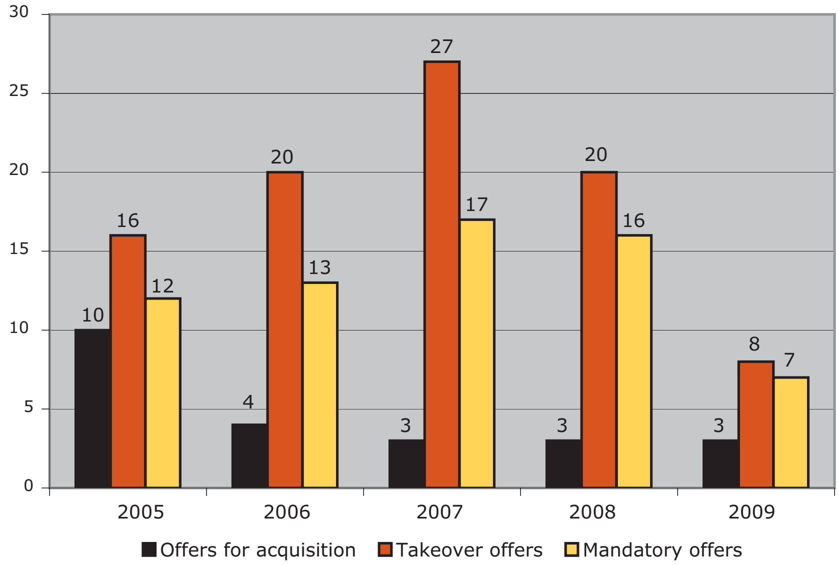
4.1 Offer procedures

Seven out of a total of 18 offers were mandatory offers that bidders have to make if they obtain control over a target company, i.e. hold 30% of more of the voting rights (2008: 16). Another eight procedures related to takeover offers that were or are aimed at acquiring such a position of control (2008: 20). Three offers were simple offers for acquisition (2008: 3), meaning that bidders either intend to purchase shares in a target company without gaining control, or already have control and wish to increase their stake. The published offer documents can be accessed on BaFin's website.[48]

[48] www.bafin.de » Databases & lists » Published offer documents (section 14 of the German Securities Acquisition and Takeover Act).

Figure 28

Number of offer procedures



Significant drop in transaction volumes.

In 2009, the offer transaction volume[49] was below the €100 million mark in the majority of cases. Only two offers fell into the €100 million to €1 billion category. The takeover offer made by SAG Beteiligungs GmbH, which was directed at the shareholders of IDS Scheer AG, had the largest transaction volume at around €420 million, followed by the acquisition offer made by Skion GmbH to the shareholders of Altana AG (approx. €160 million) and the takeover offer made by Robert Bosch GmbH to the shareholders of aleo solar AG (just under €100 million). At approx. €750,000, the lowest transaction volume related to the acquisition offer made by FMI-Film, Medien- und Internetbeteiligung GmbH to the shareholders of Odeon Film AG.

One administrative fine imposed.

In 2009, BaFin opened a total of 28 new administrative offence proceedings due to suspected breaches of the WpÜG (2008: 21). 43 cases were still pending from previous years (2008: 25). BaFin closed one proceeding with an administrative fine of €8,500, and dropped 14 cases (2008: 3). 56 cases were still pending at the end of 2009 (2008: 43).

Takeover offer made by SoFFin to the shareholders of Hypo Real Estate Holding AG

Financial crisis and takeover law.

One focal point of public interest in 2009 was the takeover offer made by the Federal Republic of Germany, acting via the financial market stabilisation fund SoFFin, to the shareholders of Hypo Real Estate Holding AG (HRE).

[49] The transaction volume is calculated as the number of shares to be acquired by the bidder multiplied by the consideration per share offered by the bidder as part of the offer procedure. The additional transaction costs are then added to this amount.

With total assets of around €420 billion as at 31 December 2008, HRE was one of Germany's largest credit institutions and, with Pfandbriefe worth just under €90 billion outstanding, accounting for more than 10% of the total German Pfandbrief market. It had run into very serious problems that posed a threat to its very existence. Had HRE gone insolvent, this would have had a substantial impact, the details of which would be impossible to foresee, on the national and international financial markets and the economy as a whole. Consequently, SoFFin planned to stabilise HRE by way of recapitalisation measures and the granting of guarantees. To achieve this objective swiftly and on a legally secure and economically viable basis, SoFFin was aiming to acquire all shares in HRE.

Accelerated procedure.

On 9 April 2009, the federal government therefore published its decision to make a voluntary public takeover offer to HRE's shareholders. The holders of the shares who accepted the offer were to receive a consideration of €1.39 per share – a premium of 10% above the statutory minimum offer price of €1.26.

In derogation of the takeover law provision that applies as a general rule, the Act Amending the Financial Market Stabilisation Act *(Finanzmarktstabilisierungsergänzungsgesetz* – FMStErgG)[50], which came into force on 9 April 2009, stipulated that the minimum price corresponded to the weighted average price on a domestic stock market in the period from 1 to 15 February 2009. Otherwise, the price taken as a basis would have had to be the weighted average price on a domestic stock market over the past three months prior to publication.

Since SoFFin submitted the offer document to BaFin as soon as the decision had been published, BaFin had already approved the offer by 16 April 2009. Normally, the acceptance period under US law would have had to amount to at least 20 US working days. The bidder had, however, obtained exemptive relief from the Securities and Exchange Commission (SEC) in advance so that it could shorten the acceptance period to the period between 17 April and 4 May 2009. The WpÜG, too, generally requires a longer acceptance period. In this case, however, the FMStErgG allowed the acceptance period to be shortened to a minimum of two weeks.

Voluntary improvement.

To ensure as high an acceptance rate as possible, the bidder incorporated two voluntary improvement mechanisms in the offer document: For one, it undertook, vis-à-vis the accepting shareholders, to pay any difference between the consideration offered and any compensation to be granted at a later date pursuant to the provisions of the Rescue Takeover Act *(Rettungsübernahmegesetz* – RettungsG)[51]. Second, the bidder included the binding stipulation that accepting shareholders would also receive a share of a higher consideration for shares acquired by the bidder, either via the stock exchange or on the OTC market,

[50] Federal Law Gazette (BGBl.), I 2009, p. 725.
[51] Federal Law Gazette (BGBl.), I 2009, pp. 725, 729 *et seq.*

within one year of the end of the acceptance period in the form of a payment for the difference compared to the offer price.

Federal government prepares to attain control.

The federal government intended to restructure the HRE Group and reposition it in terms of strategy as a specialised property and government financer in Germany and Europe with Pfandbrief-based funding. To take account of this objective, SoFFin announced in the offer document that it would be pursuing a squeeze-out under takeover law and paying shareholders who had not previously accepted the takeover offer appropriate consideration in the amount of the offer price. In derogation of the provisions set out in the WpÜG, a share of only 90% in HRE's share capital was sufficient for this purpose, another relief provision set out in the FMStErG.

If the bidder failed to achieve a stake of at least 90% in HRE's share capital as part of the offer, the federal government announced that it would implement a capital increase, excluding shareholder subscription rights, and a squeeze out under stock corporation law. The bidder also announced, as a precaution, that it would initiate expropriation proceedings pursuant to section 1 RettungsG if, by 30 June 2009, there were no sufficient guarantee that the federal government would be able to acquire a 100% stake in HRE's share capital. In such cases, the remaining shareholders would only receive compensation in the amount of the market value of HRE's shares calculated pursuant to section 4 (4) RettungsG.

On 28 April 2009, the Management Board and Supervisory Board of HRE issued a recommendation stating that the takeover offer should be accepted. The takeover offer for just under 90 million HRE shares had been accepted by the end of the acceptance period on 4 May 2009. Taking into account the 20 million HRE shares previously acquired by the bidder, the bidder's share of the share capital and voting rights of HRE thus came to around 47% following the offer procedure.

Capital increase and squeeze-out under stock corporation law allow objective to be achieved.

On 2 June 2009, HRE's shareholders resolved a capital increase of approx. €3 billion at their extraordinary general meeting with just under 74% of the votes. The only subscriber to the shares with a nominal value of €3 was – following the exclusion of subscription rights for other shareholders – SoFFin. This brought SoFFin's stake in the share capital up to 90%. After a squeeze-out under stock corporation law, and after the Regional Court of Munich entered the exclusion of minority shareholders in the commercial register, SoFFin became the 100% owner of HRE on 13 October 2009. SoFFin had previously granted cash compensation of €1.30 to the remaining minority shareholders, which an auditing firm commissioned by the Regional Court of Munich had confirmed as appropriate. Consequently, there was no need for expropriation proceedings pursuant to the RettungsG.

4.2 Exemption procedures

BaFin received 144 applications for exemption.

In the year under review, BaFin received 144 applications (2008: 94) for exemption/non-consideration. In 61 cases, holders of voting rights applied for their voting rights to be disregarded pursuant to section 36 WpÜG (2008: 37), while applications pursuant to section 37 WpÜG (2008: 57) were submitted in 83 cases. BaFin approved 67 applications and rejected ten. Applicants withdrew 50 applications, and 17 were still being processed at the end of 2009. BaFin has been publishing major exemption decisions pursuant to sections 36, 37 WpÜG on its website since 2009.[52]

Main issues: gift, internal group restructuring and reorganisation.

As in previous years, most applications submitted pursuant to section 36 WpÜG related to the acquisition of control due to internal group restructuring measures. Numerous applications also related to shares given as a gift when individuals joined a family pool. Most of the applications pursuant to section 37 WpÜG were submitted with regard to the reorganisation or restructuring of a target company.

Details on some of the exemption proceedings are set out below.

Petrotec AG

Reorganisation plans after offer prohibition.

In February 2009, BaFin exempted IC Green Energy Limited (ICG), Tel Aviv, Israel, and nine other applicants to which voting rights in Petrotec AG (Petrotec) held by ICG were attributable as subsidiaries, from the obligation to publish an attainment of control notice and make a mandatory offer.

In August 2008, BaFin had prohibited a takeover offer that ICG announced it would be making to shareholders in Petrotec because the bidder was not prepared – even within the extended period of 15 working days – to name all of the individuals acting with it in the offer document.[53]

After the applicants realised, however, that their opinion on Petrotec’s financial situation was based on incorrect information, ICG and the seller of a large package of shares in Petrotec launched renegotiations. In November 2008, they agreed to maintain the share transfer agreement that had been concluded in late August 2008. As a result, the applicants attained control over Petrotec at the beginning of December 2008 and applied for an exemption due to restructuring.

Purchaser’s objective at the time of closing the transaction decisive.

In granting an exemption due to restructuring, the decisive factor is the purchaser’s objective when executing the transaction which results in the attainment of control. Sections 35 et seq. WpÜG and sections 8 et seq. of the WpÜG Offer Regulation *(WpÜG-Angebotsverordnung* – WpÜG-AngebV) consistently refer to the

[52] www.bafin.de » Databases & lists » Published decisions pursuant to sections 36 and 37 WpÜG (exemptions from mandatory offer).
[53] 2008 Annual Report, p. 182.

attainment of control and thus to the closing of the transaction. BaFin does not deem it appropriate to make a distinction based on whether an investor is already entitled to launch restructuring measures when a transaction is executed, or only acquires this entitlement at a later date – albeit before the closing. Consequently, the fact that the applicants were only pursuing strategic interests at the time the share purchase agreement was concluded in August 2008, and were not yet acting with the intention of restructuring Petrotec at that time, was irrelevant as far as the exemption is concerned.

Finally, it was also important to consider that, according to the expert opinion prepared by an auditing firm, Petrotec objectively believed that it was already facing risks that could jeopardize its existence back in August 2008, when the agreement on the purchase of the share package was concluded. This means that – assuming they were aware of these facts - the applicants could have already submitted an exemption application back then, invoking the restructuring privilege provided for in section 9 sentence 1 no. 3 WpÜG-AngebV.

F. Reichelt AG

In December 2009, BaFin exempted Phoenix Erste Treuhand GmbH, Berlin, and Prof. Dr. Harald Wiedmann from the obligation to make a mandatory offer to the shareholders of F. Reichelt AG.

Role of the trustee in the sale process.

Phoenix Erste Treuhand GmbH is a special purpose vehicle that was set up to manage, on a trustee basis, and sell the pharmaceuticals wholesale business of the ailing Merckle Group (Phoenix Group) – consisting of shares in public and private limited companies, limited partner and other partnership shares. Prof. Dr. Harald Wiedmann is the managing director with sole rights of representation and the sole shareholder in Phoenix Erste Treuhand GmbH. In May 2009, in accordance with the trust agreement, direct and indirect interests in Phoenix Group companies were transferred to Phoenix Erste Treuhand GmbH and another trust company for a limited period to secure the restructuring and subsequent partial sale of the Phoenix Group. The interests transferred include, inter alia, 94.2% of the shares in Fedor Holding GmbH, Hamburg, which in turn holds 84.89% of the voting rights in F. Reichelt AG.

In accordance with the provisions set out in the trust agreement, Phoenix Erste Treuhand GmbH is not permitted to sell shares in Fedor Holding GmbH or equities in F. Reichelt AG; rather, these shares must be transferred back to the trustors once the process has been concluded. As far as exercising the rights from these interests is concerned, Phoenix Erste Treuhand GmbH is bound by the instructions issued by the trustors.

No independent business interests.

This means that neither Phoenix Erste Treuhand GmbH nor Prof. Dr. Wiedmann were pursuing their own business interests as far as F. Reichelt AG is concerned. Since both parties are bound by the provisions set out in the trust agreement, the remaining shareholders in F. Reichelt AG are not subject to the risk that a new controlling shareholder could have a long-term impact on the decision-making process at the target company and could revise its business policy. Accordingly, the exemption was based on the objective that was intended with the attainment of control.

This exemption pursuant to section 37 WpÜG is based on the logic that, when it also acquires voting rights in a target company in connection with the collateral provided, the protection buyer typically does not wish to exert any influence over the management of the target company, but is merely pursing protection interests, and that its owner status is for a limited period only, subject to the collateral purpose and the corresponding collateral agreement. This is also in line with the legal motive behind section 9 sentence 1 no. 4 WpÜG-AngebV, which permits exemptions from mandatory offers in cases where control over a target company has been acquired for the purposes of securing a claim.

In order to ensure adherence to the purpose of the exemption, BaFin reserved the right to revoke the exemption if Phoenix Erste Treuhand GmbH or Prof. Dr. Wiedmann delayed the planned sale and realisation of the trust assets by an unreasonable amount of time, or even abandoned the idea. The same applies if the voting rights attached to shares in the target company are exercised contrary to or without instructions issued by the trustors.

BÖWE SYSTEC AG

In November 2009, BaFin exempted BÖWE SYSTEC Treuhand GmbH & Co. KG (BÖWE SYSTEC Treuhand), as well as two other companies and one natural person from the obligation to make a mandatory offer for BÖWE SYSTEC AG, which had run into financial difficulties. Immediately after the exemption decision, the proportion of voting rights held by BÖWE SYSTEC Treuhand in BÖWE SYSTEC AG exceeded the 30% control threshold, rising to 50.1%. The share purchase was based on a trust agreement with Wanderer Werke AG, which was also encountering financial difficulties. In this agreement, BÖWE SYSTEC Treuhand and Wanderer Werke AG had agreed to transfer ownership subject to the condition precedent of an exemption.

Trust structure with no right to issue instructions...

The trust agreement was a third-party beneficiary contract. Various creditors of Wanderer Werke AG for whom BÖWE SYSTEC Treuhand was to sell the shares in Wanderer Werke AG had a lien on all of the shares in BÖWE SYSTEC AG held by Wanderer Werke AG The trust agreement did not grant Wanderer Werke AG the right to issue instructions. Rather, BÖWE SYSTEC Treuhand had the right to freely exercise the voting rights attached to the shares held in trust.

... resulting in restrictions on the exercise of voting rights in the exemption decision.

In this case, too, the exemption was based on the objective that was intended with the attainment of control – in line with the legal motive set out in section 9 sentence 1 no. 4 WpÜG-AngebV. BÖWE SYSTEC Treuhand attained control in order to sell the shares, ultimately for the benefit of the creditors of Wanderer Werke AG.

BaFin ordered, however, that the exemption would cease to apply if the applicants exercised 30% or more of the voting rights in the target company, and reserved the right to revoke the exemption of the shares in BÖWE SYSTEC AG that had been acquired were not sold on by 31 March 2011. Finally, the exemption can also be revoked if the applicants bring about substantial long-term changes to BÖWE SYSTEC AG's corporate strategy.

4.3 Supervisory intervention

BaFin's duties as far as takeover law is concerned include countervailing any irregularities that could restrict the due execution of offer procedures or have a material adverse impact on the securities market. Such cases tend to relate, for example, to the attainment of control or decisions to make a takeover offer that have not been published, or situations in which takeover offers are made public without BaFin approving the publication of these offers in advance. BaFin also, however, takes action in the event of earlier acquisitions that impact the offer price and are not taken into account by the bidder, contrary to the provisions set out in the WpÜG. In order to prevent or hinder such irregularities, BaFin can issue suitable and necessary orders. Within this context, BaFin regularly checks incoming reports on voting rights and evaluates public information or enquiries by third parties, particularly in connection with current or concluded offer procedures.

In the year under review, BaFin's activities focused on a mandatory offer for shareholders in Küppersbusch AG (renamed: Colonia Real Estate AG) dating back to 2003.

Indirect attainment of control over target company back in 2003.

With effect from 1 March 2003, Swiss AG had acquired more than 30% of the shares in Küppersbusch AG from the former majority shareholder ICC Industrie Capital Consult AG, Düsseldorf, and made a mandatory offer in April 2003. In 2008, BaFin became aware, via a report on voting rights that was submitted several years too late, that another shareholder had attained indirect control over Küppersbusch AG via Swiss AG in 2003 without making a mandatory offer to the remaining shareholders. The offer document published at that time had not contained any reference to the indirect attainment of control by another party involved.

In the course of its investigations, BaFin also found that the bidder at that time had made a parallel acquisition (section 31 (4) WpÜG) and a subsequent acquisition (section 31 (5) WpÜG) concerning shares in the target company. The bidder should have published these acquisition transactions to inform the remaining shareholders of their associated right to the payment of the difference between the offer and the acquisition price. After all, in both cases, the bidder had granted a higher amount of consideration than was specified in the mandatory offer.

Outcome in the interest of investor protection.

BaFin decided not to make the party with an indirect holding submit a mandatory offer, which is possible if there is no risk of any significant negative impact on the securities market. In particular, it took into account the fact that the party with an indirect participating interest stated that it was prepared to put the shareholders at the time – to the extent that they could still be identified – in the same financial position as they would have been if the bidder, which is now in liquidation, had adjusted the consideration/fulfilled the resulting payment claims. On the whole, this meant that more than €100,000 could be paid out to the holders of around 90% of the shares tendered at the time.

5 Enforcement

5.1 Monitoring of company financial statements

966 companies subject to enforcement.

In the year under review, the number of companies subject to enforcement fell once again, because there were only a small number of IPOs to compensate for delistings. As at 1 July 2009, a total of 966 companies from 20 countries (2008: 1,037 companies from 21 countries) were subject to the two-tier procedure, which involves not only BaFin but also the German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung – FREP). These 966 companies comprised 815 domestic companies, 107 companies from other European countries (70 of which were from EU member states) and 44 companies from six non-European countries. When auditing foreign companies, BaFin cooperates with the supervisory authorities in their home country. In order to prevent duplicate audits, BaFin first of all clarifies whether possible breaches have already been investigated by the competent enforcement agency in a company's country of origin.

The FREP concluded 118 audits in the year under review (2008: 138), which included 103 spot checks, 14 extraordinary audits and one audit that was requested by BaFin.[54]

Table 27
Enforcement by country
As at: 1 July 2009

Germany	815
USA	27
Netherlands	24
Jersey	22
Austria	15
Switzerland	12
United Kingdom	7
Israel	7
Japan	7
Ireland	6
Luxembourg	6
France	5
Spain	3
Finland	2
Guernsey	2
Italy	2
Australia	1
Iceland	1
Cayman Islands	1
Canada	1
Total	**966**

[54] Source: FREP.

In 2009, BaFin concluded a total of 39 procedures (2008: 33). In 29 cases, the companies in question approved the results revealed by the FREP's audit. BaFin ordered that the findings be publicised in 28 cases, and refrained from doing so in one case. BaFin can opt to refrain from imposing this requirement if there is no public interest in the publication or if the announcement of the error could harm the company's legitimate interests. In seven cases, the companies in question did not approve the FREP's findings. BaFin concluded all of these cases with the verdict that errors had been identified and ordered that they be published. BaFin also closed three procedures in which the companies had refused to cooperate with the FREP. In one of these cases, BaFin identified an error and ordered that it be published; it closed two cases without identifying any errors. BaFin still had ten pending cases at the end of 2009.

An overview of the results of the concluded error identification and error publication procedures since the beginning of enforcement in 2005 is set out below.

Table 28

BaFin enforcement procedures (July 2005 to December 2009)

	Error findings: yes	Error findings: no	Publication of findings: yes	Publication of findings: no
1) Company accepts FREP's findings	90		87	3
2) Company does not accept FREP's findings	16	2	14	2
3) Company refuses to cooperate with FREP	1	2	1	0
4) BaFin has considerable doubts as to the accuracy of the audit findings or the FREP procedure	1	0	0	1
5) BaFin takes over the audit (banks and insurance undertakings)	0	0	0	0
Total	**108**	**4**	**102**	**6**

Crisis on the financial markets and typical accounting errors.

Once again, companies encountered problems with reporting in management reports and group management reports. But even in view of the difficult economic environment, companies cannot dispense with the risk reports that have to be included in management and group management reports as a mandatory legal requirement entirely.

Forecast reporting

In a summary proceeding, the Higher Regional Court of Frankfurt am Main confirmed, in November 2009, BaFin's view that a company-specific forecast report is an indispensible component of the management report of any capital market-oriented company even in the face of the economic and financial crisis and the associated uncertainty.[55] It stated that the failure to publish forecasts, contrary to section 289 (1) sentence 4 and section 315 (1) sentence 5 HGB was a material error due to the particular importance of this information relating to the future for the capital market.

The court said that, although it is particularly difficult to make specific and precise statements in times of an overall global economic crisis, this did not mean that the management team should, or indeed could, evade its statutory obligation to assess and explain the company's forecasted development. The court emphasised the fact that, in times of crisis, capital market participants are especially reliant on this forward-looking information provided by the company and group management teams, as well as on the latter's assessment of the business outlook, to make their own decisions. It stated that particular difficulties and uncertainty resulting from extreme economic conditions could extend the discretion that is already available as far as forecasts are concerned. Even when confronted with such difficult conditions, however, the court said that it remains one of the management's mandatory statutory obligations to communicate its expectations on the company's future financial position and performance. The court added that, if the management team feels that it is not in a position to make specific statements, it should at least describe a trend or direction, stating the main factors that could have an impact. This could also involve describing alternative scenarios.

Several companies submitted applications to BaFin asking not to be subject to a requirement to publish these errors, citing increased financing difficulties, among other things. BaFin rejected the applications, because a general reference to the financial crisis does not constitute company-specific grounds and, according to the legislator's intent, the disadvantages that could arise on the capital market due to the publication of the errors cannot be considered to constitute legitimate company interests.

Duration of procedures cut considerably.

In the year under review, BaFin was able to conclude error publication procedures far more quickly than in previous years. The period between the end of the error findings procedure until publication to BaFin's total satisfaction spanned less than two months on average. This is because companies tended to raise fewer objections in connection with the publication order than in

[55] Case ref.: WpÜG 11 and 12/09.

the past. This is likely to be due, among other things, to the decision of the Higher Regional Court of Frankfurt am Main dating back to January 2009, in which the court clearly confirmed that the publication of errors was the key enforcement element of the procedures.[56]

Six publications following threats of coercive penalties and one administrative fine.

In 2009, BaFin threatened to impose coercive penalties in six cases after companies initially failed to comply with publication orders. In all six cases, the companies went on to publish the errors. One administrative offence proceeding was still pending from 2008 due to a breach of the information requirements set out in section 342b (4) HGB. BaFin imposed an administrative fine of €4,500 in this case.

5.2 Publication of financial reports

Financial reports are designed to provide investors with regular, reliable information so that they can perform an informed assessment of the issuer's situation. Consequently, capital-market oriented companies are obliged to draw up annual and semi-annual financial reports, as well as interim management statements. They must put all of their financial reports on the internet and publish a notice that must be passed on to the media to be disseminated across Europe indicating when and where the complete financial reports will be available on the internet. BaFin must be informed of the publication of this notice. Furthermore, the notice and the financial reports must be passed on to the company register to be stored there.

Focus on long-standing non-compliance.

In the year under review, BaFin's activities were focused on issuers that failed to meet either all or a large part of their financial reporting obligations over a period spanning several quarters. This prompted BaFin to initiate a total of 46 administrative procedures relating to remedial action for around 850 publications or notices that were not made. BaFin was able to conclude 33 of these procedures in total after the issuers agreed to publish the financial reports. BaFin had previously threatened to impose coercive penalties totalling up to €28,000, although none of these coercive penalties actually had to be imposed.

At the end of 2009, 31 administrative procedures involving around 690 obligations to take remedial action were still open. BaFin had set coercive penalties totalling up to €27,500 in six of these cases. The issuers in question raised objections in three cases. In one of these cases, the required financial reports have now been published and submitted.

No exceptions to the financial reporting obligation.

The companies in question stated a whole variety of reasons as to why they had not published financial reports in line with the

[56] 2008 Annual Report, p. 188.

statutory requirements. None of the reasons stated, however, resulted in an exemption from the reporting requirement, as the WpHG does not allow for any exceptions as far as financial reporting obligations are concerned. In particular, neither a difficult financial situation, poor staffing levels, a lack of clarity surrounding accounting issues, low turnover in the securities issued by the company, nor, for example, PR work performed by the company outside of the formal reporting system under capital market law, justifies long-standing non-compliance with the obligations set out in sections 37v et seq. WpHG. If anything, these factors can only be taken into account in individual cases when BaFin sets a deadline for remedial action in respect of these obligations.

Dialogue continued.

In the year under review, BaFin once again answered numerous enquiries from companies, lawyers and service providers on financial reporting requirements. This issue was also addressed at the annual information event on the monitoring of company financial statements and transparency obligations held at the end of November 2009.

New requirement for audits performed by third-country auditors.

In the reporting year, the Act to Modernise Accounting Law (BilMoG) stepped up the requirements that apply to the annual financial report. Issuers from non-EEA states whose financial statements are audited by a third-country auditor must now include not only the auditor's report, but also a certificate of registration of the auditor issued by the German Chamber of Public Accountants *(Wirtschaftsprüferkammer)* or a certification of exemption from the registration obligation, in their annual financial report (sections 37v (2) no. 4, 37y no. 1 WpHG). Issuers whose auditors are publicly appointed in Germany are not affected by the new statutory requirement.

21 administrative offence proceedings launched.

BaFin launched 21 administrative offence proceedings in 2009 due to suspected breaches of financial reporting obligations. It dropped one case, and 20 were still open at the end of 2009. The large number of new proceedings launched is also attributable to BaFin's transparency initiative.

Securities supervision transparency initiative

The transparency obligations that apply to capital market information were extended considerably in 2007 as a result of the Act Implementing the Transparency Directive *(Transparenzrichtlinie-Umsetzungsgesetz* – TUG). This means that capital market-oriented companies are now subject to new requirements as far as the publication of key capital market information is concerned. These requirements relate, in particular, to ad hoc disclosures, directors' dealings, changes in the proportion of voting rights, financial reporting and information on the choice of the home member state. BaFin helps market participants to adjust to the regulations set out in the TUG. In its monthly BaFin Journal, it publishes articles on current supervisory issues. In May 2009, it also published a new version of its Issuer Guideline, which contains detailed information on various rights and obligations.[57] BaFin is also committed to dialogue with the business world at its workshops. Insofar as possible, it also helps to clarify questions posed by reporting parties by telephone or e-mail or to remedy irregularities. Nevertheless, the error rate remains relatively high, as does the number of missed deadlines, especially as far as financial reporting is concerned.

This prompted BaFin to launch a transparency initiative in 2009. The aim of the initiative is to look at all breaches of transparency requirements from an all-encompassing perspective and to sanction those market participants who have breached several aspects of these requirements. Even breaches that, if subject to an isolated assessment, would only result in a warning now trigger administrative offence proceedings.

The initiative drew attention to 40 companies in particular. BaFin is considering whether to launch administrative offence proceedings in these cases, and is keeping a very close eye on the companies. It will also be incorporating other companies that have breached transparency requirements in the initiative. BaFin anticipates that this will help improve the implementation of transparency requirements, boosting transparency on the capital market, investor protection and market integrity.

6 Supervision of investment business

In 2009, the German fund industry once again had to battle with the impact of the financial crisis. While the liquidity situation of open-ended real estate funds remained tense, the situation for other investment funds eased as the year progressed.

Not least due to the crisis on the financial markets, BaFin performed 44 supervisory inspections, in addition to various ad hoc talks, in the year under review. These supervisory inspections not only allow BaFin to gain an initial insight into the situation at the asset management companies; the regular content also improves the necessary exchange of information between BaFin and the asset management companies.

[57] www.bafin.de » Publications » Guidelines.

6.1 Asset management companies

At the end of 2009, 73 German asset management companies had a licence to manage investment assets pursuant to the InvG (2008: 76). Eight asset management companies applied for an expansion of the scope of their existing licences in the year under review (2008: 24).

2,186 mutual and 3,783 special funds.

At the end of 2009, the asset management companies managed a total of 5,969 funds (2008: 6,031) with assets worth around €1,027 billion (2008: €907 billion).[58] These funds included 2,186 common funds (2008: 2,043) comprising assets worth €311.7 billion (2008: €273.5 billion) and 3,783 special funds (2008: 3,988) comprising assets worth €715.7 billion (2008: €633.5 billion).

In the period under review, 83 funds were merged and the right to manage the fund was transferred to another asset management company in nine cases. A total of 71 funds were wound up.

The total (net) fund inflows of mutual and special funds – i.e. the total fund inflows from unit purchases less the total fund outflows from unit redemptions – came in at just under €11.4 billion at the end of 2009. (Gross) fund inflows came in at just under €34.1 billion, almost €9 billion of which was attributable to the common funds and €25.1 billion of which was attributable to the special funds.

In addition to mutual and special funds, there were 20 investment stock corporations with variable capital, which launched a total of 59 sub-pools of assets (Teilgesellschaftsvermögen). These sub-pools of assets accounted for a total volume of approx. €14.4 billion.

Sharp decline in the number of new licences.

The number of new licences fell to 147 in the year under review – a sustained decline. 278 new licences were issued in 2008. The decline is explained by the ongoing global financial crisis in 2009, which had an impact on fund performance.

No applications for advance approval.

As in 2008, no applications were submitted for the advance approval of fund rules in the year under review either. The advance approval of funds pursuant to section 43a InvG means that asset management companies are not required to submit the specific fund rules for funds complying with Directive 85/611/EEC. Instead, BaFin approves the fund rules submitted as model clauses. This approval procedure was introduced by the Act Amending the Investment Act in late 2007. It would appear that there is currently no demand for this type of approval on the market due to the speed at which BaFin grants approval on the one hand, and the current model fund rules that have been agreed with the German Investment and Asset Management Association *(Bundesverband Investment und Asset Management e.V.)* on the other.

[58] The information on the number of funds and fund volume in 2009 is based on statistical data made available by the Bundesbank.

Risk-oriented supervision

Planning and managing the intensity of supervisory activities.

Since the introduction of its risk classification procedure in early 2009, BaFin has been able to gain an overview of the risk structures of asset management companies. This allows it to plan and manage the intensity of its supervisory activities at individual companies in a risk-oriented manner.

The risk classification system awards points based on pre-defined criteria. A distinction is made between three categories: "Financial position and performance" (category 1), "Management quality" (category 2) and "Organisational quality" (category 3). The impact-related element is classified as high, medium and low based on pre-defined threshold values. The overall classification mark is based on a quality assessment and the impact-related mark. The resulting rating is summarised in a twelve-field matrix.

Table 29
Risk classification results 2009

Investment companies		Quality of investment companies				
		A	B	C	D	Total
Relevance	High	25	7	0	0	32
	Medium	21	2	0	0	23
	Low	15	2	1	0	18
	Total	61	11	1	0	73

6.2 Investment funds

Focus on liquidity risks.

In 2009, BaFin continued to focus on monitoring financial risks in German funds. To ensure that it would have access to information on imminent fund closures early on, BaFin's activities focused on liquidity risks. BaFin continued to demand that German companies submit daily trend reports. This was motivated by the increased unit redemptions that ultimately resulted in a total of four fund closures in the period leading up to the end of March 2009, affecting three participation certificate funds and one fund that invested in subordinated bonds. In the course of the year, the asset management companies resumed unit issue and redemption for two of these funds, meaning that two participation certificate funds were still closed at the end of 2009.

BaFin used the trend reports to gather information on various criteria, such as net fund outflows or borrowing and asked the companies to assess their liquidity situation. This data can serve as an indicator of an imminent fund closure. Since the number of companies that deemed their liquidity situation to be highly critical was on a steady decline as the year progressed, BaFin switched the daily reporting requirement to a weekly requirement from May 2009 onwards. BaFin abolished the need for companies to submit trend reports in mid-September, but ordered asset management companies to inform it without delay in the event of any significant deterioration in their liquidity situation.

Decrease in the number of outlier reports.

Whereas in 2008, the evaluation of the notifications in accordance with the Derivatives Regulation *(Derivateverordnung* – DerivateV) had, at many funds, revealed far more outliers per year than was to be expected given the prescribed 99% confidence level, the number of outliers was on the decline in 2009 on the whole. The notifications provide BaFin with information on how asset management companies are dealing with the market risks associated with their funds. One explanation for the increased number of outlier reports is market volatility, such as that witnessed during the financial crisis.

Deterioration in results of operations.

The evaluation of the audit reports did, however, reveal (not surprisingly) that the results of operations of the vast majority of asset management companies have deteriorated. This means that the financial crisis has impacted not only fund performance, but also results of operations at asset management companies as a result of the decline in commission income.

Significant increase in the number of complaints.

In the year under review, the number of investment-related complaints submitted to BaFin more than doubled to 235 (2008: 93). As in 2008, most of the complaints related to the performance of individual funds during the financial crisis. BaFin was unable, however, to provide any assistance, because the situation on the capital markets plays a decisive role in fund performance.

New survey for information due to Madoff scandal.

In November 2009, BaFin once again carried out a survey, this time to collect up-to-date information on the impact of the fraud system put in place by the US investor Madoff on the German fund industry. The survey revealed that 90 investment funds with an original total fund volume of somewhere in the region of €232 million were indirectly affected. Most asset management companies wrote the affected assets off almost completely, i.e. leaving only a memorandum item. Consequently, the companies valued the original total fund volume worth €232 million at only around €4 million, which corresponds to a loss of around €228 million for the German fund industry. The German asset management companies have not filed any damage claims to date, because the details of the case have still not been clarified.

Survey on remuneration systems

In 2009, BaFin performed its first survey on the remuneration practices of asset management companies and investment stock corporations to gain an overview of remuneration systems in the investment fund sector. BaFin was particularly interested in whether or not, and how, fund companies avoid offering corruptive incentives for individuals to take excessive risks. A whole number of regulatory initiatives across the globe address the issue of bonus and incentive systems. An assessment is currently being performed at European level to see whether or not provisions on the remuneration systems of asset management companies and investment stock corporations should be incorporated into the UCITS IV Directive. BaFin's findings will be taken into account for this purpose.

6.3 Real estate funds

Impact of the financial crisis

The main issues in 2009 were the suspension of unit redemptions and the efforts made to lift the suspension. En masse unit redemptions in late October 2008 forced ten asset management companies to suspend unit redemption for twelve real estate common funds due to insufficient liquidity.[59] Other real estate funds were also hit by increased fund outflows for at least a temporary period.

Trying market situation for disposals.

In order to secure liquidity for their real estate funds, asset management companies tried to sell some of the properties in their portfolio, although this often proved challenging due to the general market situation. Companies also tried, with varying degrees of success, to optimise their sales activities and foster stronger ties with investors. BaFin receives regular reports on measures taken to procure liquidity to ensure that companies meet the obligations set out in section 81 InvG. Furthermore, German asset management companies still have to report the fund inflows and outflows for all 48 open-ended real estate common funds to BaFin on a daily basis. This gives BaFin an up-to-date overview of the liquidity situation at the respective funds.

Seven real estate funds closed.

Two real estate funds resumed unit redemption in late January 2009.[60] Between late May and late October 2009, six other funds

[59] KanAm US-grundinvest Fonds (27 October 2008), KanAm grundinvest Fonds, AXA Immoselect, TMW Immobilien Weltfonds (28 October 2008), Focus Nordic Cities, SEB ImmoInvest (29 October 2008), Morgan Stanley P2 Value, UBS (D) Euroinvest Immobilien, UBS (D) 3 Kontinente Immobilien (30 October 2008), CS EUROREAL, DEGI EUROPA, DEGI INTERNATIONAL (31 October 2008).
[60] Focus Nordic Cities (28 January 2009), DEGI INTERNATIONAL (30 January 2009).

opened.[61] In the case of four real estate funds, however, the companies had to extend the suspension for up to another year at the end of October 2009. Sustained fund outflows prompted another three suspensions in November 2009, although two of the affected funds have since resumed their unit redemption activities.[62] Another fund opened in December 2009, although it had to suspend unit redemption again in February 2010 due to sustained fund outflows.6 This means that seven real estate funds were still closed at the end of March 2010.

Extraordinary interim property valuations.

Due to the negative developments on the international property markets, one company decided in July 2009 to have the properties in the portfolio of a fund, for which it had suspended unit redemption, revalued outside of the regular annual cycle. One focal point of this fund's investments is Asia. A revaluation is required whenever an asset management company believes that the last determined value or the purchase price is no longer appropriate due to changes to material valuation factors, such as market prices (section 79 (1) sentence 5 InvG). This reduced the value of the property portfolio in the fund by 10.4%, bringing the fund volume down by 13.9%.
Furthermore, in February 2010, another company announced the results of an extraordinary revaluation of the properties in its fund. In this case, the new valuations brought the fund volume down by 21.6%. Unit redemptions have been suspended for this fund, too.

More complaints.

As in 2008, the suspension of unit redemption resulted in an increase in the number of complaints (58; 2008: 32). Investors not only turned directly to BaFin, but also contacted the Bundestag's Petition Committee, which then asked BaFin to comment.

General development of open-ended real estate funds

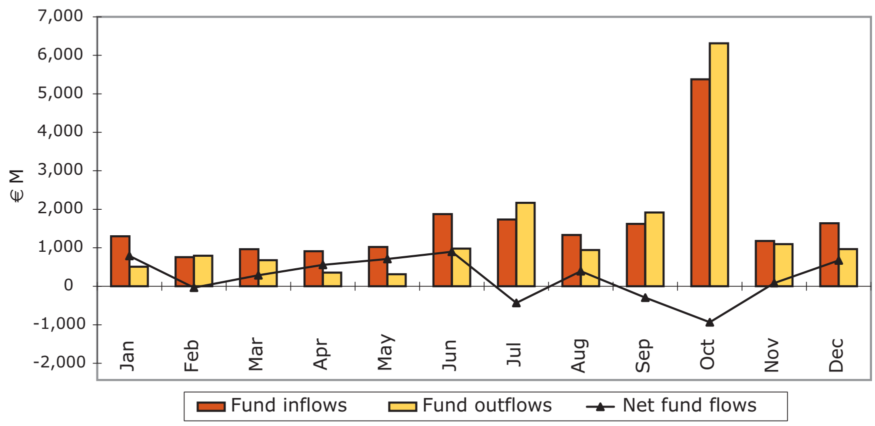
At the end of 2009, 21 German asset management companies managed 48 real estate common funds (2008: 46) accounting for a volume of €87.8 billion (2005: €85.5 billion) and 136 institutional real estate funds (2008: 123) accounting for a volume of €27.3 billion (2008: €23.2 billion).

Fund inflows still varied.

The fund inflows reported by the open-ended real estate common funds remained very varied in 2009. While those funds that had to suspend unit redemption had only low fund inflows at times and often reported a high level of fund outlows, in particular shortly after reopening, other funds reported constant fund inflows. All in all, the real estate common funds reported net fund inflows of €2.7 billion in 2009. This means that, after net fund inflows of just short of €1 billion in 2008, the sector saw a slight increase in net fund inflows overall in the year under review.

[61] SEB ImmoInvest (29 May 2009), CS EUROREAL (30 June 2009), KanAm grundinvest Fonds (8 July 2009), UBS (D) Euroinvest Immobilien (6 August 2009), AXA Immoselect (28 August 2009), UBS (D) 3 Kontinente Immobilien (27 October 2009).
[62] DEGI GLOBAL BUSINESS (11 November 2009), DEGI INTERNATIONAL (16 November 2009), AXA Immoselect (17 November 2009).
[63] TMW Immobilien Weltfonds (11 December 2009).

Figure 29
Fund flows of real estate common funds in 2009



The average annual performance of the open-ended real estate common funds, calculated based on the BVI method (comparison of redemption prices) once again fell considerably in 2009. Performance dropped from 4.7% to 2.5% year-on-year. The renewed considerable drop in average performance to the tune of around two percentage points is attributable to the continued slide in prices on the global property markets, as in 2008.

6.4 Hedge funds

More stringent hedge fund regulation remains on the international agenda.

More stringent hedge fund regulation remains one of the main issues being pushed for to combat the financial crisis. Even though hedge funds were not ultimately responsible for the crisis, the way in which they operate can have serious implications for financial stability. First, hedge funds can exert a direct influence over markets and, in particular, market liquidity (market channel). Second, the collapse of a hedge fund has implications for investors and lenders (credit channel). Consequently, hedge funds are the topic of intensive regulation debates on the international stage.

German hedge funds and their managers are already subject to extensive regulation under the InvG, meaning that the international regulatory initiatives do not pose any major challenges to the German hedge fund sector. Unlike the international regulatory initiatives, which are aimed first and foremost only at fund managers, the regulatory framework in place in Germany is also aimed directly at the hedge funds themselves. In addition to comprehensive requirements for authorisation, the regulation of managers and funds in Germany also covers ongoing supervision, including direct supervisory contacts and audits.

Number of hedge funds constant.

The total number of single hedge funds and funds of hedge funds in accordance with German law remained stable at a low level in a year-on-year comparison. BaFin authorised five new single hedge funds in 2009, with four being wound up. The newly authorised single hedge funds are investment stock corporations or their sub-pools of assets. BaFin also authorised one new fund of hedge funds, with companies winding up three such funds. This means that, as at the end of 2009, a total of 31 German single hedge funds (including five special funds) and eight German funds of hedge funds (including one special fund) were authorised (2008: 30 single and 10 funds of hedge funds).

Supervisory inspections and annual consultations.

BaFin performed five on-site supervisory inspections and annual consultations, including at companies that had been granted authorisation to launch a hedge fund in 2009. The other supervisory inspections were not performed for any specific reason. In addition to these inspections and consultations, BaFin is in constant contact with the companies it supervises, activities that have been stepped up during the crisis.

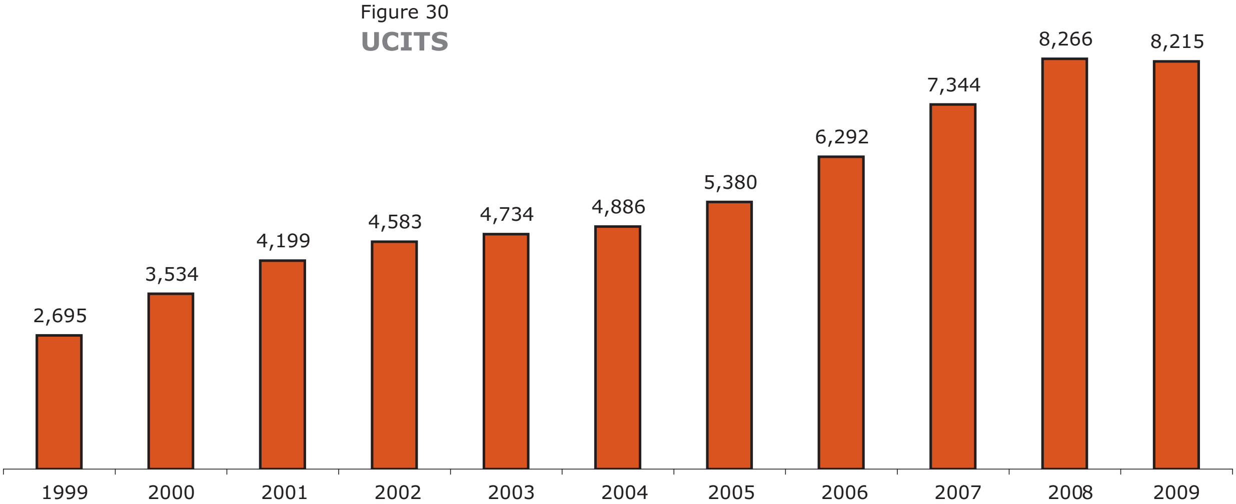
6.5 Foreign investment funds

UCITS

Fewer distribution notices due to financial crisis.

In 2009, BaFin processed 995 (2008: 1,540) new notices for the distribution of UCITS. The considerable decline is due to the financial crisis and the associated slump in demand. Almost two thirds of the new notices related to funds from Luxembourg; a significant proportion also related to funds from Ireland. Other notices were destined for Austria and France, in particular. Despite the sharp decline in the number of new notices, the total number of foreign UCITS authorised for distribution fell only slightly to 8,215 (2008: 8,266).

Figure 30
UCITS

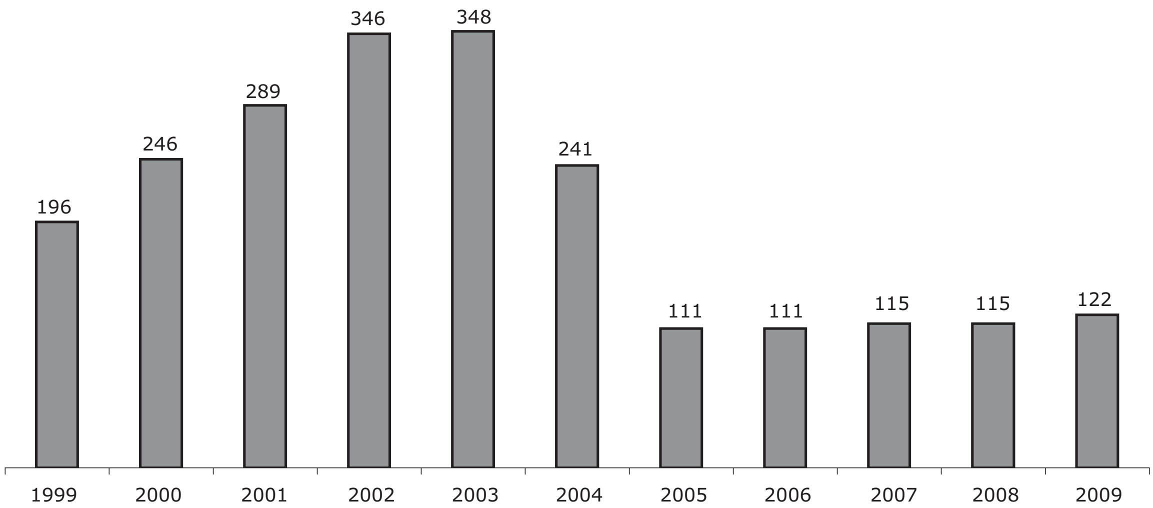


Non-UCITS

Slight increase in the number of non-UCITS.

There was a slight increase in the number of non-UCITS authorised for distribution. At present, 122 funds are authorised for public distribution in Germany (2008: 115), including six foreign funds of hedge funds. Eleven new funds successfully completed the notification procedure pursuant to section 139 InvG in 2009, with seven ceasing public distribution. For the first time, distribution authorisation was awarded to two non-UCITS which are comparable to "other funds" within the meaning of section 90g InvG. Most of the funds are from Luxembourg, although there are also funds from Switzerland, the US and Austria.

Figure 31
Non-UCITS*



* From 2006 onwards, the statistics also include the foreign funds of hedge funds authorised for distribution.

VII Cross-sectoral responsibilities

Michael Sell,
Chief Executive Director responsible for Cross-Sectoral Issues / Internal Administration

1 Guarantee and compensation schemes

BaFin supervises all statutory and institutional-level guarantee schemes in the banking and securities trading sector. It also monitors the statutory guarantee schemes for life and substitutive health insurance. On the basis of the Deposit Guarantee and Investor Compensation Act (EAEG), the Banking Act (KWG) and the Insurance Supervision Act (VAG), as well as a whole range of financing regulations, it combats irregularities that could pose a threat to the due execution of these institutions' duties or to their assets. If compensation and guarantee schemes issue administrative acts such as contribution notices, BaFin also makes decisions on any objections raised by these schemes' member institutions.

Supervision of the EdW

Phoenix case – partial compensation awarded.

In 2009, BaFin was still dealing with the Phoenix Kapitaldienst GmbH case. The Compensation Scheme of German Securities Trading Companies, the EdW *(Entschädigungseinrichtung für Wertpapierhandelsunternehmen),* had granted partial compensation to 10,735 investors by 31 December 2009. The amount paid out in (partial) compensation up until that point in time totals approximately €47 million. All in all, this means that the EdW had processed around 12,600 applications that were ready for a decision accounting for a compensation volume of around €49 million by the end of the reporting year.

The question as to whether or not the investors in Phoenix Kapitaldienst GmbH are entitled to a claim for separation from the insolvent estate *(Aussonderungsrecht)* in respect of the funds they invested with this company, remains extremely controversial. Consequently, the EdW included a retention amount when calculating the amount of the compensation claims. The EdW intends to make a final decision on the compensation claims as soon as all claims for the separation of assets and the distribution of the assets to be separated have been clarified. It shall proceed based on the order in which the claims were registered.

Federal Constitutional Court confirms EdW annual contributions for 1999 to 2001.

In November 2009, the BVerfG ruled that the system whereby the EdW is financed by annual contributions is in line with the constitution, confirming the preceding case law of the administrative courts.[64] The decision came in response to the

[64] Judgment of 24 November 2009, case ref.: 2 BvR 1387/04.

constitutional complaint *(Verfassungsbeschwerde)* lodged by a securities trading bank against the BVerwG's judgment of April 2004, which dismissed the action brought against the annual EdW contributions for the period from 1999 to 2001.[65] The BVerfG takes the view that the annual contributions are to be considered as special levies that are permissible from a constitutional law perspective. According to the court, the member institutions of the compensation scheme form a homogenous group with specific financing responsibilities for the EdW's compensation function. Where the constitutional complaint had also been lodged against the levying of special EdW contributions in the case involving Phoenix Kapitaldienst, the BVerfG refused to hear the complaint.

Reform of the Deposit Guarantee and Investor Compensation Act

Coverage level to rise to €100,000 at the end of 2010.

The Act Amending the Deposit Guarantee and Investor Compensation Act and other acts of 25 June 2009 introduced reforms to the deposit guarantee system in Germany.[66] The Act implements the EU's Directive amending the Directive on Deposit Guarantee Schemes.[67] These changes increased the minimum cover for deposits to €50,000 as of 30 June 2009 and abolished the regulation stating that investors had to bear 10% of any loss themselves. A further increase in the coverage level to €100,000 shall apply with effect from 31 December 2010. Furthermore, the payout period will be shortened to a maximum of 30 days as of 1 January 2011. The European Commission is also planning further revisions to the regulations governing deposit guarantee systems.

Early identification of imminent compensation cases.

The amendments are designed, among other things, to help identify imminent compensation cases earlier on and to further optimise the consultation between BaFin and the respective compensation scheme. Consequently, the legislation stipulates that compensation schemes are obliged to conduct regular audits of their member institutions so as to assess the risk of a compensation case arising. Moreover, BaFin will, in the future, have to inform the affected compensation scheme if it obtains information suggesting that a compensation case could occur at a particular institution (section 6 (7) EAEG).

New system for levying contributions – more focus on risks.

The provisions now explicitly stipulate that the risk of the allocated institutions triggering a compensation case must be taken into account when calculating contributions and payments. The idea behind this is to make the levying of contributions more risk-oriented. Furthermore, new empowering provisions have been put in place for the contribution regulations for the statutory compensation schemes and formal statutory provisions have been drafted on the levying of special contributions (section 8 EAEG). The revised provisions also set out regulations governing the determination of special contributions, the limit that applies to the

[65] Judgment of 21 April 2004, case ref. 6 C 20.03.
[66] Federal Law Gazette (BGBl.), I 2009, pp. 1528 et seq.
[67] D 2009/14/EC, OJ EU no. L 68/3 dated 13 March 2009, p. 3.

obligation to pay special contributions (5 times the annual contributions in a given financial period), as well as on borrowing, on levying special payments in connection with loans and on determining which individual companies are subject to payment obligations.

Contribution regulations revised to reflect EAEG provisions.

In order to implement the new statutory provisions, the Federal Ministry of Finance (BMF) has also implemented a complete overhaul of the contribution regulations for the statutory compensation schemes. BaFin had submitted corresponding drafts. Most of the resulting changes to the various contribution regulations have already come into force for the 2009 contribution year.

Contribution rates increased – new upper limit for annual contributions.

Due to the new statutory limit on the levying of special contributions and the increase in the coverage level implemented at the same time, the contribution rates for the member institutions of the Compensation Scheme of German Banks *(Entschädigungseinrichtung deutscher Banken GmbH* – EdB) and the Compensation Scheme of Public Banks *(Entschädigungseinrichtung öffentlicher Banken* – EdÖ) have doubled to 0.016% of the calculation basis (balance sheet item "Liabilities to customers") in each case. In addition, both contribution regulations now provide for an upper limit of 0.6% of the liable capital for the annual contribution to be paid by each member institution.

The amended regulations for contributions to the EdW provide for a 3.5-fold increase in the contribution rates because the annual "ex ante" financing of the compensation scheme will be more important in the future as a result of the abolition of the previously unlimited right to levy special contributions. The intention is also to strengthen the EdW against the backdrop of the compensation cases witnessed to date and the risks resulting from the current financial crisis.

EdÖ and EdB contribution regulations already based on a risk-oriented system for levying contributions.

The EdÖ and EdB contribution regulations already contain risk-oriented criteria with the valid parameters for determining the amount of the contribution (balance sheet item "Liabilities to customers") and the potential scope of the compensation claims. The EdÖ contribution regulations also grant an additional contribution rebate to institutions that benefit from a maintenance obligation (Anstaltslast) or guarantor's liability *(Gewährträgerhaftung)* of the public owners, meaning that their compensation risk is lower This means that the main requirement set out in the new section 8 EAEG, namely that the levying of contributions should be based on a risk-oriented procedure, has already been fulfilled.

Risk orientation being optimised for EdW contributions.

The previous contribution system used by the EdW, which the BVerfG had confirmed in principle in November 2009, had already considered the risk of institutions' business activities triggering compensation cases as a key aspect in determining contribution levels. The new EdW contribution regulation has now enhanced this risk-oriented contribution assessment system to include risk-oriented surcharge and rebate options. One additional feature is an individual client structure surcharge for institutions – depending on the number of clients they have – because the potential compensation volume increases in proportion to the number of clients due to the statutory compensation amounts. On the other hand, institutions that have taken out a fidelity liability insurance policy will be granted a contribution rebate in the future, provided that this insurance policy meets the requirements stipulated in the regulation. Fidelity liability insurance policies can help to reduce an institution's compensation risk due to the preventative control function and to ensure that risks can be identified early on. Furthermore, the insurance benefits can also help to prevent a situation in which a compensation case is deemed to have occurred, or can reduce the damage incurred by the compensation scheme if such a case occurs.

2 Authorisation requirements and prosecution of unauthorised transactions

Private retirement and health provision is becoming more and more important. At the same time, the range of products on offer is as large as it is confusing. Investors have to choose from numerous products and providers. Some of the products on offer appear to be highly profitable offers made by companies that are conducting their business activities without the required authorisation from BaFin. In order to protect investors and Germany's status as a financial centre, BaFin pursues these companies and prohibits their unauthorised business activities.

2.1 Assessment of authorisation requirements

BaFin gives providers the option of having their planned business activities assessed in advance to see whether or not they require a licence/authorisation pursuant to the KWG, the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG) or the VAG. Activities for which a licence is required can only be commenced once BaFin has issued written authorisation. In the event that providers conduct business without the necessary licence, BaFin can order the immediate cessation of these business operations and the reversal of any transactions that have been executed, and can also publish corresponding orders. Furthermore, individuals who conduct unauthorised business are also at risk of prosecution, because breaching the authorisation requirement is a criminal offence.

784 enquiries on the authorisation requirement.

In the year under review, BaFin assessed 784 enquiries with regard to the authorisation requirement for business plans. 763 enquiries related to the KWG, 17 to the VAG and 20 to the ZAG.

Citizens' loans to municipalities subject to authorisation.

In the year under review, a number of municipalities wanted to accept loans from their citizens in order to cover their financing requirements. The idea was that fixed-term loan agreements would be concluded between the municipality and the individual citizen. The interest rates made this form of municipal financing appear more favourable than a standard bank loan, for example. Financing models such as these are deemed a form of deposit business (section 1 (1) sentence 2 no. 1 KWG) and municipalities are prohibited from using them without prior authorisation from BaFin. In any case, the local municipal regulations generally prohibit banking business.

Purchase of existing life insurance policies not subject to authorisation in principle...

Second-hand life insurance policies have been on offer for some time now. A life insurance policy is purchased for investment purposes and is maintained by the buyer with the prospect of receiving the proceeds when the policyholders die. Neither buying nor selling such policies, nor the brokering of such a purchase agreement are deemed to constitute business activities requiring authorisation pursuant to the KWG or the VAG.

...but can be subject to authorisation in individual cases.

Recently, a new form of this business model has come to light. Companies have been proposing that consumers sell them their second-hand life insurance as an investment. The purchase price – or at least some of it – is retained, the idea being that this amount, subject to regular interest, is paid out in instalments at a later point in time. In some models, the company also promises to invest the retained amount for the consumer. In the relevant cases, these companies are not supervised by BaFin. As a result, BaFin has published an explicit reference on its website to the fact that these companies, unlike insurance undertakings, are not subject to solvency supervision by BaFin, a system which monitors, in particular, companies' ability to meet their obligations under contracts concluded with their clients at all times.[68] Depending on the structure of the individual models, they may also constitute business activities that are subject to authorisation.

New fact sheets on individual financial services.

After publishing guidance notices on the individual types of banking business in 2008, BaFin has now published up-to-date guidance on financial services. These contain fundamental information on individual types of financial services, for example investment management, which the legislature introduced to establish a secure statutory basis for the authorisation requirement for collective investment schemes, in the interests of investor protection and the integrity of the financial market. The guidance notices are designed to give companies that want to operate on the capital market, as well as their advisors and other interested parties, an initial idea as to whether or not certain business activities are deemed to constitute a financial service subject to authorisation pursuant to

[68] www.bafin.de » Verbraucher » Unerlaubte Geschäfte (only available in German).

the KWG. The guidance notices do not, however, claim to present an exhaustive list of all issues concerning the activities in question. Nor can they replace an individual authorisation inquiry submitted to BaFin or the Bundesbank. In order to be able to provide a binding assessment of possible authorisation requirements in individual cases, BaFin and the Bundesbank require full documentation on the contractual agreements on which the specific business activities are to be based. The guidance notices are available on BaFin's website.[69]

Plans for guidance notice on exemptions.

Given the extensive and very comprehensive scope of the term "institution", BaFin plans to publish further guidance notices on exemptions in the autumn of 2010. These will provide information on which credit and financial services institutions are exempted from the scope of KWG, either in full or in part.

2.2 Exemptions

Exemption from supervision.

If supervision of a particular company is not necessary due to the nature of its business activities, BaFin can exempt a company from certain KWG requirements, especially the licensing requirement (section 2 (4) KWG). Typically, banking transactions that are only auxiliary or ancillary activities of minor significance, or that are necessarily linked to other licence-free business activities, are eligible for exemption. In 2009, BaFin exempted 29 providers for the first time. At the end of 2009, a total of 300 institutions were exempted from the licensing requirement.

In 2009, the number of exempted providers operating in Germany from abroad as part of the cross-border provision of services continued to increase. These companies may apply for exemption from the licensing requirement if they are subject to similar supervision in their home country by an authority that cooperates with BaFin. Last year, BaFin exempted a total of 18 foreign institutions for the first time.

Special exemption opportunity for e-money institutions.

In addition, BaFin can also exempt companies that conduct e-money business only (section 2 (5) KWG). At the end of 2009, nine companies were exempted on these grounds.

2.3 Black capital market

Combating the black capital market in a systematic fashion is an absolute must to safeguard the integrity of Germany's financial market and also plays a key role in investor protection. The term "black capital market" is used to describe banking, financial services and insurance business, as well as payment services, that

[69] www.bafin.de » Publications » Guidance notices.

are provided without the required authorisation pursuant to the KWG, VAG or ZAG. Together with the Bundesbank, BaFin investigates the precise business processes involved and the scope of the business so that it has a basis for formal intervention against the companies in question. During the course of its investigations, BaFin can perform on-site audits at suspected companies, search their premises and seize documents.

Public prosecutor's office launches investigations against Helmut Kiener.

Helmut Kiener from Aschaffenburg has been detained awaiting trial since October 2009 due to suspected fraud and embezzlement in a particularly severe case. He is accused of taking funds from foreign institutions worth several hundreds of millions of euros and, instead of managing them as agreed, diverting them into K1 Global Ltd. and K1 Invest Ltd. and spending them on himself.

BaFin took action at an early stage.

As early on as in 2001, BaFin prohibited Helmut Kiener, in his capacity as the managing director of K1 Fonds GbR, Aschaffenburg, from conducting portfolio management activities within the meaning of section 1 (1a) sentence 2 no. 3 KWG and, in 2002, appointed a liquidator for the business that had been conducted without authorisation. BaFin had also issued prohibitory injunctions against Helmut Kiener's other schemes in Germany – in particular K1 Invest GbR and K2 Invest GbR, both based in Mörfelden-Walldorf – and the brokers involved in brokering the investment models launched by Mr Kiener, and had imposed numerous coercive penalties to enforce the prohibition. Helmut Kiener, as well as the affected companies and brokers, had initiated around 100 objections, temporary relief and main proceedings against BaFin's action, some of which are still pending before courts of law.

Kiener moves business outside of Europe.

During the investigations, Helmut Kiener proceeded to shift his business to K1 Global Ltd. and K1 Invest Ltd. based on the British Virgin Islands, to ensure that BaFin had no supervisory authority. He also revamped his offer and advertised the investment products on the Internet as allegedly offering value growth in excess of 800% since 1996. The idea was to transfer the alleged profit from company to company.

In 2002 and 2003, BaFin also banned K1 Invest Ltd. and K1 Global Ltd. from conducting business in the Federal Republic of Germany. BaFin was of the opinion that K1 Invest Ltd. and K1 Global Ltd. were providing principal broking services which are subject to authorisation, because investors who purchase profit-participation certificates or fund units were partaking in a collective investment scheme. In conducting this activity, the companies were thus purchasing and selling financial products in their own name but for the account of others.

Administrative court overturns BaFin's practice.

The courts, too, had agreed with this interpretation for years, until a surprising change in case law saw them declare this sort of business as exempt from authorisation from the outset. In the past, BaFin had often taken action against collective investment schemes. The factor that these schemes had in common was that the investors participated in the financial performance of the financial instruments purchased using the pooled investor funds. In

schemes based on the law of obligations, bonds or profit-participation certificates issued by the providers were used; in schemes based on company law, there was usually a trust limited partner that invested in a *Kommanditgesellschaft* (German limited partnership). BaFin took the view that this constituted unauthorised principal broking services. The Administrative Court of Frankfurt am Main and the Higher Administrative Court of the state of Hesse had initially confirmed this view, but then, following a change in the responsible chamber at the Administrative Court of Frankfurt am Main, stated that the activities had to be sufficiently similar to commission business in accordance with the German Commercial Code. In its judgment of 27 February 2008, the BVerwG ruled that schemes based on the law of obligations did not fulfil the requirements for classification as principal broking services. In another judgment dating from July 2009, the BVerwG confirmed this new interpretation for a company-law scheme for the first time as well. The definition of a new type of financial services, investment management, closes the resulting legal gap.

Collective investment schemes

In July 2009, the BVerwG rejected a leapfrog appeal filed by BaFin in an administrative law dispute involving the managing partner of a collective investment scheme.[70] The GmbH & Co. KG was offering interested investors an investment model which – with the involvement of a trust limited partner as an intermediary – was to invest in financial instruments. The companies are attributable to a group known as "Göttinger Gruppe". BaFin was of the opinion that the investment offer constituted principal broking services (section 1 (1) sentence 2 no. 4 KWG) for which none of the companies involved had the required authorisation. Consequently, it had prohibited these companies from conducting business in September 2004, ordered their liquidation and appointed a liquidator. Back in October 2005, the Administrative Court of Frankfurt am Main – confirmed by the Administrative High Court of the state of Hesse in February 2006 – granted the claim filed by the managing partner against BaFin's notices, which were then quashed. In derogation of the court's case law at the time of the prohibition of business, the Administrative Court of Frankfurt am Main did not deem the investment model to constitute principal broking services and exempted it from the authorisation requirement as a result. The BVerwG has now confirmed this interpretation, meaning that it does not concur with BaFin's view.

[70] Judgment of 8 July 2009, case ref. 8 C 4.09, www.bundesverwaltungsgericht.de.

Authority to take action against foreign companies.

Another point in dispute was whether or not, and to what extent, the German banking supervisor was even authorised to take action against business conducted in the Federal Republic of Germany from abroad. This had to be clarified before the European Court of Justice and the BVerwG. In this issue, however, which is extremely important from an investor protection perspective, BaFin was successful.

Landmark decision on cross-border lending business

In April 2009, in a landmark decision in the proceeding involving Fidium Finanz AG from St. Gallen, Switzerland, the BVerwG largely confirmed BaFin's administrative practice on cross-border banking and financial services.[71]

Fidium Finanz AG granted loans to individuals in the Federal Republic of Germany. In doing so, it used its Internet site and domestic brokers to approach interested parties without having a physical presence in Germany. In August 2003, BaFin prohibited Fidium Finanz AG from conducting lending business on a cross-border basis in the Federal Republic of Germany without the required authorisation. After a rejection notice was issued, the company brought an action before the Administrative Court of Frankfurt am Main, which was ultimately dismissed.

According to the decision issued by the BVerwG, companies based abroad are also subject to the authorisation requirement set out in the KWG and require a banking licence from BaFin if they provide banking or financial services in the Federal Republic of Germany without a physical presence. The court stated that, for banking business to be considered as being conducted in Germany, it is sufficient if the main steps leading to the conclusion of the contract are taken in Germany. It stated that these requirements are fulfilled because clients in Germany could, for example, download the application form on the Internet and because brokers based in Germany arranged the business with Fidium Finanz AG's knowledge.

Supervisory and investigative measures

Total of 515 new investigations.

In 2009, BaFin launched a total of 515 new investigations. Most of these related to unauthorised banking and financial services business, while only 74 related to conducting insurance business without authorisation. One investigation related to the unauthorised provision of payment services pursuant to the ZAG.

[71] Judgment of 22 April 2009, case ref. 8 C 4.09, www.bundesverwaltungsgericht.de.

In 45 cases, BaFin issued formal requests for information and the submission of documents to suspicious companies and imposed 24 coercive penalties. BaFin conducted 14 searches in the course of its investigations.

Eleven prohibitory injunctions and 14 unwinding orders.

BaFin only takes formal measures against providers that are not prepared to voluntarily discontinue their unauthorised business activities. In the year under review, it issued eleven prohibitory injunctions and 14 unwinding orders in such cases. A liquidator was appointed in two cases. BaFin can also take action against individuals and companies that are involved in the initiation, conclusion and settlement of unauthorised business of third parties. This includes not only companies that are deliberately involved in this business, but also companies that assist unauthorised business, without their knowledge, by conducting their usual services. These companies can include, for example, internet providers or other telecommunications services providers. BaFin made use of these powers in four cases in the year under review, issuing corresponding directives.

Legal remedies against BaFin measures.

In the year under review, individuals or companies against which BaFin had taken formal measures, filed objections in 40 cases. During the same period, BaFin concluded 95 objection proceedings, 16 of which were closed by means of the issue of a rejection notice. The objections were rejected in full in twelve cases.

In numerous cases, the affected individuals and companies also took legal action against the measures imposed by BaFin. The courts ruled on 24 of the 69 disputes involving BaFin in 2009; 19 rulings were in BaFin's favour. In four cases, the ruling was in favour of the affected individuals and companies, partially so in one other case.

3 Money laundering prevention

3.1 International money laundering prevention and national implementation measures

BaFin's anti-money laundering supervision assessed by the IMF.

In 2009, the International Monetary Fund (IMF) performed an assessment of Germany for the Financial Action Task Force on Money Laundering (FATF) to check the country's compliance with the international standards to curb money-laundering and the financing of terrorism. Under the auspices of the BMF, many of the ministries and authorities that are responsible for preventing and combating money laundering were involved in the assessment. BaFin's job was to work together with the BMF to set out the preventative measures to stop money laundering in the financial sector and BaFin's supervisory activities. This accounted for a large part of the assessment and, in additional to extensive written work, also involved numerous detailed talks with the audit team. The audit was concluded with the FATF's plenary meeting in February 2010, at which the report was discussed and finalised with the member states. The report itself is available on the FATF's website.

New anti-money laundering law requirements.

In the year under review, BaFin repealed both its pronouncements on combating money laundering at credit institutions and insurance undertakings and numerous circulars. This move was prompted by the implementation of the Act Supplementing the Money Laundering Act *(Geldwäschebekämpfungsergänzungsgesetz* – GewBekErgG), which resulted, in particular, in a complete overhaul of the Money Laundering Act *(Geldwäschegesetz* – GwG). At the same time, BaFin published a circular providing details on some of the new anti-money laundering law requirements for the financial industry.[72] These include, in particular, the risk categorisation of institutions and financial sector undertakings from other EU member states and countries and territories with equivalent requirements on measures to prevent money laundering and terrorist financing. The EU member states had agreed on a list of third countries in respect of which they could assume, on the basis of objectively ascertainable criteria, equivalence of the relevant due diligence requirements. BaFin pointed out that the third-country equivalence list is merely an indicator that an institution or a financial sector undertaking from a country mentioned therein applies due diligence requirements that are equivalent to the requirements within the European Union. The third-country equivalence list does not, however, mean that institutions or financial sector undertakings that have their registered office in the countries or areas listed therein can always be routinely assumed, despite any indicators in any particular case of an enhanced risk situation, to present a low risk. BaFin also set out the enhanced due diligence requirements in respect of "politically exposed persons", as well as the scale and scope of the verification of the identity of the beneficial owner.

Based on the new anti-money laundering provisions, the German Insurance Association *(Gesamtverband der Deutschen Versicherungswirtschaft* – GDV), the building society associations and the Federal Association of German Leasing Companies *(Bundesverband Deutscher Leasing-Unternehmen e.V.* – BDL) also published sector-specific practical guidelines in the year under review. The content of these guidelines was approved with both BaFin and the BMF.

Group-wide implementation of anti-money laundering obligations.

As controlling companies in respect of their controlled companies and branches in Germany and abroad, credit institutions, in particular, have to implement various anti-money laundering law requirements at group level due to the new provision set out in section 25g (1) KWG in May 2009. If this is not possible in a third country, they have to refrain from conducting the business in question or end existing business relationships. BaFin explained the details of these obligations in Circular 17/2009 (ML). One of the

[72] Circular 14/2009 (GW).

main obligations is that controlling companies have to appoint a group anti-money laundering compliance officer, perform a risk analysis for the entire group and ensure compliance with the main customer due diligence (CDD) duties at all branches and controlled companies in Germany and abroad. The institutions must also ensure a sufficient flow of information, also on a cross-border basis, within the group. BaFin also stated that, in the case of the obligation not to perform a transaction or to terminate or otherwise end an existing business relationship (section 25g (1) sentences 3 and 4 KWG), the principle of proportionality must be observed.

BaFin sets up reporting procedure pursuant to the Wire Transfer Regulation.

Pursuant to the EU Wire Transfer Regulation (Art. 9 (2)), payment service providers shall report other payment service providers that regularly fail to supply the information on the payer required pursuant to the regulation. The joint Anti Money Laundering Task Force of the three European financial supervisory bodies CEBS, CEIOPS und CESR (AMLTF), has developed guidelines for the application of the requirements set out in Articles 8 and 9 of the regulation. BaFin had these guidelines translated into German in the year under review and sent them out to the institutions concerned in a circular.[73] The circular also includes a report form which is to be used for quarterly reports to BaFin. BaFin processes these reports and then passes them on to the BMF.

3.2 Combating money laundering at banks, insurance undertakings, financial services institutions and payment institutions

Initial experience with new anti-money laundering law provisions.

In line with the instructions issued by the federal government, BaFin refrained, up until May 2009, from punishing institutions or undertakings that had failed to implement the new obligations set out in the Money Laundering Act (GwG), be it in full or in part. Although the risk-oriented approach which is now referred to in the legislation is not one of the fundamentally new obligations, BaFin has noticed that this approach is still posing something of a challenge to credit institutions in particular. In the year under review, numerous institutions once again failed to rise to this challenge in a sufficient manner. This applies, in particular, to the risk analysis, in which institutions have to list and assess the risks to which they are exposed and which is designed to serve as a basis for all of the preventative measures to be taken by them. On several occasions, there was also uncertainty among the auditors of annual financial statements and special auditors regarding the practical implementation of the risk-oriented approach in their reports. The main difficulty faced by the auditors was assessing whether or not the safeguarding measures put in place were sufficient. In addition to an appropriate presentation of the facts,

[73] Circular 9/2009 (GW).

this assessment plays a key role in ensuring that the situation at the institution or undertaking can be evaluated from a supervisory perspective.

Group-wide implementation of anti-money laundering standards.

As in the previous year, one of the main focal points of the anti-money laundering supervision of credit institutions in 2009 was the group-wide implementation of anti-money laundering obligations (section 25g (1) KWG). It is precisely the varied nature of the foreign activities pursued by German credit institutions that makes the due fulfilment of these obligations crucial to creating uniform standards in the relevant group. Consequently, BaFin once again issued information requests to various credit institutions in the year under review, the aim being to gain an overview of the group-wide implementation of anti-money laundering obligations.

Requirements for the prevention of fraudulent activities.

In 2009, there were still a number of shortfalls regarding the implementation of the requirements for the prevention of fraudulent activities to the detriment of the institutions (section 25c (1) KWG). These requirements state that institutions must create, update and monitor internal principles, as well as appropriate business and client-related security systems, as part of their proper business organisation and an appropriate risk management system. In addition to shortfalls relating to procedural guidelines, training courses and the IT systems used, for example, one of the main problems was that many institutions have still not prepared a risk analysis in line with that described in BaFin Circular 8/2005 (GW). Without an appropriate risk analysis, however, institutions are lacking the very basis for preventing fraudulent activities in a proper, systematic manner.

4 Account access procedure and blocking accounts

Account access procedure assists investigating authorities.

The "account access procedure" *(Kontenabrufverfahren)* has established itself as one of the key components of fighting crime in Germany. It helps to safeguard the integrity of the financial market, because it counteracts the misuse of credit institutions for money laundering, terrorism financing or other crimes in a large number of cases. In 2009, numerous investigation authorities once again made use of the opportunity to access account details pursuant to section 24c KWG. A survey conducted among the main users of the access procedure revealed that 95% of them are very satisfied and rate the procedure as being "very good" or "good". 98% stated that the results of the procedure helped their investigations. In 2009, for example, BaFin's access procedure helped put a stop to a child kidnapping case in which the German criminal investigation department had asked BaFin for urgent assistance outside of normal office hours, and the offenders were arrested as a result.

Use of account access procedure by BaFin.

BaFin itself once again used the account access procedure in 2009 to check individuals’ accounts when pursuing banking, insurance and financial services business that was being conducted without a licence. In one case, for example, in which BaFin had officially prohibited unauthorised health insurance business, it was able to identify and prevent the prohibited collection of premiums thanks to regular account access. The procedure is also used internally to investigate individuals suspected of belonging to terrorist organisations.

The recipients of the account information accessed and the development of the volume of data accessed by these recipients are shown in the following table.

Table 30
Account information recipients in 2009

Account information recipients	2009		2008	
	absolut	in %	absolut	in %
BaFin	547	0.6	277	0.3
Tax authorities*	11,691	12.7	10,936	13
Police authorities	52,367	57	46,132	55
Prosecution authorities	20,915	22.8	18,520	22.1
Customs authorities*	6,198	6.7	7,604	9.1
Other	158	0.2	469	0.6
Total	**91,876**	**100**	**83,938**	**100****

* 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.
** Deviations affecting the total figures are the result of rounding differences.

With 91,876 requests, BaFin processed almost as many requests as it did in 2007 (93,560). The slight decline in 2008 was attributable to the fact that the account access procedure was temporarily out of operation due to technical changes. A comparison with the previous year shows that there have been no marked changes in terms of the percentage breakdown of requests by user group.

5 Certification of basic pension products (Rürup pension)

BaFin will also be certifying basic pension policies until mid-2010.

The 2009 Annual Tax Act *(Jahressteuergesetz)* assigned BaFin responsibility for certifying not only Riester pension products, but also basic pension products *(Rürup pensions)*. The Pension Contracts Certification Act *(Altersvorsorgsverträge-Zertifizierungsgesetz* – AltZertG) was extended accordingly. This new duty is, however, only for a fixed term until 30 June 2010; from 1 July 2010, onwards, all of the duties of the Certification Authority will be handed over to the Federal Tax Office *(Bundeszentralamt für Steuern* – BZSt).

Certification requirement for basic pension policies.

For tax assessment periods from 2010 onwards, certification by the Certification Authority is mandatory. This process provides the tax authorities with binding confirmation that the basic pension policy/the relevant sample contract meets the requirements set out in the Income Tax Act *(Einkommensteuergesetz* – EstG) which are referred to in the AltZertG. This means that premiums paid for a certified basic pension policy count as special expenses *(Sonderausgaben)* in an individual's tax return (section 1 EStG). In this respect, the certification requirement applies not only to new basic pension policies taken out, but also to existing policies whose premiums are to remain tax-incentivised as of the 2010 assessment year. By contrast, it is still the tax authorities and not BaFin's Certification Authority that is responsible for the recognition of basic pension policies that have already been taken out and relate to assessment periods prior to 1 January 2010 for tax purposes.

More than 200 applications in 2009 alone.

Providers had submitted more than 200 applications for the certification of sample contracts for basic pensions by the end of 2009. A further 50 applications had been submitted by March 2010, by which time more than 100 sample contracts had been certified. Further applications are expected to follow, especially for the certification of sample existing contracts. All of the certificates issued are published in the Federal Gazette *(Bundesanzeiger)* and on BaFin's homepage.[74] The individual certification requirements are set out in the EStG (section 10 (1) no. 2b).

The requirements set out in the EStG have been explained in further detail in two letters from the BMF dated 24 February 2005 and 30 January 2008. These letters state that the sample contract to be certified must, for example, ensure that the criteria for a tax incentive are fulfilled for the entire contract term. BaFin's Certification Authority also worked with the BMF to clarify numerous fundamental questions on the application of these criteria. It has published all interpretation regulations and special information on

[74] www.bafin.de » Unternehmen » Allgemeine Pflichten » Zertifizierungsstelle (in German only).

the certification procedure on BaFin’s website as a service for all providers. The website also features special application forms, explanatory notes and checklists explaining all of the certification criteria as a guide for providers.

Certification requirements for basic pension policies

In the main, basic pension policies must meet the following requirements before a certificate can be issued (incentive requirements), although the list set out below is non-exhaustive:

- It must be a comprehensive contract, i.e. the contract itself must specify the consideration to be paid by each party.
- The insured person must also be the beneficiary.
- The provider must make a contractual commitment to pay the contractual partner a monthly, lifelong pension in an amount that will either remain the same or will increase.
- The monthly pension may not be paid out before the individual has reached the age of 60 at the earliest. For policies taken out after 31 December 2011, the individual must have reached the age of 62.
- The policy must ensure that more than 50% of the premiums paid are always used for the pension benefits.
- The benefit entitlements acquired may not be transferable, eligible for use as collateral, eligible for sale, inheritable or convertible into cash.
- The agreement of a period-certain option or any payouts – including partial payouts – of the accumulated capital is prohibited.

Exception for existing policies.

In agreement with the central associations of the institutions, BaFin’s Certification Authority started by certifying the sample contracts for new business (2010 assessment period). Existing policies can be transferred to certified sample contracts. In this respect, BaFin – in consultation with the BMF – has permitted a number of exceptions to simplify the procedure and grant the providers of existing Rürup policies more flexibility for transferring policies. By way of example, all existing basic pension policies could still be marketed without certification up until 31 March 2010. Since 1 April 2010, however, certification has been a mandatory requirement for incentivised basic pension products.

6 Consumer complaints and enquiries

In 2009, a total of 22,329 clients of insurance undertakings, credit and financial services institutions turned to BaFin with complaints, queries or information (previous year: 22,408). Insofar as possible, BaFin tries to help each individual client, for example by urging the company to correct an error or by explaining the legal situation to the client.

In the event of a breach of supervisory law provisions, BaFin issues a warning to the institution or undertaking and orders it to take measures to prevent future breaches. If there are organisational defects, BaFin urges the company to make appropriate changes to its organisational structure and then monitors the implementation of these changes.

In order to protect themselves against fraud, dubious products or the total loss of their invested capital, investors should make sure they assess the integrity and economic plausibility of the offers they are interested in very carefully. Unfortunately, there is no such thing as 100% protection against insolvency and criminal offences.

Consumer hotline

In 2009, many citizens once again made use of BaFin's consumer hotline as an information and advisory service. Most of the queries related to BaFin's supervisory activities, the basic procedure for making a complaint and the status of pending complaints. The consumer hotline has been available under a new number, 0228 - 299 70 299, since February 2010.

From the date on which the hotline was set up on 1 March 2006 until the end of 2009, the hotline received a total of 106,000 enquiries. The 100,000th enquiry was made on the evening of 5 October 2009. Around 26,700 enquiries were made in 2009, compared with 31,400 in 2008. Despite the slight decline in the overall figures for 2009, the first quarter of the year saw a marked increase in the number of enquiries, with more than 2,740 made a month, as a result of the financial crisis. The average total monthly value stands at around 2,300 calls.

Almost half of the callers in the year under review had questions relating to insurance. Around 35% of consumers were calling about banks and building societies, whereas 10% of enquiries related to securities supervision. As a general rule, the enquiries relate to all supervisory areas that are relevant from a consumer perspective. In the year under review, this included, in particular, questions regarding the safety of deposits or premium increases for private health insurance policies.

6.1 Complaints about credit and financial services institutions

In the year under review, BaFin processed 6,027 complaints about credit and financial services institutions, as well as 38 complaints made via the Bundestag's Petition Committee and 481 general enquiries. In 1,024 cases (including 9 petitions), the complaints were either fully or partly successful.

Selected cases

Number of complaints about Kaupthing Bank remains high.

The 162 complaints made about Kaupthing Bank related mainly to how to assert claims and when deposits would be paid back. Now that the deposits have been paid back, clients were mainly interested in how they should assert their outstanding claims to interest.

Complaints on amendments to the General Terms and Conditions of Business.

Many bank clients also complained about the fact that, according to the General Terms and Conditions of Business that have been in force since 1 November 2009, clients are liable for incorrect instructions for bank transfers. The European Payment Council had stipulated uniform standards for processing payment transactions in what is known as the Single European Payment Area (SEPA). These standards formed the basis for the EU's Payment Services Directive, which was transposed into German law by an implementing act dated 9 July 2009. As a result, credit institutions had to amend their General Terms and Conditions of Business to reflect the SEPA regulations, according to which bank transfers may only be credited based on the account number specified in the transfer instruction in the future. This abolishes the account number check against the account holder's name, which was required for bank transfers not issued electronically from the outset in Germany. On the one hand, this increases the risk that transfers are credited to the wrong payment recipient. On the other hand, the IBAN (international bank account number) that now has to be specified for bank transfers is structured in such a way that interchanged digits produce an invalid IBAN. Furthermore, the former General Terms and Conditions of Business of the credit institutions had already stipulated that clients were liable for incorrect instructions for bank transfers.

Account management for "Internet con artists".

Numerous complaints related to the fact that credit institutions were managing accounts for providers that clients deemed to be dubious ("Internet con artists"), allowing them to operate in the first place. As long as a provider is not acting in a clearly illegal manner, however, BaFin cannot urge institutions to terminate business relationships. It does, however, make an enquiry with the institutions. In many cases, the outcome was that the institutions had either terminated the dubious business relationships or were unable to terminate them because the client managed to defend against the termination in court.

Origination fees for building society savings contracts *(Bausparverträge).*

In 2009, individuals with building society savings contracts once again claimed that the charging of origination fees for such contracts was not permitted. This issue, however, has to be resolved in court. The OLG Stuttgart recently dismissed a claim asserted by the German Consumer Advice Centre of the state of North Rhine Westphalia (Verbraucherzentrale Nordrhein-Westfalen)[75], although the judgment is not yet res judicata.

"Autobanks" temporarily unavailable.

At the beginning of the year under review, various "Autobanks" had offered favourable deposit interest rates. The interest among new clients wanting to invest their money with these institutions was so considerable that clients and interested individuals were unable to reach BMW Bank and, in particular, Mercedes Benz Bank. Furthermore, it often took several weeks to process new account applications. Ultimately, the substantial client interest actually prompted both institutions to stop accepting new clients for a certain period of time. Organisational measures (recruiting new staff, for example) to resolve the bottleneck took some time to kick in. The statements submitted on the complaints received by BaFin, however, showed that, in the majority of cases, satisfactory solutions were found for clients.

BaFin's 1st consumer protection forum

On 5 October 2010, BaFin hosted its first consumer protection forum in Bonn. Around 200 visitors attended the event in the State Museum of the Rhineland (Rheinisches Landesmuseum), which featured a controversial debate among consumer protection activists, providers, lawyers and representatives from academia on the question "Do we need uniform consumer protection regulations for financial services?". Everyone, however, agreed that comprehensible product information for investors and consumers is an absolute must. The consumer protection forum, which is planned to be held as a series of events, is designed to promote dialogue between market participants, academia, the media and policymakers. It also highlights the key role that BaFin plays in consumer protection.

[75] Judgment of 3 December 2009, case ref.: 2 U 30/09.

6.2 Complaints about insurance undertakings

With 14,274 fully processed complaints in 2009, BaFin processed slightly fewer complaints than in 2008 (15,111).

The enquiries included 12,056 complaints, 730 non-complaint enquiries and 100 petitions that came to BaFin via the Bundestag or the Federal Ministry of Finance. BaFin also received 1,388 enquiries that did not fall within its realm of responsibility.

Overall, 33.7% of proceedings (2008: 31.5%) had a favourable outcome for the complainant; 56.6% of complaints were unfounded, and in 9.7% of cases, BaFin was not the competent authority.

Table 31

Complaints received by insurance class (since 2005)

Year	Life	Motor vehicle	Health	Accident	Liability	Legal expenses	Building/ household	Other classes	Other complaints*
2009	4,490	1,431	2,259	726	907	913	1,372	568	1,608
2008	4,941	1,600	2,157	870	949	1,004	1,387	569	1,634
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

* Wrong address, brokers, etc.

Dispatch of annual policy statements.

In 2009, most of the complaints (34.4%; 2008: 32.3%) submitted related to claims processing/settlement in the life insurance sector. These were followed by complaints on the handling of insurance policies: 26.6% (previous year: 26.1%), contract termination: 17.8% (previous year: 15.9%) and business conduct when negotiating contracts: 11.7% (previous year: 10.5%). Special features of the Pension Contracts Certification Act accounted for 1.7% of complaints (previous year: 1.3%). Within these umbrella groups, the reasons set out below were the most common:

Table 32

Reasons for complaints

Reason	Number
Amount of insurance payment	1,975
Coverage issues	1,079
Advertising/advice/application processing	950
Manner of claims processing/delays	949
Termination without cause	889
Termination for cause	856
Bonus/profit credit	847
Other (handling of insurance policies)	808
Policy alterations and extensions	705
Changes and adjustments to premiums	537

Selected cases

The Regulation on Information Obligations for Insurance Contracts *(Verordnung über Informationspflichten bei Versicherungsverträgen* – VVG-InfoV) stipulates that life insurance undertakings must inform policyholders of the development in the value of their policies once a year. Several clients of one insurance undertaking had complained that they had not been receiving any policy statements. In one case, the insurer had stopped sending statements out after a policyholder became occupationally disabled and started receiving benefits from his disability rider. Since, however, the policyholder’s primary life insurance policy was still in force, BaFin insisted that the annual information be sent out. The company ultimately agreed. In another case, the policy statements were suspended due to a technical error. The insurer only resolved the problem after BaFin made an enquiry. This ensured that clients received their annual information for another 250 or so policies affected by this problem.

Policies involving minors without the consent of the family court.

A married couple had taken out annuity policies for their two children, aged 12 and 13. The parents were dissatisfied with the policies’ performance over the first few years and asked that the policies be rescinded, claiming that they had been given insufficient advice on the policy performance when they took the policies out. Furthermore, they claimed that the consent of the parents alone had been insufficient. The company initially refused to rescind the policies because there was no evidence to show that the agent had provided false advice. Once BaFin stated that policies involving minors require the consent of the family court, however, the insurer ultimately agreed to rescind the policies.

Problems with the basic rate for health insurance.

The introduction of the general mandatory health insurance cover subjected private health insurance undertakings to the obligation to provide a uniform sector-wide basic rate as at 1 January 2009, offering benefits that are comparable, in terms of type, scope and amount, to those offered under the statutory health insurance system. This prompted a whole range of enquiries and complaints in the course of the year. Various companies, for example, made admission to the basic rate subject to a separate agreement on the notional risk surcharge, although there is no basis for this in the legislation. Once BaFin became involved, the insurers confirmed that they would refrain from requesting the additional declaration in the future and would merely inform the policyholders of the fictitious risk surcharge. There were also disputes on the deductible that applies with the automatic switch from the modified standard rate to the basic rate. In many cases, for example, policyholders were moved over to the basic rate subject to a deductible of €300, without having been asked, as of 1 January 2009. In this respect, BaFin was able to achieve a retroactive amendment after pointing out to insurers that they have to offer policyholders the basic rate subject to no deductible on request, or deductibles of €300, €600, €900 or €1,200.

Maximum admission age for medical expenses and daily hospital allowance insurance.

The approach taken by two insurance undertakings, which only allowed policyholders under the age of 65 to take out comprehensive insurance policies, prompted several complaints. These companies claimed that, even after the coming into force of the General Equal Treatment Act *(Allgemeines Gleichbehandlungs-gesetz* – AGG), it was legally permissible to stipulate maximum admission ages for insurance rates depending on the risk to be insured. They stated that this still fell under one of the recognised principles of risk-commensurate calculation, meaning that it is anchored in the Calculation Regulation. BaFin was of the opinion that the rather general statements made by the companies were insufficient, because clear calculations, derivations and criteria would have to be submitted to justify a maximum admission age. Following extensive correspondence, the insurers ultimately lifted the maximum admission age for medical expenses and daily hospital allowance insurance.

Non-compliance with the contractual right of objection following premium increase.

Another complaint was based on the fact that a contractually agreed right of objection had been disregarded in a case involving a unilateral increase in premium. The general terms and conditions of a residential building insurance policy stated that, in the event of a premium increase, policyholders could defend themselves by terminating the policy or objecting to the premium increase. The objection meant that the policy was continued for one year based on the existing premium. The insurance undertaking was obliged to always draw policyholders' attention to the right of objection in the event of premium increases. The complainant stated that the insurance company had failed to provide this information and interpreted his objection as a termination notice. Thanks to BaFin's involvement, the complainant managed to continue the insurance policy subject to no premium increase as a result of the objection – as provided for in the policy terms and conditions.

Legal expenses insurance policy unintentionally taken out online.

One complainant objected to a premium invoice that she had received from a legal expenses insurer. She claimed that she had never contacted the insurance undertaking in question. It turned out that she had obtained proposals for motor vehicle insurance via an Internet portal and had opted for one of these proposals. The procedure for taking out motor vehicle insurance via the Internet portal, however, automatically involved taking out the legal expenses insurance policy. The only way in which the complainant could have avoided this was by clicking to deactivate a check box that had been activated by default in the Internet portal before sending off the declaration of acceptance. Thanks to BaFin's involvement, the complainant's legal expenses insurance policy was rescinded and the Internet portal revamped its website to make it more consumer-friendly. The corresponding check box was deactivated by default. An additional legal expenses insurance policy can now only be included if the interested party actively confirms this by clicking on the box.

6.3 Complaints regarding securities transactions

In 2009, investors submitted 1,238 complaints regarding the securities business of credit and financial services institutions to BaFin (previous year: 1,119). 257 written enquiries were also submitted by investors (previous year: 349). As in 2008, one of the common subjects of investor complaints in the year under review was insufficient information provided during the sales pitch.

14 investors complained about financial analyses, with most of the complaints relating not to the content of financial analyses, but rather to the manner in which they were disseminated. By way of example, one investment newsletters sent unsolicited recommendations on what are known as “penny stocks” out by fax to private investors, in some cases during the night.

Selected cases

Capital guarantee must be explained.

Complaints often related to the fact that banks provided incorrect information on financial instruments during their sales pitches. In one case, for example, a client had purchased a certificate to be paid back in full at the end of the term, upon a recommendation issued by his bank. During the sales pitch, the bank had stated that the product would offer maximum security thanks to a 100% capital guarantee at maturity. The bank had not, however, informed the client of the risk that the issuer and guarantor – the issuer’s parent company – could well be unable to meet their payment obligations vis-à-vis the client in the event of insolvency, meaning that the investment did not offer maximum security. BaFin ordered the bank to provide its clients with correction information on the characteristics and risks of financial instruments.

Dubious service.

Numerous investors complained to BaFin about an institution that had immediately invested fund distributions to clients in new units in its funds without obtaining explicit instructions from the clients in advance. The bank only informed its clients once the funds had been reinvested and offered them a limited period of time during which to object. Although the company billed the clients for only a reduced front-end load of 50%, this approach allowed it to generate substantial commission income without having to invest much time or effort. The company’s explanation behind its automatic reinvestment service was that the distribution would work in the client’s favour with immediate effect, as opposed to being stuck in the client’s account without accruing any interest. However, the numerous objections submitted by its clients should have made the institution realise that the service was not in line with its clients’ presumed interests. This was particularly the case for clients who had consciously opted for a distributing fund – for example so that they could use the income to cover part of their cost of living. Once BaFin became involved, the institution in question abolished the automatic reinvestment mechanism.

Agreements on kick-backs.

The question as to whether a bank is entitled to retain sales commission, such as front-end loads or trailer fees, from the management fees charged by fund management companies, without a special agreement, has not yet been clarified by case law. It is therefore becoming increasingly commonplace for credit institutions to ask not only new clients, but also their existing clients, to sign a standard agreement on sales commission. These agreements state that the clients will waive their right to any sales commission to which they are entitled, or that the bank is entitled to keep sales commission received from third parties. Many investors informed BaFin that they were outraged at this practice. In individual cases, investors reported that their bank had virtually forced them to sign the agreement, threatening to terminate the business relationship otherwise.

Since the standard agreements relate solely to the sales commissions that the institutions are allowed to accept pursuant to the WpHG, these agreements do not breach the supervisory law requirements. Another fact to bear in mind is that the legislature made a conscious decision not to put binding provisions in place on a different remuneration system for investment service enterprises, for example by setting fixed fees for investment advice. Furthermore, based on the standard terms and conditions of business that apply in the banking sector, institutions are entitled, in principle, to terminate a business relationship even without having a particular reason for doing so. Consequently, BaFin was unable to support the complainants in these cases. Furthermore, the question as to whether these standard agreements on sales commission are in line with requirements set out in the German Civil Code regarding general terms and conditions of business is a legal question that can only be clarified by the civil courts. In order to provide effective protection for the consumers subject to such general terms and conditions of business, the Unfair Competition Act *(Gesetz gegen den unlauteren Wettbewerb* – UWG) grants certain institutions, such as consumer advice centres, the power to take legal action against institutions that use illegal general terms and conditions of business. Clients who believe that the agreements on benefits that they are asked to sign or the other regulations on sales commission set out in their bank's terms and conditions are inadmissible should therefore contact a consumer advice centre.

6.4 Enquiries based on the Freedom of Information Act

Information requests of a different quality.

The financial crisis also had an impact on applications based on the Freedom of Information Act *(Informationsfreiheitsgesetz* – IFG) in 2009. The information requests proved to be of a different quality, both in administrative proceedings and in court disputes. First, they no longer related merely to the provision of company-related information with the aim of asserting damage claims against the companies affected; the applicants also mentioned the possibility of asserting claims against BaFin in its capacity as a public authority due to breach of official duty. Second, several journalists attempted to obtain the right to inspect files, for example on the Hypo Real Estate Group case, for reporting purposes. This went so far that ultimately, in the second instance, even the Administrative High Court of Hesse had to make a decision in such a case, prior to the Bundestag elections, in summary proceedings.[76] Without making any conclusive statements on the requirements set out in the IFG – which BaFin believes definitively rule out the information procedure – the Administrative High Court of Hesse nevertheless made it clear that any immediate right to inspect files was out of the question because it would be prejudicial to the main case. The court thus made it clear that information cannot be requested by means of temporary relief proceedings. By contrast, the HessVGH still did not make a fundamental decision in the pending main proceedings in 2009.

Protection of business and trade secrets take precedence over claim to information.

In line with what is now becoming an established case law pattern, the Administrative Court of Frankfurt am Main acknowledges the protection of business and trade secrets in applications pursuant to the IFG. If the requirements set out in section 3 no. 4 IFG in conjunction with the confidentiality obligations that apply to BaFin employees are met, the court believes that there is no right to the disclosure of these secrets. Consequently, it has dismissed claims aimed at the disclosure of such information.[77]

Number of new applications on the decline.

As far as the number of new applications based on the IFG is concerned, they are down year-on-year, particularly as far as banking supervision is concerned. Nevertheless, at 166 applications (previous year: 407), they remain at a relatively high level. One reason for this is what are known as “group applications” submitted by investor protection law firms using the same wording for a large number of clients.

As in the previous year, the banking supervisory authority had to turn down most of the applications for access to information due to exemptions in 2009, too. In the insurance and securities

[76] Decision of 15 September 2009, case ref.: 6 B 2325/09.
[77] Judgment of 18 February 2009, case ref.: 7 K 4170/07.F(V); judgment of 19 March 2008, case ref.: 7 E 4067/06(1); judgment of 28 January 2009, case ref:. 7 K 4037/07.F(3).

supervision areas, BaFin was able to issue positive responses, at least in part, for more than half of the cases and provide the applicants with the desired information.

Table 33
Enquiries based on the IFG in 2009

Supervisory areas	Number	Application withdrawn	Access to information granted	Access to information partially granted	Access to information denied	In process	Objection filed	Appeal lodged
BA	87	2	1	3	11	70	15	10
VA	4	1	0	3	0	0	1	1
WA	66	9	16	12	28	1	15	11
Other	9	1	2	1	4	1	1	0
Total	**166**	**13**	**19**	**19**	**43**	**72**	**32**	**22**

VIII About BaFin

1 Personnel and organisation

Personnel

As at the end of 2009, BaFin employed a staff of 1,829 (2008: 1,716), 65% or 1,191 of whom were civil servants and 35% or 638 non-civil service employees. These staff are divided between our offices in Bonn (1,398) and Frankfurt am Main (431).

Almost 50% of our staff are female (873), with roughly a quarter of management positions held by women. Twelve BaFin employees hold long-term positions with European and international institutions and supervisory authorities.

Table 34
Number of employees as at 31 December 2009

Career levels	Employees			Civil servants	Non-civil service employees
	Total	Female	Male	Total	Total
Higher Civil Service	737	271	466	632	105
Upper Civil Service	625	289	336	495	130
Middle/basic Civil Service	467	313	154	64	403
Total	1,829	873	956	1,191	638

180 new staff recruited.

BaFin recruited 180 new members of staff in 2009 (including candidates for entry to the upper Civil Service, trainees and temporary staff), predominantly fully qualified lawyers and university of applied science graduates.

Table 35
Recruitment in 2009

Career levels				Qualifications			
	Total	Female	Male	Fully qualified lawyers	Econo-mists	Mathemati-cians Sta-tisticians	Other
Higher Civil Service	93	38	55	65	17	6	5
				Business law-specialists	Econo-mists	IT specialists	Other
Upper Civil Service	52	23	29	15	30	1	6
Middle Civil Service	12	8	4				
Candidates for entry to the upper Civil Services / trainees	23	11	12				
Total	**180**	**80**	**100**				

BaFin provides training for three career paths.

BaFin provides training for three career paths: IT specialist (1), office communication specialist (31), and media and information services specialist (1). In collaboration with the Bundesbank, it also prepares the candidates for entry to the upper Civil Service for their responsibilities (29). Twenty-three people started training or preparation for civil service with BaFin in 2009 (2008: 22), taking the total number of trainees and candidates to 62 at the end of the year (2008: 58).

Organisation

Integrated supervision programme developed for new employees.

BaFin developed an "Allfinanz" programme for new employees in 2009. They go through different modules within the first 18 months on the basic issues of all supervisory areas. The programme is designed to establish cross-sectoral understanding of BaFin's activities among new recruits, promoting a sense of identity and the connections between the different areas. The pilot phase started in January 2010.

Further professional training.

BaFin offered its staff 470 further professional training events in the year under review, on topics such as the Act to Modernise Accounting Law which came into effect in May 2009. A total of 1,145 employees took part in these training sessions – 71% of the entire BaFin staff. On average, each employees had a total of 3.85 days of further professional training in 2009.

Performance-related pay for non-civil service employees.

In 2009, BaFin distributed the first bonuses of the performance-related pay scheme for non-civil service employees which was introduced in 2008. Payments were made to 524 employees relating to their performance, which was evaluated either via systematic assessments or based on performance objectives agreements. BaFin paid out a total of approximately €132,000 in bonuses.

New data protection office.

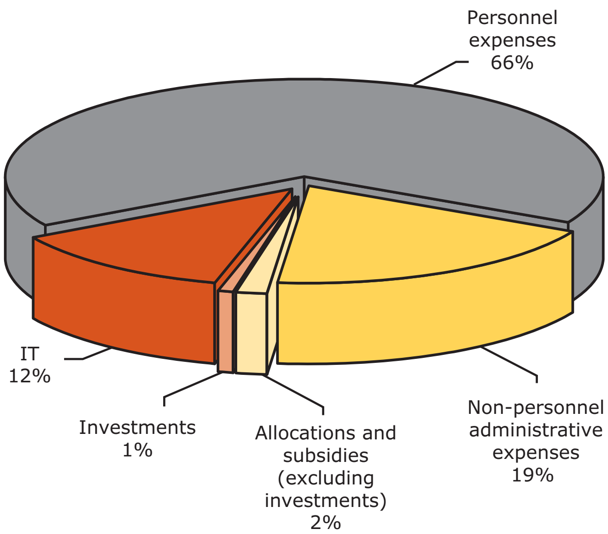
BaFin introduced a new data protection concept and new implementation regulations relating to the Federal Data Protection Act *(Bundesdatenschutzgesetz* – BDSG) in December 2009. These include regulations on dealing with the rights to information of persons whose data has been processed by BaFin. This affects both employees of BaFin and external persons. The data protection concept and implementation regulations form the central component of data protection management at BaFin. Statutory data protection requirements are implemented according to BaFin's activities, and internal responsibilities have been established e.g. for preliminary checks in data processing which entails particular risks to the freedom and rights of the persons involved. BaFin also established a data protection office, which supports the data protection officer in meeting the statutory requirements.

2 Budget

Budget plan 2009: €135.3 million.

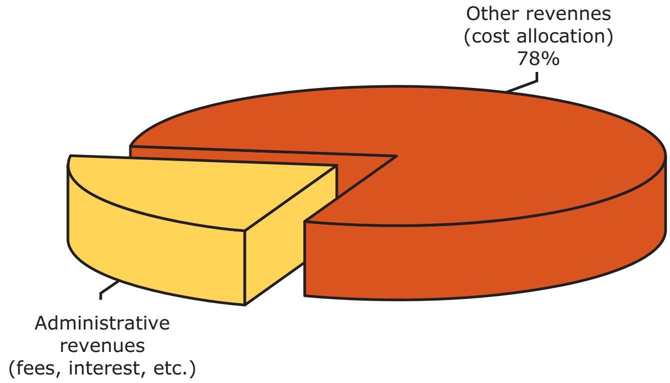
BaFin's 2009 budget plan projected approximately €135.3 million for revenues and expenditures (2008: €122.9 million). Personnel expenses accounted for around 66% of the projected expenditure (€89.4 million; 2008: €81.7 million), and non-personnel expenses for around 19% (€25.6 million; 2008: €21.8 million).

Figure 32
Expenditure (budget plan 2009)



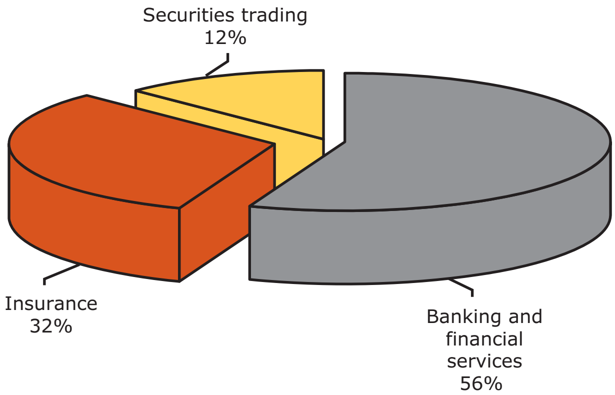
The annual cost allocation projected for 2009 of approximately €105.9 million (2008: €97.7 million) and the projected administrative revenue of €29.4 million (2008: €25.2 million) cover all BaFin expenditure. BaFin is thus independent of the federal budget.

Figure 33
Revenue (budget plan 2009)



In accordance with the settlement for budget year 2008, the banking industry contributed 55.7% to the total revenue. The insurance sector financed 31.9% and the securities trading sector 12.4%. The final cost allocation for 2009 will be determined during 2010. BaFin based advance payments for 2010 on these preliminary allocation scales.

Figure 34
Cost allocation by supervisory area 2008



Minimum allocation constitutional

The BVerfG rejected a constitutional complaint in September 2009 regarding the minimum allocation BaFin charges smaller companies. The court not only confirmed the type and amount of the minimum allocation, it also declared cost-allocation financing to be constitutionally permissible.

The complainant did not consider the minimum allocation charge to be compliant with the federal financial constitution (Art. 104a et seq. of the Basic Law for the Federal Republic of Germany *(Grundgesetz* – GG)). He also considered it to violate professional freedom and the principle of equality. The BVerfG judges refused to hear the complaint. They held it was advantageous for companies to participate in a regulated market, and correspondingly, that they must bear a direct share of the costs of regulation. They held that the minimum expense incurred by the Supervisory Authority for every company justified the minimum allocation charge.

€139.0 million revenue, €129.1 million expenditure.

BaFin's actual expenditure was approximately €129.1 million in 2009 (2008: €120.4 million). Revenue was approximately €139.0 million (2008: €136.5 million). The Administrative Council has yet to approve the annual financial statements.

Separate enforcement budget.

A separate enforcement budget provided for revenues and expenditures of around €7.7 million for 2009 (2008: €7.8 million), of which approximately €6.1 million (2008: €6.3 million) was an allocation to the German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung). Actual expenditure amounted to around €7.1 million (2008: €7.3 million). Revenue was generated in the amount of approximately €15.8 million, including allocation advance payments for 2010 (2008: €15.6 million).

3 Public relations

Great interest from the press and public.

BaFin was the focus of considerable public attention again in 2009. It answered over 4,000 inquiries from press representatives alone. The media and the public followed the progress of the parliamentary investigation committee efforts to save Hypo Real Estate with great interest. The press inquiries also included current events at other banks and the record of investment advice that investment services enterprises have to complete for any investment advice from January 2010. Given the environment of worldwide discussions on bonuses, the new remuneration regulations for banks and insurance undertakings were also the subject of a large number of inquiries. There was also a lot of interest in the market manipulation investigation relating to VW shares and the suspected Kiener fraud. Inquiries relating to insurance were predominantly about the Supervisory Authority's survey of low interest rates among life insurance undertakings and the premium demanded from some private health insurers from customers who change their coverage type. And last but not least, many inquiries related to the discussion on the consolidation of the Bundesbank and BaFin.

Press briefings on issues relevant to the market.

In addition to the annual press conference in May and the New Year press reception in January, BaFin also organised press briefings on issues of particular market relevance. These briefings provide media representatives with an intensive insight into supervisory matters. For example, in October 2009, there was a press briefing held in connection with the Islamic Finance Conference about sharia-compliant financial products and the question as to the supervisory requirements under which they could be offered in Germany. In a press briefing in December 2009, BaFin used the Basel Committee's consultation paper as an occasion to explain what regulatory capital will consist of in the future and what the capital requirements for certain transactions will be.

6. Forum for white-collar crime and the capital market.

The BaFin forum showed evidence that the courts are imposing increasingly high fines and even prison sentences on insider traders and market manipulators. This was the sixth meeting of judges, public prosecutors, police officers and staff from stock exchange trading surveillance units, the Bundesbank and BaFin, to discuss the latest developments in market abuse. The event is an important platform for cooperation in combating white-collar crime.

The meeting started with a general introduction to investment management now requiring a licence, and moved on the first item on the agenda – the BVerwG's decision on cross-border financial transactions. This concerned whether banking business is deemed to be conducted in Germany if the provider has no physical presence there at all. The court of last instance approved this question, thereby confirming supervisory practice. Prior to this, the ECJ had ruled that BaFin's legal position was not in breach of EU law. It declared that BaFin's interpretation of the term "in Germany" hampered access to the German market for companies based in third countries, as they required both a licence and a fixed branch office in Germany. However, companies based in third countries could not plead the associated impairment of freedom to provide services. A representative of the Austrian Financial Market Authority (FMA) reported on the methods used to combat unauthorised transactions in Austria.

The event also focussed on warrants and leverage certificates. Insiders had used these derivative instruments, among others, to generate multi-million price gains in the largest insider case to date (Telekom).[78] In the closing panel discussion, the public prosecutor's office, the police and BaFin agreed on the importance of working together intensively as soon as possible.

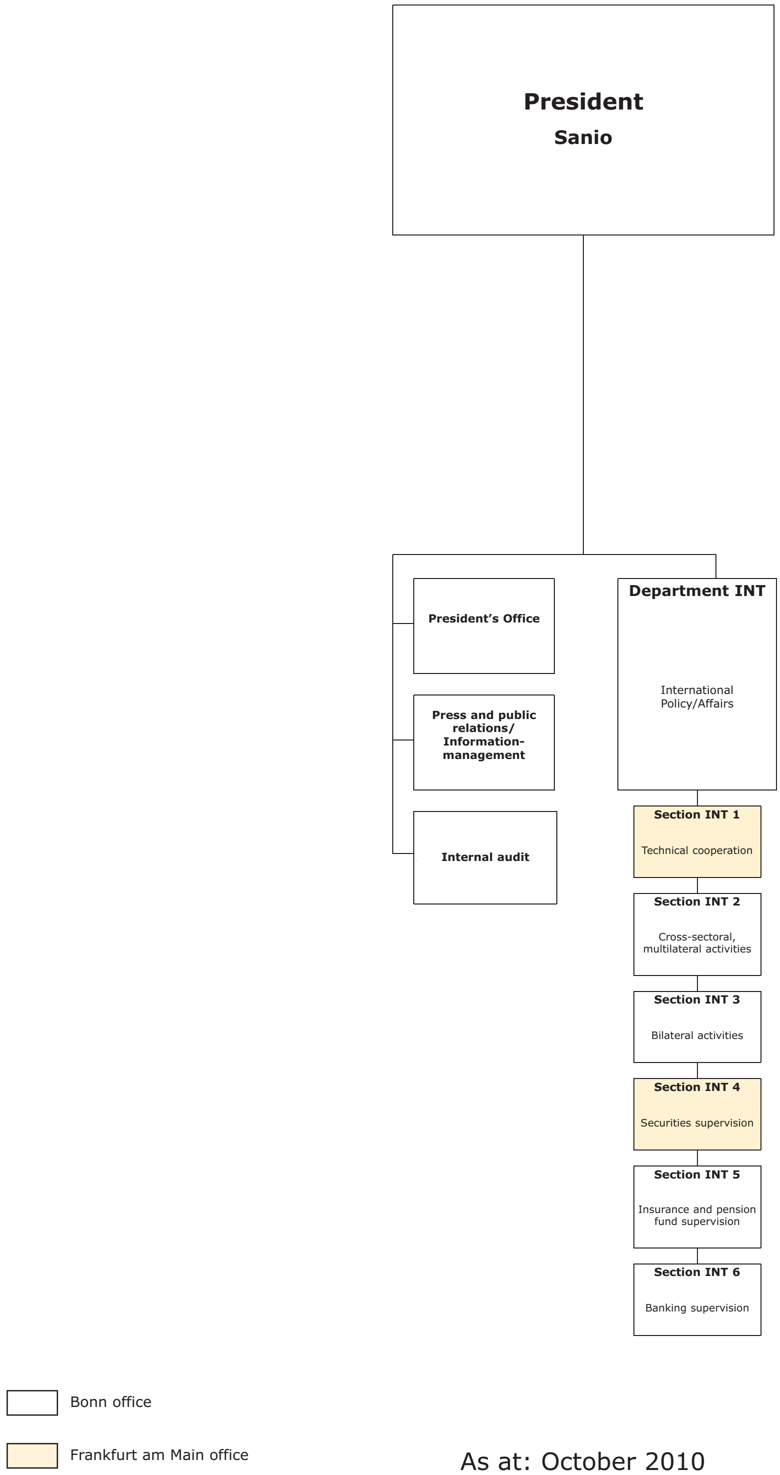
[78] See chapter VI.2.3.

Invest and Börsentag trade fairs

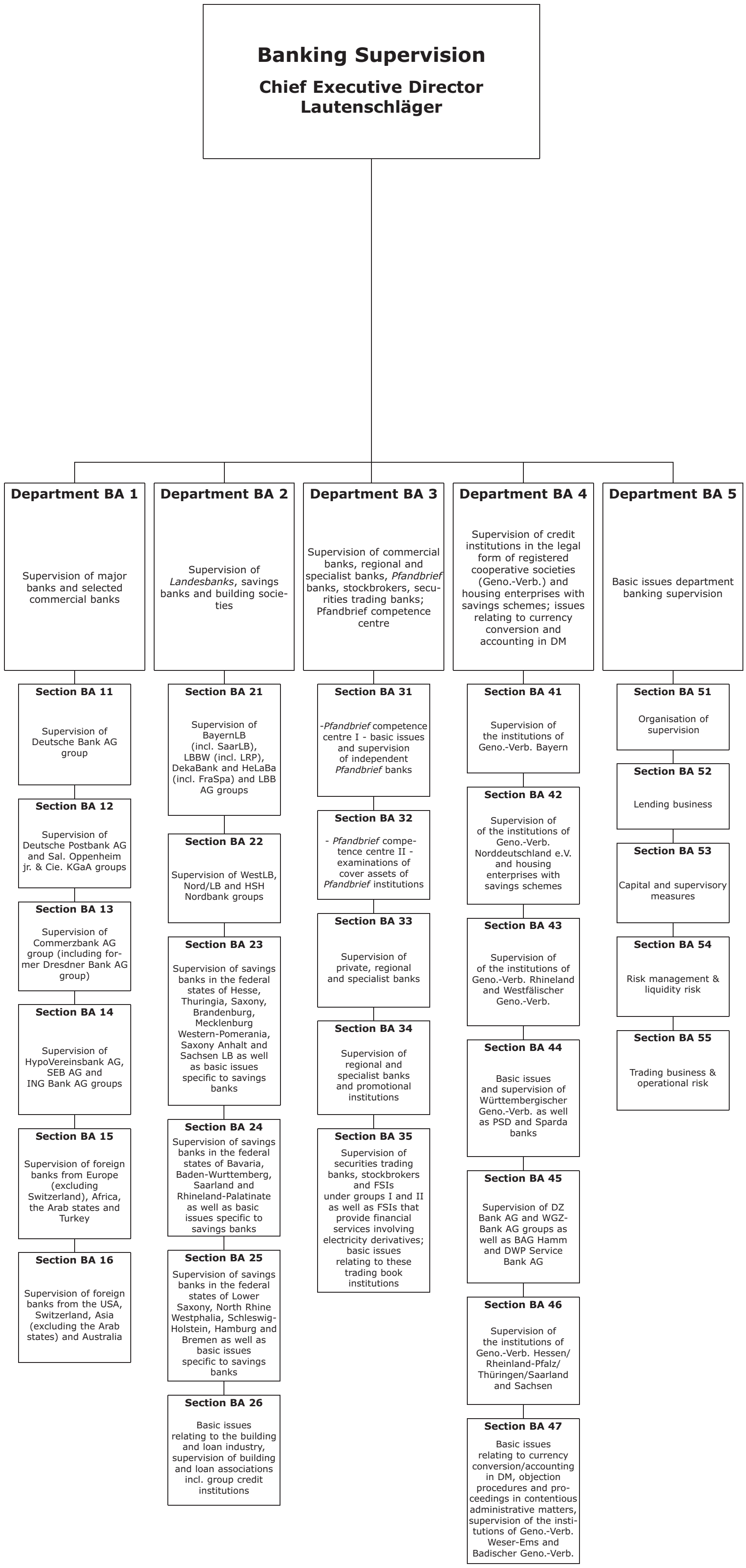
BaFin participated in the “Invest” financial trade fair in Stuttgart in 2009, along with the one-day “Börsentag” stock exchange trade fairs in Dresden, Hamburg, Munich, Frankfurt and Berlin. As in the past two years, attendees were primarily concerned with the financial crisis and the banks’ situations. The restructuring of supervision was also a hot topic. The Dusseldorf IAM investor fair was not held in 2009.

Appendix

Organisation chart



As at: October 2010


Banking Supervision
Chief Executive Director Lautenschläger
Department BA 1
Supervision of major banks and selected commercial banks
Department BA 2
Supervision of *Landesbanks*, savings banks and building societies
Department BA 3
Supervision of commercial banks, regional and specialist banks, *Pfandbrief* banks, stockbrokers, securities trading banks; Pfandbrief competence centre
Department BA 4
Supervision of credit institutions in the legal form of registered cooperative societies (Geno.-Verb.) and housing enterprises with savings schemes; issues relating to currency conversion and accounting in DM
Department BA 5
Basic issues department banking supervision
Section BA 11
Supervision of Deutsche Bank AG group
Section BA 12
Supervision of Deutsche Postbank AG and Sal. Oppenheim jr. & Cie. KGaA groups
Section BA 13
Supervision of Commerzbank AG group (including former Dresdner Bank AG group)
Section BA 14
Supervision of HypoVereinsbank AG, SEB AG and ING Bank AG groups
Section BA 15
Supervision of foreign banks from Europe (excluding Switzerland), Africa, the Arab states and Turkey
Section BA 16
Supervision of foreign banks from the USA, Switzerland, Asia (excluding the Arab states) and Australia
Section BA 21
Supervision of BayernLB (incl. SaarLB), LBBW (incl. LRP), DekaBank and HeLaBa (incl. FraSpa) and LBB AG groups
Section BA 22
Supervision of WestLB, Nord/LB and HSH Nordbank groups
Section BA 23
Supervision of savings banks in the federal states of Hesse, Thuringia, Saxony, Brandenburg, Mecklenburg Western-Pomerania, Saxony Anhalt and Sachsen LB as well as basic issues specific to savings banks
Section BA 24
Supervision of savings banks in the federal states of Bavaria, Baden-Wurttemberg, Saarland and Rhineland-Palatinate as well as basic issues specific to savings banks
Section BA 25
Supervision of savings banks in the federal states of Lower Saxony, North Rhine Westphalia, Schleswig-Holstein, Hamburg and Bremen as well as basic issues specific to savings banks
Section BA 26
Basic issues relating to the building and loan industry, supervision of building and loan associations incl. group credit institutions
Section BA 31
-*Pfandbrief* competence centre I - basic issues and supervision of independent *Pfandbrief* banks
Section BA 32
- *Pfandbrief* competence centre II - examinations of cover assets of *Pfandbrief* institutions
Section BA 33
Supervision of private, regional and specialist banks
Section BA 34
Supervision of regional and specialist banks and promotional institutions
Section BA 35
Supervision of securities trading banks, stockbrokers and FSIs under groups I and II as well as FSIs that provide financial services involving electricity derivatives; basic issues relating to these trading book institutions
Section BA 41
Supervision of the institutions of Geno.-Verb. Bayern
Section BA 42
Supervision of of the institutions of Geno.-Verb. Norddeutschland e.V. and housing enterprises with savings schemes
Section BA 43
Supervision of of the institutions of Geno.-Verb. Rhineland and Westfälischer Geno.-Verb.
Section BA 44
Basic issues and supervision of Württembergischer Geno.-Verb. as well as PSD and Sparda banks
Section BA 45
Supervision of DZ Bank AG and WGZ-Bank AG groups as well as BAG Hamm and DWP Service Bank AG
Section BA 46
Supervision of the institutions of Geno.-Verb. Hessen/ Rheinland-Pfalz/ Thüringen/Saarland and Sachsen
Section BA 47
Basic issues relating to currency conversion/accounting in DM, objection procedures and proceedings in contentious administrative matters, supervision of the institutions of Geno.-Verb. Weser-Ems and Badischer Geno.-Verb.
Section BA 51
Organisation of supervision
Section BA 52
Lending business
Section BA 53
Capital and supervisory measures
Section BA 54
Risk management & liquidity risk
Section BA 55
Trading business & operational risk

Insurance and Pension Fund Supervision
Chief Executive Director
TBA

- **Department VA 1**
  Occupational retirement provision; supervision of *Pensionskassen*, pension funds and health insurers
  - **Section VA 11** – Basic issues relating to occupational retirement provision and *Pensionskassen*; supervision of *Pensionskassen* and pension funds; supervision of foreign IORPs; notification procedure
  - **Section VA 12** – Supervision of *Pensionskassen* (incl. church and insurance sector)
  - **Section VA 13** – Supervision of *Pensionskassen* (incl. industrial sector but excl. chemical industry)
  - **Section VA 14** – Basic issues relating to pension funds; supervision of *Pensionskassen* and pension funds, incl. Allianz *Pensionskasse* and the *Pensionskasse* for public-law broadcasting corporations
  - **Section VA 15** – Supervision of *Pensionskassen* and pension funds incl. chemical industry
  - **Section VA 16** – Basic issues relating to health insurance; supervision of health insurers, incl. Allianz Kranken and DKV
  - **Section VA 17** – Supervision of health insurers, incl. Barmenia Group
- **Department VA 2**
  Supervision of life insurers and death benefit funds
  - **Section VA 21** – Basic issues / supervision of life insurers incl. Allianz Leben; supervision of death benefit funds
  - **Section VA 22** – Supervision of life insurers, incl. public insurance undertakings; supervision of death benefit funds; notification procedure
  - **Section VA 23** – Supervision of life insurers, incl. Hamburg-Mannheimer; supervision of death benefit funds
  - **Section VA 24** – Supervision of life insurers, incl. AachenMünchener Leben; supervision of death benefit funds
  - **Section VA 25** – Supervision of life insurers, incl. AXA Leben; supervision of death benefit funds
  - **Section VA 26** – Supervision of life insurers, incl. Nürnberger Group; supervision of death benefit funds
- **Department VA 3**
  Supervision of property/casualty insurers; national insurance groups; quantitative supervision
  - **Section VA 31** – Basic issues relating to property and legal expenses insurance; supervision of, inter alia, VHV Group; notification procedure
  - **Section VA 32** – Supervision of, inter alia, Gothaer Group
  - **Section VA 33** – Basic issues relating to HUK; supervision of, inter alia, HUK-Coburg Group and DEVK Group
  - **Section VA 34** – Supervision of, inter alia, VGH Group
  - **Section VA 35** – Supervision of, in particular, small mutual associations
  - **Section VA 36** – Basic issues relating to quantitative supervision, incl. technical provisions; supervision of R+V Group
- **Department VA 4**
  Supervision of international insurance groups, financial conglomerates and reinsurers; qualitative supervision; internal models
  - **Section VA 41** – Supervision of, in particular, Allianz Group
  - **Section VA 42** – Basic and international issues relating to reinsurance; supervision of, inter alia, Munich Re Group
  - **Section VA 43** – Basic issues relating to the MaRisk VA; supervison of, inter alia, W&W Group and Zurich Group
  - **Section VA 44** – Supervision of, in particular, Talanx Group
  - **Section VA 45** – Supervision of, in particular, AMB and other host groups
  - **Section VA 46** – Basic issues relating to internal models and centre of competence for insurance groups; supervision of Signal/Iduna Group
- **Department VA 5**
  Basis issues; VA policy; risk orientation
  - **Section VA 51** – Cooperation; Communication; Implementation of Solvency II; internal coordination in insurance supervision
  - **Section VA 52** – Legislation; legal issues; general good
  - **Section VA 53** – Databases; statistics; reporting
  - **Section VA 54** – Market risk; investments
  - **Section VA 55** – Risk orientation of insurance supervision

Securities Supervision/ Asset Management

Chief Executive Director Caspari

Department WA 1

Basic issues relating to securities supervision; company takeovers; major holdings of voting rights; reporting

- **Section WA 11** – Basic issues relating to securities supervision; assistance in the legislative process and advisory boards; Stock Exchange Expert Commission
- **Section WA 12** – Major holdings of voting rights (issuers A-K)
- **Section WA 13** – Major holdings of voting rights (issuers L-Z; numbers)
- **Section WA 14** – Reporting
- **Section WA 15** – financial reporting enforcement
- **Section WA 16** – Mandatory offers, takeover bids and offers for the acquisition of securi-ties; office of the Objections Committee; exemptions [trading portfolio, mandatory offers, voting rights]
- **Section WA 17** – Administrative offence procedures

Department WA 2

Insider surveillance; ad hoc disclosure; directors’ dealings; stock exchange competence centre; market surveillance and analysis; prospectuses

- **Section WA 21** – Insider surveillance
- **Section WA 22** – Ad hoc disclosure; directors’ dealings; stock exchange competence centre
- **Section WA 23** – Monitoring of market manipulation
- **Section WA 24** – Market analysis

PRO Group – Prospectuses

- **Section PRO 1** – Prospectuses – issuers A – F
- **Section PRO 2** – Prospectuses – issuers G – Z
- **Section PRO 3** – Non-securities investment prospectuses

Department WA 3

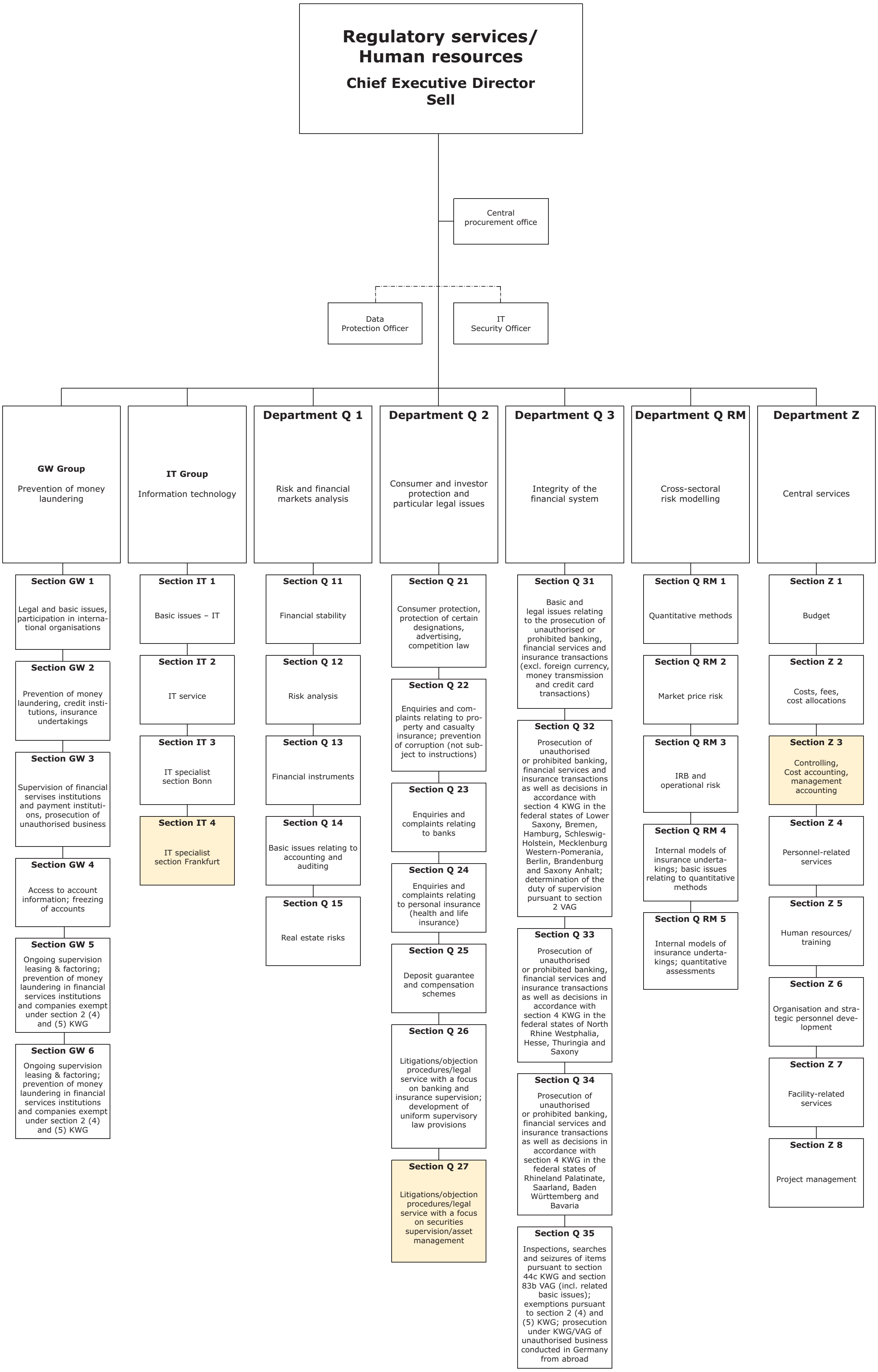
Supervision of FSIs in accordance with the Ban-king Act (KWG) and the Securities Trading Act (WpHG); supervision of credit institutions in accordance with WpHG; basic issues relating to the interpretation and verification of rules of conduct (section 31 et seq. WpHG)

- **Section WA 31** – Basic issues relating to investor protection; supervision of FSIs in accordance with KWG (excl. securities trading banks and EEA branches) and WpHG (incl. securities trading banks, but excl. EEA branches) in the federal states of Hesse, Saxony and Thuringia
- **Section WA 32** – Rules of conduct/ credit institutions; supervision of savings banks and cooperative banks
- **Section WA 33** – Rules of conduct/ credit institutions; supervision of foreign banks and private banks
- **Section WA 34** – Supervision of FSIs in accordance with KWG (excl. securities trading banks and EEA branches) and WpHG (incl. securities trading banks, but excl. EEA branches) in the federal states of Berlin, Brandenburg, Hamburg, Schleswig-Holstein, Mecklenburg Western Pomerania and Baden-Württemberg
- **Section WA 35** – Supervision of FSIs in accordance with KWG (excl. securities trading banks and EEA branches) and WpHG (incl. securities trading banks, but excl. EEA branches) in the federal states of Bavaria, Lower Saxony, Saxony Anhalt and Bremen
- **Section WA 36** – Monitoring of securities analysts as well as the expertise and disclosure rules pursuant to section 34b WpHG
- **Section WA 37** – Supervision of FSIs (incl. cross-border EEA-based FSIs and branches) in accordance with KWG and WpHG; supervision of securities trading banks in accordance with WpHG in the federal states of North Rhine Westphalia, Rhineland Palatinate and Saarland; KWG basic issues relating to ongoing supervision of FSIs

Department WA 4

Investment funds

- **Section WA 41** – Basic issues section
- **Section WA 42** – Supervision of asset management companies (KAGs), in particular those licensed to establish real estate funds, German invest-ment funds; custodian banks and foreign UCITS (excluding hedge funds and other foreign non-UCITS)
- **Section WA 43** – Supervision of asset management companies (KAGs), German investment funds; custodian banks and foreign UCITS (exclu-ding real estate funds, hedge funds and other foreign non-UCITS)
- **Section WA 44** – Supervision of asset management companies (KAGs), German investment funds; custodian banks and foreign UCITS (exclu-ding real estate funds, hedge funds and other foreign non-UCITS)
- **Section WA 45** – Supervision of asset management companies (KAGs), German investment funds; custodian banks and foreign UCITS (exclu-ding real estate funds, hedge funds and other foreign non-UCITS)
- **Section WA 46** – Supervision of asset management companies (KAGs), German investment funds; custodian banks, for-eign UCITS, foreign non-UCITS (including hedge funds but exclu-ding real estate funds) and venture capital companies


Regulatory services/
Human resources
Chief Executive Director
Sell
Central
procurement office
Data
Protection Officer
IT
Security Officer
GW Group
Prevention of money laundering
IT Group
Information technology
Department Q 1
Risk and financial markets analysis
Department Q 2
Consumer and investor protection and particular legal issues
Department Q 3
Integrity of the financial system
Department Q RM
Cross-sectoral risk modelling
Department Z
Central services
Section GW 1
Legal and basic issues, participation in international organisations
Section GW 2
Prevention of money laundering, credit institutions, insurance undertakings
Section GW 3
Supervision of financial servises institutions and payment institutions, prosecution of unauthorised business
Section GW 4
Access to account information; freezing of accounts
Section GW 5
Ongoing supervision leasing & factoring; prevention of money laundering in financial services institutions and companies exempt under section 2 (4) and (5) KWG
Section GW 6
Ongoing supervision leasing & factoring; prevention of money laundering in financial services institutions and companies exempt under section 2 (4) and (5) KWG
Section IT 1
Basic issues – IT
Section IT 2
IT service
Section IT 3
IT specialist section Bonn
Section IT 4
IT specialist section Frankfurt
Section Q 11
Financial stability
Section Q 12
Risk analysis
Section Q 13
Financial instruments
Section Q 14
Basic issues relating to accounting and auditing
Section Q 15
Real estate risks
Section Q 21
Consumer protection, protection of certain designations, advertising, competition law
Section Q 22
Enquiries and complaints relating to property and casualty insurance; prevention of corruption (not subject to instructions)
Section Q 23
Enquiries and complaints relating to banks
Section Q 24
Enquiries and complaints relating to personal insurance (health and life insurance)
Section Q 25
Deposit guarantee and compensation schemes
Section Q 26
Litigations/objection procedures/legal service with a focus on banking and insurance supervision; development of uniform supervisory law provisions
Section Q 27
Litigations/objection procedures/legal service with a focus on securities supervision/asset management
Section Q 31
Basic and legal issues relating to the prosecution of unauthorised or prohibited banking, financial services and insurance transactions (excl. foreign currency, money transmission and credit card transactions)
Section Q 32
Prosecution of unauthorised or prohibited banking, financial services and insurance transactions as well as decisions in accordance with section 4 KWG in the federal states of Lower Saxony, Bremen, Hamburg, Schleswig-Holstein, Mecklenburg Western-Pomerania, Berlin, Brandenburg and Saxony Anhalt; determination of the duty of supervision pursuant to section 2 VAG
Section Q 33
Prosecution of unauthorised or prohibited banking, financial services and insurance transactions as well as decisions in accordance with section 4 KWG in the federal states of North Rhine Westphalia, Hesse, Thuringia and Saxony
Section Q 34
Prosecution of unauthorised or prohibited banking, financial services and insurance transactions as well as decisions in accordance with section 4 KWG in the federal states of Rhineland Palatinate, Saarland, Baden Württemberg and Bavaria
Section Q 35
Inspections, searches and seizures of items pursuant to section 44c KWG and section 83b VAG (incl. related basic issues); exemptions pursuant to section 2 (4) and (5) KWG; prosecution under KWG/VAG of unauthorised business conducted in Germany from abroad
Section Q RM 1
Quantitative methods
Section Q RM 2
Market price risk
Section Q RM 3
IRB and operational risk
Section Q RM 4
Internal models of insurance undertakings; basic issues relating to quantitative methods
Section Q RM 5
Internal models of insurance undertakings; quantitative assessments
Section Z 1
Budget
Section Z 2
Costs, fees, cost allocations
Section Z 3
Controlling, Cost accounting, management accounting
Section Z 4
Personnel-related services
Section Z 5
Human resources/ training
Section Z 6
Organisation and strategic personnel development
Section Z 7
Facility-related services
Section Z 8
Project management

BaFin bodies

2.1 Members of the Administrative Council

Representing the Federal Ministries
Jörg Asmussen (Chairman) (Federal Ministry of Finance – BMF)
Dr. Rolf Wenzel (Deputy Chairman) (BMF)
Uwe Schröder (BMF)
Dr. Werner Kerkloh (BMF)
Christian Dobler (Federal Ministry of Economics and Technology – BMWi)
Erich Schaefer (Federal Ministry of Justice – BMJ)

Representing the Bundestag (Lower House of Parliament)
Leo Dautzenberg MP
Bartholomäus Kalb MP
Manfred Zöllmer MP
Frank Schäffler MP
Dr. Axel Troost MP

Representing credit institutions
Uwe Fröhlich
Andreas Schmitz
Heinrich Haasis
Jan Bettink
Christian Brand

Representing insurance undertakings
Rolf-Peter Hoenen
Dr. Jörg von Fürstenwerth
Dr. Torsten Oletzky
Dr. Friedrich Caspers

Representing asset management companies
Thomas Neiße

As at: November 2010

2.2 Members of the Advisory Board

Representing credit institutions
Dr. Hans-Joachim Massenberg (Deputy Chairman)
Dr. Karl-Peter Schackmann-Fallis
Gerhard P. Hofmann
Dr. Oliver Wagner
Karl-Heinz Boos
Andreas J. Zehnder

Representing insurance undertakings
Dr. Bernhard Schareck (Chairman)
Dr. Gerhard Rupprecht
Dr. Nikolaus von Bomhard
Friedrich Schubring-Giese

Representing asset management companies
Rudolf Siebel

Representing the Bundesbank
Erich Loeper

Representing the Association of Private Health Insurers
Reinhold Schulte

Representing academic groups
Prof. Dr. Andreas Hackethal
Prof. Dr. Fred Wagner
Prof. Dr. Isabel Schnabel

Representing the Task Force for Occupational Retirement Provision (aba)
Joachim Schwind

Representing consumer protection organisations
Stephan Kühnlenz (Stiftung Warentest)
Prof. Dr. Günter Hirsch (Ombudsman for insurance undertakings)
Peter Gummer (Ombudsman at German Savings Banks Association (DSGV))

Representing liberal professions
Frank Rottenbacher (Association of employers in the financial services industry – AfW)

Representing associations for SMEs
Dr. Peter König (Society of Investment Professionals in Germany – DVFA)

Representing trade unions
Uwe Foullong (ver.di)

Representing industry
tba

As at: November 2010

2.3 Members of the Insurance Advisory Council

Dr. Helmut Aden	Member of Management Board of BVV Versicherungsverein des Bankgewerbes a.G. Member of Management Board of aba
Prof. Dr. Christian Armbrüster	Court of appeal judge Freie Universität Berlin Faculty of law
Dr. Alexander Barthel	The German Confederation of Skilled Crafts (ZDH)
Beate-Kathrin Bextermöller	Stiftung Warentest Financial Services Department
Dr. Georg Bräuchle	The Association of German Insurance Brokers (VDVM) Marsh GmbH
Lars Gatschke	Federation of German Consumer Organisations (vzbv) Financial Service Department
Ira Gloe-Semler	ver.di – Vereinte Dienstleistungsgewerkschaft Finance Services
Norbert Heinen	Member of Management Board of the German Actuarial Society (DAV)
Michael H. Heinz	President of the Association of German Insurance Representatives (BVK)
Werner Hölzl	Auditor (Wirtschaftsprüfer) and tax advisor Member of Management Board of PricewaterhouseCoopers
Uwe Laue	Chairmen of the Management Board of Debeka Versicherungen
Dr. Ursula Lipowsky	Member of Management Board of Swiss Re Germany
Dr. Torsten Oletzky	Chairman of the Management Board of ERGO Versicherungsgruppe AG
Prof. Dr. Catherine Pallenberg	Head of insurance studies at DHBW university Stuttgart

Prof. Dr. Petra Pohlmann	Director of Institute for International Business Law at Münster University
Prof. Dr. Heinrich R. Schradin	Managing director of the Institute of Insurance Science at the University of Cologne
Reinhold Schulte	Chairman of Association of Private Health Insurers (PKV) Chairman of Management Boards of the SIGNAL IDUNA Group
Ilona Stumm	Thyssen Krupp Risk and Insurance Services GmbH
Prof. Dr. Manfred Wandt	Dean of law faculty at Frankfurt University
Elke Weidenbach	Specialist consultant for insurance at North Rhine Westphalia Consumer Advice Centre (financial services group)
Michael Wortberg	Consultant for insurance law at Rhineland Palatinate Consumer Advice Centre
Prof. Dr. Wolfram Wrabetz	Hesse State Parliament representative for insurance Member of Helvetia Group Management CEO of Helvetia Deutschland
Dr. Maximilian Zimmerer	Chairman of the Management Board of Allianz Lebensversicherungs-AG and Private Krankenversicherungs-AG Member of the Management Board of Allianz Deutschland AG Prof.
Dr. Jochen Zimmermann	Bremen University faculty of economics

As at: November 2010

2.4 Members of the Securities Council

Baden-Württemberg State Ministry of Economics

Bavarian State Ministry for Economics, Infrastructure, Transport and Technology

Berlin Senate Department for Economics, Technology and Women

Brandenburg State Ministry of Economics

The Free Hanseatic City of Bremen Senator for Economic Affairs and Ports

The Free Hanseatic City of Hamburg Authority for Economics and Labour

Hesse State Ministry of Economics, Transport and State Development

Mecklenburg Western Pomerania State Ministry of Economics, Labour and Tourism

Lower Saxony State Ministry of Economics, Labour and Transport

North Rhine Westphalia State Ministry of Finance

Rhineland Palatinate State Ministry of Economics, Transport, Agriculture and Viticulture

Saarland State Ministry of Economics and Science

Saxony State Ministry of Economics and Labour

Saxony Anhalt State Ministry of Economics and Labour

Schleswig-Holstein State Ministry of Economics and Transport

Thuringen State Ministry of Finance

As at: November 2010

3 Complaint statistics with respect to individual undertakings

3.1 Information on these statistics

BaFin has been publishing complaint statistics by insurance undertaking and class for a number of years now. Its predecessor, the Federal Insurance Supervisory Office *(Bundesaufsichtsamt für das Versicherungswesen- BAV)* had been ordered to include this information following a ruling passed by the Higher Administrative Court *(Oberverwaltungsgericht* – OVG) of Berlin on 25 July 1995 (Case ref.: OVG 8 B 16/94).

In order to provide an indicator of the quality and volume of insurance business, the number of complaints fully processed by BaFin in the course of 2009 is compared to the total number of contracts within the respective insurance class as at 31 December 2008. Figures regarding existing business are provided by the individual insurance companies. The information on existing business puts those insurers that recorded strong growth in the reporting period at a disadvantage (often newly established companies), because the new business generated in the course of the year, which gives rise to the complaints, is not accounted for in the complaint statistics. As a result, this statistic is of limited informational value when it comes to assessing the quality of individual undertakings.

For collective insurance within the category of life insurance, the existing business figure specified relates to the number of insurance contracts. Within the area of health insurance, existing business is based on the number of natural persons with health insurance policies rather than the number of insureds under each policy section, which is usually higher. This figure is still not completely reliable.

The existing business figures reported within the property and casualty sector relate to insured risks. If companies have concluded group policies with a large number of insureds, this increases the existing business figure.

Owing to limited disclosure requirements (section 51 (4) no. 1 sentence 4 of the Regulation on Insurance Accounting *(Verordnung über die Rechnungslegung von Versicherungsunternehmen* – RechVersV), the existing business figures can only be included for insurers whose gross premiums earned in 2008 exceeded €10 million in the respective insurance classes or types. In the case of undertakings 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 include insurance undertakings that operate within one of the classes listed but have not been the subject of complaints in the reporting year.

Given that undertakings from within the European Economic Area were not required to submit reports to BaFin, no data is stated for the existing business of EEA insurers. The number of complaints, however, has been included in order to present a more complete overview.

3.2 Life insurance

Reg. no.	Name of insurance undertaking	Number of life insurance policies in 2008	Complaints
1001	AACHENMÜNCHENER LEB.	5,492,088	150
1006	ALLIANZ LEBEN	10,303,778	358
1007	ALTE LEIPZIGER LEBEN	1,004,330	35
1035	ARAG LEBEN	345,773	30
1181	ASPECTA LEBEN	697,782	76
1303	ASSTEL LEBEN	354,169	51
1020	AXA LEBEN	1,928,966	122
1011	BARMENIA LEBEN	244,917	27
1012	BASLER LEBEN	172,476	7
1013	BAYER. BEAMTEN LEBEN	351,066	11
1015	BAYERN-VERS.	1,711,173	54
1132	CIV LEBEN	1,812,681	37
1122	CONCORDIA LEBEN	146,156	7
1021	CONDOR LEBEN	208,068	11
1078	CONTINENTALE LEBEN	650,692	22
1022	COSMOS LEBEN	1,382,533	36
1146	DBV DEUTSCHE BEAMTEN	2,141,938	71
1023	DEBEKA LEBEN	3,276,376	47
1017	DELTA LLOYD LEBEN	586,248	24
1136	DEVK ALLG. LEBEN	681,746	17
1025	DEVK DT. EISENBAHN LV	773,082	4
1113	DIALOG LEBEN	243,114	3
1110	DIREKTE LEBEN	138,758	6
1180	DT. ÄRZTEVERSICHERUNG	199,643	16
1148	DT. LEBENSVERS.	288,922	5
1028	DT. RING LEBEN	948,660	102
1107	EUROPA LEBEN	446,081	5
1310	FAMILIENFÜRSORGE LV	286,171	9
1175	FAMILIENSCHUTZ LEBEN	133,852	6
1139	GENERALI LEBEN AG	5,309,532	216
1108	GOTHAER LEBEN AG	1,230,928	87
1040	HAMB. LEBEN	25,105	1
1184	HAMB. MANNHEIMER LV	5,943,867	167
1312	HANNOVERSCHE LV AG	823,539	42
1114	HANSEMERKUR LEBEN	218,493	5
1033	HDI-GERLING LEBEN	2,089,735	192
1158	HEIDELBERGER LV	473,106	42
1137	HELVETIA LEBEN	128,622	6
1055	HUK-COBURG LEBEN	722,999	35
1047	IDEAL LEBEN	527,331	14
1048	IDUNA VEREINIGTE LV	2,157,642	112
1330	INTER LEBENSVERS. AG	185,033	12
1119	INTERRISK LEBENSVERS.	88,041	4
1045	KARLSRUHER LV AG	121,977	13
1130	KARSTADTQUELLE LV AG	1,303,284	19
1062	LEBENSVERS. VON 1871	718,062	12
1112	LVM LEBEN	757,702	9

Reg. no.	Name of insurance undertaking	Number of life insurance policies in 2008	Complaints
1109	MECKLENBURG. LEBEN	162,277	4
1064	MÜNCHEN. VEREIN LEBEN	144,400	5
1134	NEUE BAYER. BEAMTEN	81,897	1
1164	NEUE LEBEN LEBENSVERS	787,737	17
1147	NÜRNBG. LEBEN	3,078,628	158
1177	OECO CAPITAL LEBEN	22,920	5
1056	OEFF. LEBEN BERLIN	170,184	7
1115	ONTOS LEBEN	43,221	2
1194	PB LEBENSVERSICHERUNG	373,242	26
1145	PBV LEBEN	969,478	60
1123	PLUS LEBEN	32,031	1
1309	PROTEKTOR LV AG	180,220	18
1081	PROV. LEBEN HANNOVER	843,887	13
1083	PROV.NORDWEST LEBEN	1,826,262	35
1082	PROV.RHEINLAND LEBEN	1,327,693	40
1085	R+V LEBEN	81,271	1
1141	R+V LEBENSVERS. AG	4,007,747	87
1018	RHEINLAND LEBEN	282,768	7
1157	SKANDIA LEBEN	375,559	25
1153	SPARK.-VERS.SACHS.LEB	427,103	1
1104	STUTTGARTER LEBEN	438,160	29
1091	SV SPARKASSENVERS.	1,708,588	34
1090	SWISS LIFE AG (CH)	1,053,139	54
1092	UNIVERSA LEBEN	216,115	14
1093	VER.POSTVERS.	22	1
1314	VHV LEBENSVERSICHER.	11,550	1
1140	VICTORIA LEBEN	2,367,184	109
1099	VOLKSWOHL-BUND LEBEN	1,256,874	30
1151	VORSORGE LEBEN	115,743	10
1160	VPV LEBEN	1,125,342	17
1005	WÜRTT. LEBEN	2,786,129	75
1103	WWK LEBEN	969,292	50
1138	ZURICH DTSCH. HEROLD	3,552,786	177

3.3 Health insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31 Dec. 2008	Complaints
4034	ALLIANZ PRIV.KV AG	2,412,527	306
4142	ALTE OLDENBURGER	138,387	10
4112	ARAG KRANKEN	367,650	24
4095	AXA KRANKEN	1,401,042	224
4042	BARMENIA KRANKEN	1,209,283	46
4134	BAYERISCHE BEAMTEN K	958,850	125
4004	CENTRAL KRANKEN	1,696,520	102
4118	CONCORDIA KRANKEN	80,533	2
4001	CONTINENTALE KRANKEN	1,218,713	91
4028	DEBEKA KRANKEN	3,504,796	88
4131	DEVK KRANKENVERS.-AG	191,976	3
4044	DKV AG	3,209,839	213
4013	DT. RING KRANKEN	625,391	38
4115	DÜSSELDORFER VERS.KR.	16,856	1
4121	ENVIVAS KRANKEN	210,370	5
4089	EUROPA KRANKEN	213,946	3
4053	FREIE ARZTKASSE	29,843	1
4119	GOTHAER KV AG	501,487	35
4043	HALLESCHE KRANKEN	572,168	38
4144	HANSEMERKUR KRANKEN	1,118,967	37
4122	HANSEMERKUR S.KRANKEN	3,570,726	2
4117	HUK-COBURG KRANKEN	818,632	36
4031	INTER KRANKEN	388,347	41
4126	KARSTADTQUELLE KV AG	1,219,760	9
4011	LANDESKRANKENHILFE	415,695	26
4051	LIGA KRANKEN	4,112	1
4109	LVM KRANKEN	281,550	8
4123	MANNHEIMER KRANKEN	77,811	5
4141	MECKLENBURGISCHE KRA.	33,738	1
4037	MÜNCHEN.VEREIN KV	224,661	18
4125	NÜRNBG. KRANKEN	235,638	7
4143	PAX-FAMILIENF.KV AG	150,168	2
4135	PROVINZIAL KRANKEN	131,118	1
4116	R+V KRANKEN	437,977	8
4002	SIGNAL KRANKEN	1,985,474	77
4039	SÜDDEUTSCHE KRANKEN	545,834	14
4108	UNION KRANKENVERS.	1,008,585	25
4045	UNIVERSA KRANKEN	362,837	30
4105	VICTORIA KRANKEN	1,225,938	53
4139	WÜRTT. KRANKEN	140,417	1

3.4 Motor insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5342	AACHENMÜNCHENER VERS.	1,797,372	22
5135	ADAC AUTOVERSICHERUNG	680,899	22
5498	ADAC-SCHUTZBRIEF VERS	n/a	5
5581	ADLER VERSICHERUNG AG	n/a	2
5312	ALLIANZ VERS.	14,531,698	168
5405	ALTE LEIPZIGER VERS.	436,388	8
5455	ARAG ALLG. VERS.	n/a	1
5397	ASSTEL SACH	n/a	15
5515	AXA VERS.	4,089,916	56
5593	BAD. ALLG. VERS.	n/a	2
5316	BAD. GEMEINDE-VERS.	460,764	5
5633	BASLER SECURITAS	456,349	8
5310	BAYER. BEAMTEN VERS.	262,143	9
5324	BAYER.VERS.VERB.AG	1,887,232	15
5098	BRUDERHILFE SACH.AG	376,121	8
5338	CONCORDIA VERS.	1,002,538	8
5340	CONTINENTALE SACHVERS	388,317	5
5552	COSMOS VERS.	452,823	10
5529	D.A.S. VERS.	418,958	11
5343	DA DEUTSCHE ALLG.VER.	1,426,249	55
5311	DBV DT. BEAMTEN-VERS.	331,826	2
5037	DBV-WINTERTHUR	639,750	5
5549	DEBEKA ALLGEMEINE	694,928	5
5513	DEVK ALLG. VERS.	3,004,954	20
5344	DEVK DT. EISENB. SACH	955,254	2
5055	DIRECT LINE	709,459	35
5084	DTSCH. INTERNET	n/a	5
5508	EUROPA SACHVERS.	374,933	13
5470	FAHRLEHRERVERS.	308,634	3
5024	FEUERSOZIETÄT	204,782	5
5505	GARANTA VERS.	972,319	8
5473	GENERALI VERSICHERUNG	2,914,257	41
5589	GGG KFZ REPARATURVERS	n/a	1
5858	GOTHAER ALLGEMEINE AG	1,167,357	18
5485	GRUNDEIGENTÜMER-VERS.	n/a	2
5585	GVV-PRIVATVERSICH.	246,405	1
5420	HAMB. MANNHEIMER SACH	469,184	5
5131	HANNOVERSCHE DIREKT	n/a	8
5085	HDI DIREKT	2,517,797	44
5512	HDI-GERLING FIRMEN	1,272,088	32
5096	HDI-GERLING INDUSTRIE	824,639	10
5044	HDNA VVAG	n/a	2
5384	HELVETIA VERS.	255,912	4
5086	HUK24 AG	1,556,900	24
5375	HUK-COBURG	6,794,580	70
5521	HUK-COBURG ALLG. VERS	5,437,421	72
5401	ITZEHOER VERSICHERUNG	783,449	10
5078	JANITOS VERSICHERUNG	290,385	10
5562	KARSTADTQUELLE VERS.	n/a	4

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5058	KRAVAG-ALLGEMEINE	1,167,844	13
5080	KRAVAG-LOGISTIC	699,984	12
5402	LVM SACH	4,662,790	21
5061	MANNHEIMER VERS.	198,540	3
5412	MECKLENBURG. VERS.	761,350	3
5414	MÜNCHEN. VEREIN ALLG.	n/a	1
5426	NÜRNBG. ALLG.	268,931	8
5686	NÜRNBG. BEAMTEN ALLG.	304,320	8
5791	ONTOS VERS.	n/a	3
5787	OVAG - OSTDT. VERS.	n/a	2
5499	PALLAS VERS.	n/a	1
5446	PROV.NORD BRANDKASSE	677,092	3
5095	PROV.RHEINLAND VERS.	1,199,312	8
5438	R+V ALLGEMEINE VERS.	3,578,493	15
5798	RHEINLAND VERS. AG	217,486	3
5528	ROLAND SCHUTZBRIEF	n/a	2
5051	S DIREKTVERSICHERUNG	n/a	6
5773	SAARLAND FEUERVERS.	145,985	1
5690	SCHWARZMEER U. OSTSEE	n/a	2
5448	SCHWEIZER NATION.VERS	n/a	2
5125	SIGNAL IDUNA ALLG.	1,043,584	8
5781	SPARK.-VERS.SACHS.ALL	171,436	2
5036	SV SPARK.VERSICHER.	905,139	6
5462	UNITED SERVICES AUTO	n/a	2
5441	VEREINTE SPEZIAL VERS	802,451	19
5042	VERS.KAMMER BAYERN (KOMMUNALVERSICHERER)	144,511	3
5400	VGH LAND.BRAND.HAN.	1,819,723	15
5862	VHV ALLGEMEINE VERS.	3,872,069	42
5472	VICTORIA VERS.	1,647,972	13
5093	WESTF.PROV.VERS.AG	1,352,200	5
5525	WGV-VERSICHERUNG	755,300	4
5479	WÜRTT. GEMEINDE-VERS.	978,844	4
5783	WÜRTT. VERS.	2,289,524	24
5476	WWK ALLGEMEINE VERS.	277,732	3
5050	ZURICH VERS. AG	2,316,839	36

3.5 General liability insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5342	AACHENMÜNCHENER VERS.	1,232,283	20
5035	AGILA HAUSTIER AG	n/a	4
5370	ALLIANZ GLOBAL AG	1,876	1
5312	ALLIANZ VERS.	4,897,649	125
5405	ALTE LEIPZIGER VERS.	218,368	6
5455	ARAG ALLG. VERS.	21,206,532	21
5397	ASSTEL SACH	n/a	4
5515	AXA VERS.	2,248,260	37
5316	BAD. GEMEINDE-VERS.	125,056	1
5317	BARMENIA ALLG. VERS.	n/a	1
5633	BASLER SECURITAS	266,104	6
5310	BAYER. BEAMTEN VERS.	n/a	2
5324	BAYER.VERS.VERB.AG	1,004,998	12
5098	BRUDERHILFE SACH.AG	220,184	2
5338	CONCORDIA VERS.	341,785	5
5340	CONTINENTALE SACHVERS	305,208	6
5552	COSMOS VERS.	289,469	5
5529	D.A.S. VERS.	216,529	11
5343	DA DEUTSCHE ALLG.VER.	n/a	2
5037	DBV-WINTERTHUR	1,050,249	7
5549	DEBEKA ALLGEMEINE	1,132,877	5
5513	DEVK ALLG. VERS.	1,025,925	12
5344	DEVK DT. EISENB. SACH	608,078	2
5129	DFV DEUTSCHE FAM.VERS	n/a	2
5582	DT. ÄRZTE-VERS. ALLG.	n/a	1
5350	DT. RING SACHVERS.	139,037	2
5516	FAMILIENSCHUTZ VERS.	n/a	5
5024	FEUERSOZIETÄT	132,595	6
5473	GENERALI VERSICHERUNG	1,936,296	54
5858	GOTHAER ALLGEMEINE AG	1,339,687	36
5485	GRUNDEIGENTÜMER-VERS.	n/a	5
5469	GVV-KOMMUNALVERS.	2,853	5
5585	GVV-PRIVATVERSICH.	n/a	2
5374	HAFTPFLICHTK.DARMST.	711,196	8
5420	HAMB. MANNHEIMER SACH	552,592	8
5501	HANSEMERKUR ALLG.	n/a	1
5085	HDI DIREKT	699,374	10
5512	HDI-GERLING FIRMEN	697,317	19
5096	HDI-GERLING INDUSTRIE	17,764	4
5384	HELVETIA VERS.	365,792	1
5086	HUK24 AG	n/a	2
5375	HUK-COBURG	1,840,174	15
5521	HUK-COBURG ALLG. VERS	934,266	5
5546	INTER ALLG. VERS.	112,628	5
5401	ITZEHOER VERSICHERUNG	168,575	3
5078	JANITOS VERSICHERUNG	n/a	2
5080	KRAVAG-LOGISTIC	n/a	1

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5402	LVM SACH	1,117,495	12
5061	MANNHEIMER VERS.	142,325	2
5412	MECKLENBURG. VERS.	266,483	10
5334	MEDIENVERS. KARLSRUHE	n/a	1
5426	NÜRNBG. ALLG.	317,910	9
5686	NÜRNBG. BEAMTEN ALLG.	n/a	1
5446	PROV.NORD BRANDKASSE	390,231	2
5095	PROV.RHEINLAND VERS.	839,030	71
5438	R+V ALLGEMEINE VERS.	1,586,625	39
5798	RHEINLAND VERS. AG	130,620	3
5121	RHION VERSICHERUNG	n/a	6
5773	SAARLAND FEUERVERS.	85,448	3
5491	SCHLESWIGER VERS.V.	n/a	1
5448	SCHWEIZER NATION.VERS	n/a	1
5125	SIGNAL IDUNA ALLG.	559,784	8
5781	SPARK.-VERS.SACHS.ALL	n/a	3
5036	SV SPARK.VERSICHER.	786,440	12
5459	UELZENER ALLG. VERS.	156,540	3
5463	UNIVERSA ALLG. VERS.	n/a	2
5042	VERS.KAMMER BAYERN (KOMMUNALVERSICHERER)	16,745	3
5400	VGH LAND.BRAND.HAN.	701,963	5
5862	VHV ALLGEMEINE VERS.	831,548	25
5472	VICTORIA VERS.	1,104,539	27
5484	VOLKSWOHL-BUND SACH	n/a	4
5461	VPV ALLGEMEINE VERS.	n/a	1
5082	WALDENBURGER VERS.	n/a	1
5093	WESTF.PROV.VERS.AG	808,249	4
5525	WGV-VERSICHERUNG	310,728	2
5479	WÜRTT. GEMEINDE-VERS.	264,813	2
5480	WÜRTT. U. BADISCHE	215,973	2
5783	WÜRTT. VERS.	1,205,343	31
5476	WWK ALLGEMEINE VERS.	n/a	1
5050	ZURICH VERS. AG	993,473	27

3.6 Accident insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5342	AACHENMÜNCHENER VERS.	1,664,716	23
5498	ADAC-SCHUTZBRIEF VERS	2,942,679	7
5581	ADLER VERSICHERUNG AG	222,259	1
5312	ALLIANZ VERS.	5,215,343	100
5405	ALTE LEIPZIGER VERS.	85,823	3
5068	AMMERLÄNDER VERS.	9,344	1
5455	ARAG ALLG. VERS.	20,529,467	9
5397	ASSTEL SACH	32,539	1
5515	AXA VERS.	697,007	6
5357	BAD. BEAMTENBANK	k.A.	1
5316	BAD. GEMEINDE-VERS.	45,420	2
5792	BADEN-BADENER VERS.	278,260	7
5317	BARMENIA ALLG. VERS.	126,456	3
5310	BAYER. BEAMTEN VERS.	94,080	5
5324	BAYER.VERS.VERB.AG	619,242	6
5040	CIC DEUTSCHLAND	k.A.	1
5790	CIV VERS.	185,502	5
5338	CONCORDIA VERS.	284,997	3
5339	CONDOR ALLG. VERS.	79,490	1
5340	CONTINENTALE SACHVERS	720,695	15
5552	COSMOS VERS.	194,244	1
5529	D.A.S. VERS.	259,060	26
5311	DBV DT. BEAMTEN-VERS.	200,133	1
5037	DBV-WINTERTHUR	257,486	4
5549	DEBEKA ALLGEMEINE	1,744,006	7
5513	DEVK ALLG. VERS.	738,635	2
5344	DEVK DT. EISENB. SACH	267,218	2
5129	DFV DEUTSCHE FAM.VERS	14,856	2
5350	DT. RING SACHVERS.	386,173	11
5508	EUROPA SACHVERS.	58,059	1
5470	FAHRLEHRERVERS.	26,892	1
5516	FAMILIENSCHUTZ VERS.	275,966	8
5024	FEUERSOZIETÄT	48,902	1
5473	GENERALI VERSICHERUNG	3,307,594	34
5858	GOTHAER ALLGEMEINE AG	709,569	26
5585	GVV-PRIVATVERSICH.	17,257	1
5420	HAMB. MANNHEIMER SACH	1,917,198	50
5501	HANSEMERKUR ALLG.	80,748	4
5085	HDI DIREKT	194,216	5
5512	HDI-GERLING FIRMEN	417,121	10
5384	HELVETIA VERS.	131,542	3
5375	HUK-COBURG	1,030,726	2
5521	HUK-COBURG ALLG. VERS	504,014	1
5573	IDEAL VERS.	19,002	4
5546	INTER ALLG. VERS.	135,404	2
5057	INTERLLOYD VERS.AG	56,085	2
5780	INTERRISK VERS.	399,130	1
5078	JANITOS VERSICHERUNG	110,756	2

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5562	KARSTADTQUELLE VERS.	322,130	10
5058	KRAVAG-ALLGEMEINE	121,409	1
5399	KRAVAG-SACH	14,830	1
5402	LVM SACH	882,766	8
5412	MECKLENBURG. VERS.	140,042	4
5334	MEDIENVERS. KARLSRUHE	746	1
5426	NÜRNBG. ALLG.	630,464	34
5686	NÜRNBG. BEAMTEN ALLG.	104,724	2
5791	ONTOS VERS.	3,596	1
5074	PB VERSICHERUNG	52,168	3
5095	PROV.RHEINLAND VERS.	1,029,074	39
5583	PVAG POLIZEIVERS.	309,909	1
5438	R+V ALLGEMEINE VERS.	1,482,917	8
5798	RHEINLAND VERS. AG	86,499	4
5690	SCHWARZMEER U. OSTSEE	6,631	1
5125	SIGNAL IDUNA ALLG.	1,802,685	17
5586	STUTTGARTER VERS.	231,309	10
5511	VER. VERS.GES.DTSCHL.	116,679	2
5400	VGH LAND.BRAND.HAN.	5,588,170	1
5862	VHV ALLGEMEINE VERS.	294,832	2
5472	VICTORIA VERS.	920,772	39
5484	VOLKSWOHL-BUND SACH	179,624	7
5093	WESTF.PROV.VERS.AG	1,064,329	4
5783	WÜRTT. VERS.	764,459	30
5590	WÜRZBURGER VERSICHER.	56,604	2
5476	WWK ALLGEMEINE VERS.	202,356	8
5050	ZURICH VERS. AG	2,468,705	21

3.7 Household contents insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5342	AACHENMÜNCHENER VERS.	878,052	19
5312	ALLIANZ VERS.	2,840,438	73
5405	ALTE LEIPZIGER VERS.	149,724	2
5068	AMMERLÄNDER VERS.	n/a	7
5455	ARAG ALLG. VERS.	809,607	14
5397	ASSTEL SACH	n/a	2
5515	AXA VERS.	965,084	12
5317	BARMENIA ALLG. VERS.	n/a	1
5633	BASLER SECURITAS	228,016	2
5310	BAYER. BEAMTEN VERS.	n/a	4
5324	BAYER.VERS.VERB.AG	539,902	5
5098	BRUDERHILFE SACH.AG	193,776	1
5338	CONCORDIA VERS.	215,642	5
5340	CONTINENTALE SACHVERS	152,181	5
5552	COSMOS VERS.	n/a	3
5529	D.A.S. VERS.	135,712	7
5311	DBV DT. BEAMTEN-VERS.	214,714	1
5037	DBV-WINTERTHUR	299,545	1
5549	DEBEKA ALLGEMEINE	688,304	4
5513	DEVK ALLG. VERS.	822,392	7
5344	DEVK DT. EISENB. SACH	448,487	3
5129	DFV DEUTSCHE FAM.VERS	n/a	2
5350	DT. RING SACHVERS.	199,317	2
5470	FAHRLEHRERVERS.	n/a	3
5516	FAMILIENSCHUTZ VERS.	n/a	3
5024	FEUERSOZIETÄT	n/a	2
5365	GEGENSEITIGKEIT VERS.	n/a	1
5473	GENERALI VERSICHERUNG	1,441,904	27
5858	GOTHAER ALLGEMEINE AG	746,352	23
5485	GRUNDEIGENTÜMER-VERS.	n/a	1
5585	GVV-PRIVATVERSICH.	n/a	2
5420	HAMB. MANNHEIMER SACH	407,473	16
5501	HANSEMERKUR ALLG.	n/a	1
5085	HDI DIREKT	362,306	10
5512	HDI-GERLING FIRMEN	323,369	6
5086	HUK24 AG	n/a	1
5375	HUK-COBURG	1,277,702	5
5521	HUK-COBURG ALLG. VERS	563,431	4
5546	INTER ALLG. VERS.	n/a	1
5780	INTERRISK VERS.	n/a	2
5078	JANITOS VERSICHERUNG	n/a	1
5404	LBN	n/a	3
5402	LVM SACH	666,943	9
5061	MANNHEIMER VERS.	88,053	1
5412	MECKLENBURG. VERS.	166,156	4
5334	MEDIENVERS. KARLSRUHE	n/a	1
5426	NÜRNBG. ALLG.	155,109	10
5686	NÜRNBG. BEAMTEN ALLG.	n/a	1

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5446	PROV.NORD BRANDKASSE	299,674	5
5095	PROV.RHEINLAND VERS.	541,392	64
5583	PVAG POLIZEIVERS.	n/a	2
5438	R+V ALLGEMEINE VERS.	816,948	13
5798	RHEINLAND VERS. AG	90,107	4
5773	SAARLAND FEUERVERS.	n/a	1
5491	SCHLESWIGER VERS.V.	n/a	2
5125	SIGNAL IDUNA ALLG.	353,230	5
5781	SPARK.-VERS.SACHS.ALL	n/a	4
5036	SV SPARK.VERSICHER.	417,889	4
5463	UNIVERSA ALLG. VERS.	n/a	2
5400	VGH LAND.BRAND.HAN.	479,726	1
5862	VHV ALLGEMEINE VERS.	283,463	9
5472	VICTORIA VERS.	679,165	23
5484	VOLKSWOHL-BUND SACH	n/a	2
5461	VPV ALLGEMEINE VERS.	179,157	5
5093	WESTF.PROV.VERS.AG	2,429,343	4
5783	WÜRTT. VERS.	803,383	24
5476	WWK ALLGEMEINE VERS.	n/a	2
5050	ZURICH VERS. AG	718,956	13

3.8 Residential building insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5342	AACHENMÜNCHENER VERS.	337,661	7
5312	ALLIANZ VERS.	2,101,415	66
5405	ALTE LEIPZIGER VERS.	139,395	6
5455	ARAG ALLG. VERS.	n/a	4
5397	ASSTEL SACH	n/a	1
5515	AXA VERS.	555,873	21
5316	BAD. GEMEINDE-VERS.	53,518	1
5317	BARMENIA ALLG. VERS.	n/a	1
5633	BASLER SECURITAS	165,563	3
5043	BAYER.L-BRAND.VERS.AG	2,483,725	18
5324	BAYER.VERS.VERB.AG	559,173	12
5098	BRUDERHILFE SACH.AG	n/a	2
5338	CONCORDIA VERS.	175,093	6
5339	CONDOR ALLG. VERS.	n/a	1
5340	CONTINENTALE SACHVERS	74,367	7
5529	D.A.S. VERS.	57,492	7
5311	DBV DT. BEAMTEN-VERS.	103,425	1
5037	DBV-WINTERTHUR	115,828	2
5549	DEBEKA ALLGEMEINE	214,734	4
5513	DEVK ALLG. VERS.	305,389	9
5350	DT. RING SACHVERS.	47,121	1
5024	FEUERSOZIETÄT	88,344	5
5365	GEGENSEITIGKEIT VERS.	n/a	3
5473	GENERALI VERSICHERUNG	565,780	24
5858	GOTHAER ALLGEMEINE AG	287,382	11
5485	GRUNDEIGENTÜMER-VERS.	65,434	2
5557	HÄGER VERS.VEREIN	n/a	2
5420	HAMB. MANNHEIMER SACH	126,812	10
5512	HDI-GERLING FIRMEN	110,196	4
5096	HDI-GERLING INDUSTRIE	n/a	2
5384	HELVETIA VERS.	170,279	1
5375	HUK-COBURG	553,776	17
5521	HUK-COBURG ALLG. VERS	168,225	3
5546	INTER ALLG. VERS.	n/a	1
5780	INTERRISK VERS.	n/a	2
5401	ITZEHOER VERSICHERUNG	45,033	1
5402	LVM SACH	455,336	5
5061	MANNHEIMER VERS.	53,188	1
5412	MECKLENBURG. VERS.	97,020	6
5334	MEDIENVERS. KARLSRUHE	n/a	1
5426	NÜRNBG. ALLG.	69,866	1
5446	PROV.NORD BRANDKASSE	324,771	9
5095	PROV.RHEINLAND VERS.	609,628	70
5438	R+V ALLGEMEINE VERS.	832,338	16
5798	RHEINLAND VERS. AG	n/a	5
5773	SAARLAND FEUERVERS.	77,905	1
5125	SIGNAL IDUNA ALLG.	138,390	4
5036	SV SPARK.VERSICHER.	2,378,464	53
5459	UELZENER ALLG. VERS.	n/a	1

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5042	VERS.KAMMER BAYERN (KOMMUNALVERSICHERER)	n/a	1
5400	VGH LAND.BRAND.HAN.	478,697	8
5862	VHV ALLGEMEINE VERS.	76,727	1
5472	VICTORIA VERS.	346,036	16
5461	VPV ALLGEMEINE VERS.	63,069	3
5093	WESTF.PROV.VERS.AG	2,024,347	7
5525	WGV-VERSICHERUNG	n/a	5
5479	WÜRTT. GEMEINDE-VERS.	n/a	1
5480	WÜRTT. U. BADISCHE	48,434	2
5783	WÜRTT. VERS.	452,262	21
5590	WÜRZBURGER VERSICHER.	n/a	2
5050	ZURICH VERS. AG	391,525	13

3.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2008	Complaints
5826	ADAC-RECHTSSCHUTZ	2,649,378	3
5809	ADVO CARD RS	n/a	73
5312	ALLIANZ VERS.	2,565,385	76
5825	ALLRECHT RECHTSSCHUTZ	249,079	12
5405	ALTE LEIPZIGER VERS.	409,283	17
5800	ARAG ALLG. RS	n/a	112
5455	ARAG ALLG. VERS.	n/a	11
5801	AUXILIA RS	n/a	16
5838	BADISCHE RECHTSSCHUTZ	146,806	6
5310	BAYER. BEAMTEN VERS.	n/a	12
5098	BRUDERHILFE SACH.AG	n/a	2
5831	CONCORDIA RS	n/a	16
5340	CONTINENTALE SACHVERS	68,815	2
5802	D.A.S. ALLG. RS	n/a	89
5529	D.A.S. VERS.	n/a	1
5343	DA DEUTSCHE ALLG.VER.	n/a	8
5311	DBV DT. BEAMTEN-VERS.	26,312	1
5037	DBV-WINTERTHUR	145,800	5
5549	DEBEKA ALLGEMEINE	339,428	5
5803	DEURAG DT. RS	873,163	30
5829	DEVK RECHTSSCHUTZ	1,003,781	17
5129	DFV DEUTSCHE FAM.VERS	15,487	1
5834	DMB RECHTSSCHUTZ	755,266	12
5858	GOTHAER ALLGEMEINE AG	n/a	2
5828	HAMB. MANNHEIMER RS	424,534	9
5420	HAMB. MANNHEIMER SACH	n/a	2
5501	HANSEMERKUR ALLG.	n/a	1
5827	HDI-GERLING RECHT.	n/a	28
5086	HUK24 AG	n/a	4
5818	HUK-COBURG RS	1,506,466	31
5401	ITZEHOER VERSICHERUNG	42,999	5
5812	JURPARTNER RECHTSSCH.	n/a	2
5815	LVM RECHTSSCHUTZ	699,905	7
5402	LVM SACH	n/a	3
5412	MECKLENBURG. VERS.	139,984	15
5334	MEDIENVERS. KARLSRUHE	n/a	1
5805	NEUE RECHTSSCHUTZ	n/a	21
5426	NÜRNBG. ALLG.	n/a	1
5813	OERAG RECHTSSCHUTZ	1,250,025	52
5095	PROV.RHEINLAND VERS.	n/a	3
5438	R+V ALLGEMEINE VERS.	n/a	5
5836	R+V RECHTSSCHUTZ	611,233	14
5807	ROLAND RECHTSSCHUTZ	n/a	50
5400	VGH LAND.BRAND.HAN.	172,362	2
5093	WESTF.PROV.VERS.AG	n/a	1
5525	WGV-VERSICHERUNG	n/a	23
5479	WÜRTT. GEMEINDE-VERS.	n/a	1
5783	WÜRTT. VERS.	642,551	21
5476	WWK ALLGEMEINE VERS.	n/a	1
5050	ZURICH VERS. AG	474,417	31

3.10 Insurers based in the EEA

Reg. no.	Abbreviated name of insurance undertaking	Complaints
5902	ACE EUROPEAN (GB)	4
9053	ADMIRAL INSURANCE(GB)	10
5551	AIOI (GB)	1
5029	AIOI MOTOR (GB)	5
7197	ALGEMENE LEVENS. (NL)	1
7907	ALLIANZ HUNGARIA (H)	1
7671	ASPECTA ASSUR. (L)	7
7323	ASPIS PRONIA (GR)	1
5119	ASSURANT ALLG. (GB)	1
7203	ATLANTICLUX (L)	33
1324	ATLANTICLUX LEBEN (L)	8
5064	ATRADIUS KREDIT (NL)	3
5090	AXA CORPORATE S. (F)	5
7775	AXA FRANCE VIE (F)	2
1319	AXA LIFE EUR.LTD(IRL)	20
9146	AXA SUN LIFE (GB)	2
7811	CACI LIFE LIM. (IRL)	6
7807	CACI NON-LIFE (IRL)	1
1300	CANADA LIFE (IRL)	26
1182	CARDIF LEBEN (F)	5
5056	CARDIF VERS. (F)	27
5595	CHARTIS EUROPE (F)	14
5574	CHUBB INS. COMP.(B)	5
7690	CIGNA LIFE (B)	1
1189	CIGNA LIFE INS. (B)	3
7453	CLERICAL MED.INV.(GB)	34
7724	CREDIT LIFE INT. (NL)	12
7985	CSS VERSICHERUNG (FL)	1
7614	DB VITA SA (L)	1
5048	DOMESTIC AND GEN.(GB)	1
7309	DONAU VERSICHERUNG(A)	1
1161	EQUITABLE LIFE (GB)	3
7641	EURO INSURANCE (IRL)	1
7668	EUROMAF (F)	1
5115	EUROMAF SA (F)	1
7813	FINANCELIFE (A)	1
5053	FINANCIAL INSUR.(GB)	10
7246	FOYER ASSURANCES (L)	1
7410	FOYER INTERNAT. (L)	1
7268	GENERALI VERS.AG (A)	2
5116	GENWORTH FIN (GB)	1
7776	GENWORTH FINANC. (GB)	3
1304	INORA LIFE NL (IRL)	1
5788	INTER PARTNER ASS.(B)	1
7587	INTERN.INSU.COR.(NL)	12
9031	LIBERTY EURO.(IRL/E)	20
7899	LIGHTHOUSE LIFE (GBZ)	3
5592	LLOYD'S VERS. (GB)	2
7504	LONDON GEN.LIFE (GB)	1
1308	MEDIOLANUM INT.(IRL)	1

Reg. no.	Abbreviated name of insurance undertaking	Complaints
1323	MONUTA VERS. (NL)	1
7237	MUTUELLE DES ARCH.(F)	1
9040	NATIONALE SUISSE(B)	1
7579	NEMIAN LIFE & P. (L)	3
7806	NEW TECHNOLOGY (IRL)	1
7225	OBERÖSTERR.VERS AG(A)	2
7723	PRISMALIFE AG (FL)	44
7455	PROBUS INSURANCE(IRL)	4
9062	PRUDENTIAL ASS. (GB)	1
7407	QUINN INSURANCE (IRL)	2
1317	R+V LUXEMB. LV (L)	18
7415	R+V LUXEMBOURG L (L)	9
7730	RIMAXX (NL)	30
7490	SCOTTISH MUT.IN.(IRL)	1
1320	STANDARD LIFE (GB)	15
7763	STONEBRIDGE (GB)	2
7773	UBS INTERNAT. (IRL)	1
7456	VDV LEBEN INTERN.(GR)	21
7643	VIENNA-LIFE (FL)	6
7483	VORSORGE LUXEMB. (L)	17
7929	ZURICH INSURANCE(IRL)	14

4 Index of tables

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6 Index of abbreviations

A

ABCP	Asset-Backed Commercial Papers
ABS	Asset-Backed Securities
ACAM	Autorité de Contrôle des Assurances et des Mutuelles
AG	Aktiengesellschaft (public limited company)
AGG	Allgemeines Gleichbehandlungsgesetz (General Equal Treatment Act)
AidA	Anstalt in der Anstalt (liquidation agency)
AIF	Alternative investment fund
AIFM	Alternative Investment Fund Managers
AIG	American International Group
AKIM	Arbeitskreis zu Internen Modellen (Internal Models Working Group)
AktG	Aktiengesetz (Stock Corporation Act)
AltZertG	Altersvorsorgeverträge-Zertifizierungsgesetz (Pension Contracts Certification Act)
AMA	Advanced Measurement Approaches
AMLTF	Anti Money Laundering Task Force
AnlV	Anlageverordnung (Regulation on the Investment of Restricted Assets of Insurance Undertakings – Investment Regulation)
APRA	Australia Prudential Regulation Authority
Art.	Article

B

BA	Bankenaufsicht (banking supervision)
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
BAG	Bundesarbeitsgericht (Federal Labour Court)
BAV	Bundesaufsichtsamt für das Versicherungswesen (former Federal Insurance Supervisory Office)
BCBS	Basel Committee on Banking Supervision
BDL	Bundesverband Deutscher Leasing-Unternehmen e.V. (Federal Association of German Leasing Companies)
BDSG	Bundesdatenschutzgesetz (Federal Data Protection Act)
BerVersV	Verordnung über die Berichterstattung von Versicherungsunternehmen (Regulation on the Reporting by Insurance Undertakings to the Federal Financial Supervisory Authority)
BerPensV	Verordnung über die Berichterstattung von Pensionsfonds (Regulation on the Reporting by Pension Funds to the Federal Financial Supervisory Authority)
BGB	Bürgerliches Gesetzbuch (Civil Code)
BGBl.	Bundesgesetzblatt (Federal Law Gazette)
BGH	Bundesgerichtshof (Federal Court of Justice)
BIA	Basic indicator approach
BilMoG	Gesetz zur Modernisierung des Bilanzrechts (Act to Modernise Accounting Law)
BIS	Bank for International Settlements

	BMF	Bundesministerium der Finanzen (Federal Ministry of Finance)
	bn	billion
	BSC	Banking Supervision Committee
	BT-Drs.	Bundestags-Drucksache
	BVerfG	Bundesverfassungsgericht (Federal Constitutional Court)
	BVerwG	Bundesverwaltungsgericht (Federal Administrative Court)
	BVI	Bundesverband Investment und Asset Management (German Investment and Asset Management Association)
	BZSt	Bundeszentralamt für Steuern (Federal Tax Office)
C	**C**	Circular
	CCAF	Commission de contrôle des activités financières
	CCPs	Central Counterparties
	CDO	Collateralised Debt Obligation
	CDS	Credit Default Swaps
	CEBS	Committee of European Banking Supervisors
	CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
	CESR	Committee of European Securities Regulators
	CFD	Contracts for Difference
	CIT	Commercial Investment Trust
	CLO	Collateralised Loan Obligation
	CME	Chicago Mercantile Exchange Inc.
	CMBS	Commercial Mortgage Backed Securities
	ComFrame	Common Framework
	CONSOB	Commissione Nazionale per le Società e la Borsa
	CRD	Capital Requirements Directive
	CBS	Cross-border provision of services
D	**DAV**	Deutsche Aktuarvereinigung (German Actuarial Society)
	DAX	Deutscher Aktienindex (Blue Chip Index listing the 30 largest German companies)
	DEPFA	Deutsche Pfandbriefbank AG
	DerivateV	Derivateverordnung (Derivatives Regulation)
	DNB	De Nederlandsche Bank
	DOBI	New Jersey Department of Banking and Insurance
	DSGV	Deutscher Sparkassen- und Giroverband (German Savings Banks Association)
E	**EAEG**	Einlagensicherungs- und Anlegerentschädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
	EBA	European Banking Authority
	ECB	European Central Bank
	ECJ	European Court of Justice

Ecofin	Economic and Financial Council
EdB	Entschädigungseinrichtung deutscher Banken GmbH (Compensation Scheme of German Banks)
EdÖ	Entschädigungseinrichtung öffentlicher Banken (Compensation Scheme of Public Banks)
EdW	Entschädigungseinrichtung der Wertpapierhandelsunternehmen (Compensation Scheme of German Securities Trading Companies)
EEA	European Economic Area
EEG	Gesetz für den Vorrang erneuerbarer Energien (Renewable Energy Act)
EEX	European Energy Exchange
EIOPA	European Insurance and Occupational Pensions Authority
EMU	Economic and Monetary Union of the European Union
ESAs	European Supervisory Authorities
ESCB	European System of Central Banks
ESFS	European System of Financial Supervisors
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Boards
EStG	Einkommensteuergesetz (Income Tax Act)
etc.	et cetera
EU	European Union
e.V.	eingetragener Verein (registered association)

F

FATF	Financial Action Task Force on Money Laundering
FCD	Financial Conglomerates Directive
FFMS	Federal Financial Markets Service of Russia
FINREP	Financial Reporting
FinReq	Financial Requirements Expert Group
FLOIR	Florida Office of Insurance Regulation
FMA	Austrian Financial Market Authority
FME	Financial Supervisory Authority – Iceland
FMSA	Finanzmarktstabilisierungsanstalt (Financial-Market Stabilisation Agency)
FMStErgG	Finanzmarktstabilisierungsergänzungsgesetz (Act Amending the Financial-Market Stabilisation Act)
FMStFG	Finanzmarktstabilisierungsfondsgesetz (Act on the Establishment of a Financial-Market Stabilisation Fund – Financial-Market Stabilisation Fund Act)
FMStG	Finanzmarktstabilisierungsgesetz (Act on the Implementation of a Package of Measures to Stabilise the Financial Market - Financial-Market Stabilisation Act)
FREP	Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung)
FRUG	Finanzmarktrichtlinie-Umsetzungsgesetz (Act Implementing the Markets in Financial Instruments Directive)
FSA	Financial Services Authority
FSB	Financial Stability Board

	FSC	Financial Stability Committee
	FSF	Financial Stability Forum
	FSI	Financial Stability Institute
G	**GAAP**	General Accepted Accounting Principles
	GBP	British pound sterling
	GbR	Gesellschaft bürgerlichen Rechts (German civil-law partnership)
	GDP	Gross domestic product
	GDV	Gesamtverband der deutschen Versicherungswirtschaft e.V. (German Insurance Association)
	GG	Grundgesetz (Basic Law)
	GmbH	Gesellschaft mit beschränkter Haftung (German private limited company)
	GW	Geldwäsche (money laundering)
	GwG	Geldwäschegesetz (Money Laundering Act)
H	**HessVGH**	Hessischer Verwaltungsgerichtshof (Administrative High Court of Hesse)
	HGB	Handelsgesetzbuch (Commercial Code)
	HSH	Hamburg and Schleswig Holstein
	HRE	Hypo Real Estate
	HVB	Hypo-Vereinsbank
I	**IADI**	International Association of Deposit Insurers
	IAIS	International Association of Insurance Supervisors
	IAM	Internationale Anlegermesse (International Investor Fair)
	IAS	International Accounting Standards
	IASB	International Accounting Standards Board
	IBAN	International Bank Account Number
	ICG	IC Green Energy Limited
	IdW	Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany)
	IFG	Informationsfreiheitsgesetz des Bundes (Freedom of Information Act)
	IFRS	International Financial Reporting Standards
	IGSC	Insurance Groups Supervision Committee
	IGSRR	Internal Governance, Supervisory Review and Reporting Expert Group
	IKB	Industriekredit Bank
	IMF	International Monetary Fund
	ING	Internationale Nederlande Group
	IntMod	Internal Model Expert Group
	InvÄndG	Investmentänderungsgesetz (Act Amending the Investment Act)

	InvMaRisk	Mindestanforderungen für die Ausgestaltung einer ordnungsgemäßen Geschäftsorganisation und insbesondere des Risikomanagements von Kapitalanlagegesellschaften und Investmentaktiengesellschaften (Minimum Requirements for Risk Management in Asset Management Companies)
	InvRBV	Investment-Rechnungslegungs- und Bewertungsverordnung (Investment Accounting and Valuation Regulation)
	InvG	Investmentgesetz (Investment Act)
	IOPS	International Organization of Pension Supervisors
	IOSCO	International Organization of Securities Commissions
	IP	Investment portfolio
	IPO	Initial Public Offering
	IRBA	Internal Ratings Based Approach
	IT	Information technology
	IWCFC	Interim Working Committee on Financial Conglomerates
J	**JF**	Joint Forum
	JCFC	Joint Committee on Financial Conglomerates
	JPY	Japanese yen
K	**KG**	Kommanditgesellschaft (German limited partnership)
	KSP	Kreditsonderprüfung (lending-related special audit)
	KWG	Gesetz über das Kreditwesen (Banking Act)
L	**LB**	Landesbank
	LBBW	Landesbank Baden-Württemberg
	LG	Landgericht (Regional Court)
	LIBOR	London Interbank Offered Rate
	LiqV	Liquiditätsverordnung (Regulation on the Liquidity of Institutions – Liquidity Regulation)
	LI	Life insurance
	LIU	Life insurance undertaking
M	**MaComp**	Mindestanforderungen an die Compliance (Minimum Requirements for the Compliance Function)
	MaRisk	Mindestanforderungen an das Risikomanagement (Minimum Requirements for Risk Management)
	m	million
	MAS	Monetary Authority of Singapore
	MBS	Mortgage-Backed Securities
	MCeV	Market Consistent Embedded Value
	MCR	Minimum Capital Requirement

	MDOC	Minnesota Department of Commerce
	MIA	Maryland Insurance Administration
	MiFID	Markets in Financial Instruments Directive
	MoU	Memorandum/a of Understanding
	MMoU	Multilateral Memorandum/a of Understanding
	MSCI	Morgan Stanley Capital International
	MTF	Multilateral trading facility
N	**NCFM**	National Commission of Financial Markets
	No.	number
	NPL	Non-Performing Loans
O	**OCI**	Other Comprehensive Income
	OECD	Organisation for Economic Cooperation and Development
	OIS	Overnight Indexed Swap
	OJ	Official Journal
	OLG	Oberlandesgericht (Higher Regional Court)
	OTC	Over the counter
	OVG	Oberverwaltungsgericht (Higher Administrative Court)
P	**p.**	Page
	p.a.	per annum
	PfandBG	Pfandbriefgesetz (Pfandbrief Act)
	PF	Pension fund
	PRIPs	Packaged Retail Investment Products
	PV facilities	Photovoltaic facilities
Q	**Q RM**	Querschnitt Risikomodellierung (cross-sectoral risk modelling)
	QIS	Quantitative Impact Studies
R	**REITs**	Real Estate Investments Trusts
	RettungsG	Rettungsübernahmegesetz (Rescue Takeover Act)
	RMBS	Residential Mortgage-Backed Securities
S	**S.a.r.l.**	Société à responsabilité limitée
	SADC	Southern African Development Community
	S&P	Standard & Poor´s
	SCR	Solvency Capital Requirement
	SdK	Schutzgemeinschaft der Kapitalanleger e.V. (German Association for the Protection of Shareholders)
	SEPA	Single European Payment Area
	SEC	Securities and Exchange Commission
	SGB	Sozialgesetzbuch (Social Code)
	SME	Small and medium-sized companies
	SoFFin	Sonderfonds Finanzmarktstabilisierung

		(Financial-Market Stabilisation Fund)
	SolvV	Solvabilitätsverordnung (Solvency Regulation)
	SPV	Special Purpose Vehicle
	SRP	Supervisory Review Process
	StPO	Strafprozessordnung (Code of Criminal Procedure)
T	**TRACE**	Trade Reporting and Compliance Engine
	TUG	Transparenzrichtlinie-Umsetzungsgesetz (Act Implementing the Transparency Directive)
U	**UBS**	Union Bank of Switzerland
	UCITS	Undertakings for the Collective Investment in Transferable Securities
	UK	United Kingdom
	US	United States
	USA	United States of America
V	**VA**	Versicherungsaufsicht (insurance supervision)
	VAG	Versicherungsaufsichtsgesetz (Insurance Supervision Act)
	VAStrRefG	Gesetz zur Strukturreform des Versorgungsausgleichs (Act on Structural Reforms to Pension Rights Adjustments)
	VerkProspG	Wertpapier-Verkaufsprospektgesetz (Act on the Prospectus for Securities Offered for Sale)
	VersAusglG	Gesetz für den Versorgungsausgleich (Act on Pension Rights Adjustments)
	VG	Verwaltungsgericht (Administrative Court)
	VGH	Verwaltungsgerichtshof (Higher Administrative Court)
	VVG	Versicherungsvertragsgesetz (Insurance Contract Act)
	VVG-InfoV	Verordnung über Informationspflichten bei Versicherungsverträgen (Regulation on Information Obligations for Insurance Contracts)
W	**WA**	Wertpapieraufsicht (securities supervision)
	WpHG	Wertpapierhandelsgesetz (Securities Trading Act)
	WpPG	Wertpapierprospektgesetz (Securities Prospectus Act)
	WpÜG	Wertpapiererwerbs- und Übernahmegesetz (Securities Acquisition and Takeover Act)
Z	**ZAG**	Zahlungsdiensteaufsichtsgesetz (Payment Services Supervision Act)

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