BaFin

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


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Preface

2010 was a year in which ambitious ideas for regulation were implemented. Of course, new ideas, by their very nature, do not always go down well with everyone. In fact they are often a major headache for those who have to deal with the consequences. "Basel III" is one such example that might be causing many banks considerable pain. In December, the Basel Committee on Banking Supervision published its new capital and liquidity standards. We do not yet know if these will attain the global importance that their intellectual parents claim for them, since at the time of writing this preface it is still relatively unclear whether all major banking countries will actually apply them. The EU member states are willing to do so, but will be unable to accept for a second time that horrendous regulatory costs are imposed on their banks alone, while major overseas competitors get off unscathed again because firm commitments have been broken.

It would be unfortunate if Basel III had to be buried again immediately due to a lack of global participation. This would almost certainly sound the death knell for the Basel Committee, which would lose its raison d'être from one day to the next and would at best be relegated to a sad existence as a non-binding discussion forum. Anyone who is prepared to play such a role as a two-fold gravedigger after the last financial crisis – the shock of which could hardly be outdone – will shoulder a heavy burden of guilt.

Granted, what the Basel Committee ultimately produced is not perfect. What is more, Basel III contains injustices that Germany finds difficult to swallow. Nevertheless the basic thrust of the new rules is correct: prior to the crisis, the international banking system was undercapitalised. This is why it is necessary to ensure that institutions hold much more capital, and higher-quality capital, in future to cover their risks. This is the only viable means of bringing the risks that have made the international banking system so very dangerous under control. The crisis also showed that the banks' liquidity position left a lot to be desired, and the Basel Committee's two new liquidity standards draw the long-overdue conclusions from this.

In Germany there are a lot of complaints that the Basel III regime is too stringent. Indeed, the BaFin representatives who participated in the Basel negotiations would have preferred solutions here and there that would give the German banks a little more room to breathe. That said, the new regulations will not strangle the banks because we managed to negotiate lengthy transition periods in order that the banks will be able to adapt to the new requirements

gradually. This was crucial to the goal of preventing the new rules from impacting the credit supply by imposing sudden increases in capital and liquidity requirements.

However, the ink on the signatures under the new Basel Agreement was hardly dry when those parties who were unable to realise their completely exaggerated ideas in Basel made a further attempt to turn the hard-fought debate in their favour after all. The question to be addressed in what is hopefully the final act relates to the additional requirements that the "SIFIs" – systemically important financial institutions – will have to meet. That the SIFIs must be subject to particularly strict supervision goes without saying in light of the "too big to fail" problem. However, we must not allow large banks to be put in a capital straitjacket that is clearly designed to impose new banking structures. Excessive capital surcharges are the wrong way to avert systemic risk. German companies also need large banks that can provide comprehensive support for their cross-border transactions. Other countries are free to opt for a system with smaller banks; what is not acceptable, however, is that they should force their extreme view on us by trying to turn it into a new international standard.

Even more questionable is the attempt to undo the future Basel capital package through decisions taken at the level of the second European bank stress test that began in April 2011. Without any legal authority, let alone legitimation, the new European Banking Authority (EBA), which has been charged with implementing the stress test, has come up with a new definition of capital that simply ignores both the current legal position and the transition periods agreed by the Basel Committee for Basel III – with consequences that no one can foresee. The general public is not privy to how this decision was reached. People would be rather perplexed by the considerable lack of clearly defined corporate governance structures – such structures being the only way of ensuring that the processes have legitimacy. This throws up a number of concerns for the future. It would be unfortunate if the European Banking Authority were to fall into disrepute right at the start of its activities.

The significance of the EU's new financial supervisory structures, which were agreed in autumn last year by the ECOFIN Council, the European Parliament and the European Commission, should not be underestimated. In 2011, a new era of supervision dawned in Europe: the three new European Supervisory Authorities and the European Systemic Risk Board have commenced work and will dominate the scene from now on. Even though national supervisors will generally remain responsible for operational supervision, in practice almost nothing will be the same for them as it was before. BaFin will have to bow to the increasingly long reach of European requirements right down to questions of detail, because the new European Supervisory Authorities have wide-ranging powers. As one member amongst many, BaFin's influence there is extremely limited: many important votes in the Boards of Supervisors in which the national supervisory authorities are represented are

taken in line with the principle of one country, one vote. Will we succeed in exerting a significant influence over the direction to be taken by the next waves of regulation in Europe? Only time will tell. What is certain is that we are set to be living in "interesting times" – which according to the Chinese is not a very attractive prospect.

Bonn and Frankfurt/Main | April 2011

Jochen Sanio
President

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I Introduction

Basel Committee adopts Basel III.

In December 2010, the Basel Committee on Banking Supervision (BCBS) published the new Basel III framework, comprising the capital and liquidity standards for banks that will apply in future worldwide. Under Basel III capital components, for example, will have to meet much stricter qualitative requirements going forward. Banks will also have to hold much more capital than before to cover their risks. With a small number of exceptions, Basel III will increase the burden on institutions across the board. This was demonstrated by the Basel Committee's Quantitative Impact Study (QIS), which is based on consolidated data as at 31 December 2009. Germany therefore advocated adequate transition periods. The Basel Committee's leverage ratio aims to limit the build-up of leverage in the banking system, as required by the G20. Following an observation period, the plan is to introduce the leverage ratio as a binding limit in 2018.

Restructuring Act – a consequence of the financial crisis.

In December 2010, German lawmakers passed the Restructuring Act (*Restrukturierungsgesetz*) as one of the responses to the financial crisis. The amendments to the Banking Act (*Kreditwesengesetz* – KWG) introduced by this Act, which entered into force on 1 January 2011, also strengthened BaFin's crisis prevention powers. The Restructuring Act establishes procedures that can be used to restructure and reorganise institutions whose continued existence is under threat at an early stage, while requiring owners to share in the costs. It also provides the option of orderly unwinding. The Restructuring Act is an important step towards solving the "too big to fail" problem, but only at a national level. Uniform principles are also required at the European and international level to make national liquidation processes more consistent and ensure better coordination of cross-border interventions. The conditions for this are being developed by the European Commission and international bodies such as the Financial Stability Board (FSB).

More than 4,000 administrative and supervisory body appointments.

Over 4,000 new appointments had been reported to the supervisory authority by the end of the year under review, i.e. a good year and a half after the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector (*Gesetz zur Stärkung der Finanzmarkt- und der Versicherungsaufsicht*) first introduced statutory minimum requirements for the individual expertise and reliability of members of administrative and supervisory bodies. In early 2010, BaFin issued a guidance notice providing more detailed information on the requirements for members of administrative and supervisory bodies in accordance with section 36 (3) KWG. Additionally, in October 2010 BaFin provided members of supervisory bodies, members of executive boards and representatives of associations with an opportunity to

obtain information about the new requirements for administrative and supervisory bodies of credit institutions at its "Forum for Credit Institution Supervisory Bodies".

14 German banks took part in the EU stress test in 2010.

In June 2010, the heads of state and government in the European Union (EU) resolved to publish the results of an EU-wide stress test. The objective of the exercise was to demonstrate the resilience of the European banking system in the event of an economic downturn and negative financial market developments (in particular, a drop in the value of European government bonds). Credit institutions were deemed to have passed the test if their Tier 1 capital ratio did not fall below 6% even in the most severe stress scenario. In this test, the German banking system has shown itself to be robust and proved its resilience even under extremely pessimistic assumptions. Even in the most severe scenario, 13 of the 14 German banks participating in the test reported a Tier 1 capital ratio of more than 6% and nine posted a Tier 1 capital ratio of more than 8% – more than twice the regulatory minimum. Only one bank, Hypo Real Estate Holding AG (HRE Holding AG), posted a Tier 1 capital ratio of less than 6% in one of the two years considered in the supplementary stress scenario. However, the stress test analysis did not take the radical restructuring at HRE Holding AG into consideration.

Germany's insurance industry stable.

The German insurance industry again proved stable in 2010; the direct impact of the global financial crisis on the insurance sector remained limited. Stabilising factors included strict supervisory requirements, improved crisis management by German insurers after the stock market crash in 2002 and their conservative investment policy.

Nevertheless, risks do exist. Low interest rates, for example, are impacting the performance of German life insurers. One of the supervisory authority's priorities was therefore to develop measures to strengthen life insurance undertakings' risk-bearing capacity and to help them cope with the low interest rates as well as possible. In the process, BaFin drew substantially on the results of the forecast of interest rate guarantees in life insurance performed in the previous year. Capital market interest rates continued to fall in the course of 2010. BaFin will take supervisory countermeasures if necessary.

Improvement in medium- and long-term risk-bearing capacity in the life insurance industry.

Capital market developments are the principal factors influencing the life insurance industry's risk-bearing capacity in the medium and long term. The measures that can be taken to improve the sector's risk-bearing capacity are currently under discussion by the Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF), BaFin and the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e.V.* – GDV). One measure envisaged is to increase the premium reserve in order to take lower interest income into account at an early stage (*Zinszusatzreserve*).

Rise in sovereign debt.

The rise in sovereign debt is also extremely significant for the insurance industry because insurers traditionally hold large exposures in government bonds. The supervisory authority therefore monitors the undertakings' investment policies extremely closely and increasingly analyses individual exposures. For example, BaFin requested industry participants to provide information about their exposure to government bonds issued by the PIIGS countries (Portugal, Ireland, Italy, Greece and Spain). In May and October 2010, BaFin for example requested from life insurance undertakings information about the country risk inherent in their investments. Besides the PIIGS countries, particular attention was paid to countries with increased credit default swap spreads (CDS spreads). The surveys showed that life insurers only hold limited investments of this kind and actively manage such risks.

Act on the Prevention of Improper Securities and Derivatives Transactions.

The Act on the Prevention of Improper Securities and Derivatives Transactions (*Gesetz zur Vorbeugung gegen missbräuchliche Wertpapier- und Derivategeschäfte* – WpMiVoG) entered into force in July 2010. Since then, naked short sales of shares and of debt securities issued by central and regional governments as well as by local authorities of eurozone countries that are admitted to trading on the regulated market of a domestic exchange have been prohibited by law in Germany. The Act also prohibits credit default swaps (CDSs) on liabilities of central governments, regional governments and local authorities in the eurozone where these are not used to hedge default risks. In addition, the Act gives BaFin greater and more specific powers to adopt measures to safeguard the financial system in emergency situations.

Improved investor protection.

In response to the financial crisis, German lawmakers passed the Act to Increase Investor Protection and Improve the Functioning of the Capital Markets (*Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts* – AnsFuG), which was published in the Federal Law Gazette (*Bundesgesetzblatt* – BGBl.) in April 2011. The Act aims to increase trust in the integrity and functioning of the capital markets, for example through increased market transparency and better protection of retail investors.

Minimum holding period introduced for real estate funds.

The AnsFuG was also introduced in response to developments in open-ended real estate funds. For example, the Act stipulates a one-year redemption notice period for all investors. Newly acquired units in open-ended real estate funds must have been held for at least 24 months at the time they are redeemed. However, investors can continue to redeem up to €30,000 worth of units per calendar half-year without observing these requirements. The lawmakers' aim in introducing these changes is to prevent large sums of money being parked temporarily in these funds, which are designed as long-term investments, without imposing excessive restrictions on small investors.

Takeover bids.

The takeover bids made by Deutsche Bank AG to the shareholders of Deutsche Postbank AG and by ACS, Actividades de Construcción y Servicios, S.A., to the shareholders of Hochtief AG attracted a great deal of public interest in 2010.

Market survey on investment advice.

Investment advice was another key topic in the securities supervision area during the year under review. In February 2010, BaFin conducted a market survey of the credit and financial services institutions it oversees to ascertain how these have implemented the regulations on documenting investment advice provided to retail customers that have been in place since the beginning of 2010. BaFin initially wrote to some 310 institutions, after which it also requested individual records of investment advice given in January 2010 on a sample basis. It evaluated some 1,100 records from over 190 undertakings and determined that these were incomplete in the case of 15 credit institutions and 37 financial services institutions. In May 2010, BaFin discussed the results of its market survey at a joint meeting with the associations of credit and financial services institutions, the Federation of German Consumer Organisations (*Verbraucherzentrale Bundesverband e.V.* – vzbv) and the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer in Deutschland e.V.* – IDW). At the beginning of November of the year under review, BaFin issued a letter reiterating that investment services enterprises are required to prepare written records of all investment advice given to retail clients.

New supervisory structure in the European Union.

In autumn 2010, the ECOFIN Council, the European Parliament and the European Commission agreed on new supervisory structures for the EU. Since 1 January 2011, the European Systemic Risk Board (ESRB), which is based in Frankfurt/Main, has been in charge of macroprudential supervision, which seeks to enhance the stability of the financial system. Although the ESRB is hosted by the European Central Bank (ECB), it is independent of the latter and does not have its own legal personality. The members of the ESRB's General Board with voting rights include the President and Vice-president of the ECB, the governors of the national central banks and one member of the European Commission. The representatives of national supervisory authorities are non-voting members.

Microprudential supervision, which relates to individual institutions, continues to be performed by national supervisory authorities such as BaFin. In addition, however, there are three European Supervisory Authorities that have independent powers: the London-based European Banking Authority (EBA), which is active in the area of banking supervision, the Frankfurt-based European Insurance and Occupational Pensions Authority (EIOPA), which is responsible for insurance supervision, and the Paris-based European Securities and Markets Authority (ESMA), which is in charge of securities supervision. The three European Supervisory Authorities have the power, for example, to develop regulatory technical standards and implementing technical standards (although these only become binding when endorsed by the European Commission) and also to enact non-binding guidelines and recommendations. What is more, the EBA, EIOPA and ESMA have direct powers of enforcement as against the national supervisory authorities and – in certain strictly defined circumstances – against enterprises.

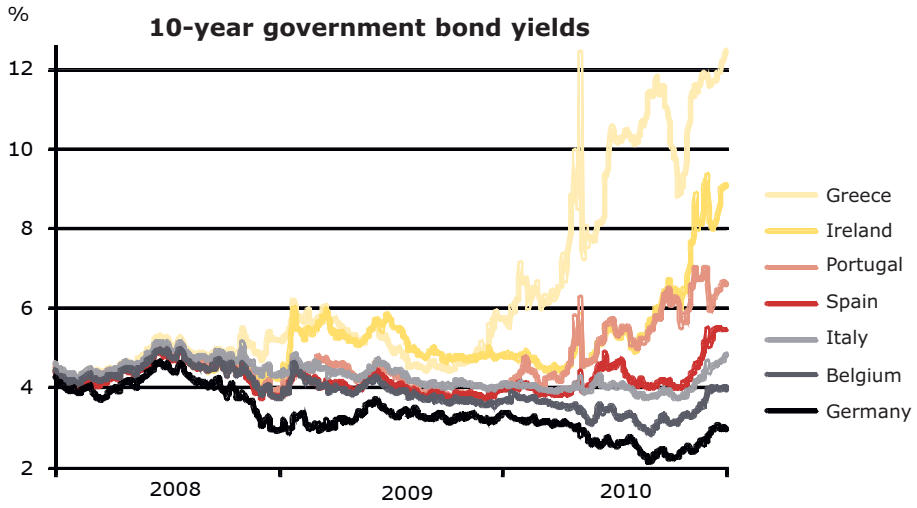
II Economic environment

1 Sovereign debt crisis

Financial and economic crisis impacts state finances.

In 2010, the financial markets increasingly turned their attention to country risk again. Rising public debt in a number of European countries cast growing doubt on their solvency. The first country in which the capital markets lost confidence was Greece, after the officially reported budget deficit turned out to be false and had to be revised upwards significantly. As a result, Greece's financing costs on the capital markets rocketed. It was only when an emergency plan providing bilateral aid was drawn up that the situation calmed down somewhat. However, it was not long before scepticism gained the upper hand again, with the yield on ten-year Greek government bonds shooting up to over 12% at the beginning of May 2010, for example.

Figure 1
Interest rate differentials in Europe



Source: Bloomberg

Gigantic rescue package in Europe.

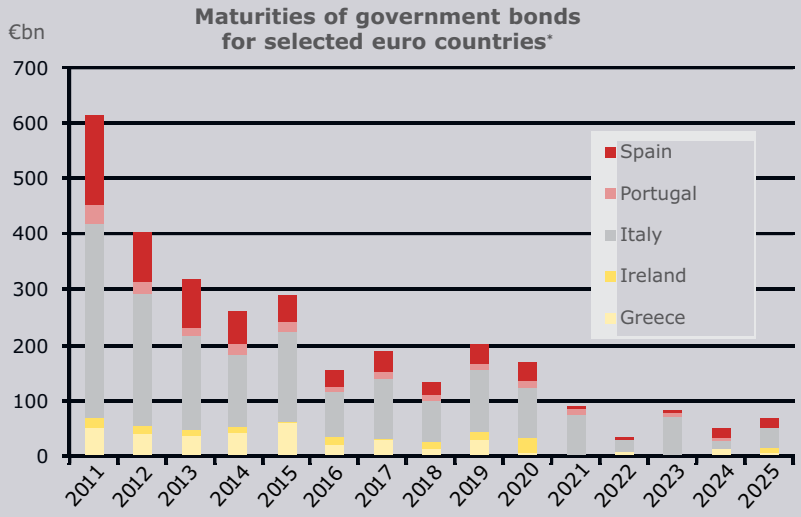
Greece's runaway sovereign debt was primarily attributable to a lack of budgetary discipline over a long period of time. The financial and economic crisis exacerbated the strained situation. Since the loss of confidence threatened to spill over to other peripheral eurozone countries, the member states of the European Union stepped in. With the assistance of the International Monetary Fund (IMF) they created the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) in May 2010, putting together a rescue package worth a total of €750 billion for ailing countries as part of these support measures. The firm response of policymakers to the worsening sovereign debt crisis had the desired effect on the capital markets, substantially reducing financing costs.

Nevertheless, it proved impossible to dispel the mistrust on the capital markets completely.

Growing funding risks

Many countries are facing significantly higher funding volumes in 2011, particularly on account of the extensive measures their governments have taken to combat the financial crisis. In parallel, banks are seeing an increased need for funding as a result of higher regulatory capital requirements. A race between countries, credit institutions and corporate entities to secure scarce capital runs the risk of a sharp interest rate hike and that the private sector will find it more difficult to access the capital market (known as the "crowding-out effect"). Among the industrialised nations, Japan and the United States in particular, but also Germany and the United Kingdom, have high absolute funding requirements. However, the spotlight is on the countries on the periphery of the eurozone, which have been under severe pressure from the markets for some time; these countries will have to overcome considerable funding challenges in the next few years.

Figure 2
Funding structure for sovereign debt in Europe



*Bonds and loans, incl. interest; as of beginning of 2011.
Source: Bloomberg; BaFin calculations

European bank stress test increases transparency.

Doubts also arose concerning credit institutions' risk-bearing capacity, which was already severely limited, in a progressively deteriorating environment. There was an acute need for information on the part of market participants, investors and supervisory authorities – particularly about potential losses arising from critical sovereign exposures held by the banks. In light of this situation, the Committee of European Banking Supervisors (CEBS, now the EBA) initiated a stress test in which 91 institutions from

20 EU member states took part. While the basic scenario assumed a slight economic recovery, the stress scenario entailed a further slump in economic growth together with a shift in the yield curve and an increase in European government bond yields. Credit institutions were deemed to have passed the test if their Tier 1 capital ratio did not drop below 6%. The vast majority of the banks were able to cope with even the difficult negative scenario. Seven institutions did not pass the test, however. In addition to five Spanish savings banks and one Greek bank, the nationalised HRE Holding AG was the only one of the 14 participating institutions in Germany to fail. The predominant reaction on the financial markets to the publication of the results was one of relief. The transparency created helped to reduce uncertainty and to restore lost confidence in part.

Flight to safe government bonds.

In spite of all efforts taken to manage the crisis, the capital markets remained jittery. Spreads for a number of countries did not narrow significantly due to the fear that these countries could be forced sooner or later to bow to the growing pressure from their populations and abandon their strict consolidation course. Interest rate spreads in countries around Europe widened and investors reallocated their investments. German government securities were particularly popular as a safe haven. The ten-year Bund yield fell to 2.1% at the end of August 2010, an all-time low. As the year progressed, the buoyant economic climate in Germany, rising capital market rates in the United States and growing anxiety as to whether the richer countries in the eurozone can bail out the weaker ones in the long term again pushed up yields for long-dated federal government securities somewhat. At the end of 2010, the ten-year Bund yield was hovering around the 3% mark.

Mounting problems in Ireland...

Ireland’s ongoing financial problems increasingly took centre stage in the second half of the year. Rescuing its oversized banking sector proved too much for the country. After some initial hesitation, Ireland became the first country to tap the European bailout programme in November. The EU and the IMF provided a €85 billion rescue package with strict conditions attached. Nevertheless, the spreads on Irish government bonds, which had widened sharply in the weeks before, hardly decreased at all. At the end of the year, the ten-year bond yield was over 9%. The spread against Bunds with matching maturities was 6 percentage points, compared with less than 1.5 percentage points a year earlier.

...increase contagion risk for other eurozone countries.

After Greece and Ireland, the markets turned their attention to Portugal and Spain as the next candidates for a bailout. Italy and Belgium, which had joined the European Monetary Union in 1999 as founder members despite having a debt ratio far in excess of the Maastricht criterion of 60%, also saw funding costs for government bonds increase substantially since they had made little progress in reducing their debt in recent years. Spain was severely impacted by the fallout from its burst real estate bubble in 2010 and lagged behind most other European countries in terms of economic growth. In the course of the crisis in Ireland, the yield on ten-year Spanish government bonds increased from 4% in

October 2010 to around 5.5% at year-end, the highest level since mid-2002. The spread to Bunds widened to 2.5 percentage points, whereas the difference had been 0.6 percentage points at the beginning of 2010, and a mere 0.1 percentage points or so at the start of 2008. The massive increase in spreads makes it more expensive to fund sovereign debt on the capital markets and reduce public sector debt capacity in the countries in question.

US monolines

The US monoline industry was hit hard by the financial crisis. Reckless guarantees – especially in the structured finance sector – had led to substantial losses back in 2009. The position of the US monolines remained fragile in 2010. In November, the financial holding company **Ambac Financial Group** was forced to file for bankruptcy after it failed to reach an agreement with its investors and creditors.

Monolines' core business is insuring bonds for a fee. This insurance cover gives the guaranteed bonds a higher credit rating, which reduces the financing costs for the issuer. A good rating is vital for monolines. In the years preceding the crisis, many companies moved over to insuring more risky financial products such as structured finance products for US real estate, or to acting as a protection seller for credit default swaps. The fate of the monoline industry is therefore closely tied to the performance of these financial products. If the insured financial product defaults, the monoline is obliged to make the payments provided for in the contract. During the crisis, the majority of the monolines lost their Triple A ratings. This means that most of these companies are no longer able to generate new business and are merely engaged in settling existing transactions.

The risk to the beleaguered monolines is likely to increase if public sector finances in the United States deteriorate further and they have to make good credit defaults in the US public finance sector, which has been relatively stable up to now, under the default guarantees that they issued. In the event of a double default (simultaneous default of the insured bond and the monoline providing the guarantee), defaults on insured US government bonds and municipal bonds would directly impact investors, who would be forced to write down their investments. This would also affect a number of German institutions. Since several monolines are already rated at sub-investment grades, banks' credit reviews are increasingly examining whether monoline guarantees can still be recognised. In the case of extremely low ratings, most institutions are switching to merely using the creditworthiness of the underlying bond issuer in their valuations.

Rapid increase in government debt, including in the United States.

In 2010, the financial markets mainly focused their attention on the sovereign debt crisis in Europe. However, the health of public finances in some other key economic regions of the world is no better. For example, in 2010 Japan's national debt was more than twice its gross domestic product, resulting in a leverage ratio substantially higher than that of Greece (130%). Public finances in the United States, where the financial crisis had its origins in the subprime mortgage market, are also deteriorating rapidly. In 2010, federal debt already accounted for 94% of economic output, around 30 percentage points more than before the outbreak of the crisis in 2007. Including federal states and local authorities, the US debt ratio is actually fast approaching the 120% mark. Another sharp increase is inevitable because the highly expansionary fiscal policy adopted to rescue the banks and stimulate the economy is still having an effect and the budget deficit can only be reduced slowly.

Financial crisis: A chronology of important events in 2010

January

The US administration announces a **special bank levy.**

The Chinese government decrees more **restrictive lending terms** for banks to prevent the economy overheating and a bubble forming in the property market.

February

Germany's federal government resolves stricter rules for **bonus payments** in the financial sector.

Eurozone periphery countries come under pressure on the financial markets; there are growing concerns about the single European currency. Greek public finances are put under EU control.

March

The German government presents the key points of a **Restructuring Act** providing for the orderly unwinding of banks in the event of a crisis and the introduction of a bank levy.

Under pressure from the EU, **Greece** approves a further **austerity package** to reform its finances; eurozone countries agree on an emergency plan with the participation of the IMF.

April

WestLB transfers securities worth €77 billion to Germany's first active bad bank.

Greece asks the EU and the IMF for financial aid. Market doubts about whether the **aid package** (€45 billion) is large enough start surfacing early on.

Rating agencies downgrade **Greece**, **Portugal** and **Spain**. The spreads for these countries' bonds soar.

May

BaFin prohibits **naked short sales** of eurozone government bonds as well as of credit default swaps on such bonds. At the same time, the ban on naked short sales of certain financial sector stocks, which had been temporarily suspended, is reinstated.

SoFFin, the bank rescue fund, reports a €4.3 billion loss for 2009. The deficit is due to a write-down on the investment in nationalised bank, Hypo Real Estate.

The **aid package** for **Greece** is topped up to €110 billion with strict conditions attached.

Shortly afterwards, the EU and the IMF are forced to prop up the euro by implementing a massive rescue scheme for affected EU countries as the sovereign debt crisis worsens. A **€750 billion** credit facility is made available up to 2013.

The ECB launches a **programme to buy bonds** on the secondary market and resolves to accept Greek government bonds as collateral for its bank funding transactions, regardless of their credit quality.

June

Aareal Bank becomes the first bank to start repaying the capital injections it received from SoFFin.

The G8 countries fail to reach agreement on the global introduction of a financial transaction tax and a bank levy. At the ensuing G20 Summit in Toronto, participating countries pledge to halve budget deficits by 2013 and to balance their budgets by 2016.

The European Commission announces plans for the central supervision of rating agencies.

July

The ban on **naked short sales** is enshrined in law in Germany.

Hypo Real Estate establishes a **liquidation agency** under SoFFin to which toxic securities and loans will be transferred.

Europe's banking supervisors publish the results of the stress tests they conducted. Seven out of a total of 91 banks fail the tests, including the nationalised Hypo Real Estate – the only one out of the 14 German banks tested.

A comprehensive **financial market reform** is implemented in the **United States** with the introduction of the **Dodd Frank Act**.

August

The debt crisis in **Ireland** worsens as a result of the escalating costs of rescuing the beleaguered banking sector. The uncertainty on the financial markets prompts **a flight to safety**; ten-year Bund yields fall to an all-time low.

September

SoFFin temporarily increases the **guarantee facility** for **Hypo Real Estate** by a further €40 billion to €142 billion.

Deutsche Bank announces a €9.8 billion capital increase and publishes details of its takeover of **Postbank**.

The Basel Committee on Banking Supervision agrees on stricter **capital and liquidity requirements** (Basel III).

October

Hypo Real Estate transfers €173 billion of assets to the liquidation agency, FMS Wertmanagement.

Shortly afterwards, it returns part of the state guarantees to SoFFin.

EU finance ministers agree on the goal of more stringent **hedge fund** supervision.

November

The **Restructuring Act** is approved by the Bundestag (the lower house of the German Parliament) and the Bundesrat (Federal Council).

After some initial hesitation, **Ireland** accepts the offer of aid and becomes the first country to use the newly created EU/IMF rescue fund. The volume of financial aid granted is €85 billion.

After Greece and Ireland, the markets increasingly turn their attention to **Portugal** and **Spain**. The spreads for bonds of both these countries soar.

The **Federal Reserve** maintains its **expansionary monetary policy** and plans to buy up to $600 billion's worth of government bonds to prop up the weak economy.

Basel III is adopted at the G20 Summit in Seoul. The new capital adequacy requirements for banks can now be implemented internationally.

December

Germany's governing parties agree on a ten-point plan to **reform national financial supervision**.

Hypo Real Estate successively returns most of the state guarantees it received. At the end of the year the remaining guarantees amount to €15 billion.

A **permanent crisis mechanism** including personal liability for creditors will be established for eurozone countries following the expiry of the rescue package in 2013.

For the first time, the **ECB** resolves to increase its share capital in view of the increased risk associated with its activities to combat the financial and sovereign debt crisis.

2 Financial markets

Financial markets remain fragile despite improvement.

On the whole, the financial markets continued to recover in 2010. Nevertheless, the fallout of the financial and economic crisis and potential threats still cast a large shadow in many areas. In Europe, for example, default spreads for financial sector institutions remained high. Since the scope and content of the regulatory measures to be taken in response to the crisis are not yet fully known, there is still uncertainty as to their effects on companies' capital bases and potential earnings. The segmentation of the money market also continued in 2010. Many credit institutions in the countries affected by the European debt crisis were dependent on the measures implemented by the European Central Bank to boost liquidity. A look to the United States reveals a highly expansionary policy, the primary goal of which is to stimulate the economy through an extremely low headline interest rate, a substantial increase in the money supply and fiscal programmes. The generally low interest rates coupled with high liquidity are producing problematic incentives. For example, they may result in large flows of capital into riskier investments offering higher returns. The concentration of capital in these areas may in turn lead to renewed excesses. Last but not least, the high debt levels in many countries – including outside Europe – run the risk of further turmoil on the financial markets.

Stock markets see brisk trading at year-end.

The key international share indices turned in a mixed performance up to the middle of 2010. The MSCI World index posted substantial gains at the beginning of the year before coming under pressure from the European debt crisis in the weeks that followed. The risk of a double dip in US economic activity, with its implications for the global economy, was also still acute. It was not until the second half of the year that a clear upward trend began to emerge. This was driven in particular by the emerging markets, which recorded substantial inflows of capital. The MSCI World index ultimately closed 2010 up 112 points as against the start of the year, a gain of around 9.5%.

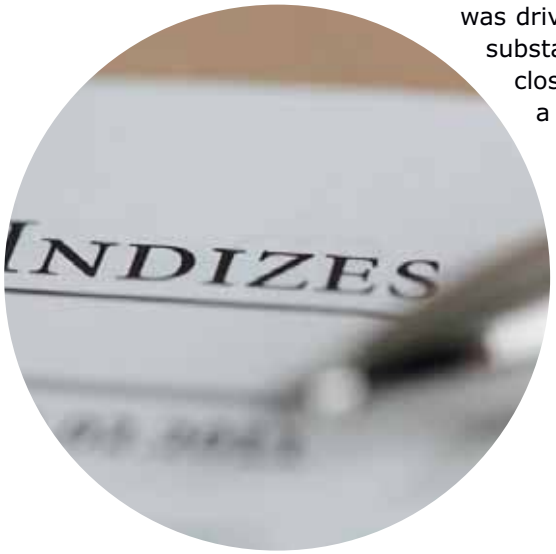
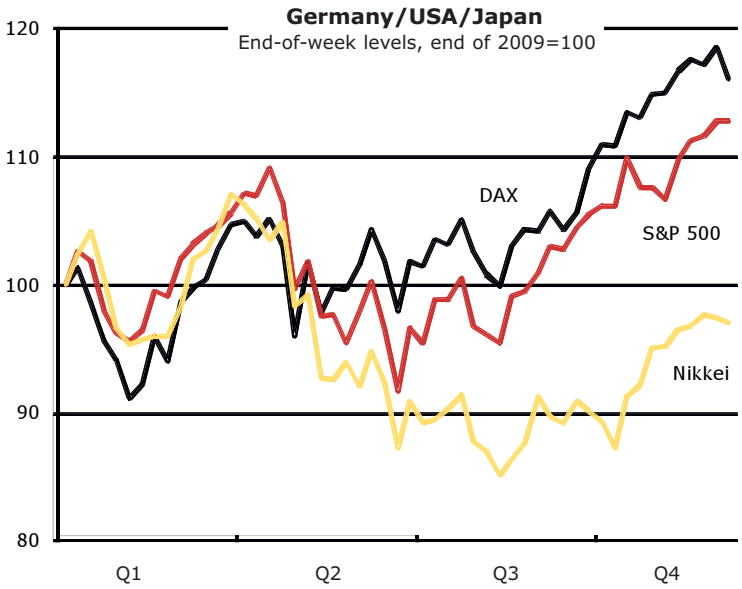


Figure 3
Comparison of stock markets in 2010



Source: Bloomberg; BaFin calculations

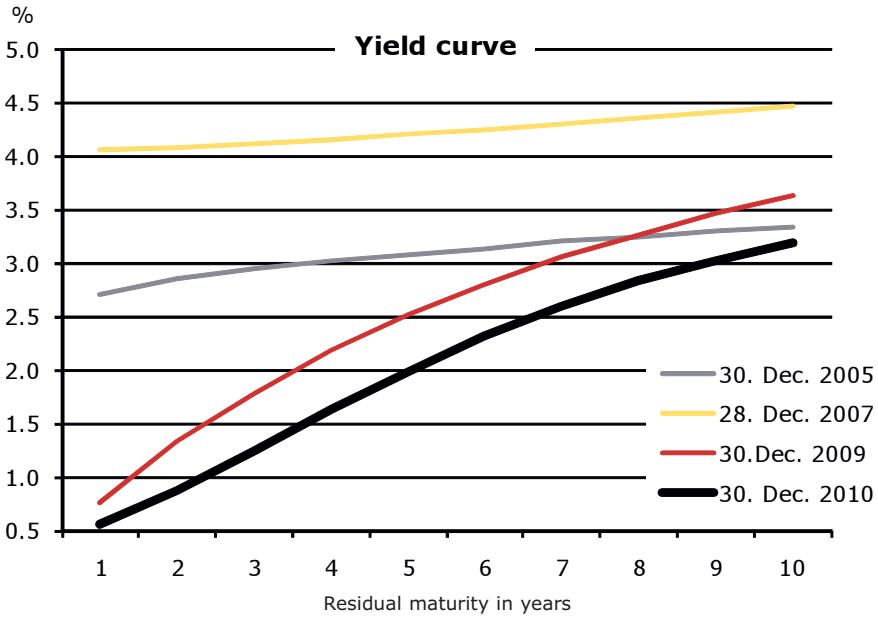
DAX witnesses resounding rally.

The DAX, which moved almost in tandem with the S&P 500 and the Nikkei in the first quarter, struck out on its own in the second quarter, outperforming its large international counterparts with gains of more than 15% for the year as a whole. This result is mainly attributable to developments in the second half of the year, when expectations of a sustained economic upswing in Germany intensified. The S&P 500 was also buoyed by positive investor sentiment in the US – even though the economic recovery in this country was more fragile and the labour market much weaker than in Germany.

Steep yield curve.

The slope in the yield curve remained quite steep in 2010, similar to the year before. However, clear parallel shifts could be observed as the year progressed. The curve showed a pronounced downward trend until the autumn, before moving upwards again until the end of the year. The main driver at the short end was the low key interest rate set by the European Central Bank. The yield on one-year paper was marginally above 0.5% at the end of 2010. As a result, the yield curve showed a pronounced slope by historical standards in 2010, in spite of the relatively low long-term yields.

Figure 4
Yield curve for the German bond market*



* Interest rates for (hypothetical) zero coupon bonds with no credit default risk.
Source: Deutsche Bundesbank

Monetary policy supports fight against European debt crisis.

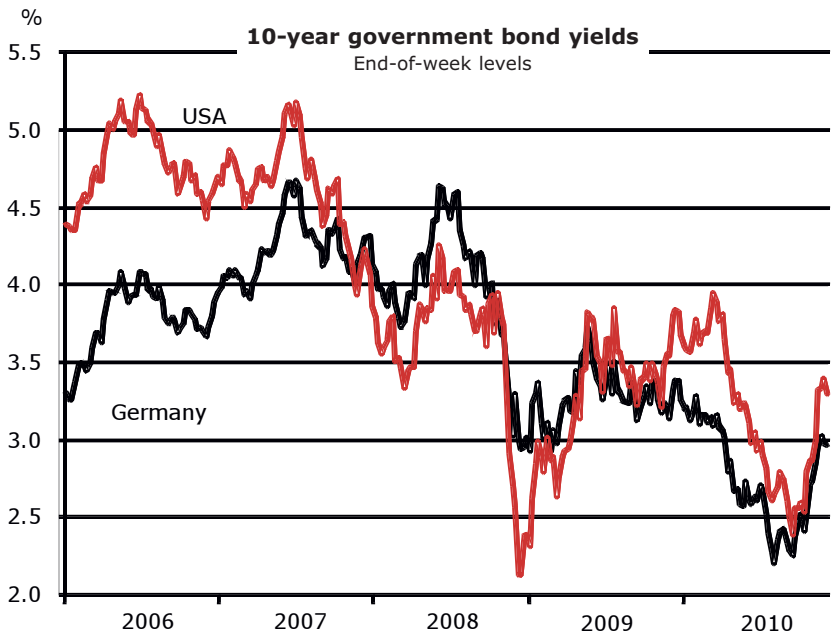
The key factor influencing the monetary policy environment in the eurozone in 2010 was the ongoing low key interest rate (only 1%). At the beginning of the year, many market participants were still speculating that rates would rise in the course of the year. Later on, however, this step was not expected until 2011 at the earliest. The European Central Bank's goal of gradually abandoning the emergency measures it had taken was thwarted last year by the debt crisis in Europe. It did take initial steps in 2010 to withdraw from its liquidity-oriented monetary policy. For example, the covered bond purchase programme expired once the planned aggregate volume had been reached. In addition, there were no further special one-year tenders. However, the intensification of the Greek crisis in the spring made new emergency measures necessary, such as the ECB's announcement that it would accept downgraded European government bonds as collateral. It also launched a programme for purchasing government bonds on the secondary market to prevent yields from widening (excessively) – a measure that generated heated debate among market participants, monetary policymakers and academics alike.

Government bond yields now at record low.

The yields on German and US government bonds continued to fall during 2010, reaching record lows in some cases by the autumn. The ten-year Bund yield at the end of August was just 2.1%, for example. The pronounced flight to safety prompted by the European debt crisis was undoubtedly a key cause of this development. Part of the capital invested was channelled back into

other havens when investors' risk perception fell slightly towards the end of the year and the global economy started to recover. As a result, government bond yields in Germany and the United States picked up noticeably again.

Figure 5
Capital market rates

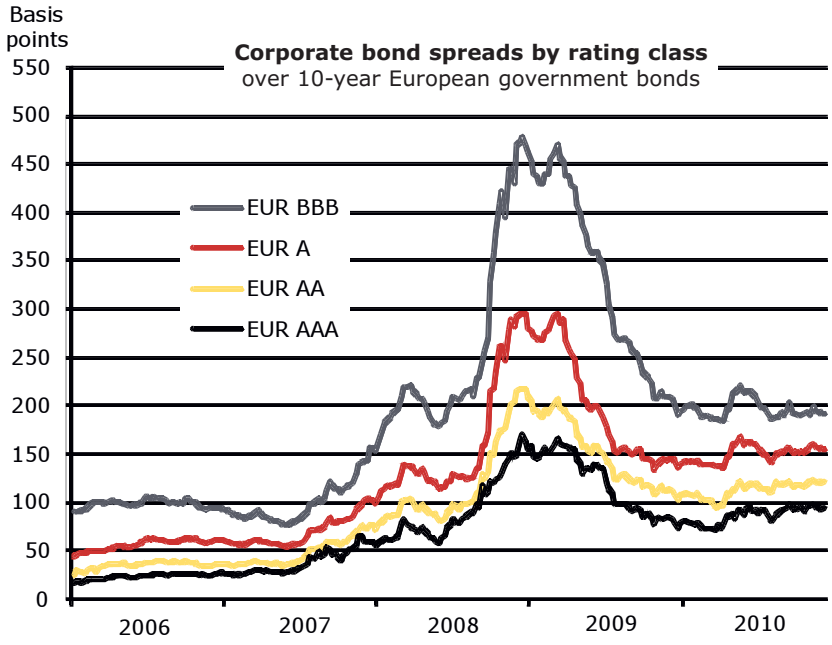


Source: Bloomberg

Spreads unchanged at high level.

Most types of spreads had fallen substantially in 2009 and did not show any further marked decreases last year. Spreads in the European corporate sector, for example, widened substantially during the market turmoil caused by the Greek crisis in early summer 2010. After that, no significant changes in their levels were observed in most rating classes. This meant that their full-year values were therefore still significantly higher than before the crisis.

Figure 6
Corporate bond spreads in Europe

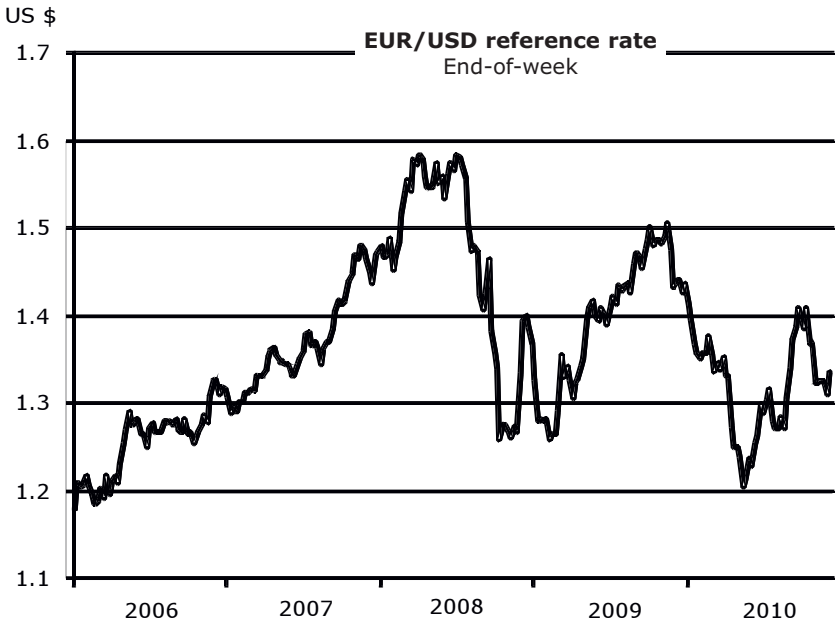


Source: Bloomberg; BaFin calculations

Euro on rollercoaster ride.

Last year, the euro/dollar exchange rate was dominated by the debt crisis in a number of eurozone countries. The Greek crisis undermined financial market participants' confidence in the euro during the first two quarters, leading initially to a country-specific rescue facility and later to a rescue package covering the entire eurozone. After this, the euro appreciated substantially again, rising to over $1.40 in autumn 2010. The crisis in Ireland that followed and the ensuing speculation about other possible defaults by European countries then caused the euro to take a further nosedive. However, due to the rescue package that had been established, the euro devalued by less than in the spring.

Figure 7
Exchange rate movements



Source: Bloomberg

3 Banks

Banks halfway between financial crisis and economic recovery.

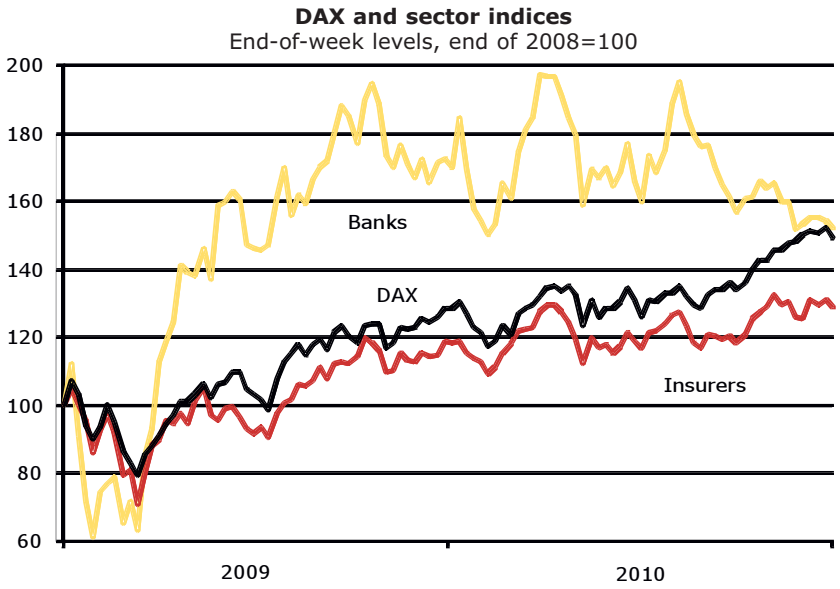
The position of the banks in 2010 was mixed. On the one hand, their balance sheets still reflected uncertainties as to the continuing recovery from the global financial and economic crisis – uncertainties that were reinforced by the euro crisis. On the other hand, the sustained economic recovery in Germany boosted business and reduced write-downs for the banks. The main winners in this environment were those credit institutions that had contained their losses during the crisis thanks to comparatively good risk management. Other beneficiaries were the traditional retail banks, which gained customers from other institutions and increased their business volumes thanks to a growing aversion to risk. At the same time, they used the steep yield curve to generate additional income from maturity transformation. By contrast, the situation worsened for those credit institutions that had already reported heavy losses during the financial crisis. The economic upturn largely passed them by, because the capital needed to write new business is particularly expensive for them – to say nothing of potential EU requirements and the stricter demands imposed by Basel III.

Bank stocks fall despite rise in DAX.

2010 presented a different picture on the stock market to the previous year. In 2009, bank stocks (+70%) were still one of the drivers of the DAX (+29%). In 2010, by contrast, the sector index for German banks lost around 10% of its value and did not take part in the rise in the DAX of around 16%. Share prices were hit

particularly hard in the last quarter. In spite of this, both indices posted an almost identical, above-average increase of 50% over two years. The sector index for German insurers slightly underperformed the DAX in both years.

Figure 8
Share indices for the German financial sector



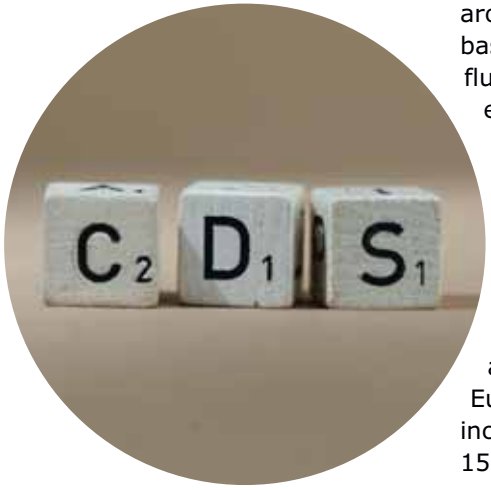
Source: Bloomberg; BaFin calculations

From early February until the end of March 2010, the banking index climbed around 30% within a few weeks on the back of the brighter economic outlook and earnings prospects. However, this was followed by a major setback at the beginning of May, as the euro crisis spread beyond Greece. German banks in particular were impacted by substantial exposure to peripheral eurozone countries. Despite the euro rescue package put in place by the EU and IMF, it was August before the bank index regained its spring high. Another positive factor was that in July all German banks apart from HRE that took part in the CEBS stress test passed it.

From mid-August onwards, the banking index and the DAX moved in different directions. Whereas the DAX gained almost 20% in the period up to the year-end thanks to the economic upturn, the banking index fell by around 20%. This is all the more astonishing when we consider that banks in particular can be expected to benefit from the increase in business and lower default risk associated with the upturn.

Nevertheless, risks continue to exist as a consequence of the financial crisis and the uncertain earnings prospects. Regulatory interventions in respect of bank stocks probably also had a negative impact. For example, the bank levy resolved as part of

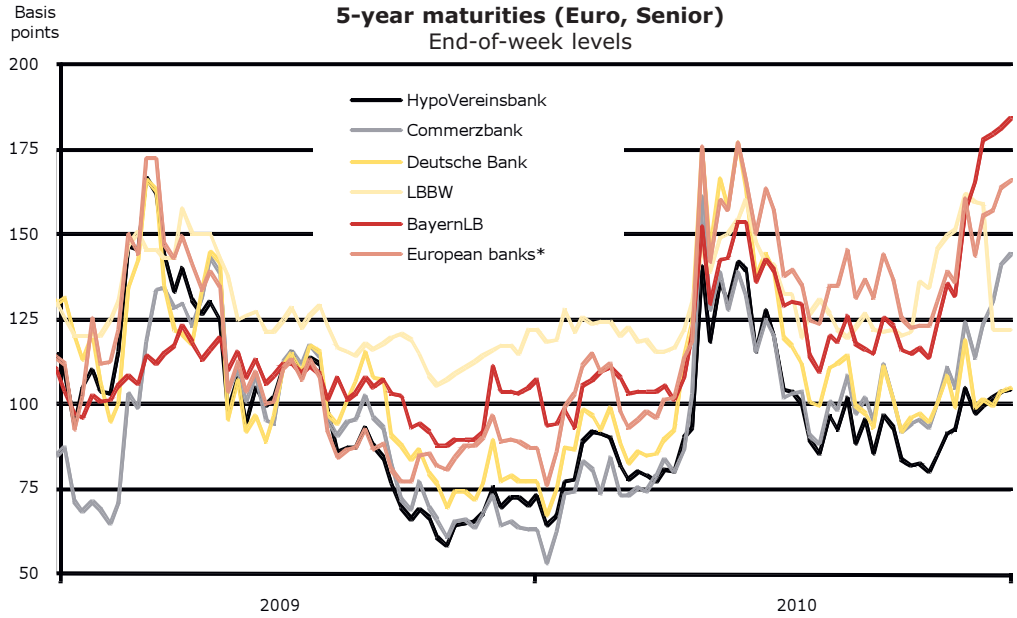
the Restructuring Act entails not insignificant additional costs for large institutions in particular. What is more, considerable effort will be required in future to meet the higher quantitative – but above all qualitative – capital requirements laid down in the new Basel III rules.



The renewed uncertainty was clearly illustrated in the high volatility recorded for credit default swap spreads.[1] After rising to around 60 basis points in 2007 from a historic low of below ten basis points, CDS spreads for major German banks have mostly fluctuated between 50 and 150 basis points since 2008. They exceeded this level at times during the second quarter of 2010 as a result of the risks associated with the currency crisis. The situation eased markedly in the third quarter, especially in the case of CDSs for large private banks.

At the end of the year, bank spreads picked up again in line with the rise in country risk. This was particularly noticeable in the case of both the Landesbanks, which are still trying to find a viable long-term business strategy, and the peer group of European banks. Average CDS spreads for the latter also increased – in lockstep with the relevant country CDSs – to over 150 basis points.

Figure 9
Credit default swap spreads for major German banks



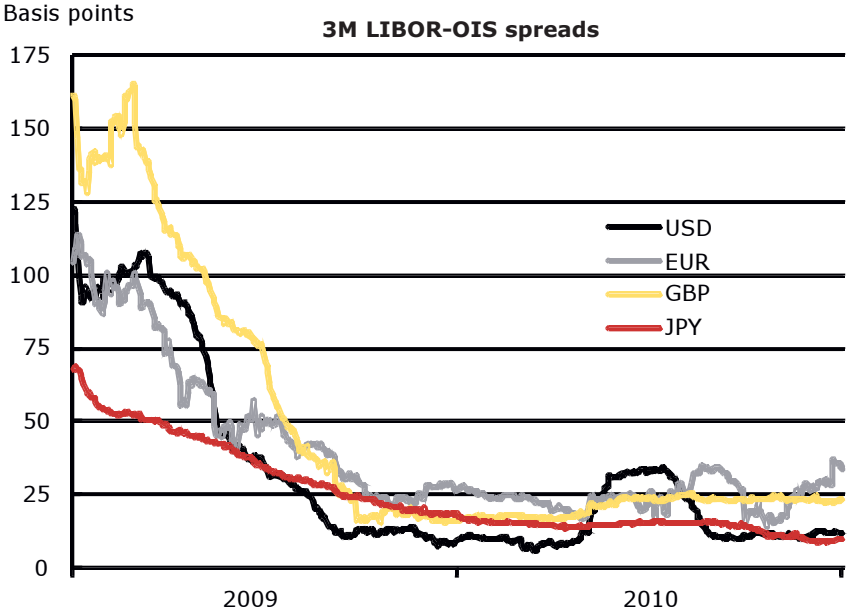
* Unweighted average of CDS spreads for 15 major European banks.
Source: Bloomberg; BaFin calculations

[1] CDS spreads are the OTC market prices for taking on an undertaking's credit default risk (only the risk is traded, not the entire loan). Conventionally, they are quoted in basis points. A spread of 120 basis points means that in the case of a contract worth €100 million, an annual premium of €1.2 million must be paid. The higher the risk, the higher the spread.

Volatile interbank market.

The decisive action taken by the central banks had already prompted a marked recovery on the interbank market and in the liquidity supply during 2009. This trend continued in the year under review with brief interruptions. Key money market indicators such as overnight funding rates or three-month LIBOR money market rates eased significantly against their exceptionally high levels during the financial crisis, at times even falling to new lows. The overnight rate in the first half of 2010 was below 0.5%, while three-month LIBOR was marginally in excess of this figure. In the second half of the year, money market rates rose slightly, with LIBOR increasing somewhat faster than the overnight rate towards the end of the year. The LIBOR-OIS spreads illustrated in the following chart underline this trend.[2]

Figure 10
Interbank market indicators



Source: Bloomberg

The LIBOR-OIS spread for Europe widened sharply at the end of the year after initially recording very low values. One of the reasons for this is the increase in the liquidity surplus in the banking sector during the last quarter of 2010, as credit institutions went back to stockpiling cash instead of making it available on the interbank market. It is important to point out, however, that the tensions in the European money market were not evenly distributed, but rather that they mainly affected individual peripheral eurozone countries.

[2] The Libor-OIS spread is the difference between the London Interbank Offered Rate and the overnight index swap rate. The spread, which is calculated in basis points, represents the risk premium payable in the case of the three-month LIBOR as against a three-month revolving overnight index swap. It can therefore be taken as a pure-play indicator of the credit risk on the interbank market.

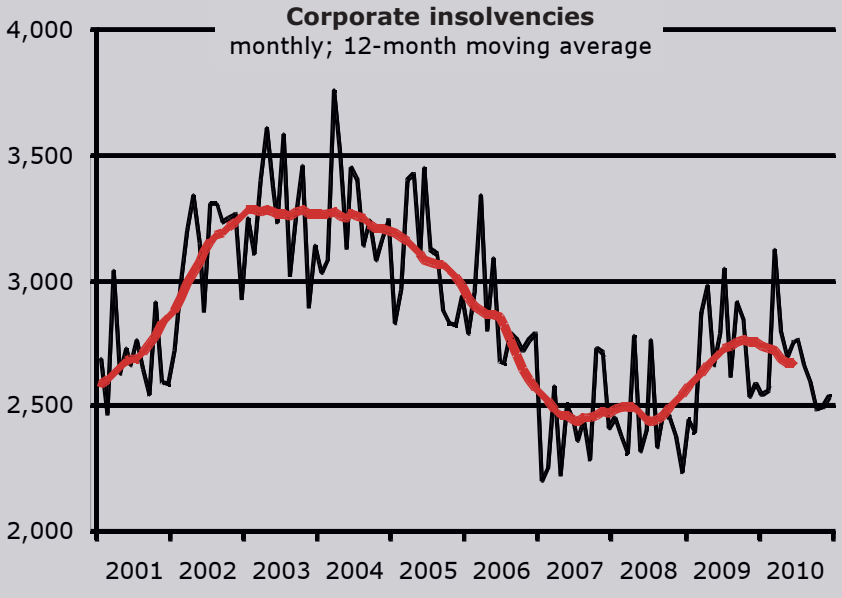
Increasing demand for loans.

Given the upturn in the economy, German credit institutions left their lending standards for corporate clients, which had been tightened in 2008 and 2009, unchanged in the first half of 2010 before easing them slightly from the third quarter onwards, according to the ongoing Bank Lending Survey conduced by Deutsche Bundesbank. In addition, the margins on personal loans and, in some cases, on corporate loans, were lowered slightly starting in the second quarter. This basically positive development for the economy as a whole was also facilitated by the favourable liquidity situation and the more stable financing conditions for banks on the money and capital markets. At the same time, there was a surge in demand for loans among both corporate clients and private households – in the latter case for residential construction in particular – from the second quarter onwards. According to an ECB survey, the more difficult situation seen in some other eurozone countries shows that lending standards became tighter on average in Europe during 2010.

Insolvency trend

The number of **corporate insolvencies** declined slightly in 2010 after rising perceptibly in the previous year in the aftermath of the severe recession. German local courts reported 32,000 corporate insolvencies, 2% less than in 2009. The improvement, which gained momentum as the year progressed, is due to the remarkably robust economic upturn in Germany. Outstanding creditor receivables decreased substantially from €73 billion in 2009 – which saw several spectacular large-scale insolvencies – to €27 billion in 2010, but were still noticeably higher than the average for 2005 to 2008 (€21 billion). As the economy continues to recover, the number of insolvencies is expected to continue to fall and to have a positive effect on banks' credit quality.

Figure 11
Number of corporate insolvencies in Germany



Source: Statistisches Bundesamt

Around 109,000 **private individuals filed for insolvency** in Germany in 2010, 8% more than in the previous year. This figure also topped the previous record of around 105,000 cases in 2007. A growing number of private individuals are becoming overindebted. The potential economic loss is significantly lower than in the corporate sector, however. In 2010, the courts estimated outstanding creditor receivables at €6.3 billion, up from €5.8 million in 2009.

Uneven consolidation process.

The German banking market will see further takeovers in the medium term, despite the risks involved. The financial crisis enabled competitors with sufficient capital that had gained in strength in relative terms to take over weaker competitors. Deutsche Bank's moves to strengthen its retail business by taking over Sal. Oppenheim and Deutsche Postbank are particularly significant for the competitive situation in Germany.

This contrasts with the situation in the Landesbank sector, where mergers that were envisaged have not yet been implemented despite (or because of) economic difficulties and corresponding EU requirements.

4 Insurers

Rise in premiums collected but interest rates still low.

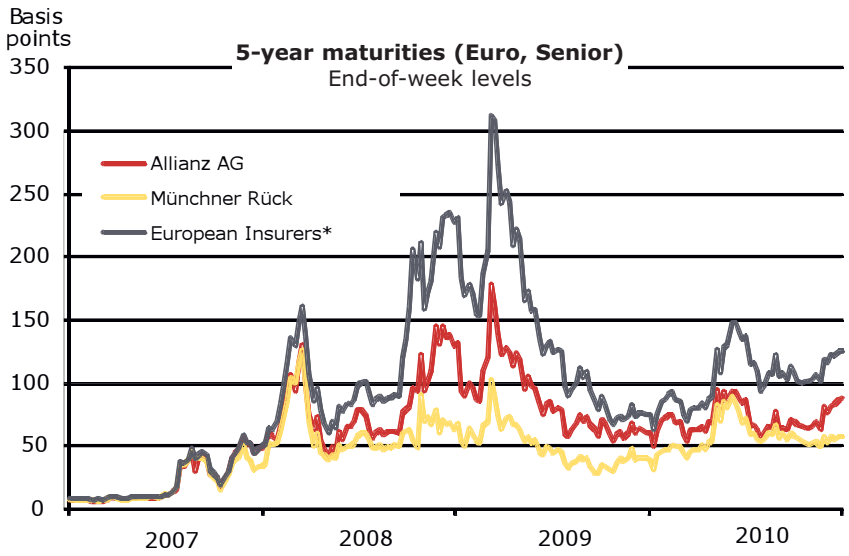
The overall economic recovery in 2010 led to a significant rise in the premiums collected by insurance undertakings. Single premiums in the life insurance industry were the main driver of this growth. In the volatile market environment, however, even minimal changes in interest rates or profit participation can cause strong fluctuations in the single-premium business. As in the previous year, low interest rates dragged down income from new investments. A protracted period of low interest rates may diminish life insurers' risk-bearing capacity if these companies are no longer able to generate their guarantee obligations on the capital markets.

The equities index for the German insurance sector largely mirrored the DAX in the first three quarters of 2010, moving in parallel with it. However, it fell behind when the DAX started its sharp climb in late summer due to the upturn in the real economy. While its performance was positive at around 9% for the year as a whole, the DAX rose by over 15% during this period.

CDS spreads up again.

Credit default swap spreads for insurance undertakings were highly volatile in 2010. Spreads widened sharply year-on-year, probably due to the eurozone sovereign debt crisis in particular. The markets rated the credit quality of major German insurers highly compared with their European peers. Credit default swap spreads for Allianz and Munich Re, for example, were significantly lower than the European average, as in previous years.

Figure 12
CDS spreads for selected insurers



* Unweighted average of the CDS spreads for the nine European insurers included in the iTRAXX Europe Series 14 index.
Source: Bloomberg; BaFin calculations

Rating agencies' outlook stable.

German insurance undertakings benefited from the economic rebound in 2010. The rating agencies considered that their financial strength had improved overall year-on-year. Whereas 2009 had seen substantially more ratings downgrades than upgrades, almost equal numbers of both were recorded in 2010. Additionally, almost all rating outlooks are stable.

Low interest rates put a strain on insurers.

2010 was a year of low interest rates, continuing the trend seen in past years. Ten-year Bund yields actually fell below 2.2% in August 2010, before rising to around 3% again by the year-end. The low interest rates are impacting insurers' revenue-generating opportunities. This presents a risk for life insurers in particular, because if interest rates remain low for protracted periods, these undertakings may be unable to generate the guarantee payments promised to customers from capital market income in the long term. Since 2007, life insurers have been prohibited from guaranteeing more than 2.25% on new policies in line with the maximum technical interest rate and there are plans to reduce this rate to 1.75% from January 2012.

Higher losses from natural disasters.

In 2010, natural disasters claimed an unusually high number of lives and caused significant economic losses. A total of five disasters in the top category were recorded.[3] These comprised the earthquakes in Haiti, Chile and Central China, the floods in Pakistan, and the heatwave in Russia. Of these events, the earthquake in Haiti was the most devastating. However, the costs incurred by the insurance industry were low because very few people in Haiti – like in many other developing countries – have

[3] According to the definitions used by the United Nations (UN).

insurance. Hurricanes, which can potentially hit areas with higher insurance coverage, caused little damage last year, with the US coast in particular being spared in 2010. On the whole, the costs for the insurance industry rose substantially compared with 2009 but remained manageable. The rating agencies give reinsurance undertakings a stable outlook.

Table 1

Overview of the German economy and financial sector*

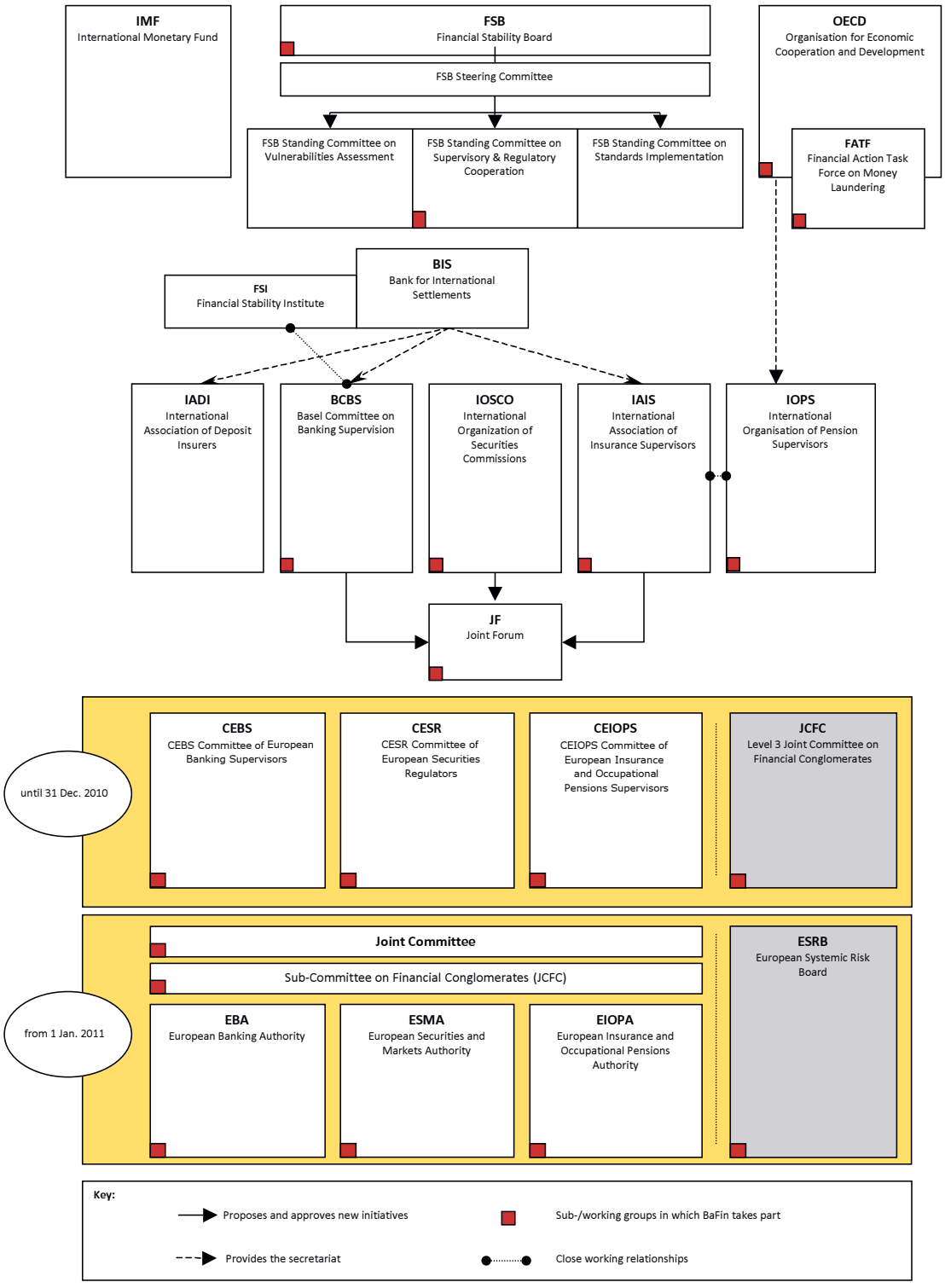
Selected economic data	Unit	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Economic growth [1]											
Global economy	%	2.3	2.9	3.6	4.9	4.6	5.2	5.3	2.8	- 0.6	5.0
USA	%	1.1	1.8	2.5	3.6	3.1	2.7	1.9	0.0	- 2.6	2.8
Eurozone	%	1.9	0.9	0.8	2.2	1.7	3.1	2.9	0.4	- 4.1	1.7
Germany	%	1.2	0.0	- 0.2	1.2	0.8	3.4	2.7	1.0	- 4.7	3.6
Corporate insolvencies	Number	32,278	37,579	39,320	39,213	36,843	34,137	29,160	29,291	32,687	31,998
DAX (end of 1987=1,000) [a]	Points	5,160	2,893	3,965	4,256	5,408	6,597	8,067	4,810	5,957	6,914
Money market rate [2]	%	4.26	3.32	2.33	2,11	2.19	3.08	4.28	4.63	1.22	0.81
Capital market rate [3]	%	4.86	4.81	4.08	4,04	3.36	3.78	4.27	4.09	3.27	2.77
Euro exchange rate	€1 = $...	0.90	0.95	1.13	1.24	1.24	1.25	1.37	1.47	1.39	1.33
Gross sales of fixed-income securities [4]	€ bn	688	819	959	990	989	926	1,022	1,337	1,534	1,375
Credit institutions											
Individual institutions [a] [5]	Number	2,697	2,593	2,466	2,400	2,349	2,301	2,276	2,169	2,121	2,102
Branches [a] [5]	Number	54,089	50,868	47,244	45,467	47,333	40,332	39,817	39,565	39,441	
Lending volume [a] [6]	€ bn	2,236	2,241	2,242	2,224	2,227	2,242	2,289	2,358	2,358	2,355
Net interest margin [7]	%	1.12	1.20	1.16	1.18	1.17	1.15	1.12	1.09	1.14	
Net commission income	€ bn	25.3	24.3	24.4	25.3	27.8	29.9	31.7	29.7	27.4	
Administrative expenses	€ bn	81.0	78.3	77.3	75.8	78.8	81.5	81.6	78.7	82.2	
Risk provisions	€ bn	19.6	31.2	21.8	17.2	14.1	14.0	23.6	36.6	27.0	
Cost-income ratio [8]	%	71.4	67.2	66.5	65.5	61.0	62.3	64.9	73.4	65.1	
Return on equity (RoE) [9]	%	6.2	4.5	0.7	4.2	13.0	9.4	6.6	- 7.7	- 0.8	
Equity ratio [a] [10] [21]	%	12.1	12.8	13.4	13.3	13.1	13.3	12.5	14.0	15.0	15.8
Private commercial banks											
Lending volume [a] [6]	€ bn	605	594	579	575	580	587	627	662	654	644
Net interest margin [7]	%	1.15	1.34	1.17	1.25	1.27	1.33	1.30	1.20	1.20	
Cost-income ratio [8]	%	80.4	74.2	74.0	73.5	59.8	66.0	65.5	93.6	73.5	
Return on equity (RoE) [9]	%	4.7	1.0	- 6.2	- 0.4	21.8	11.2	19.1	- 15.5	- 5.8	
Equity ratio [a] [10]	%	13.6	14.4	14.5	13.7	12.7	13.7	11.8	14.8	15.0	14.6
Savings banks											
Lending volume [a] [6]	€ bn	563	572	577	573	574	576	578	589	598	612
Net interest margin [7]	%	2.28	2.38	2.40	2.35	2.30	2.23	2.06	2.00	2.12	2.18
Cost-income ratio [8]	%	69.9	66.5	66.4	64.9	66.0	65.8	69.5	68.8	63.0	60.6
Return on equity (RoE) [9]	%	9.2	8.2	10.9	9.7	10.4	8.9	7.2	4.0	8.7	10.8
Equity ratio [a] [10]	%	10.8	11.2	11.5	12.1	12.6	13.1	13.1	14.4	14.7	15.1
Cooperative banks											
Lending volume [a] [6]	€ bn	331	335	338	342	348	353	360	369	382	398
Net interest margin [7]	%	2.41	2.49	2.51	2.51	2.46	2.30	2.15	2.06	2.23	2.33
Cost-income ratio [8]	%	76.7	73.1	69.6	68.7	70.0	64.3	70.5	68.3	70.6	66.6
Return on equity (RoE) [9]	%	7.5	9.7	10.6	10.3	13.8	11.0	8.1	5.5	9.0	12.2
Equity ratio [a] [10]	%	11.1	11.0	11.7	12.1	12.2	12.2	12.8	14.2	14.0	14.7
Insurance undertakings											
Life insurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	31.3	6.2	14.9	35.6	44.0	35.2	14.7	9.0	22.7	30.6
as a percentage of the IP carrying amount	%	5.5	1.1	2.4	5.5	6.5	5.3	2.0	1.2	3.0	4.2
Percentage of investment units in IP [12]	%	22.5	23.0	23.3	22.0	23.2	23.1	22.7	23.5	23.0	26.1
Percentage of promissory notes and loans in IP [12]	%	17.1	18.1	19.3	22.0	22.2	23.0	21.9	22.1	21.0	
Net rate of return on IP [13]	%	6.0	4.4	5.0	4.8	5.0	5.4	4.5	3.4	5.0	
Premium reserve	€ bn	476.4	502.8	520.6	536.2	551.2	566.5	586.1	599.6	621.0	
as a percentage of total assets	%	83.7	83.8	79.4	78.8	78.1	77.3	77.6	79.7	77.2	
Surplus 1 [4]	€ bn	13.4	5.1	9.2	9.7	14.2	14.1	13.5	6.6	11.6	
as a percentage of gross premiums earned	%	21.5	7.9	13.6	14.1	19.5	18.8	17.8	8.6	14.1	
Eligible own funds (A+B+C)	€ bn	44.2	39.8	42.3	43.9	49.1	54.6	57.5	54.4	55.0	
Solvency margin [15]	€ bn	22.2	23.3	24.0	24.8	25.9	26.8	27.8	28.4	29.5	
Solvency margin cover [16]	%	199.0	170.4	176.2	177.4	190.0	203.8	206.8	191.5	186.4	
Return on equity [17]	%	7.0	3.4	5.7	5.8	9.7	9.5	8.8	7.4	9.6	
Property/casualty insurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	31.7	22.3	26.0	26.6	27.7	29.8	28.9	21.4	24.6	25.7
as a percentage of the IP carrying amount	%	31.4	21.3	23.8	22.6	22.2	22.4	20.7	15.7	17.8	18.6
Percentage of investment units in IP [12]	%	25.3	27.0	27.3	26.5	29.8	30.5	31.0	30.7	30.5	31.4
Percentage of promissory notes and loans in IP [12]	%	13.2	13.2	14.1	16.6	18.3	15.6	19.4	20.2	19.6	
Net combined ratio [18]	%	100.2	103.2	94.7	92.2	92.6	90.6	92.7	92.0	95.0	
# Eligible own funds (A+B)	€ bn	24.4	25.0	27.1	24.1	22.5	27.4	28.3	26.8	27.8	
Solvency margin [15]	€ bn	7.1	7.4	7.8	8.4	8.8	8.8	8.8	8.5	8.6	
Solvency margin cover [16]	%	342.7	336.9	346.0	286.3	255.3	310.7	321.6	315.3	323.3	
Return on equity [17]	%	8.9	2.8	4.2	3.0	4.5	4.6	4.1	3.6	4.2	
Reinsurers											
Hidden reserves in the investment portfolio [11]	€ bn	89.2	35.8	34.3	37.2	49.9	57.7	63.6	33.7	33.4	34.3
as a percentage of the carrying amount	%	54.2	18.5	15.6	17.2	22.0	26.4	27.6	14.7	14.7	16.5
Net combined ratio [18]	%	115.3	101.6	92.8	93.5	93.8	89.2	94.1	94.1	94.0	
Eligible own funds (A+B)	€ bn	-	-	-	-	-	-	66.9	68.8	69.3	
Solvency margin	€ bn	-	-	-	-	-	-	6.2	6.4	6.1	
Gross technical provisions	€ bn	122.3	130.6	135.8	140.8	154.4	143.1	131.1	126.4	118.2	
as a percentage of gross premium income	%	278.6	244.0	264.4	298.5	340.0	330.3	329.7	328.4	289.7	
Net profit for the year [19]	€ bn	0.3	5.4	1.4	3.4	1.8	7.3	8.0	5.7	6.5	
Available capital [20]	€ bn	31.5	40.2	51.4	55.1	57.6	66.3	71.0	70.5	72.0	
Return on equity [17]	%	1.0	13.3	2.7	6.1	3.1	11.0	11.2	8.1	9.0	

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

* Annual totals or annual averages unless otherwise stated.
a) At year-end.
1) Year-on-year change in real GDP.
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 2010.
6) Book loans to domestic enterprises and private individuals.
7) Net interest income as a percentage of total assets.
8) Administrative expense as a percentage of operating income.
9) Net profit for the year before tax as a percentage of average balance-sheet equity.
10) Liable capital or own funds as a percentage of risk-weighted assets (from 2007 overall capital ratio; up to 2006 solvency ratio in accordance with Principle I)
11) Fair values – carrying amount of the entire investment portfolio (IP).
12) As a percentage of the entire IP excluding deposits retained.
13) (Income from IP less expenses for IP) / arithmetic mean of IP (beginning/end of year).
14) Net profit for the year + gross expenses for premium refunds.
15) Minimum own funds free of foreseeable liabilities.
16) Eligible own funds / solvency margin.
17) Net profit for the year / equity
18) Net expenses for insured events and insurance operations / net premiums earned.
19) Corresponds to item II.14 in format 2 of the RechVersV.
20) Total equity less outstanding capital contributions.
21) The average overall capital ratio was calculated at the level of the individual institutions; for reporting purposes 51 financial services institutions with an average overall capital ratio of 40.3% were included. In particular this figure does not include the large banks Deutsche Bank, Commerzbank and UniCredit Bank. At group level these have an average overall capital ratio of 15.3%.

III International issues

Figure 13
International institutions and committees



Key international focuses

Two topics dominated events in 2010:

The central issues at a global level were the new capital requirements for banks under Basel III and, in this context, the supervision of systemically important financial institutions. Under the new framework, minimum capital requirements are to be increased and capital buffers introduced to increase banks' stability and robustness in the event of a crisis. The new requirements must first be incorporated into European directives and, then on the basis of those directives, transposed into national law. The G20 wishes them to be fully implemented by 2019.

Systemically important financial institutions (SIFIs) will receive particular attention in future. In 2010, the Financial Stability Board, the Basel Committee and the International Association of Insurance Supervisors started to develop criteria for measuring systemic importance, which varies considerably across the different sectors. It is expected that far more banks will be identified as SIFIs than will insurance undertakings. One key aspect is the search for a compelling method of identifying SIFIs. In addition to size, international interconnectedness, for example, is one indicator that can be measured comparatively well. The focus, however, is on systemically important banks (SIBs). Which banks will be on the list of global systemically important institutions (G-SIFIs)? By July 2011, a decision is to be taken as to which financial institutions are systemically important to global markets and which supervisory tools are to be used to immunise those groups against market shocks. The in-depth discussions that began in 2010 are being continued in 2011.

On 17 November 2010, the ECOFIN Council completed the EU legislative process to reform the supervision of financial services in Europe. Ahead of this, there had been numerous discussions in both the individual member states and Brussels about the need for a new, effective supervisory structure and how it should look. The aim is to create an integrated network for financial supervision in the European Union. In light of the financial market crisis, strengthening and improving the integration of financial supervision in Europe are to play a central role in ensuring the stability of the entire financial system and increasing oversight of the financial markets. On 1 January 2011, three new European supervisory authorities became operational: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).[4] The European Systemic Risk Board (ESRB) also started work.

[4] The documents mentioned in chapter III are available on the websites of the organisations concerned (www.bafin.de » BaFin » International).

1 Financial stability

Impact of the G20 decisions on global and European bodies

Established in 1999, the **Group of Twenty Finance Ministers and Central Bank Governors** (G20) is an informal alliance of 19 countries plus the European Union. It serves a forum for cooperation and consultation with the aim of promoting international financial stability. G20 summits are also attended by representatives of the International Monetary Fund (IMF) and the World Bank.

G20 decisions.

The financial crisis and its effects were again the focus of the G20 summits and meetings held in Washington in April, in Toronto in June and in Seoul in November. In Washington, the G20 reaffirmed that it was sticking to the decisions taken in London in 2008. At the same time, it acknowledged the progress achieved to date. Nevertheless, the aim of the G20 remains to strengthen the stability of the financial system. This includes international reform of the financial sector. The G20 divides this reform agenda into four pillars and has delegated responsibility for its implementation to the Financial Stability Board (FSB):

- The first pillar is a strong regulatory framework. This includes the work of the Basel Committee on Banking Supervision (BCBS) on capital and liquidity. The G20 believes that Basel III will improve the resilience of the banking system considerably. This pillar also includes measures to improve the transparency and regulatory oversight of hedge funds, rating agencies and over-the-counter derivatives.
- The second pillar is effective supervision. Only supervisors with sufficient powers and resources can be effective, capable of fulfilling their mandate and able to identify risks quickly and reliably.
- The third pillar relates to resolution and addressing systemically important financial institutions. Here, the G20 is calling for a system that enables it to restructure or unwind financial institutions in crisis. This includes effective measures, stricter supervisory requirements and a strong financial market infrastructure.
- The fourth pillar comprises transparent international assessment and peer review. More specifically, this means the IMF Financial Sector Assessment Program and the peer reviews conducted by the FSB. All G20 members have undertaken to participate in these assessments.

The **Financial Stability Board** (FSB) is a global body comprising high-ranking representatives of finance ministries, central banks and supervisory authorities from the G20 countries and Spain as well as representatives of the European Commission, international standard-setters (including the BCBS, IAIS and IOSCO) and major financial institutions (e.g. the IMF, the World Bank, the BIS and the ECB). The Basel-based body was established in 1999 partly in response to the Asian crisis and was originally known as the Financial Stability Forum (FSF). The decision to transform it into the FSB was taken at the G20 summit in London on 2 April 2009. The FSB discusses issues of fundamental systemic importance to financial stability. These do not always have to affect supervision directly, but may instead have only indirect repercussions for it.

FSB responsible for implementing the G20 decisions.

In 2010, the FSB drove forward implementation of the G20 decisions in close cooperation with global standard-setters. The FSB's prime objective here is to maintain a more stable financial system and reduce global systemic risks. The focus of the FSB's work was on:

- New bank capital and liquidity standards
- Supervisory intensity and effectiveness
- Reform of the OTC derivatives market
- Development of principles to reduce reliance on ratings.

The latter principles are aimed at supervisory authorities and ministries. The FSB has requested that references to the use of external ratings in laws be reviewed and where possible replaced by alternatives. The aim is to reduce dependence on ratings.

A further focus was on systemically important financial institutions (SIFIs). The FSB has developed a framework to improve supervision of these systemically important institutions. This framework combines five separate strands:

- Improved options for restructuring and unwinding institutions
- Higher loss absorption capacity of capital instruments beyond the Basel III standards
- Intensified supervisory oversight of institutions that may pose systemic risks
- Standards to strengthen financial market infrastructures in the event of the failure of individual institutions
- A peer review at the end of 2012 of the effectiveness and consistency of national G-SIFI policy measures.

Finally, the FSB conducted various peer reviews, both country-specific and thematic. In September, the FSB published the country review of Mexico conducted in 2010, which examined Mexico's adherence to international standards. The FSB conducted its first thematic peer review on the topic of executive compensation, allowing it to examine, assess and compare compensation principles in the individual member countries. The Board published the report in March. On a positive note, the report stresses that

many member countries have adapted their rules in line with the FSB compensation principles. Due to the very short implementation period, however, some members and the institutions concerned still need to take further measures to implement the principles. The FSB will assess the status of implementation in a further peer review in 2011.

FSB publishes supervisory framework for SIFIs.

The FSB outlined a framework for the supervision of systemically important institutions in a set of 32 recommendations. On 1 November 2010, it published new, additional standards for the supervision of systemically important banks in a report entitled "Intensity and Effectiveness of SIFI Supervision".

The starting point for the work on the report was the realisation that, during the financial crisis, national supervisory regimes worldwide proved to be insufficiently robust to identify undesirable developments at an early stage and in full, particularly at systemically important institutions. They were also unable to effectively limit the damaging effects stemming from such banks on the national and international financial system. In keeping with this logic, the mere fact that SIFIs can impact the entire financial system in the event of a crisis justifies and demands particularly intense and effective supervision. It takes up this goal and sets out a total of 32 recommendations describing a framework for the supervision of systemically important institutions that is designed to enable precisely that. The report does not contain a definition or list of systemically important institutions. That task is the responsibility of the FSB and the national FSB member countries. One striking point is that the report states that the recommendations it contains should also be taken into consideration in the supervision of institutions other than SIFIs. The recommendations can be condensed into four core principles which, on a general level, reflect overriding objectives, particularly for the supervision of SIFIs:

- Firstly, supervisory authorities should have unambiguous, independent mandates and an operating environment in which they are able to access the appropriate quantity and quality of human resources.
- Secondly, supervisory authorities should have a full suite of supervisory tools to enable them to promptly identify developments that pose the risk of a crisis and to take equally effective action to prevent or minimise such developments.
- Thirdly, supervisors of systemically important banks must meet higher expectations, which in turn increase the requirements on the supervisory techniques and practices used.
- Fourthly, stricter and more specific criteria should make it easier to monitor supervisory systems and help to track down weaknesses in those systems, thereby enabling authorities to improve the quality of supervision.

Where recommendations go beyond intensifying supervisory practices, the report also contains proposals for expanding on the existing core principles of banking supervision established by the Basel Committee in the Basel Core Principles.

Founded in 1994, the **International Association of Insurance Supervisors** (IAIS) sets international standards for the supervision of the insurance industry. It also promotes cooperation between supervisory authorities and provides staff training. The members of the IAIS comprise insurance supervisors from over 120 countries; around 80 further organisations (including a number of insurance industry associations) have observer status.

IAIS working to identify systemically important insurers.

The size of an insurance undertaking, its significance as an institutional investor for the financial system and capital markets, and its role as a key risk bearer in economies could be relevant criteria in identifying systemically important insurance undertakings. This is currently the prevailing opinion at the IAIS, arrived at during a project commissioned by the FSB. The FSB is developing criteria that are to be used in future to measure systemic importance in close consultation with the Basel Committee, the IAIS and other high-ranking international bodies. The IAIS Financial Stability Committee (IAIS FSC) is therefore driving forward development of a methodology for identifying systemically important financial institutions in the insurance industry. In the course of this work, it is important to bear in mind that there are significant differences between the business models of banks and insurers.

SIFIs are also the focus of other work being performed by the IAIS FSC. For example, the Committee is also looking at reporting issues in the context of macroprudential supervision and examining the development of supervisory measures that can be used for macroprudential supervision of SIFIs. Here, too, it is important to ensure that the supervisory measures are tailored to the business models of insurers, as these differ significantly from those of banks. The IAIS will present its assessment of the issues relating to SIFIs to the FSB in the course of 2011.

IAIS initiates development of ComFrame.

On 1 July 2010, the IAIS officially began the development of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), including binding solvency rules. The goal is to produce an initial concept paper by mid-2011. The new rules are intended to make global group-wide supervision more effective and more reflective of actual business practices. ComFrame also aims to establish a comprehensive framework for supervisory authorities to better integrate group-wide activities and risks into their supervisory approaches and to improve cooperation between international supervisory authorities. ComFrame could develop in a similar manner to Basel II in the area of banking regulation.

ComFrame comprises several modules, which in turn consist of various elements. This structure has the advantage that the various "building blocks" can be developed simultaneously, but at the same time requires extensive coordination of the work in order to prevent any inconsistencies and duplication. Each ComFrame element is assigned a priority (A, B, or C) depending on its

urgency. Priority A elements will be released for public consultation in mid-2011, priority B elements in mid-2012 and priority C elements from mid-2013 onwards. The three-year development phase will be followed by an impact assessment for the calibration of ComFrame.

Founded in 1996, the **Joint Forum** is the joint working committee of the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissioners (IOSCO) and the Basel Committee on Banking Supervision (BCBS), the global standard-setters. The Joint Forum brings together supervisors from 13 countries to deal with supervisory issues from a cross-sector perspective. Among other things, this aims to improve supervisors' understanding of the other sectors.

Joint Forum publishes report on risk aggregation.

The Joint Forum believes that the widespread use of risk aggregation methods sometimes leads to ineffective management decisions. This is the view expressed in its report of October 2010 entitled "Developments in Modelling Risk Aggregation". In light of the financial crisis, the Joint Forum's aim was to gain an understanding of the current practices adopted by firms and supervisory authorities with regard to risk aggregation. Risk aggregation is the process of combining different types of risk into a single, aggregate risk without simply adding them together. The aim is to determine a firm's aggregate risk position and the relative significance of individual risks in relation to the firm's performance. The Joint Forum found that risk aggregation methods are used in a wide range of areas, especially in complex corporate structures. This includes areas for which these methods were not originally designed. For example, risk aggregation methods were initially developed to support decisions regarding the allocation of risk and capital. Gradually, however, the methods also came to be used for solvency and capital adequacy assessments, for which they were not designed. As a result, the use of the methods to assess solvency led to inaccurate results, which the Joint Forum believes led to less than effective or even wrong management decisions. To make risk aggregation models more effective, the Joint Forum therefore recommends that firms adapt their methods to reflect current conditions, among other things, and to better integrate risk aggregation with business activities and management.

The **Senior Supervisors Group** (SSG), a forum composed of international banking supervisory authorities, was formed in autumn 2007 in response to the financial crisis. The SSG's mission is to gather, evaluate and exchange practical experience of risk management and related aspects at internationally active banks. The information gathered and processed in pursuing this mission is made available to international and national standard-setters. The SSG originally comprised representatives of US authorities (the Federal Reserve Bank of New York, the Federal Reserve Board in Washington, the SEC, and the Office of the Comptroller of the

Currency (OCC)), the Swiss Financial Market Supervisory Authority (FinMa), the French Prudential Control Authority (ACP, then the Commission Bancaire), the UK Financial Services Authority (FSA) and BaFin. In the meantime the Bank of Italy, the Netherlands Bank, the Bank of Spain, the Japanese FSA and the Canadian Office of the Superintendent of Financial Institutions (OSFI) are also represented. The SSG's best-known project is the series of "lessons learned" exercises, an analysis of risk management practices at the height of the financial crisis. The reports on those exercises were published in 2008 and 2009 and can be accessed on the SSG and BaFin websites.

SSG report on risk appetite published.

Despite initial improvements at institutions, further measures are required almost across the board to better integrate risk appetite, i.e. the level of risk acceptable to a bank, and use it as one factor in making decisions. This is the observation made by the SSG in its report "Observations on Developments in Risk Appetite Frameworks and IT Infrastructure" published in December 2010. The publication of this report marks the completion of a project on the subjects of risk appetite and IT infrastructure, which the SSG set up in light of the findings of the second "lessons learned" exercise in 2009. The SSG also identified weaknesses in the development of appropriate infrastructures that enable risks to be managed efficiently and at all times. In particular, weaknesses in the aggregation of data across different business lines continue to hinder effective and flexible risk management.

CEIOPS analyses of financial stability in the insurance sector.

One of the key events in 2010 was the sovereign debt crisis. During that crisis, CEIOPS again provided the EU with regular insights into the effects on the insurance sector, just as it had done previously during the years of the global banking and financial crisis. The crises in several European countries were a particular focus. Here, the CEIOPS Financial Stability Committee (CEIOPS FSC) promptly conducted ad hoc surveys across the European insurance sector, with the topics in each case being determined by market developments. In particular, these surveys covered the exposure of undertakings to European government bonds and banks as well as real estate risks. CEIOPS drew up internal reports on the basis of the survey data and made them available to EU politicians so that the latter always had an up-to-date overview of the European insurance sector.

As part of its regular reporting, CEIOPS was able to further improve the quality and timeliness of the data in its half-yearly financial stability reports. Special surveys conducted among the largest European insurance groups supplement the data gathered on a routine basis.

EU stress tests

CEBS stress test for European banks.

In 2010, CEBS again performed a stress test on European banks in cooperation with national supervisors and the ECB, the results of

which were published on 23 July 2010. Based on a decision taken by the EU heads of state and government, the national supervisory authorities for the first time published the results of the individual institutions that took part in the exercise. This was intended to provide transparency over the resilience of the European banking system in the event of an economic downturn and negative financial market performance – particularly a decline in the value of European government bonds. A total of 91 credit institutions from 20 member states took part in the stress test exercise, representing 65% of the EU banking system measured in terms of total assets. The 14 participating banks from Germany accounted for over 60% of the total assets of the German banking system. Of those 14 banks, only Hypo Real Estate failed the stress test; across Europe as a whole, a total of seven institutions failed. A bank was considered to have passed the test if its Tier 1 capital ratio did not fall below 6% in the scenarios.

Europe-wide CEIOPS stress test.

In 2010, CEIOPS also performed a joint Europe-wide stress test on the largest insurance groups together with national supervisory authorities with the aim of testing the sector's ability to withstand further shocks. This first test conducted by CEIOPS started at the end of 2009 and consisted of three scenarios: an adverse scenario, which extrapolates trends during the financial crisis; a recession scenario, which assumes a more severe and prolonged recession; and an inflation scenario, which assumes a sharp rise in inflation and capital market interest rates. The results of the test show that, overall, the largest and most important European insurance groups could withstand the scenarios. In all the scenarios tested, aggregate available own funds were above the regulatory capital requirements.

OTC derivatives

FSB's 21 recommendations on regulating of OTC derivatives.

At their summit in Pittsburgh in September 2009, the G20 heads of state and government had pledged to introduce effective supervision of trading in risky derivatives, which had previously not been regulated, and to check the systemic risks stemming from these trades. In order to fulfil this pledge, the G20 asked the FSB to draw up international recommendations. In October 2010, the FSB therefore adopted a widely acclaimed report containing 21 recommendations on the future regulation of over-the-counter (OTC) derivatives. These are generally highly complex contracts (often swaps) that are tailored to the individual needs of market participants in which one party assumes a specific risk from another party in return for payment or in return for the other party assuming another risk. The hitherto largely opaque, unregulated OTC derivatives markets are regarded as a major cause of the financial crisis. The FSB recommendations, which BaFin was involved in drafting, can be summarised as follows:

- By the end of 2012, all standardised derivatives should be cleared and settled multilaterally through central counterparties rather than bilaterally between the counterparties to the contract. This in turn requires adequate standardisation of as many products as possible.

- Where possible, OTC derivatives should be traded on organised markets.
- In order to ensure transparency, all derivatives transactions should be reported to an electronic trade repository so that the macro- and microprudential risks associated with the trade can be assessed and any necessary measures taken. Transparency also promotes market integrity and efficiency.
- Supervisory authorities should have sufficient powers to effectively supervise derivatives trading and should cooperate internationally.

In mid-September, the European Commission published a draft regulation aimed at achieving these objectives. Ahead of this, it had been supported in an advisory capacity by CESR. Key elements included the nature of the clearing obligation, regulatory requirements for central counterparties and trade repositories, and possible ways to improve settlement discipline. Under the Commission's proposal, central counterparties would be supervised by national authorities, while the trade repositories would be regulated at European level by ESMA. ESMA would also be responsible for deciding whether those classes of derivatives already cleared by a central counterparty should be subject to a clearing obligation. In addition, the proposal provides for exemptions from the clearing obligation for entities that make limited use of derivatives solely to hedge risks arising from their commercial activities. If it is ESMA's opinion that a class of contracts should be centrally cleared, but no central counterparty has so far expressed a willingness to do so, ESMA should publish its opinion in a register and investigate in cooperation with the national authorities why no central counterparty is willing to clear the contracts concerned.

The groundwork for introducing a requirement to trade derivatives on organised trading platforms is far less advanced. In a report released in February 2011, IOSCO suggests measures that could be taken to implement such a requirement. As part of the revision of MiFID, the European Commission has already proposed that all centrally cleared derivatives should also be traded on organised trading platforms.

Founded in 1983, the **International Organization of Securities Commissions** (IOSCO) is the leading international forum for securities regulators. The Madrid-based body is recognised as being the standard-setter for the world's securities markets. The standards and resolutions adopted by IOSCO are incorporated by its 181 members from over 100 countries into their national regulatory frameworks.

IOSCO devotes greater attention to systemic risk.

IOSCO has taken the first step towards increasing its focus on investigating and reducing systemic risk by including this in the list of the Organization's objectives. Previously, it dealt mainly with market transparency, market integrity and investor protection. IOSCO followed up on the objective by establishing a working

group to analyse the role of securities regulators in the early identification and reduction of systemic risk. It also started setting up a network of economists, whose core tasks include monitoring current market developments for possible systemic risks.

Commodities

G20 wants more transparency over commodity derivatives.

Commodity derivatives, emission rights and the futures based on them play a special role in the equation of systemic risk. The prices of commodities are affected by the prices of the related futures and derivatives, and vice versa. In addition, the opacity and complexity of the various commodity markets hinder effective supervision of derivatives trading. In the year under review, IOSCO therefore continued and stepped up the work begun in autumn 2008 to standardise regulatory requirements for trading platforms, tradable contracts and supervisory methods. IOSCO's most recent report to the G20 heads of state and government contained concrete proposals for further work aimed at making trading in commodity derivatives more transparent and preventing excessive price volatility. At their Seoul summit in November, the G20 heads of state and government asked IOSCO to prepare a study in 2011 on transparency and price formation in the oil markets in cooperation with the International Energy Agency, and in particular to examine in closer detail the role of price reporting agencies. These international bodies calculate widely-followed average prices from the prices of OTC products and therefore have a major influence on commodity price movements.

Short selling

CESR sets out the details of European short selling disclosure regime.

Having presented a proposal for a pan-European obligation to report and publish net short-selling positions in shares in March 2010, CESR then published technical details of this disclosure regime in May 2010. This technical details report explains in greater detail the two-tier disclosure regime, under which a net short position of 0.2% of the shares issued by a company must be reported to the relevant supervisory authority and a short position of 0.5% or above must be published. The technical details concern, in particular, issues relating to the calculation of net short-selling positions, such as the financial instruments and number of shares that must be included. CESR also clarifies at what level of an entity, group, or other organisational unit short positions held by different sub-units should be netted and aggregated. Finally, the CESR proposal contains a concrete definition of the exemptions from the disclosure obligations and further details of the disclosure mechanisms.

European Commission presents draft regulation on short selling.

In autumn 2010, the European Commission presented an initial draft regulation on short selling and certain aspects of credit default swaps, which is expected to be negotiated between the Commission, the Council and the European Parliament in mid-2011. Among other things, the draft provides for measures relating to the disclosure of net short-selling positions in shares and

government bonds as well as naked CDS positions. Further topics for discussion include the introduction of measures to restrict naked short selling and harmonised powers in crisis situations for national supervisors and ESMA. In addition, the draft regulation provides for ESMA to set out more specific technical details in regulatory technical standards and implementing technical standards, for example in order to specify notification thresholds for the obligation to disclose net short-selling positions in government bonds and naked CDS positions.

Financial conglomerates and group-wide supervision

In 2010, key developments with respect to financial conglomerates and group-wide supervision took place at both European and international level.

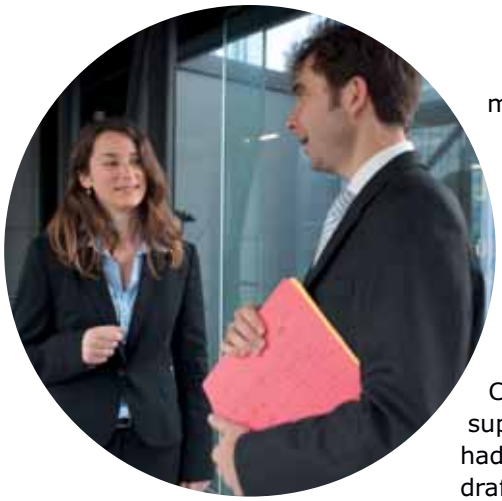
The **Joint Committee on Financial Conglomerates** (JCFC) was previously the permanent joint committee of European banking and insurance supervisors. Its work aimed to ensure that the Financial Conglomerates Directive was implemented fully and consistently throughout the individual member states. On 1 January 2011, a Joint Committee was established alongside the three new European supervisory authorities to ensure cross-sectoral convergence. The JCFC will operate in future as a sub-committee of this Joint Committee.

JCFC draws up recommendations for supervisory colleges.

The work of the Joint Committee on Financial Conglomerates (JCFC), where BaFin took over as chair in June 2010, focused on developing recommendations for supervisory colleges. The Committee drew up seven recommendations for supervisory colleges of financial conglomerates, which CEBS and CEIOPS approved and published in December. The seven recommendations relate to the measures through which supervisory authorities of financial conglomerates can ensure that supervisory colleges also address cross-sectoral issues adequately. The central thread is the recommendation to establish a platform within the existing (sectoral) college structure, where the relevant supervisory authorities can discuss issues related to financial conglomerate supervision. The supervisory authorities involved should consider using web-based communication tools to ensure communication is adequate and unhindered. According to the JCFC, cross-sectoral issues should also always be kept in mind when coordinating activities in crisis situations.

European Commission aims to tighten rules on the supervision of large financial conglomerates.

The European Commission wishes to tighten the rules governing the supervision of large financial conglomerates while establishing an additional option to waive supplementary supervision under the Financial Conglomerates Directive for small financial conglomerates. The proposals to amend the Financial Conglomerates Directive published by the European Commission in August 2010 are based on the JCFC Advice of October 2009. In particular, the aim is to tighten up the supervision of large financial conglomerates by



making mixed financial holding companies subject to sectoral group supervision as well as financial conglomerate supervision at the parent holding company level. The waiver option, on the other hand, allows small financial conglomerates to be exempted if the total assets of their smallest sector do not exceed €6 billion. The waiver is intended to enable small, heterogeneous groups to be exempted from supplementary financial conglomerate supervision even though they initially fall within its scope. This is consistent with the aim of the Commission proposals to make financial conglomerate supervision more risk-based. By November, the ECOFIN Council had already adopted its preliminary position on the Commission draft. The Commission and the Council must now harmonise their ideas with those of the European Parliament, which wishes to beef up financial conglomerate supervision even more. Among other things, the parliament is calling for stress tests to be performed at financial conglomerate level and alternative investment fund managers (AIFMs) to be included in the scope of financial conglomerate supervision. The legislative process is scheduled to be completed in 2011 so that the amendments to the Financial Conglomerates Directive can be transposed into national law no later than 2012.

Joint Forum revises principles on financial conglomerates.

Work to improve the supervision of financial conglomerates was also carried out at an international level. The Joint Forum commissioned a working group to review and revise its existing financial conglomerates principles. In May, the working group began to adapt the principles in line with the new financial market conditions. It will present the results in 2011.

IAIS revises principles on cooperation and group-wide supervision.

In the year under review, the IAIS revised its Insurance Core Principles (ICPs), devoting particular attention to the principles on cooperation and group-wide supervision. The relevant working group, which is also responsible for the development of some of the ComFrame elements (Insurance Groups and Cross-Sectoral Issues Subcommittee – IGSC), has produced a Standard on Group-wide Regulatory Requirements and corresponding Guidance on the Group-wide Supervision Framework. The two documents provide an overview of the key elements of insurance group supervision and will form part of the ICPs on group-wide supervision. Particularly with regard to colleges, existing IAIS resolutions will be set out in greater detail so as to allow them to be applied to international insurance undertakings.

IAIS adopts paper on non-regulated entities.

One of the main lessons learned from the financial crisis is to ensure that no financial market participant or product remains unregulated. In response to G20 recommendations, the IAIS developed a guidance paper on non-regulated entities and adopted it in mid-2010. This paper identifies regulatory gaps highlighted by the global financial crisis and helps to close those gaps. In it, the IAIS calls on its members to shape their regulation so as to ensure that in future it covers all those entities of an insurance group that may affect the risk profile or financial position of the insurance group. Holding companies in particular are often unregulated even though they can bring the entire group to the brink of failure, as

was seen in the case of American International Group (AIG). In addition, the international insurance supervisors advocate making the necessary amendments to rules and regulations worldwide as globally consistent as possible.

IAIS calls for colleges to be used in crisis management.

The IAIS recommends that colleges be used as platforms for cooperation when managing crises. This is the view set out in the IAIS Standard on Cross-border Cooperation on Crisis Management, which the IGSC completed in the year under review. The Standard addresses the action insurance supervisors should take in the event of a crisis at specific insurance groups. The paper is a prompt response from the IAIS to the FSB's Principles for Cross-border Cooperation on Crisis Management, which it places in an insurance context.

Deposit guarantee schemes

European Commission proposes revision of the Directive on Deposit Guarantee Schemes.

In July 2010, the European Commission presented a far-reaching legislative proposal for a thorough reform of deposit guarantee schemes. Firstly, the proposal provides for maximum compensation of €100,000, which would, in effect, mean the end of the voluntary deposit guarantee scheme in Germany. The members of institutional protection schemes will also have to grant their customers a legally documented right to compensation of €100,000, which means that they too will be obliged to make contributions to statutory deposit guarantee schemes in future. Deposit guarantee schemes will be required to use their funds primarily to repay depositors, although it will also be possible to use funds to finance stabilising measures or to transfer deposits to another institution.

If the European Commission does indeed intend to regulate voluntary deposit guarantee schemes, this raises the question of the legal basis on which it would so. It also seems doubtful whether such action would be compatible with the subsidiarity principle under European law. Including the members of institutional protection schemes in statutory deposit guarantee schemes is likely to increase the contribution burden on those institutions, which sooner or later could mean the end of institutional protection.

Under the Commission's proposals, the depositor's liabilities to the credit institution would not be taken into account when calculating the amount to be reimbursed. Unjustifiably, this exclusion of set-off puts the depositor of an insolvent institution in a better position than the depositor of a solvent institution: the amount of compensation from the deposit guarantee scheme would ultimately be higher than the depositor's enforceable claims against the solvent credit institution. In addition, the Commission wishes to reduce the deadline for payouts to eligible depositors to seven days. BaFin believes that historical data should first be gathered on the reduced payout deadlines introduced in 2009.

The proposal for the revised Directive contains detailed funding rules. Deposit guarantee schemes will be required to save 1.5% of reimbursable deposits ex ante (uniform target fund level). To do so, they will have to levy risk-based contributions. BaFin supports an ex ante funding component and the system of levying risk-based contributions. However, it should be left to the member states to develop a model for risk-based contributions so that they can take account of aspects specific to their respective national markets. The Commission is also proposing an additional mutual borrowing facility between the member states' deposit guarantee schemes. BaFin believes this poses the risk of creating adverse incentives. It also has doubts in light of German law on special levies.

European Commission presents proposal to reform investor compensation.

The European Commission's legislative proposal of July 2010 extends the scope of the Investor Compensation Schemes Directive to include all investment services and activities falling under the Markets in Financial Instruments Directive (MiFID). Investors will be entitled to compensation if an investment firm de facto holds client assets, irrespective of whether the firm does so in contravention of any limitation on its authorisation. The list of professional investors ineligible for compensation is to be brought into line with MiFID. The impact of these extensions on the potential volume of compensation is unclear. Compensation is also to be granted in the event of the insolvency of third parties acting as a custodian of financial instruments and of depositaries of undertakings for collective investment in transferable securities (UCITS). BaFin does not see the need for these extensions to the right to compensation. In addition, it is entirely unclear how the parties mentioned are to be made to contribute to the scheme.

The draft raises the maximum amount of compensation to €50,000. The previous provision requiring investors to bear 10% of the loss has been removed. These amendments are intended to take account of the increased risks the Commission believes investors in financial instruments face and the increased coverage provided under deposit guarantee schemes. BaFin believes both measures should be rejected, as they may encourage moral hazard, inducing investors to be careless in selecting particular types of investment, at least when investing up to €50,000. It is also not convinced by the reference to deposit guarantee schemes. Unlike bank deposits, clients' claims arising out of investment transactions do not usually serve to satisfy daily needs.

The Commission's draft requires compensation schemes to pay partial compensation within certain periods if there is a delay in examining the eligibility of a claim once it has been established that investors are to be compensated. These extensions represent a barely justifiable increase in the burden on compensation schemes, as they may ultimately lead to the payment of compensation for assets that are not in fact eligible for compensation.

The draft directive provides for a uniform target fund level to be saved by guarantee schemes by levying annual contributions over a ten-year period (ex ante funding). This will be 0.5% of the value of the monies and financial instruments covered by the compensation scheme. If this is not sufficient to pay the compensation required, the compensation schemes will be able to levy additional contributions ex post and obtain short-term funding elsewhere, for example by raising loans. The European Commission will stipulate uniform parameters for funding. The draft directive links the schemes by providing for a mutual borrowing facility in cases of need, for which each compensation scheme will be required to reserve 10% of its ex ante-funded contributions. These requirements significantly restrict national funding decisions. They risk increasing the burden on contributors, creating adverse incentives to take risks and conflicting with German law on special levies. Overall, therefore, BaFin believes that the reform proposal will inevitably have to be adapted to the specific issues relating to German investor compensation.

White Paper on insurance guarantee schemes.

In the White Paper published on 12 July 2010, the European Commission advocates ensuring minimum harmonisation for the introduction of guarantee schemes in the insurance sector. This is largely in line with the recommendations made by CEIOPS last year. The Commission is basically proposing to adopt a directive that ensures that guarantee schemes are established in all member states and that the most important standards are harmonised. Guarantee schemes should be established in each member state as a last-resort mechanism and – as regards their geographical scope – should be based on the "home country principle". Both life and non-life insurance policies will be protected. The White Paper states that, in principle, all natural persons and selected legal persons should be eligible to bring claims under the guarantee schemes. The Commission advocates ex ante funding of guarantee schemes. This could be complemented by risk-based measures taken ex post, i.e. after the occurrence of a guarantee event, such as special contributions, special payments, or loans in the event of a lack of funds. An appropriate target level is to be set for funding and must be reached within a suitable period. The Commission leaves it to the member states to decide whether, in the event of a guarantee event, portfolios of policies should be transferred or claims compensated. BaFin rejects an EU-wide equalisation mechanism between the national guarantee schemes as outlined in the White Paper. This would be in conflict with the principle of minimum harmonisation that was also recommended by CEIOPS. Finally, it believes that such a scheme also seems questionable in light of German law on special levies.

2 Basel III

Hosted by the Bank for International Settlements (BIS), the **Basel Committee on Banking Supervision** (BCBS) was founded in 1974 by the G10 central banks. It comprises representatives of the central banks and banking supervisory authorities of 27 countries. The Basel Committee develops supervisory standards and recommendations for banking supervision and is also tasked with improving cooperation between national supervisory authorities.

New framework

Basel Committee agrees on new capital and liquidity framework.

On 16 December 2010, the Basel Committee on Banking Supervision published the new capital and liquidity framework known in the supervisory nomenclature as Basel III. The package also introduces a leverage ratio and measures to buffer any procyclical effects of risk-sensitive capital requirements.

The provisions, which aim to improve the quality of regulatory Tier 1 capital, are far-reaching. In future, a joint stock company's Common Equity may only consist of issued capital and disclosed reserves. Financial instruments of non-joint stock companies are only recognised as Common Equity if they satisfy a set of strict criteria. These require the contracts governing shares in cooperatives and capital contributions by silent partners to be structured in such a way that they are equivalent to paid-up share capital. The criteria are strongly geared to ensuring loss absorption. Hybrid capital instruments may only be recognised as components of Tier 1 capital to a limited extent and subject to much stricter conditions.

The Basel Committee has set out 14 criteria for Common Equity, the most important of which are listed below:

- The capital instrument represents the most subordinated claim in the event of the institution's liquidation.
- The capital is transferred for an unlimited period and is only repaid in the event of liquidation (although it remains at the institution's discretion to make repurchases).
- At the time of issue, the institution does not promise in its statutory or contractual terms that the instrument will be bought back, redeemed, or cancelled.

The 14 criteria apply to both joint stock companies and non-joint stock companies.

Ratios and transition periods take account of impact study.

The limits, percentages, criteria and transition periods were calibrated (i.e. set) using the results of a quantitative impact study (QIS) based on consolidated data as at 31 December 2009. With few exceptions, Basel III will increase the burden on institutions across the board. However, this does not rule out the possibility that credit institutions and their operations will be affected by the changes to varying degrees due to the different focus of their business activities. In all areas, BaFin advocated judicious transition periods for existing but no longer permissible instruments. It also urged that new deductions and the increased capital and supervisory requirements be phased in gradually.

Although the Total Capital requirement is still 8%, the rules governing its composition have been tightened up considerably; following a transition period, credit institutions must hold Tier 1 capital of 6%, rather than the current 4%, and Common Equity of at least 4.5% by 2015 at the latest. To meet the minimum capital requirement of 8%, an institution can use Tier 2 capital up to a limit of 2%. Tier 3 capital is being eliminated. In addition, institutions must gradually build up a capital conservation buffer of 2.5% consisting solely of Common Equity by 2019. Including this buffer, they will therefore be required to hold Common Equity of 7% from 2019 onwards. The capital conservation buffer is intended to ensure that banks hold capital reserves that are available to absorb losses during periods of stress in the business and financial sector. Banks will be permitted to draw down the buffer in such situations.

Table 2
New capital requirements

Request (%) \ Year	2013	2014	2015	2016	2017	2018	2019
Common Equity	3.5	4.0	4.5	4.5	4.5	4.5	4.5
Capital Conservation Buffer (Common Equity)	-	-	-	0.625	1.25	1.875	2.5
Additional Tier I capital	1.0	1.5	1.5	1.5	1.5	1.5	1.5
Tier II capital	2	2	2	2	2	2	2
Countercyclical Buffer	**Depending on cyclicality**						

Source: BaFin

Countercyclical buffer

Countercyclical buffer.

The Basel Committee has also developed a countercyclical buffer designed to dampen excessive credit growth. Excessive growth in individual credit sectors can exacerbate or even trigger crises, as the collapse of the subprime sector in the USA showed. The

countercyclical buffer, consisting of Common Equity or other fully loss absorbing capital, will be between 0% and 2.5%, depending on national circumstances. The buffer will be built up when credit sector growth is excessive. Macroeconomic indicators such as GDP growth will help supervisory authorities to decide on the size of the buffer, which may vary from country to country, but are not binding.

Liquidity

New liquidity requirements for institutions.

In December 2010, the Basel Committee adopted a document entitled Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring and in doing so resolved to introduce globally uniform minimum standards for what until now has been one of the least harmonised areas of banking supervision. Back in 2009, the Basel Committee started to develop two regulatory standards that were to form the cornerstones of a global framework to strengthen liquidity risk management. These were revised on the basis of the results of the consultation process and impact study and were finally adopted in December 2010.

The objective of these minimum standards is to ensure that internationally active banks are able to withstand severe liquidity stress in future. To achieve this objective, a short-term stress test standard (liquidity coverage ratio – LCR) aims to ensure that a group of institutions has sufficient highly liquid assets to cover defined net cash outflows for at least 30 days under a scenario specified by supervisors. This short-term minimum standard is complemented by a long-term funding standard (net stable funding ratio – NSFR), which aims to prevent longer-term structural liquidity mismatches.

While the LCR is to enter into force on 1 January 2015, a transition period ending on 1 January 2018 was agreed for the NSFR. These two liquidity risk standards will then form the cornerstones of quantitative liquidity supervision worldwide, and therefore in Germany as well. In the run-up period, the standards will be closely analysed, specified in greater detail and, if necessary, adapted again, particularly if they lead to undesirable macroeconomic effects.

Leverage ratio

Leverage ratio designed to prevent destabilising processes.

In introducing a leverage ratio, the Basel Committee is aiming to constrain the build-up of leverage in the banking system, as stipulated by the G20. Any necessary reduction in excessive leverage during difficult periods may trigger destabilising processes that exacerbate the damage to the financial system and the economy. The leverage ratio is being introduced in light of the fact that when institutions are forced as a result of losses or a general deterioration in economic conditions to reduce their leverage by selling assets, this may put market prices under pressure, as witnessed during the financial crisis. This can lead not only to

losses on the sales, but also to declines in the value of the assets that institutions continue to hold on their balance sheet. This erodes their capital, which in turn creates a negative feedback loop, forcing them to reduce their leverage further. Above all, however, the erosion of the institutions' capital can limit their ability to lend or serve the economy in other ways. In a recession, this could also exacerbate the crisis for the real economy. The Basel Committee's objective in introducing the leverage ratio is also to reinforce the risk-based capital requirements, i.e. the minimum capital requirements that distinguish between different levels of risk, with a non-risk based "backstop" measure, i.e. a measure that disregards such differences.

Observation period for leverage ratio.

So far, the Basel Committee has only set the timetable through to the final introduction of the leverage ratio on 1 January 2018 und provided a provisional definition to be used until then for observation purposes. Worksheets are to be developed by 2012 so that the leverage ratio can be observed from 2013 onwards, including its behaviour relative to the risk-based capital requirements. Using a minimum ratio provisionally set at 3%, the aim is to test whether the proposed design and calibration of the leverage ratio are appropriate as a minimum requirement in Pillar 1 both over a full credit cycle and for different business models. To answer this question, the banks will calculate their leverage ratio on a half-yearly basis. Starting in 2015, the responses of capital providers and lenders, banks' counterparties and other market participants to the leverage ratio will also be tested, as from that date onwards international banks will be required to publish their leverage ratio on the basis of the provisional definition. An appropriate review based on the results of this parallel run will then be used to make any final adjustments to the definition and calibration of the leverage ratio in the first half of 2017, with a view to migrating to Pillar 1 from January 2018 onwards.

Whether the Basel Committee does indeed decide to introduce a binding minimum requirement for the leverage ratio in 2017 will depend, firstly, on whether the findings of the observation phase allow the leverage ratio to be adjusted and calibrated appropriately for a binding minimum requirement. It will also have to consider whether and how the possible side-effects of such a minimum requirement can be avoided. Above all, however, it will depend on the evidence as to whether a leverage ratio would actually help to prevent the destabilising deleveraging processes caused by the build-up of excessive leverage.

Counterparty credit risk

Capital charge for the risk of credit value adjustments to derivatives.

Basel III also includes extensive changes to the capital charges for counterparty credit risk. These represent the Basel Committee's response in particular to the fact that, during the financial crisis, deteriorations in counterparty credit quality led to heavy losses on derivatives transactions. The deterioration of a counterparty's credit quality is reflected in increased credit value adjustments.

Institutions must make these adjustments when valuing the outstanding derivatives transactions with the counterparty. As at 1 January 2013, a separate capital charge will be introduced to reflect the risk of a change in these credit value adjustments for derivatives transactions. The exact amount of the capital charges is the subject of a further quantitative impact study conducted in the first quarter of 2011.

Capitalisation exposures to central counterparties.

As a result of the financial crisis, institutions are to be induced to clear more of their derivatives transactions through central counterparties. Because the involvement of central counterparties can significantly reduce but not fully prevent settlement risk, the aims is that institutions should capitalise their exposures to central counterparties in future. In December 2010, the Basel Committee set out its ideas in a consultative document. The consultation process is supplemented by a parallel quantitative impact study.

Operational risk

Revised standards on operational risk.

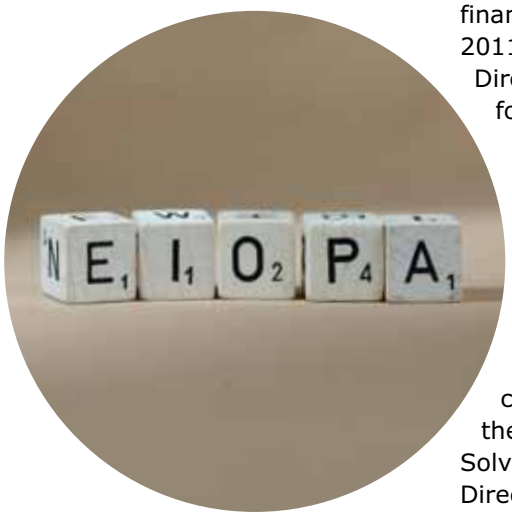
In introducing capital requirements for operational risk as part of Basel II in 2007, the Basel Commission deliberately adopted an open wording for the standards on modelling operational risk. The member supervisory authorities are collating their experiences of the approval processes on an ongoing basis with a view to successively enhancing their joint standards. In December 2010, the Basel Committee presented a consultative document designed to expand on the supervisory guidelines on the assessment of institutions' Advanced Measurement Approaches. It also issued for general consultation revised guidelines on the management and supervision of operational risk.

3 Solvency II

Among other things, Solvency II – the project to reform the European legal framework for insurance supervision – harmonises the solvency capital requirements for insurance firms and groups. Following the adoption of the Solvency II Directive in November 2009, the focus in 2010 was on developing the implementing measures that are to be adopted and on performing the fifth quantitative impact study (QIS5).[5]

It is currently planned to make the initial amendments to the Solvency II Directive at the end of 2011 by way of the Omnibus II Directive, for which the European Commission presented a proposal on 19 January 2011. This contains amendments to two key areas of legislation. Firstly, it amends directives governing insurance and securities prospectuses to reflect the new EU rules

[5] Directive 2009/138/EC dated 25 November 2009, OJ EC no. L 335 dated 17 December 2009.



on financial market supervision and in particular the new EU financial supervisory authorities that began work on 1 January 2011. For example, EIOPA is incorporated into the Solvency II Directive as the successor to CEIOPS. Provision is also made for the binding settlement of disputes by EIOPA. Secondly, the proposal contains amendments to the Solvency II Directive. For example, the Directive provides for the implementation of Solvency II to be postponed by two months until 1 January 2013. The Omnibus II Directive also enables the European Commission to specify transitional requirements for individual elements of the Framework Directive, with different maximum transition periods being set for each area. The Omnibus II Directive is of considerable significance for the continuing evolution of Solvency II. For technical reasons, the European Commission cannot present the official draft of the Solvency II implementing measures until after the Omnibus II Directive has been adopted. The Omnibus II Directive will therefore have a significant influence on the ongoing work on the implementing measures.

European Commission presents full draft of the implementing measures.

Implementing measures

The Solvency II Directive gives the European Commission the authority to adopt implementing measures for particular areas. These are intended to add detail to the Directive and hence improve the harmonisation and consistency of supervision in Europe. In spring 2010, CEIOPS submitted its proposals in this area to the Commission, which at the end of 2010 presented an initial informal full draft of the implementing measures based on the proposals. In 2011, this draft will be discussed further with the member states, with specific consideration being given to the findings of QIS5. The official draft of the Solvency II implementing measures will not be presented by the Commission and discussed with the Council and the Parliament until after the Omnibus II Directive has been adopted.

Impact studies

The QIS5 study conducted by the Commission in the year under review is based on the Solvency II Directive and reflects the implementing measures developed up until that time. The objective was to test the quantitative impact of Solvency II in detail. European insurance firms and groups were asked to take part in the study between July and November 2010. The results received from solo firms were initially evaluated by the national supervisory authorities, while the data received from groups were analysed by CEIOPS or EIOPA. All results and findings were incorporated into a European report, which EIOPA presented to the Commission in March 2011. In addition, BaFin published a national report. The results of the study will have a major influence on the discussion regarding the Solvency II implementing measures.

Guidelines for supervisors

Harmonisation of supervisory practice.

In future, the provisions of the Directive and the implementing measures adopted by the European Council and the European Parliament will be complemented by guidelines for supervisors adopted by EIPOA, with the aim being to further harmonise supervisory practice in Europe. The four existing CEIOPS and EIOPA working groups began work on these guidelines in the year under review. In addition, EIOPA will develop binding standards (on the design of the yield curve, for example).

One of the working groups, the Financial Requirements Expert Group (FinReq), has three areas of work: capital requirements (SCR/MCR), the statement of technical provisions and own funds. Among other things, it has drawn up initial proposals for guidelines related to the procedure to be followed for the approval of undertaking-specific parameters for use in calculating the solvency capital requirement and the recognition of ancillary own funds. In cooperation with the Groupe Consultatif, a forum of European actuarial associations, it is also developing actuarial standards for calculating technical provisions.

The Internal Governance, Supervisory Review and Reporting Expert Group (IGSRR) is responsible for the requirements for public disclosure and supervisory reporting by undertakings, capital add-ons and the valuation of assets and liabilities, and is developing guidance for supervisors on what the supervisory process may look like under Solvency II. In doing so, it is focusing specifically on the evaluation of the own risk and solvency assessment (ORSA) and the templates for future reporting to supervisors. On a closely related topic, consideration is being given to how and which data may in future be exchanged electronically between national supervisory authorities and with EIOPA.

In 2010, the Internal Models Expert Group (IntMod) developed guidance on the use test and on calibration, showing supervisors and the insurance industry how they can fulfil the future requirements. The Group also drew up general guidelines on hitherto less-discussed topics, such as the inclusion of profit and loss attribution in the internal model.

The fourth CEIOPS/EIOPA working group, the Insurance Groups Supervision Committee (IGSC), is drawing up guidance on practical cooperation in the colleges and in coordinating measures. The working group is also developing harmonised approaches for identifying, reporting and assessing risk concentrations and intra-group transactions.

4 European supervisory structure

At a European level, supervisors previously carried out their work on the three Lamfalussy Committees. As an integrated supervisory authority, BaFin was represented on 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 task of the three committees was, firstly, to provide advice to the Commission as part of the European legislative process and, secondly, to ensure that supervisory practice in their respective areas was consistent across Europe. On 1 January 2011, three new European Supervisory Authorities (ESAs) became operational: the **European Banking Authority** (EBA), the **European Insurance and Occupational Pensions Authority** (EIOPA) and the **European Securities and Markets Authority** (ESMA). The three ESAs are the legal successors to the former Level 3 committees, CEBS, CEIOPS and CESR, and have their own legal personality.

1 January 2011: new EU supervisory authorities start work.

In autumn 2010, following extensive negotiations, the ECOFIN Council, the European Parliament and the European Commission agreed on a new EU supervisory architecture to take effect on 1 January 2011. The new set-up for the supervision of financial activities in the EU single market is based on the European System of Financial Supervision (ESFS), which encompasses both microprudential supervision (i.e. the supervision of institutions and markets) and macroprudential supervision. The Regulations establishing the ESFS were published in the Official Journal of the European Union on 15 December 2010.

European System of Financial Supervision (ESFS)

Macroprudential supervision is the supervision of the stability of the financial system as a whole. It is performed by the European Systemic Risk Board (ESRB) based in Frankfurt am Main. The ESRB is hosted by but independent of the ECB and does not have its own legal personality. The voting members comprise the designated representatives of the ECB, the governors of all the national central banks, the European supervisory authorities, a member of the European Commission and the chairs of the advisory committees. The national supervisory authorities also participate, but do not have voting rights. If the ESRB identifies systemic risks to the financial stability of the single European market as a whole, it can issue warnings and, where appropriate, related recommendations.

These may be addressed to one or more member states, or to national or European supervisory authorities. However, the ESRB can only enforce its warnings and recommendations with the help of political pressure. The addressee must inform the ESRB and the Council of the measures it has taken to act on the warnings or recommendations, or provide an adequate explanation as to why it will not heed a warning or recommendation ("act or explain" mechanism).

Institutional and market supervision, also referred to as microprudential supervision, continues to be performed by the national supervisory authorities. However, these will be complemented by three European supervisory authorities with independent powers. The European Banking Authority (EBA) based in London is active in the field of banking supervision, the European Insurance and Occupational Pensions Authority (EIOPA) based in Frankfurt am Main in the field of insurance supervision and the European Securities and Markets Authority (ESMA) based in Paris in the field of securities market supervision. The objective in establishing independent supervisory authorities at EU level was to ensure greater harmonisation and consistent application of supervisory rules in the EU single market. To this end, the three ESAs can not only issue non-binding guidelines and recommendations, but also and in particular draft binding regulatory and implementing technical standards, which can be adopted by the European Commission. Subject to certain conditions, they also have direct supervisory powers that enable them to enforce EU supervisory law. The EBA, EIOPA and ESMA have powers to intervene directly when national supervisory authorities fail to apply EU law or apply it incorrectly. In crisis situations, they also have a tiered system of measures at their disposal. Firstly, the authorities can request that national supervisory authorities take measures. If these fail to do so, however, the ESAs can take a decision that is directly applicable to a particular financial institution, subject to strict conditions. However, a precondition for this is that the Council, in consultation with the European Commission and the ESRB, has established that a crisis exists.

Finally, in the event of cross-border disagreements, they can mediate between national supervisory authorities, resolving disputes by taking a binding decision. To achieve greater harmonisation between the banking, insurance and securities sectors, a Joint Committee has been established, where the three EU authorities are to liaise with one another.

5 Financial accounting and reporting

Accounting for insurance contracts

The **International Accounting Standards Board** (IASB) is the ultimate body that develops and adopts accounting standards. The IASB's members are accountants, analysts and preparers and users of financial statements. The pronouncements issued by the IASB are the International Accounting Standards (IASs)/International Financial Reporting Standards (IFRSs), which are used in a large number of companies throughout the world and have been adopted by the European Union.

IASB issues exposure draft on accounting for insurance contracts.

After 13 years of discussion, the IASB exposed for comment a draft International Financial Reporting Standard (IFRS) on accounting for insurance contracts in July 2010. The "Insurance Contracts Exposure Draft" represents an important milestone in the IASB's project to develop a new, unified standard governing accounting for insurance contracts. A feature of current accounting practice is that insurance undertakings apply different accounting standards (e.g. US GAAP and German GAAP - *Handelsgesetzbuch*) in parallel, because this is permitted by the current interim accounting standard, IFRS 4. In consequence, an eclectic patchwork of accounting practices has evolved over a number of years. The new exposure draft is the IASB's attempt at establishing a unified concept for accounting for all types of insurance and reinsurance contracts. The comment period ended on 30 November 2010. The IAIS and CEIOPS, in both of which BaFin is represented, were closely involved in the controversial debates on the exposure draft and submitted comment letters to the IASB. The final accounting standard will complete Phase II of this joint project between the IASB and the Financial Accounting Standards Board (FASB) in the United States. As the IASB plans to adopt the final standard by mid-2011, initial application for years beginning 1 January 2013 appears to be realistic. Before this, however, the exposure draft will be "field tested" to assess its impact on accounting by insurers – in particular in conjunction with the new IFRS 9. BaFin is in favour of aligning the implementation dates of both accounting standards.

Implementation of the exposure draft will have a fundamental impact on accounting by insurers; this ranges from the definition of an insurance contract, through the measurement models to be used, down to the presentation and disclosure of insurance contracts in IFRS financial statements.

Measurement at the current fulfilment value rather than fair value.

Up to now, the IASB has favoured measuring insurance contracts at their current exit value. In future, however, they will be measured at their current fulfilment value using a building block

approach. This is designed to reflect the insurer's entity-specific obligations to fulfil the insurance contract.

The following three building blocks are used to measure insurance contracts:

- An unbiased and probability-weighted estimate of the future cash flows (expected value of the cash flows from the contract).
- A discount rate that adjusts the cash flows for the time value of money.
- A risk adjustment that reflects the effects of uncertainty.

The amount resulting from application of the three building blocks is termed the present value of the fulfilment cash flows (also known as the "current fulfilment value"). Any accounting profit resulting from this initial measurement is eliminated by recognising a residual margin.

Dealing with volatility.

The concept of measuring insurance contracts at the current fulfilment value does not, as a matter of principle, rely on observing or estimating current exit values. This avoids the emergence of volatility in accounting for insurance contracts. However, because the residual margin to be recognised in the subsequent reporting periods is not remeasured in each period, but is released in a systematic way to profit or loss over the coverage period, all changes in the inputs used to estimate cash flows, or in the discount rates and the risk adjustment, are recognised directly in profit or loss. Over time, this in turn leads to substantial earnings volatility at the insurance undertakings, which runs counter to the aim of reducing procyclical effects.

Acquisition costs.

Another significant revision proposed by the IASB affects how insurers account for costs incurred to sell, underwrite and initiate insurance contracts ("acquisition costs"). Previously, all components of acquisition costs were recognised and amortised as intangible assets over the term of the contract, but now the entity must distinguish between directly attributable acquisition costs and those that are only indirectly attributable. Costs that can be directly attributable to an insurance contract are recognised in profit or loss as incurred. The extent to which these revisions do justice to the information requirements of users of financial statements will no doubt be the subject of further debate.

Financial reporting conference

Should promoting financial market stability be one of the objectives of accounting? What contribution can prudential rulebooks make to safeguarding financial market stability? And where do we go from here with fair value? These were the fundamental issues addressed by the first "Financial Market Stability, Accounting and Supervision" conference organised by BaFin in February 2010. Almost 200 high-level representatives of the financial industry, accountants, standard-setters and academics

were invited to this event in Bonn. The public debate centred around the future shape of accounting and the promotion of financial market stability, due not least to the measures initiated to deal with the fall-out from the financial market crisis. Corporates focused in particular on changes in IFRSs, especially the IFRS 9 and IFRS 4 (Phase II) projects and convergence with US GAAP. Equally, though, conference participants focused on national GAAP perspectives. BaFin was able to recruit prominent speakers for these topics, for instance from the World Bank, the IASB, the US Securities and Exchange Commission (SEC) and the Institute of Public Auditors in Germany (Institut der Wirtschaftsprüfer). The speakers discussed the issues in depth with the conference participants together with two of BaFin's Chief Executive Directors.

CEBS: Harmonising solvency reporting formats

European Commission aims for single European reporting system.

The European Commission wants to establish a single European reporting system that will come into force on 31 December 2012, with standard reporting formats, cycles and dates. Where solvency requirements are concerned, the Commission has therefore used the revision of the Capital Adequacy Directive to expand the reporting requirements set out in directive 2006/48/EC. In line with the principle of proportionality, the reporting formats must be structured to reflect the nature, extent and complexity of the credit institution's business. To ensure this, the CEBS Subgroup on Reporting, in which BaFin is represented, analysed of the COREP data reported by the institutions in the year under review. This process will continue in the course of 2011.

Consultation and dialogue between supervisors and industry.

The European Commission's initiative to further harmonise solvency reporting formats is welcomed by supervisors and industry alike. This became evident in the course of a public consultation on the COREP framework, the "Guidelines on Common Reporting", which CEBS has revised. During the consultation phase from mid-June to mid-September, BaFin organised several meetings with representatives of industry together with the Bundesbank. Both sides also advocate applying the principle of proportionality to the decision on reporting cycles. Uniform cycles should apply to internationally operating institutions and – in contrast to previous practice – no different rules should be imposed at national level. The proposal by supervisors and industry means that there would no longer be any national scope for discretion, which would lead to better comparability.

EU: Green Paper on audit policy

The European Commission launched a consultation process with the publication of its Green Paper on "Audit Policy: Lessons from the Crisis" in October 2010. The Green Paper discusses the fundamental role of the auditor as well as the question of whether audits provide financial market participants with decision-useful

information. Some of the issues raised by the Commission are very far-reaching, for instance on the topics of joint audits or "audit only" firms. However, the Commission emphasises that its initial objective in publishing the Green Paper is to initiate a comprehensive discussion, with an open outcome, of all audit-related issues. CESR, CEBS and CEIOPS reject in their comments the dirigiste measures proposed by the Green Paper in the field of auditing, as does BaFin. Nevertheless, the international supervisors and BaFin recognise that – as discussed in the Green Paper – external rotation could improve the quality of audit services. They also believe that a stricter separation between audit and consulting services makes sense. The consultation was completed in December, and the first steps towards implementing the findings are expected to be reflected in EU legislation in the course of 2011.

IFRS 9: Financial instruments accounting

Phase 2 of the IAS 39 replacement project is ongoing.

The IASB ushered in Phase 2 of its project to replace IAS 39 when it published its exposure draft on the recognition of impairment losses on financial instruments measured at amortised cost in November 2009. However, the comment period did not end until June 2010 because of the complexity of the exposure draft. In contrast to the requirements of IAS 39, which remains in force and which uses an incurred loss model for impairment recognition, the new requirements contained in IFRS 9 would recognise impairment losses at an earlier stage using the "expected cash flow" approach. This aims to mitigate the procyclical effect of impairment losses.

The first step is to estimate any credit losses expected at initial recognition of the financial instruments. The expected losses are then recognised over the life of the financial instrument and reported as impairment losses (loan loss allowance). This is accompanied by a reduction in the contractually agreed interest income. The entity re-estimates the expected credit loss over the life of the financial asset at the end of each reporting period. Any change in the expected loss is recognised in profit or loss and adjusts the carrying amount. This re-estimate of the future expected cash flows is performed on an individual exposure or portfolio basis.

BaFin sees need for improvement in impairment rules.

BaFin shares the unanimous view that impairment losses should be recognised anticyclically in the future. However, because the model presented by the IASB is based largely on estimates, BaFin believes that there is still room for improvement in the details. In response to widespread criticism on this point, the IASB issued a supplement to the exposure draft in January 2011.

Phase 3: Hedge accounting.

The IASB issued an exposure draft on hedge accounting in December 2010 – the third and final phase of the IAS 39 replacement project. The fundamental approach underlying this exposure draft aligns hedge accounting more closely with an entity's risk management. Previously, hedge accounting was based on strict quantitative criteria, but the exposure draft would allow

qualitative criteria to be used to demonstrate hedge effectiveness. The exposure draft largely aligns the requirements for accounting for fair value hedges with those for cash flow hedges. This move will see changes in the fair value of the hedged item being presented in a separate line item in the statement of financial position, and gains or losses on hedged items or hedging instruments recognised in other comprehensive income (hedging reserve).

Completion of IFRS 9 project planned by mid-2011.

The comment period for Phase 3 lasted until the end of March 2011. Despite the criticism levied at the requirements published in the first two phases, the IASB is sticking to its timetable of completing the IFRS 9 project by June 2011. It remains to be seen whether this ambitious timetable can be met.

FASB: Exposure draft on financial instruments accounting

The FASB issued its own exposure draft on accounting for financial instruments under US GAAP in May 2010. As well as classification and measurement, this exposure draft also governs the recognition of impairment losses on financial instruments and hedge accounting, and thus covers in a single exposure draft all three phases in which the IASB is revising its own financial instruments accounting pronouncements.

FASB focuses more heavily on fair value.

The exposure draft would retain fair value measurement of financial instruments, although it came in for criticism following the financial market crisis. The FASB proposes that an entity's own liabilities will also be accounted for at fair value, with the result that a deterioration in credit quality could generate income. The FASB is also sticking to an incurred loss model for accounting for impairment losses on financial instruments. In line with this, the majority of comment letters on the FASB exposure draft were critical. As well as criticising the underlying concepts, commenters fear that the call by the G20 to the standard-setters to create a global framework for financial reporting (convergence) will be ineffectual. There are no indications as to how the FASB will proceed with the exposure draft and the extent to which there will be convergence with the IASB's model.

SEC: Survey of European experience with IFRSs

The Securities and Exchange Commission (SEC) approached the European supervisory authorities in September 2010 with an extensive list of questions about their experiences with the introduction of IFRSs. The background to this is an SEC work plan to evaluate the potential effects of the adoption of IFRSs by US companies. The SEC issued a roadmap in November 2008 for the potential admission of IFRS financial statements for use by US issuers. The SEC plans to take a final decision on this issue in 2011.

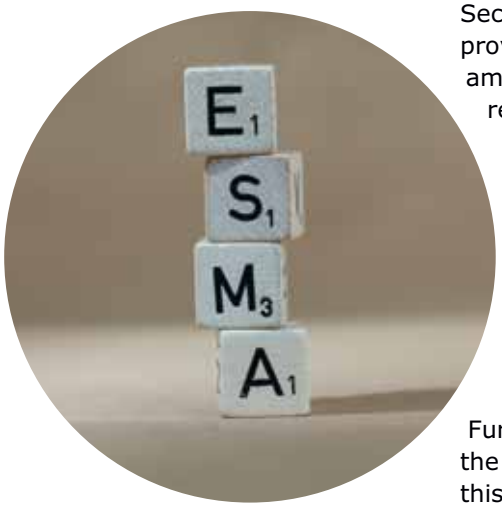
6 Rating agencies

Supervision of rating agencies...

2010 was dominated by the practical implementation of the EU Credit Rating Agencies Regulation, which entered into force on 7 December 2009. This required all rating agencies operating in Europe to apply for registration with CESR by 7 September 2010. Without such registration, their ratings may not – after a transition period – be used by institutions for regulatory purposes. Under the first version of the EU Credit Rating Agencies Regulation in force in the year under review, it is the responsibility of the national supervisory authorities to register rating agencies. CESR, or since 1 January 2011 ESMA, plays only a coordinating or advisory role in this process for the time being. In line with this, CESR has drawn up various guidelines, for example on the registration process that set out and interpret numerous aspects of the Regulation in greater detail. ESMA will assume responsibility for the registration process at a future date.

CESR had also been tasked with examining the equivalents of the EU Credit Rating Agencies Regulation in the USA, Japan, Canada and Australia and with reporting back on the findings to the European Commission. If a third country has a regulatory regime for rating agencies that is equivalent in terms of content to the requirements of the EU Credit Rating Agencies Regulation, the ratings of smaller, non-systemically important rating agencies from that third country may be used within the EU. In 2010, based on the CESR report on Japan, the Commission determined that the regulatory framework in Japan is equivalent to that in the EU and that it therefore can be considered as equivalent to the Credit Rating Agencies Regulation. The report on the situation in the USA has been submitted to the European Commission for its decision, but will be revised as the Dodd Frank Act is implemented in the USA.

…in light of the restructuring of financial supervision in the EU.



In mid-2010, the EU began revising the EU Credit Rating Agencies Regulation. This had become necessary as financial supervision in Europe had been restructured in the course of the financial crisis and the Commission was convinced that a centralised European Securities and Markets Authority (ESMA) would be better able to provide consistent oversight of rating agencies across Europe. The amendments to the Credit Rating Agencies Regulation therefore relate almost exclusively to the changes affecting responsibility for the supervision of rating agencies. From July 2011 onwards, ESMA will be solely responsible for all aspects of rating agency supervision, including the enforcement of supervisory measures and sanctions. Transitional provisions ensure that the registration applications dealt with by the national supervisors in the colleges are completed in those colleges. ESMA may delegate tasks to national supervisory authorities and thus continue to involve them in the supervisory process.

Further work is already under way at a European level to revise the content of the Credit Rating Agencies Regulation. As part of this, the Commission published a consultation paper in November

2010. The issues presented in this paper include reducing reliance on ratings, sovereign debt ratings, enhancing competition in the credit rating industry, introducing a civil liability regime for credit rating agencies and reducing conflicts of interest due to the "issuer pays" model.

7 Market transparency/ integrity and prospectuses

EU publishes revised Prospectus Directive.

By publishing the new Prospectus Directive, the EU has increased investor protection. This Directive, which governs requirements related to the preparation and publication of securities prospectuses, was published in the Official Journal of the European Union in December 2010 and must be transposed into national law by member states by the end of June 2012. The crucial element in terms of investor protection is the requirement to prepare a summary of a securities prospectus that provides key information in a concise manner and in non-technical language. This is intended to give investors an initial indication of whether a product meets their investment objectives. In addition, the summary of the securities prospectus is to be standardised in future so that potential investors are better able to compare different products. The aim in revising the Prospectus Directive is not only to increase investor protection, but also to reduce the administrative hurdles facing issuers.

High-frequency trading.

Discussions relating to market transparency and integrity centred on high-frequency trading (HFT) in the year under review, not least because of the "flash crash" on the New York Stock Exchange. On 6 May 2010, prices on the New York Stock Exchange plummeted: the Dow Jones temporarily lost 9%, but recovered within minutes and closed down 3.3%. The public blamed the crash primarily on HFT. Although the official SEC report on the investigation into the crash did not state that high-frequency trading was directly responsible, it was unable to fully dispel doubts about the potential ability of HFT to increase volatility, particularly in times of crisis. The European Commission describes HFT as a subcategory of algorithmic trading that mostly uses traditional trading strategies, but that employs very sophisticated technology such as particularly fast computers to do so. HFT is now extremely widespread and at many trading venues accounts for up to 50% of turnover.

First initiatives to regulate high-frequency trading.

The G20 has also taken up the issue and asked IOSCO to draw up recommendations by June 2011 to promote market integrity and efficiency so as to mitigate the risks posed to the financial system by the latest technological developments. One focus of the work is HFT, on which IOSCO has already held panel sessions for the North America, Europe and Australia/Asia regions, involving key sectors and academic representatives. The Organization is working at full

speed to develop recommendations for regulation by the deadline set. At a European level, CESR initially launched a call for evidence in April 2010, although from a regulatory perspective this was unable to clarify the potentially negative effects of HFT conclusively. In autumn 2010, CESR therefore set up a working group, which looked at HFT and related topics such as sponsored access and co-location services and is to develop regulatory guidelines at short notice for consideration during the MiFID review at the end of 2011. The most concrete regulatory proposal to date is contained in the public consultation document on the MiFID review released by the European Commission in December 2010. Among other proposals, it would require investment firms engaging in HFT to put in place special risk controls to prevent errors in trading.

IOSCO: more transparency over dark pools.

IOSCO recommends that supervisors regularly monitor exemptions from trade transparency obligations. This is the view expressed in a consultation report in which the Organization recommends generally increasing transparency in the context of dark pools. Dark pools are facilities that are exempt from pre-trade and, in certain cases, also post-trade transparency requirements. In Europe, the relevant supervisory authority has until now been able to grant a waiver for pre-trade transparency obligations for certain types of order, the main example being large-in-scale orders, which could have an undesirable influence on the market if all the transparency obligations were met. Due to the increasing use of waivers, however, a significant number of orders were not being included in the price formation process. In its consultation report, IOSCO therefore requests that the relevant supervisor intervene when the price formation process is adversely impacted. In addition, IOSCO members should incentivise market participants to rely more on public trading and make the way in which dark pools function transparent. Following the end of the consultation period at the end of January 2011, IOSCO intends to prepare a final report by April at the latest.

At a European level, CESR started to draw up guidelines on improving waiver harmonisation in autumn 2010. ESMA is expected to release the guidelines for consultation in the first half of 2011.

IAIS releases revised Insurance Core Principles on market supervision for consultation.

In 2010, the IAIS revised its Insurance Core Principles (ICPs) on the market conduct of insurers and intermediaries as well as on insurance fraud and drafted corresponding standards and guidance material. One notable aspect of the revised ICPs is that all papers are now addressed directly to the national insurance supervisor responsible for monitoring compliance with them. In the guidance material, the IAIS shows supervisory authorities how they can implement the binding standards in practice. For example, the guidance on the market conduct of insurers and intermediaries contains analyses of the existing disclosure and information obligations from before a contract is entered into through to the point at which all obligations under a contract have been satisfied. Conflicts of interest, contract management, data protection, the handling of customer complaints and claims procedures are also analysed. The standards and guidance on insurance fraud describe

possible scenarios as well as measures to prevent, and appropriate action to be taken after, cases of fraud. The ICPs, standards and guidance material are to be adopted by IAIS members in 2011 following the consultation. The background to the work is the project to revise all IAIS Insurance Core Principles by October 2011.

CEIOPS: recommendations for the revision of the Insurance Mediation Directive.

In reviewing national implementation of the Insurance Mediation Directive (Directive 2002/92), the European Commission identified differences in its application in practice between member states. The European Commission therefore intends to present a proposal for the revision of Directive 2002/92 in the second half of 2011. The Insurance Mediation Directive establishes the principle of a single European passport and sets out basic standards of consumer protection in relation to insurance mediation. By revising the Directive, the European Commission wishes to enhance the single European market for insurance intermediation for all participants involved in the selling of insurance policies. To achieve this objective, CEIOPS, at the European Commission's request, has drawn up recommendations on aspects the Commission will pay particular attention to when revising the Directive:

- Legal structure and scope of the Directive.
- Greater legal clarity in relation to intermediaries from third countries.
- Professional requirements, or qualifications, of intermediaries.
- Cross-border aspects of intermediation.
- Conflicts of interest.
- Transparency of remuneration.

The disclosure of intermediary remuneration was a particularly controversial topic of discussion. Here, most CEIOPS members came out in favour of a minimum harmonisation regime under which intermediaries are obliged to disclose the commission they receive at the customer's request. The recommendations, which BaFin as a CEIOPS member was involved in developing, were presented to the European Commission in November 2010.

8 Investment funds

International efforts to regulate hedge funds and alternative Investment funds.

Even though hedge funds did not trigger the financial crisis, their behaviour can affect financial stability. As a consequence of the global financial crisis, the G20 and others also demanded stricter regulation of hedge funds. IOSCO responded to this call. Alongside registration of hedge funds, it is recommending continuous regulatory requirements such as setting up an appropriate risk management system, holding assets in segregated custody and minimum standards for investor information. In addition, managers should notify the supervisory authorities about systemically important information. The Joint Forum has refined these recommendations, especially with regard to hedge funds that could give rise to systemic risks.

EU adopts AIFM Directive.

The EU has adopted a directive regulating alternative investment fund managers (AIFM Directive). However, this stipulates not only that managers of hedge funds, but also all managers of funds that are not already covered by the UCITS Directive must be regulated. In addition, the Directive makes the approval of alternative investments by the supervisory authority subject to specific requirements such as the suitability of the managers or capital backing. It also imposes extensive requirements with regard to the organisation and transparency of alternative investment funds.

9 Corporate governance

European Commission Green Paper on Corporate Governance.

Strengthening corporate governance at financial institutions is at the heart of the programme on financial market reform drawn up by the European Commission. In its Green Paper of 2 June 2010, the Commission assumes that a lack of effective control mechanisms within these entities was a key factor facilitating excessive risk taking by financial institutions. In its opinion, the nature and extent of the risks taken were not adequately understood. In addition, financial supervisors did not sufficiently monitor the effective implementation of an efficient, functioning corporate governance system. BaFin and the Bundesbank have drawn up a joint proposal for the federal government's comment on the Green Paper that emphasises the initiatives Germany has taken to implement improvements in key areas:
The inclusion of requirements relating to the reliability and expertise of members of supervisory bodies in the Banking Act and the Insurance Supervision Act was followed in February 2010 by a BaFin guidance notice providing additional details of the legal requirements. Both the Banking Act and the Insurance Supervision Act cap the number of supervisory body appointments that may be held, while under the Stock Corporation Act an executive board member may generally only transition to the supervisory board after a two-year cooling-off period. This aims to prevent mixing up the executive board's management function with the supervisory board's supervisory function. Remuneration practices are regulated by the Act on the Appropriateness of Management Board Remuneration (Gesetz zur Angemessenheit der Vorstandsvergütung), which has been in force since mid-2009, and, since the end of July 2010, by two regulations on the supervisory requirements to be met by remuneration schemes for the banking and insurance sectors.

OECD reviews implementation of Principles of Corporate Governance.

It is not yet clear what conclusions the European Commission will draw from the Green Paper. A draft directive on corporate governance is expected for June 2011. What is decisive, however, is that good corporate governance is put into practice.

Due to the inadequate implementation of its Principles of Corporate Governance, the OECD will perform peer reviews in the future that will help it monitor implementation and better identify any

problems that arise in the process. In 2010, it conducted its first peer review on corporate governance in five countries in the area of "Board Practices: Incentives and Governing Risks". One of the main findings of this review is that boards should aim for greater cooperation between the risk committee and the remuneration committee so as to better align risk management and remuneration practices. The OECD recommends that boards play an active role in tailoring remuneration structures to enterprises' specific situations. In particular, strategy should be aligned with the entity's risk appetite. In addition, the OECD considers it wise to have the system of board remuneration approved by the general meeting – the 'say on pay' rule – because it is of the opinion that greater involvement by shareholders leads to better control of remuneration practices. It also recommends making it easier for institutional investors to exercise their rights. The criteria underlying the remuneration process should therefore be disclosed. Prior to this, in February 2010, the OECD had published a report on corporate governance and the financial crisis that explicitly calls for more effective implementation of the OECD Principles, among other things. The subject of the next peer review will be the principles applicable to institutional investors.

BCBS publishes Principles for Enhancing Corporate Governance.

In October 2010, the Basel Committee issued its new Principles for Enhancing Corporate Governance in Banks. Under the shadow of the financial crisis, the Basel Committee had decided in 2009 to revise its Guidelines on Corporate Governance in Banking from 2004. Case studies were evaluated and the existing principles were then defined in greater detail and enhanced by a working group, and new aspects were added. The rules were also structured much more clearly on the basis of the principal corporate functions and individual areas of responsibility. The Basel Committee then issued the consultative draft document for comment between March to June 2010 before overhauling it again in light of the comments received and publishing the revised version in October.

The Principles for Enhancing Corporate Governance focus on the following new aspects in particular:

- The role of the board (i.e. the executive and supervisory boards), including its responsibility for setting and overseeing banks' risk strategies.
- Board qualifications.
- The importance of separate, independent units for risk management, compliance and internal audits.
- The need for effective risk management and control processes to ensure that risks are identified, monitored and managed on an ongoing firm-wide and individual entity basis.
- Promotion of the board's active involvement in the design and operation of the compensation systems for employees, including ensuring that these are aligned with risk and focused on achieving sustainable business success.

Finally, the guidelines stress the importance of extensive knowledge of the banking organisation – especially in the case of groups of banks – and awareness of its complexity on the part of the board and senior management.

CEBS Guidebook on Internal Governance.

CEBS resolved a Guidebook on Internal Governance and published a draft for public consultation. This comprehensive Guidebook consolidates and updates the existing Guidelines on Internal Governance. Although CEBS had already addressed the relevant questions in the "High-level Principles on Risk Management" published in February 2010 and the "High-level Principles on Remuneration" dating from 2009, it decided to consolidate and update the existing Guidelines in an extensive Guidebook. Prior to this, CEBS had conducted a study to review the implementation of the existing Guidelines and their application by the national supervisory authorities and by institutions. This revealed a number of weaknesses, especially with regard to the oversight of the supervisory function, risk management and internal control frameworks. CESR is also examining and analysing corporate governance topics. The predecessors of the ESMA set up a working group that evaluates the European Commission's Green Papers from the perspective of securities supervision.

IAIS revises Core Principles on Corporate Governance.

In the field of corporate governance, the IAIS also revised its Insurance Core Principles, or in many areas developed them for the first time in 2010. Specifically, these related to the licensing of insurance undertakings, the suitability of persons, corporate governance, risk management and internal control mechanisms. The documents on internal control give detailed consideration to those key control functions that are also the subject of the Solvency II Framework Directive in Europe, i.e. the actuarial function, internal audits and testing adherence to applicable laws and regulations. The new standards and guidelines, particularly on internal control and corporate governance, incorporate the lessons learned from the financial crisis: all documents also apply to insurance groups and contain advice on the application of the rules at group level. The corporate governance material additionally contains detailed recommendations on remuneration practice. These specify that there must be defined remuneration practices at least for those employees who are largely responsible for the enterprise's risk taking. The documents on internal control and corporate governance are due to enter into force in 2011 after consultation with the IAIS members. The core principles, standards and guidelines on licensing and the suitability of persons were adopted by the IAIS in 2010.

10 Occupational retirement provision

Founded in 2004, the Paris-based **International Organisation of Pension Supervisors** (IOPS) performs a similar function to the IAIS in the area of occupational retirement provision. IOPS aims to serve as the international standard-setter for the supervision of private pension arrangements, to promote international cooperation and to provide a global forum for exchanging information.

IOPS adopts Principles of Private Pension Supervision.

A risk-based approach to supervision can help to avoid or minimise procyclical effects. This was a lesson that IOPS learned from the financial crisis and took into account when revising its Principles of Private Pension Supervision, which first appeared 2006. In doing so, the international supervisors of private pension arrangements further emphasised the importance of a risk-based approach. One of the aims of this approach, which must be accompanied by a suitable risk assessment methodology, is to ensure the more efficient use of resources. This means that material risks require more intensive supervision while minor ones require proportionally less attention.

IOPS members perform regular self-assessments of how these Principles are applied. The results of these reviews are incorporated into IOPS's work.

IOPS publishes Toolkit for Risk-based Supervision.

The organisation has also published a Toolkit for Risk-based Supervision. Besides case studies, this practical handbook for supervisors and supervised entities primarily contains examples of quantitative and qualitative measures.

MIOPS adopts Good Practices for Pension Funds' Risk Management Systems.

The trend towards risk-based supervision also forms the basis for the Good Practices for Pension Funds' Risk Management Systems, which IOPS adopted together with the OECD in 2010. In addition to risk-based supervision, the Paper also stresses the central importance of sound, high-quality risk management and the accuracy of the risk assessment. IOPS and the OECD propose a structured approach which focuses on identifying and managing potentially critical risks faced by pension plans or funds. The risk-based approach is designed to facilitate the continuous assessment by all affected areas of the pension plans or funds of the financial and operational factors, with the aim of minimising and mitigating risk.

CEIOPS welcomes EU Green Paper on Pensions.

CEIOPS welcomes the Green Paper entitled "Towards adequate, sustainable and safe European pension systems" and supports its aims. The European supervisors for insurance and occupational pensions took part in the European Commission's consultation on the Green Paper that ran until mid-November 2010. In particular, CEIOPS considers the fact that the Green Paper does not question the prerogatives of the EU member states or the role of unions and management in the area of pensions to be one of the Green Paper's most important messages. CEIOPS also draws attention to the diversity and complexity of pensions, which should be taken into account in future initiatives at European level. While the Green Paper takes a comprehensive, holistic approach to old-age provision, CEIOPS concentrated in its answers to the questions on supervision of the institutions for occupational retirement provision (IORPs). The focus in this context was on the question of the solvency rules for IORPs.

CEIOPS paper on cross-border activity of IORPs.

Only a political decision can resolve the issues caused by different definitions of what constitutes cross-border activity by IORPs, according to CEIOPS in a note presented to the European Commission in November 2010. In this note, the Committee describes the practical issues and possible outcomes that occur

when EU member states and EEA signatory states use differing definitions of what constitutes cross-border activity by IORPs. As the EU's IORP Directive does not provide a precise definition of cross-border activity, different definitions exist within the EU and the EEA. While a number of member states define cross-border activity on the basis of the location of the sponsoring undertaking, other member states use the approach based on the nationality of the applicable social and labour law or the nationality of the scheme. Consequently, EU member states and EEA signatory states may have different views of what potentially constitutes cross-border status for IORPs.

Developments in cross-border occupational retirement schemes.

As in previous years, CEIOPS reported on the development of cross-border arrangements by IORPs within the EU and EEA in 2010. Between June 2009 and June 2010, the number of IORPs engaged in cross-border activity rose only marginally, from 76 to 78. During this period, seven new cross-border IORPs were reported, while five others ceased cross-border activity. The reasons for withdrawal vary. The number of home member states (seven) and the number of host member states (22) did not change in this period.

11 Colleges and bilateral cooperation

Colleges

One of the primary aims of the supervisory authorities is to improve the supervision of cross-border banking and insurance groups and of rating agencies. **Supervisory colleges** are the primary means of doing this. A college is a structure designed to facilitate cooperation between the home and host supervisors of a cross-border banking or insurance group or rating agency; this also includes regular meetings between the group's supervisors. The aim of the colleges is to enhance the cooperation and information exchange between the relevant supervisory authorities, and hence increasing the efficiency and effectiveness of international supervision. Working groups promote and coordinate the establishment of new colleges and the ongoing work performed by existing colleges at both a global and a European level. One key aspect here is the exchange of experience, since in some countries colleges have been in place for a number of years while in others they are only just being set up.

According to the CEBS definition, supervisory colleges are "permanent, although flexible, structures for cooperation and coordination among the authorities responsible for and involved in the supervision of the different components of cross-border groups, particularly large groups". One of the main tasks of the banking supervisory colleges is the joint assessment of the group's risk situation and capital adequacy. Other key tasks include information exchange, the establishment of supervisory review processes and, where applicable, the transfer of tasks and responsibilities from one supervisory authority to another.

Colleges for cross-border banking groups mandatory in the EEA.

Article 131a of the amended Capital Requirements Directive (CRD II), which entered into force on 31 December 2010, introduces a legally binding requirement to set up a college for cross-border banking groups in the EEA. In Germany, the Directive was transposed into national law by amending the Banking Act. A supervisory college must be established if an EU parent credit institution has at least one subsidiary or two significant branches in another EU member state.

CEBS guidelines regulate operational functioning and supervisory practice.

The operational functioning and practical work of the supervisory colleges is largely governed by two sets of CEBS guidelines, which were developed by the latter, in accordance with the provisions of the CRD II and published on the CEBS website in 2010. These are the CEBS "Guidelines for the Operational Functioning of Colleges" and "Guidelines for the Joint Assessment and the Joint Decision Regarding the Capital Adequacy of Cross-border Groups".

BaFin and Bundesbank – home supervisor for 18 banking groups.

In 2010, CEBS provided support at European level for the colleges of the 44 largest banking groups in Europe, including six German banking groups. BaFin and Deutsche Bundesbank are the home supervisor for 18 banking groups, meaning they are responsible for setting up and implementing the colleges. The number of host supervisory authorities belonging to the various colleges ranges from 1 to 16. In addition, the German supervisory authority is a host supervisor in a steadily growing number of European supervisory colleges.

BCBS publishes guidelines for colleges.

BaFin continued its work on global colleges at an international level as well. During the year under review, the Basel Committee on Banking Supervision (BCBS) also adopted guidelines on future cooperation between the supervisory authorities in colleges (Good Practice Principles on Supervisory Colleges), which it published in October 2010. These Principles apply globally, and hence also cover supervisory authorities from non-EU countries. The BCBS guidelines merely constitute recommendations and go into much less detail than the European guidelines.

BaFin organises seminar on supervisory colleges

Does it make a difference whether a supervisory college is responsible for insurance supervision or for rating agency registration? This question would be answered in the affirmative by

the 25 people who attended the cross-sectoral seminar on colleges that BaFin organised in collaboration with CEIOPS in December to present the legal background and the work of the colleges at an interdisciplinary level for the first time. The seminar covered both the work of the colleges active in the area of banking and insurance supervision and that of the colleges responsible for registering rating agecies. Representatives of supervisory authorities and central banks from all over Europe travelled to Berlin for the event. The goal of the meeting was to increase participants' expertise – regardless of whether they have to coordinate a college as the home supervisor or participate in a college as a host supervisor. Participants came away with a clear sense of both the points in common and the considerable differences. While the Allianz college has up to 70 participants, the college responsible for registering a major rating agency comprises eight to nine people. In addition, colleges in the banking and insurance sector tend to be used to prepare supervisory decisions that are then resolved by specific national supervisors. The college for the rating agencies, on the other hand, can decide on the registration itself. Due to the success of the seminar, there are plans to hold it again in 2011.

Bilateral and multilateral cooperation

Five MoUs signed.

In 2010, BaFin signed MoUs in the field of banking supervision with two other supervisory authorities, the State Bank of Vietnam and the Mexican Comisión Nacional Bancaria y de Valores. The signatories agreed to step up their cooperation, especially with respect to the exchange of information about cross-border credit institutions as well as the procedure for on-site inspections.

A formal basis now exists for the information exchanges between BaFin and the Korean Financial Services Commission (FSC) designed to combat insider trading and market manipulation: the FSC and BaFin expanded the existing MoU, which covered cooperation in the field of banking and insurance supervision, to include cooperation in the area of securities supervision.

In the year under review, BaFin also signed MoUs on closer cooperation with the Egyptian Financial Supervisory Authority (EFSA) and the Thai Office of Insurance Commission (OIC). The supervisory authorities agreed arrangements for potential on-site inspections of subsidiaries and branches in the host country in question. In addition, the MoUs provide for the exchange of information that is relevant to the supervisory and regulatory work performed by the authorities concerned.

IAIS Multilateral Memorandum of Understanding.

The IAIS Multilateral Memorandum of Understanding (MMoU), which entered into force in June 2009, was signed by eight more countries in 2010:

- Financial Market Authority (FMA), Austria
- Insurance Supervisory Commission (CSA), Romania
- Comisión Nacional de Seguros y Finanzas (CNSF), Mexico

- Monetary Authority of Singapore (MAS), Singapore
- Jersey Financial Services Commission, Jersey
- Malta Financial Services Authority (MFSA), Malta
- Dubai Financial Services Authority (DFSA), United Arab Emirates
- Guernsey Financial Services Commission, Guernsey.

This brought the number of signatories to 14 at the end of 2010. BaFin had already signed the MMoU in 2009. The IAIS MMoU aims to improve cross-border cooperation among insurance supervisors. The signatories agree on arrangements for the exchange of information on the cross-border activities of insurers, reinsurers and insurance groups and reach an understanding on minimum standards for ensuring that this information remains confidential.

Table 3
Memoranda of Understanding (MoUs) in 2010

Banking supervision		Securities supervision		Insurance supervision	
Argentina	2001	Argentina	1998	Australia	2005
Australia	2005	Australia	1998	California (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	Egypt	2010
Czech Republic	2003	Dubai	2006	Estonia	2002
Denmark	1993	France	1996	Florida (USA)	2009
Dubai	2006	Hong Kong	1997	Hong Kong	2008
Estonia	2002	Hungary	1998	Hungary	2002
Finland	1995	Italy	1997	Korea	2006
France	1992	Jersey	2000	Latvia	2001
Greece	1993	Korea	2010	Lithuania	2003
Hong Kong	2004	Luxembourg	2004	Malta	2004
Hungary	2000	Monaco	2009	Maryland (USA)	2009
Ireland	1993	Poland	1999	Minnesota (USA)	2009
Italy (BI)	1993	Portugal	1998	Nebraska (USA)	2007
Italy (BI-Unicredit)	2005	Qatar	2008	New Jersey (USA)	2009
Jersey	2000	Russia	2001	New York (USA)	2008
Korea	2006	Russia	2009	Qatar	2008
Latvia	2000	Singapore	2000	Romania	2004
Lithuania	2001	Slovakia	2004	Singapore	2009
Luxembourg	1993	South Africa	2001	Slovakia	2001
Malta	2004	Spain	1997	Thailand	2010
Mexico	2010	Switzerland	1998	USA (OTS)	2005
Netherlands	1993	Taiwan	1997		
Norway	1995	Turkey	2000		
Philippines	2007	United Arab Emirates	2008		
Poland	2004	USA (CFTC)	1997		
Portugal	1996	USA (SEC)	1997		
Qatar	2008	USA (SEC)	2007		
Romania	2003				
Russia	2006				
Singapore	2009				
Slovakia	2002				
Slovenia	2001				
South Africa	2004				
Spain	1993				
Sweden	1995				
United Kingdom (BE/FSA)	1995				
United Kingdom (SIB/SROs)	1995				
United Kingdom (BSC)	1995				
USA (OCC)	2000				
USA (NYSBD)	2002				
USA (FedBoard/OCC)	2003				
USA (OTS)	2005				
USA (FDIC)	2006				
USA (SEC)	2007				
Vietnam	2010				

Technical cooperation

In the year under review, BaFin once again provided advice and support to foreign supervisory authorities establishing supervisory systems.

Cooperation with China.

In July, the president of BaFin and the chairman of the Chinese Securities Regulatory Commission (CSRC) signed a joint declaration agreeing to strengthen the exchange of expertise. The technical project, which is being supported by the German Agency for International Cooperation (*Deutsche Gesellschaft für international Zusammenarbeit* – GTZ), takes the institutionalised exchange of information to a new level. The closer cooperation reflects the importance of the Chinese financial market. In the year under review, delegations from the Chinese supervisory authorities and employees of Chinese financial institutions again visited BaFin on fact-finding missions and for seminars. The cooperation will continue in 2011, with both countries wishing to step up their collaboration to include banking and insurance supervision as well.

Strong contacts with Ukraine and Russia…

Contacts with Ukraine's financial supervisory authority have strengthened in the course of cooperation. In December 2010, for example, BaFin staff gave presentations to the Ukrainian specialist supervisors in Kiev on a number of bank licensing issues and the possibility of licences being revoked. The supervisors also exchanged in-depth information on combating insider trading and market manipulation. A number of workshops in the field of insurance supervision were held as part of an EU TACIS (Technical Assistance to the Commonwealth of Independent States) project. Topics included consumer complaints, reporting, early warning systems, insurance statistics, risk management, asset management, on-site inspections and the freedom to provide services. The events were attended by Ukrainian insurance supervisors as well as representatives from Ukraine's Ministry of Finance. There are plans to continue the successful cooperation between the German and the Ukrainian supervisory authority in 2011.

BaFin also expanded its excellent ties with Russia in the area of insurance supervision. In May, another Russian delegation visited BaFin accompanied by a representative of the Russian Insurance Association. The delegation talked with BaFin about the effects of the financial market crisis, capital requirements for and asset management by insurance undertakings, as well as about early warning systems and stress tests. In November, BaFin presented its role in complaints processing at a meeting in Berlin with representatives of the Russian Economics and Finance Ministry.

...as well as with South Korea (Republic of Korea) and Turkey.

Employees of South Korea's Financial Supervisory Service (FSS) completed multi-week internships in securities and insurance supervision during June and October. In November, a seminar on macroprudential regulation and supervision was also arranged at the FSS in Seoul, reinforcing the already strong ties to the FSS.

BaFin held discussions with representatives of the Vietnamese and Taiwanese insurance supervisory authorities about the EU's new Solvency II Directive.

In the area of banking supervision, a BaFin employee took part in discussion forums on consumer protection in the field of financial services in both Ankara (Turkish Securities Trading Service) and Perm (branch of the Russian state bank). Collaboration with BaFin's partner agency in Turkey was also reinforced in the field of securities supervision, with joint workshops being organised.

In October, a BaFin employee discussed the new draft banking supervisory legislation for Azerbaijan in Baku with representatives of Azerbaijan Central Bank, the Banking Association and the Parliamentary Committee.

Support for Montenegro, Armenia, Mongolia and Malta.

A lively exchange with Montenegro's Financial Services Authority developed for the first time. The Authority used a visit to Frankfurt/Main as well as a return visit by BaFin in Skopje to obtain information on issues relating to market supervision.

BaFin once again welcomed representatives of the Armenian insurance and securities supervisors on fact-finding visits. Ties with the Mongolian financial supervisory authority were also strengthened in the year under review: two meetings of large-scale delegations in Frankfurt/Main and in Ulan Bator were used to discuss issues relating to the monitoring of insider trading in particular.

In March, six representatives of the Maltese Financial Services Authority (MFSA) visited BaFin. Among the issues discussed in the area of insurance supervision topics were stress tests, internal models and risk-based supervision.

Contacts with Africa.

In early March, a BaFin employee presented financing issues relating to small and medium-sized enterprises to the Federation of Egyptian Banks. In October, a BaFin employee also attended an African regional conference in Nairobi aimed at creating a common market within the regional economic associations and the African Union. BaFin outlined its experience with the European Single Market, especially with respect to an integrated capital market and the concept of a single European passport for cross-border activities. In addition, a further meeting was held with the Tanzanian securities authority, CMSA, as well as with representatives of the Dar es Salaam Stock Exchange.

Gabriele Hahn,
Chief Executive Director of
Insurance Supervision

IV Supervision of insurance undertakings and pension funds

1 Bases for supervision

1.1 Remuneration Regulation for the Insurance Industry

The Remuneration Regulation for the Insurance Industry (*Versicherungs-Vergütungsverordnung* – VersVergV) and the Remuneration Regulation for Institutions (*Instituts-Vergütungs-verordnung* – InstitutsVergV) of 6 October 2010 round off the Federal Government's three-step package of measures to implement international requirements as quickly as possible.[6] In insurance, this related primarily to the decisions taken by the heads of government of the G20 countries at the Pittsburgh summit in autumn 2009, which aim to promote a remuneration culture based on a sustainable business strategy. The decisions were implemented in Germany in December 2009, firstly through a voluntary commitment undertaken by eight large banks and the three largest insurance undertakings to comply with the requirements set out by the Financial Stability Board. BaFin then published circulars 22/2009 (BA) and 23/2009 (VA) containing requirements for remuneration systems.

Rules taken over from circular 1/1978.

In a third step, the Remuneration Act (*Vergütungsgesetz*) of 21 July 2010 stipulates through section 64b Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) that remuneration systems must be appropriate, transparent and sustainable.[7] Details are governed by the VersVergV (section 64b (5) VAG). The VersVergV incorporates tried-and-tested rules taken over from circular 1/1978, in which principles had already been published or the remuneration of supervisory board members, for example. BaFin repealed circulars 22/2009 (BA) and 23/2009 (VA) when the InstitutsVergV und the VersVergV entered into force on 13 October 2010.

Grandfathering rule for existing contracts.

The requirements of the VersVergV apply to all contracts signed or extended after the Regulation's entry into force, i.e. from 13 October 2010 onwards. However, free collective bargaining remains unaffected. A grandfathering rule applies to existing contracts.

[6] Regulation on the Regulatory Requirements for Remuneration Systems in the Insurance Sector, Federal Law Gazette (BGBl.), I 2010, p. 1379; Regulation on the Regulatory Requirements for Remuneration Systems of Institutions, Federal Law Gazette (BGBl.), I 2010, p. 1374.

[7] Act on the Regulatory Requirements for the Remuneration Systems of Financial Institutions and Insurance Undertakings, Federal Law Gazette (BGBl.), I 2010, p. 950.

1.2 Investment Regulation

Amended Investment Regulation entered into force on 1 July 2010.

The Regulation on the Investment of Restricted Assets of Insurance Undertakings (*Verordnung über die Anlage des gebundenen Vermögens von Versicherungsunternehmen* – AnlV) was last amended in 2007 by way of the Second Regulation Amending the Investment Regulation (*Zweite Verordnung zur Änderung der Anlageverordnung – 2.* AnlVÄndV). Since then, financial market legislation, particularly the Investment Act (*Investmentgesetz* – InvG), has been adapted on several occasions, for example to introduce infrastructure funds. In addition, the financial market crisis has shown that a lack of diversification represents a major risk and intra-group investments pose a significant threat of contagion. These changes are addressed in the Third Regulation Amending the Investment Regulation of 29 June 2010.[8]

Schedule of investments extended.

Among others, the following changes have been made to the schedule of investments in section 2 AnlV:

- The term "equity investment" has been more narrowly defined. The percentage that may be invested in equity investments under section 2 (1) no. 13 AnlV has been amended by section 4 (4) AnlV to 1% of restricted assets, giving grounds to believe that the amended percentage will in future give rise to cases of circumvention.
- The three-property limit applicable to real estate companies has been removed (section 2 (1) no. 14 a) AnlV) and loans to real estate companies have been introduced (section 2 (1) no. 4 b) AnlV), making it easier for insurers to invest in real estate.
- Closed-end real estate funds are now a permitted form of investment under section 2 (1) no. 14 c) AnlV. This new type of investment is counted towards the 25% that may be invested in real estate and therefore does not reduce the percentage that may be invested in equity investments.
- The exceptions provided for in section 2 (4) no. 3 AnlV now include undertakings whose sole purpose is to operate plants that produce electricity from renewable sources within the meaning of section 3 no. 3 Renewable Energy Act (*Gesetz für den Vorrang Erneuerbarer Energien* – EEG). Under section 2 (1) no. 13 AnlV, insurers will therefore be able to make intra-group investments in infrastructure which previously fell foul of the group investment prohibition.

Changes to the rules governing diversification and spread.

There have also been significant changes to the rules in sections 3 and 4 AnlV governing diversification and spread, although these have been supplemented by transitional and grandfathering rules in section 6 AnlV:

- Under section 3 (2) no. 3 AnlV, 5% of restricted assets may now be invested in commodities, which are counted towards the 35% limit on risk asset investments. This extends the range of investment options available to insurers.

[8] Third Regulation Amending the Investment Regulation (*Dritte Verordnung zur Änderung der Anlageverordnung* – 3. AnlVÄndV), Federal Law Gazette (BGBl.), I 2010, p. 841.

- For the same reason, section 3 (3) AnlV raises the percentage that may be invested in equity investments from 10% to 15% of restricted assets. The limit on equity investments and similar instruments of 10% of the investee's equity under section 4 (4) AnlV has been replaced by a limit of 1% of restricted assets, making it far easier to invest in limited liability companies and limited partnerships.
- Investments held through funds will in future be included in calculating the percentages related to insurers' asset spreads (section 4 (1) AnlV). This will make it easier to identify concentrations of risk, as primary insurers invest a quarter of their assets in funds, and direct and fund investments often have the same focus.
- The increased limit under section 4 (2) AnlV for privileged investments in debt securities with a legally established cover pool and investments in credit institutions subject to a deposit guarantee scheme, including investments in public-sector banks, has been reduced from 30% to 15%, thereby ensuring that investments are more widely spread among multiple debtors. The increased limit of 30% on investments in countries of the European Economic Area (EEA) and the Organisation for Economic Cooperation and Development (OECD) und in similar public institutions remains the same.

Interpretation issues and details of the above-mentioned changes to the Investment Regulation can be found in the new investment circular and the new reporting circular. On 15 April 2011, BaFin published a circular containing guidance on the investment of restricted assets of insurance undertakings (*Hinweise zur Anlage des gebundenen Vermögens von Versicherungsunternehmen, Rundschreiben 4/2011 (VA)*)[9]. This circular supplements the collective decree also published in April 2011 setting out the disclosure requirements under section 1 (4) AnlV (*Sammelverfügung vom 15.04.2011 – Anordnung betreffend die Darlegungspflichten gemäß § 1 Abs. 4 Anlageverordnung*)[10]. Work to revise circular 11/2005 (VA) began even before the Investment Regulation entered into force, and the revised version is scheduled to be published in the first half of 2011.

1.3 Capital redemption operations

Circular and collective decree published.

On 7 September 2010, BaFin published a collective decree on capital redemption operations and a circular containing guidance on single-premium life insurance policies and capital redemption operations.[11] This was BaFin's response to the fact that, for some time now, capital redemption products have been becoming increasingly important in life insurance. As far as possible, the aim is to prevent products that may serve as a short-term investment from becoming a means of speculating against a portfolio.

[9] Circular 4/2011 (VA), www.bafin.de » Veröffentlichungen » Rundschreiben » Versicherungsaufsicht (only available in German).
[10] www.bafin.de » Aufsichtsrecht » Verfügungen » Versicherungsaufsicht (only available in German).
[11] Circular 8/2010 (VA), www.bafin.de » Veröffentlichungen » Rundschreiben » Versicherungsaufsicht (only available in German).

In the collective decree, BaFin for the first time established binding requirements for capital redemption operations. In particular, insurers are required to establish separate accounts within guarantee assets (*Sicherungsvermögen*) for capital redemption operations if these account for at least 3% of guarantee assets. The related investments are subject to the usual rules governing diversification and spread.

The circular describes BaFin's administrative practice to date with regard to single-premium insurance policies and capital redemption operations and supplements the collective decree.

1.4 Monitoring of supervisory board members

Cross-sector guidance notice on the monitoring of supervisory board members.

The Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector (*Gesetz zur Stärkung der Finanzmarkt- und der Versicherungsaufsicht*) introduced specific legal minimum requirements with regard to the personal expertise and reliability of members of supervisory bodies. There was noticeable amount of uncertainty as to the content and scope of the documents required to be filed when providing notification of the intention to appoint a supervisory board member. In a cross-sector guidance notice dated 22 February 2010, BaFin explained the requirements applicable to all members of supervisory bodies at insurance undertakings and credit institutions as a result of the new legal provisions contained in the VAG and the Banking Act (*Kreditwesengesetz* – KWG).[12] The focus here is on the reliability and knowledge of appointees (section 7a (4) sentences 1 and 2 VAG).

Reliability.

The requirement for reliability is based on the principles of trade law. Supervisory board members must demonstrate personal integrity and give no cause to doubt that they will discharge their duties in a conscientious and proper manner. This means that there may be no convictions with legal force attributable to relevant financial criminal offences or indications of significant conflicts of interest. Indications of such conflicts of interest exist, for example, if appointees have an economic relationship with the undertaking that intends to appoint them and therefore could benefit as a result of serving on the supervisory board.

Expertise.

The ability to track and monitor an undertaking's performance effectively requires appropriate knowledge of the economic and legal environment in which the insurance industry operates. The level of expertise required varies depending on the business model and complexity of the undertaking in question. Supervisory board members may already possess this knowledge as a result of experience gained through their professional employment or acquire it through training. This applies both to employee representatives on the supervisory board and to external persons. A person is usually assumed to have the appropriate expertise if he or she is a member of the senior management or supervisory board of a similar undertaking.

[12] Guidance Notice on the monitoring of members of administrative and supervisory bodies pursuant to the German Banking Act and the German Insurance Supervision Act, www.bafin.de » Publications » Guidance Notice » Insurance supervision.

Documents required to be submitted when filing the notification.

BaFin must be notified of the initial appointment of all supervisory board members. To enable it to assess an appointee's suitability, a detailed curriculum vitae listing all other appointments must be submitted together with a "*Straffreiheitserklärung*", a statement that the person concerned has no prior or pending charges or convictions. A certificate of good conduct for submission to an authority must also be obtained.

1.5 Multiple management appointments

Guidance notice on the approval of multiple management appointments.

A further significant amendment to the VAG resulting from the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector relates to the managers of insurance undertakings, pension funds, insurance holding companies and special purpose insurance companies. Under section 7a (1) sentence 5 VAG, such persons can usually hold only two appointments. By limiting the number of appointments, lawmakers intend to ensure the proper performance of management functions. There was previously no legal requirement in the area of insurance supervision governing the number of appointments a manager may hold.

Undertakings within the same insurance group or group of undertakings may request a higher number of appointments.

In the case of undertakings that are part of the same insurance group or group of undertakings, BaFin can allow a manager to hold more than two appointments at the undertaking's request. On 15 June 2010, BaFin explained which criteria are taken into account in making its discretionary decision on those requests in a guidance notice on multiple management appointments.[13] Relevant factors include the breadth of a manager's remit, for example. In addition, specialist subsidiaries may be managed by the same persons, provided there are no conflicts of interest between the undertakings. However, further criteria and aspects must also be taken into account in examining individual requests due to the varied nature of the organisational structures of insurance groups.

Sections 123f VAG provided for a transitional period ending 31 December 2010 in which to change the permitted numbers of appointments.

2 Ongoing supervision

2.1 Authorised insurance undertakings and pension funds

The number of insurance undertakings supervised by BaFin continued to decline. At the end of the year under review, BaFin supervised a total of 603 insurance undertakings (previous year: 614) and 30 pension funds. 582 of the insurance

[13] www.bafin.de » Veröffentlichungen » Merkblätter » Versicherungsaufsicht (only available in German).

undertakings conducted business activities, and 21 did not have any business activities. The explanations in the rest of chapter IV also cover ten public-law insurance undertakings supervised by the federal states (nine conducting business activities and one without business activities). The breakdown by sector is shown in the following table:

Table 4
Number of supervised insurance undertakings and pension funds*
as at 31.12.2010

	Insurers with business activities			Insurers without business activities		
	BaFin supervision	State supervision	Total	BaFin supervision	State supervision	Total
Life insurers	95	3	98	10	0	10
Pensionskassen	152	0	152	2	0	2
Death benefit funds	40	0	40	1	0	1
Health insurers	48	0	48	0	0	0
Property/casualty insurers	211	6	217	5	1	6
Reinsurers	36	0	36	3	0	3
Total	**582**	**9**	**591**	**21**	**1**	**22**
Pension funds	30	0	30	0	0	0

* Small mutual insurance associations that are mostly regionally active are not included in these figures (BaFin 2009 statistics – Primary insurers and pension funds, p. 9, table 5).

Two German life insurers supervised by BaFin ceased operating altogether in 2010, while one new life insurer came under supervision by BaFin. Two undertakings from EEA countries (United Kingdom and Luxembourg) established branch offices (BO). In addition, seven foreign life insurers from the EEA registered for the cross-border provision of services (CBS) in Germany (previous year: 22). A number of service providers expanded their business activities.

Table 5
Registrations by EEA life insurers in 2010

Country	CBS*	BO**
France	2	0
United Kingdom	5	1
Luxembourg	0	1

* Cross-border provision of services within the meaning of section 110a (2a) VAG.
** Branch office business within the meaning of section 110a (2) VAG.

Health insurers

The number of health insurers declined by three compared with 2009 to 48.

Property and casualty insurers

Seven property and casualty insurance undertakings (including two branch offices) ceased operating altogether in 2010. Foreign property and casualty insurers from the European Union (EU) established four branch offices: one each from Ireland and Luxembourg, and two from the United Kingdom.

Table 6
Registrations by EEA property and casualty insurers in 2010

Country	CBS*	BO**
Austria	1	0
Belgium	2	0
Bulgaria	1	0
Denmark	2	0
France	3	0
Ireland	2	1
Italy	1	0
Luxembourg	2	1
Netherlands	1	0
Poland	1	0
Portugal	1	0
Spain	3	0
Sweden	1	0
United Kingdom	3	2
of which: Gibraltar	1	0

* Cross-border provision of services within the meaning of section 110a (2a) VAG.
** Branch office business within the meaning of section 110a (2) of the VAG.

24 insurers from the EEA registered for the cross-border provision of services in Germany (previous year: 24). In addition, insurers already authorised to provide cross-border services registered expansions of their business activities. A number of insurers also discontinued the provision of services in Germany in 2010.

Reinsurers

One reinsurer from a third country (in this case the USA) applied in 2010 for a licence to establish business activities for a branch office, which was granted by the Federal Ministry of Finance (BMF). Three companies ceased operating as independent German reinsurers. Six branches of EU undertakings operated reinsurance business in Germany in the year under review. Branch offices were established by undertakings domiciled in the EU member states of France, Ireland, Luxembourg and Spain.

Pensionskassen and pension funds

BaFin authorised one Pensionskasse and one pension fund to start operating in 2010. Two Pensionskassen transferred their entire in-force business to another undertaking. This means that BaFin supervised a total of 152 Pensionskassen and 30 pension funds at 31 December 2010.

One institution for occupational retirement provision domiciled in another EU member state (Luxembourg) registered with BaFin in the year under review.

2.2 Interim reporting

2.2.1 Effects of the financial market crisis

German insurance sector again stable in 2010.

The German insurance sector remained stable in 2010, so the direct impact of the global financial crisis on German insurers was limited. In the international arena, insurers were also seen to be at risk following the outbreak of the crisis. Problems arose, for example, because AIG had unregulated operations in a complex group, or because at SwissRe, speculative trading in credit default swaps drove business models that contained banking risks. This was avoided in Germany, not least thanks to the country's strict supervisory regime. The investment regulations, enhanced crisis management following the 2002 equity market crisis and the prohibition on non-insurance business deserve particular mention here. The conservative investment policy implemented by German insurers also had a stabilising effect. The ratio of equities held in insurers' portfolios was low, and they had very little exposure to toxic assets.

Risks should not be ignored.

Nevertheless, risks do exist. On the one hand, for example, the low level of interest rates is dampening business growth in the German insurance sector. On the other, German insurers are still highly exposed to credit institutions. Finally, the growing levels of sovereign debt are also very significant for the sector, because insurance undertakings traditionally have a high exposure to government bonds. The spreads for government bonds issued by the "PIIGS" countries (Portugal, Ireland, Italy, Greece and Spain) already led to a considerable drop in market prices. In response to these risks, BaFin stepped up its monitoring of insurers' investment policies and increasingly analysed single exposures. BaFin surveyed the level of exposure to PIIGS government bonds in a large-scale sample of 25 insurance groups and six individual insurers, for example. This country exposure varies from around 0.5% to 3% of total investments, depending on the country involved.

2.2.2 Business trends

Life insurers

New direct life insurance policies rose by 0.5% year-on-year, from 5.96 million to 5.99 million new policies in 2010. At €234.9 billion, the total value of new policies underwritten was 7.5% higher than in 2009 (€218.5 billion).

The share of mixed endowment insurance policies as a proportion of the total number of new contracts declined slightly year on year from 14.7% to 13.8%. The proportion of term insurance policies also declined slightly from 29.2% to 26.8%. The share of pension and other life insurance policies increased from 56.2% to 59.4%. The proportion of endowment policies decreased to 7.1% of the total value of new policies underwritten (from 8% in the previous year). This figure declined from 34.0% to 32.2% for term insurance. Bucking the prior-year trend, pension and other life insurance rose from 58.6% to 60.8%.

Early terminations (surrender, conversion to paid-up policies and other forms of early termination) declined from 3.4 million to 3.2 million contracts. At €111.8 billion, the amount insured under contracts terminated early was lower than in the previous years (€120.3 billion in 2009 and €113.8 billion in 2008). The number of early terminations of endowment policies dropped by 18.6%, and the total amount insured attributable to early terminations fell by 24.7%.

Direct insurance policies totalled 90.3 million contracts at the end of 2010 (–0.6%), and the total amount insured was €2,581 billion (+2.1%). The share taken by mixed endowment policies declined from 45.5% to 43.1%, and the total amount insured under these policies decreased from 33.9% to 31.6%, continuing the trend seen in previous years. Both the number of term insurance policies, at 14.1%, and the amount insured under these policies, at 22.0%, were almost unchanged as against the previous year. Pension and other insurance policies continued their positive trend, with the proportionate number of contracts growing from 40.1% to 42.8% and the share of the total amount insured rising from 44.3% to 46.4%.

Gross premiums written in the direct insurance business increased from €80.7 billion to €86.2 billion. The share attributable to endowment policies declined further from 37.2% to 32.9%, while the share of pension and other life insurance policies recorded further growth, from 57.7% to 62.2%.

Health insurers

Gross premiums written in the direct insurance business increased by 6.1% to €33.3 billion in 2010. The number of insured natural persons rose by 2.6% to 35.7 million.

Property and casualty insurers

Property and casualty insurers recorded a slight year-on-year decrease in gross premiums written in the direct insurance business in 2010 to €58.0 billion (previous year: €58.6 billion).

Gross expenditures for claims relating to the year under review increased by 2% to €20.7 billion (previous year: €20.3 billion), while gross expenditures for claims relating to previous years also rose, to €14.8 billion. Gross provisions recognised for individual claims relating to 2010 amounted to €15.4 billion, compared with €14.7 billion in the previous year, while gross provisions recognised for individual claims relating to previous years amounted to €46.6 billion, compared with €45.8 billion in 2009.

With gross premiums written amounting to €19.2 billion, motor vehicle insurance was by far the largest insurance class, although the premium volume declined by 1.5% compared with the previous year. Gross expenditures for claims relating to 2010 rose by 3.2%

year on year, whereas gross expenditures for claims relating to previous years declined by 3.1%. Overall, gross provisions recognised for individual claims relating to 2010 and for outstanding claims relating to previous years increased by 4.7% and 1.7% respectively year on year.

Property and casualty insurers collected premiums amounting to €7.5 billion (–1.3%) for general liability insurance, paying out €1 billion for claims relating to the year under review, as in the previous year, and €2.25 billion (+2.5% year on year) for claims relating to previous years. Gross provisions for individual claims, which are particularly important in this insurance class, rose by 4.5% (previous year: –3.0%) to €2.3 billion for outstanding claims relating to 2010, while gross provisions for outstanding individual claims relating to the previous year remained constant at €13.2 billion.

Insurers recorded gross fire insurance premiums written of approximately €1.8 billion (+1.5%). Gross expenditures for claims relating to the year under review declined by 7.2% to €450 million.

Premiums collected for comprehensive household insurance and comprehensive contents insurance policies amounted to €7.15 billion (+0.7%) in the aggregate. Expenditures for claims relating to 2010 increased by 10.1% year on year, while provisions for individual claims rose by 10.9%. Expenditures for claims relating to previous years increased by 12.1%, while provisions for claims relating to previous years rose by 4.8% compared with 2009.

Premiums for general accident insurance policies amounted to €6.3 billion, as in the previous year. Gross payments for claims relating to the year under review were unchanged, at €0.3 billion, while provisions recognised for outstanding claims relating to 2010 increased by 4.4% year on year.

Pensionskassen

Pensionskassen competing on the open market (*Wettbewerbs-pensionskassen*) have been established since 2002, and this market segment is now largely saturated. This is illustrated by the figures for new business growth, with premium income hovering around the previous year's level of approximately €2.6 billion.

In the case of *Pensionskassen* funded largely by employers, premium income trends depend on the headcount at the sponsoring company. Premium income at these Pensionskassen declined slightly to €3.3 billion.

Pension funds

The number of beneficiaries rose to a total of 757,388 persons in calendar year 2010, of whom 429,454 were members of defined contribution plans and 159,542 were members of defined benefit plans. The majority of pension plans authorised in previous years were plans with non-insurance-based benefit commitments in accordance with section 112 (1a) VAG.

2.2.3 Investments

German primary insurers increase investments in 2010.

Following the far-reaching financial market turmoil in 2008, 2010 saw further recovery in the global equity markets and historically low interest rates in the eurozone.

The aggregate investments of all German insurers supervised by BaFin, including reinsurers, increased by 3.4% year-on-year to €1,368 billion (previous year: €1,323 billion). The book value of all investments by German primary insurers as at 31 December 2010 amounted to €1,160 billion, a year-on-year increase of 3.7% (previous year: €1,119 billion). Health insurers recorded a strong 7.7% or €12.6 billion increase to €176 billion. The lowest investment growth rates were reported by property and casualty insurers, whose total investments hardly changed, and *Pensionskassen*, which rose by 1.5% or €1.6 billion to €109.6 billion.

There were no significant changes in the investment patterns exhibited by primary insurers compared with the previous year. The largest year-on-year shifts in investment within the various overarching investment categories compared with the previous year recorded a maximum change of two percentage points, measured in terms of total assets.

Primary insurers continued to focus their investments on fixed-income securities and promissory note loans. Pfandbriefe, municipal bonds and other debt instruments comprised the largest single item in investments by primary insurers. Listed debt instruments, loans to EEA states, promissory note loans and registered bonds issued by credit institutions accounted for around one-third of the total assets of the primary insurers.

Additionally, around one-quarter of all investments were attributable to investment funds. Because of the volume of their investments, this share is largely driven by life insurers. By contrast, health and property/casualty insurers invested 19% and 31% of their total assets respectively in investment funds. Within this category, primary insurers were approximately 96% invested in domestic investment funds, almost unchanged as against the previous year. Fund investments across all insurance classes were clearly dominated by fixed-income funds.

Table 7

Investments by insurance undertakings

Investments by insurance undertakings	Portfolio as at 31.12.2010		Portfolio as at 31.12.2009*		Change in 2010	
	in € million	in %	in € million	in %	in € million	in %
Land, land rights and shares in real estate companies	27,082	2.0	25,748	1.9	+ 1,335	+ 5.2
Fund units, shares in investment stock corporations and investment companies	320,008	23.4	293,775	22.2	+ 26,233	+ 8.9
Loans secured by mortgages and other land charges	56,569	4.1	58,170	4.4	- 1,602	- 2.8
Securities loans and loans secured by debt securities	1,347	0.1	797	0.1	+ 550	+ 68.9
Loans to EEA states, their regional governments and local authorities, international organisations	113,436	8.3	105,543	8.0	+ 7,893	+ 7.5
Corporate loans	12,209	0.9	11,451	0.9	+ 757	+ 6.6
ABSs	863	0.1	910	0.1	- 47	- 5.1
Policy loans	4,938	0.4	5,369	0.4	- 431	- 8.0
Pfandbriefe, municipal bonds and other debt instruments issued by credit institutions	265,644	19.4	265,901	20.1	- 257	- 0.1
Listed debt instruments	139,612	10.2	120,951	9.1	+ 18,661	+ 15.4
Other debt instruments	14,068	1.0	11,777	0.9	+ 2,291	+ 19.5
Subordinated debt assets	23,224	1.7	22,780	1.7	+ 444	+ 1.9
Profit participation rights	7,541	0.6	8,590	0.6	- 1,049	- 12.2
Book-entry securities and open market instruments	1,826	0.1	1,173	0.1	+ 652	+ 55.6
Listed equities	9,077	0.7	15,391	1.2	- 6,314	- 41.0
Unlisted equities and interests in companies, excluding private equity holdings	128,711	9.4	121,269	9.2	+ 7,441	+ 6.1
Private equity holdings	7,801	0.6	7,166	0.5	+ 635	+ 8.9
Investments at credit institutions	200,857	14.7	214,101	16.2	- 13,244	- 6.2
Investments covered by the enabling clause	16,485	1.2	16,271	1.2	+ 214	+ 1.3
Other investments	16,527	1.2	15,836	1.2	+ 690	+ 4.4
Total investments	**1,367,824**	**100.0**	**1,322,971**	**100.0**	**+ 44,853**	**+ 3.4**
Life insurers	734,427	53.7	707,370	53.5	+ 27,057	+ 3.8
Pensionskassen	109,560	8.0	107,986	8.2	+ 1,574	+ 1.5
Death benefit funds	1,879	0.1	1,813	0.1	+ 67	+ 3.7
Health insurers	176,429	12.9	163,856	12.4	+ 12,573	+ 7.7
Property/casualty insurers	138,024	10.1	137,971	10.4	+ 53	+ 0.0
Reinsurers	207,504	15.2	203,974	15.4	+ 3,530	+ 1.7
All insurers	**1,367,824**	**100.0**	**1,322,971**	**100.0**	**+ 44,853**	**+ 3.4**
Primary insurers	1,160,320	84.8	1,118,996	84.6	41,323	+ 3.7

* The 2010 figures are based on interim reports and are only preliminary. These figures may therefore differ from those published in the previous year.

Pension funds

Investments for the account and risk of pension funds increased from €871 million to €1,044 million in 2010, representing relative growth of 20% (previous year: +17.2%). Their portfolios were dominated by contracts with life insurers, fund units and fixed-income securities. At the balance sheet date, net hidden reserves in the investments made by pension funds amounted to approximately €16 million. The volume of write-downs avoided due to application of the less strict principle of the lower or cost of market value in accordance with section 341b German Commercial Code (*Handelsgesetzbuch* – HGB) was relatively low.

Assets administered for the account and risk of employees and employers increased by a total of €16.3 billion in 2010 to approximately €24 billion. These investments primarily consist of fund units, which recorded sharp falls in value in some cases during the financial crisis. By contrast, the value of these investments recovered significantly overall in 2010. In total, the provisions to be covered by these investments matched the investments.

All 30 pension funds supervised by BaFin in 2010 were able to cover their technical provisions in full.

Greek sovereign debt downgraded

The turmoil in the sovereign debt market culminated in the downgrade of Greek sovereign debt by a rating agency in early 2010. As further downgrades to non-investment grade appeared likely, the insurers were forced to examine whether these instruments could be classified as high-yield bonds (at least a "B–" speculative grade rating from Standard & Poor's and Fitch, or "B3" from Moody's), or whether they should apply the enabling clause. The high-yield ratio is a minimum diversification requirement and, as with the enabling clause, it is limited to 5% of restricted assets. The enabling clause allows assets to be added to restricted assets that are not listed in the schedule of investments, do not meet the relevant criteria, or exceed the minimum diversification requirement in the Investment Regulation. In order to mitigate procyclical effects, support financial market stability and limit losses at the affected insurers in a very difficult market environment, BaFin published an assessment of the allocation of Greek government bonds and loans in the restricted assets of German insurers in May 2010.[14] In this report, BaFin gave an assurance that, in light of the bailout measures taken by the EU, it would not object until further notice to a situation where the 5% high-yield ratio is exceeded by downgraded Greek sovereign debt. These means that the insurers do not have to start fire sales of these bonds in order to maintain their high-yield ratio. However, they may not invest in new high-yield assets for as long as the ratio is exceeded.

2.3 Composition of the risk asset ratio

All primary insurers reported on their total investments as at 31 December 2010. The undertakings were required to report the investment types broken down in accordance with the schedule of investments in the AnlV, as well as by specific risks.[15]

The following assessments are based on the data for life, health and property/casualty insurers, as well as *Pensionskassen*. The book value of all investments in the restricted assets of these classes amounted to €1.11 trillion at that date (previous year: €1.08 trillion).

[14] BaFin Quarterly Q2/2010, p. 4.
[15] Section 2 (1) AnlV; financial statement form 670.

Table 8

Composition of the risk asset ratio

as at 31.12.2010

Investment type in accordance with section 2 (1) no. ... of the AnlV (version dated 29 June 2010)	Restricted assets									
	Life		Health		Property/casualty		Pensionskassen		Total of all four classes	
	absolute in € m	share in %	absolute in € m	share in %	absolute in € m	share in %	absolute in € m	share in %	absolute in € m	share in %
Total investments*	711,657	100.0	173,902	100.0	120,215	100.0	108,815	100.0	1,114,589	100.0
Of which attributable to:										
Securities loans (no. 2), where equities (no. 12) are the subject of the loan	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Subordinated debt assets and profit participation rights (no. 9)	16,529	2.3	4,824	2.8	2,927	2.4	2,227	2.0	26,507	2.4
Fully paid-up equities admitted to a regulated market (no. 12)	3,468	0.5	277	0.2	570	0.5	18	0.0	4,333	0.4
Unlisted fully paid-up equities, shares in a German limited liability company (GmbH), limited partner shares and silent partnership interests within the meaning of the HGB (no. 13)	9,957	1.4	2,629	1.5	2,984	2.5	536	0.5	16,106	1.4
Units in funds (nos. 15-17, incl. hedge funds) that										
- include fully paid-up equities and profit participation rights admitted to a regulated market in the EEA	19,126	2.7	2,440	1.4	7,348	6.1	5,984	5.5	34,898	3.1
- cannot be clearly assigned to other investment types; fund residual value and non-transparent funds	12,627	1.8	1,597	0.9	2,179	1.8	2,422	2.2	18,825	1.7
Investments in high-yield bonds	9,529	1.3	1,551	0.9	1,277	1.1	1,237	1.1	13,594	1.2
Increased fund market risk potential **	8,254	1.2	1,080	0.6	1,158	1.0	170	0.2	10,662	1.0
Investments linked to hedge funds (partly in categories other than the AnlV nos. shown above) ***	2,345	0.3	618	0.4	393	0.3	622	0.6	3,978	0.4
Total investments subject to the 35% risk asset ratio	81,835	11.5	15,016	8.6	18,836	15.7	13,216	12.1	128,903	11.6

* Including cash at credit institutions excluding liabilities from mortgages, land charges and annuity land charges.
** This refers to the market risk potential exceeding 100% that must be included in the calculation of the risk asset ratio under section 3 (3) sentence 1 AnlV.
*** These amounts are approximations.

Source: Sector totals as at 31.12.2010 for life, health and property/casualty insurers, as well as Pensionskassen, from financial statement forms 670 and 673, Circular 11/2005 (VA)

Insurance undertakings can invest up to 35% of their restricted assets in investments associated with a higher level of risk. Specifically, these risk investments include equity investments, profit participation rights, subordinated debt assets and hedge funds. They also include the "residual value" of a fund and the higher potential market risk of investment funds. The risk asset ratio for these primary insurers was 11.6% at the reporting date.

3.5% average ratio of equities held in the sector.

Excluding residual value, investments in equities accounted for an average of 3.5% of insurers' restricted assets, slightly lower than the previous year's figure of 3.7%. This figure varies from class to class, ranging from 1.6% for health insurers to 6.6% for property/casualty insurers.

The risk asset ratio also includes investments in hedge funds or other direct and indirect investments linked to hedge funds. A very small number of direct investments in hedge funds are contained in securities investment fund units. However, most hedge fund investments are promissory note loans issued by eligible credit institutions or debt instruments whose yield and/or principal redemption is linked to a hedge fund or hedge fund index. They are allocated to the schedule of investments depending on their cash market instrument. However, under section 3 (3) AnlV, they must also be factored in full into the risk asset ratio. They account for 0.4% of the risk asset ratio.

Subject to certain conditions, insurers are also permitted to invest up to 5% of their restricted assets in high-yield investments. These are investments that have not been given an investment grade rating by a recognised rating agency. However, at a minimum they must have a "B–" speculative grade rating from Standard & Poor's and Fitch, or "B3" from Moody's. These investments are also counted towards the 35% ratio and accounted for 1.2% at the reporting date.

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

Non-transparent funds and all investments by a fund that are not attributable to other types of investment are attributed to the "residual value". This position accounted for 1.7% of restricted assets for all classes within the risk asset ratio. The residual value was between 0.9% for health insurers and 2.2% for *Pensionskassen*.

Under the Investment Act or the corresponding statutory provisions of another country, a fund may exhibit leveraged potential market risk by using certain derivatives. Under section 3 (4) AnlV, this higher potential market risk of a fund is also factored into the risk asset ratio.

Table 9
Share of total investments attributable to selected asset classes
as at 31.12.2010

Investment type	Total assets									
	Life		Health		Property/casualty		Pensionskassen		Total of all four classes	
	absolute in € m	share in %	absolute in € m	share in %	absolute in € m	share in %	absolute in € m	share in %	absolute in € m	share in %
Total investments*	734,427	100.0	176,429	100.0	138,011	100.0	109,560	100.0	1,158,427	100.0
of which attributable to:										
Investments in private equity holdings (in restricted assets in accordance with section 2 (1) no. 13 of the AnIV)	4,957	0.7	855	0.5	1,100	0.8	277	0.3	7,189	0.6
Directly held asset-backed securities and credit-linked notes in accordance with C 1/2002	4,215	0.6	547	0.3	408	0.3	460	0.4	5,630	0.5
Asset-backed securities and credit-linked notes in accordance with C 1/2002 held via funds	4,903	0.7	837	0.5	1,755	1.3	416	0.4	7,911	0.7
Investments in hedge funds and investments linked to hedge funds (in restricted assets in accordance with C 7/2004)	3,194	0.4	744	0.4	796	0.6	797	0.7	5,532	0.5

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

Source: Sector totals as at 31.12.2010 for life, health and property/casualty insurers, as well as *Pensionskassen*, from financial statement forms 670 and 673, Circular 11/2005 (VA)

The table shows that the proportion of total investments attributable to alternative investments did not change compared with the previous year.

2.4 Solvency

Continued good solvency in all insurance classes.

Preliminary estimates indicate that, overall, primary insurers and reinsurers again met the minimum capital requirements in 2010 by a healthy margin.

Life insurers

Life insurers' solvency was again good in 2010. In the projection as at 15 October 2010, all life insurers demonstrated that they met the solvency requirements as at 31 December 2010. Compared with the previous year, the solvency margin ratio improved significantly in 2010 to an expected 215% of the minimum requirement.

Health insurers

All health insurers also comply with the solvency requirements according to the forecast contained in the projected scenario. At 230%, the target solvency margin ratio for this sector is expected to be slightly lower than the 240% reported in 2009, although the sector still has a good level of own funds.

Property and casualty insurers

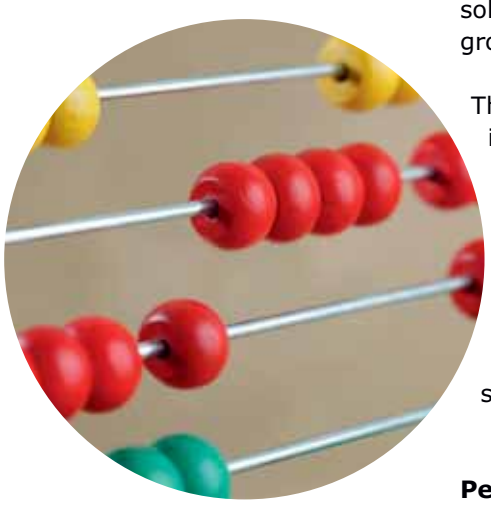
Solvency margin ratio lower, but still at a high level.

The solvency margin ratio of property and casualty insurers declined from 317% in 2009 to 290%. This is attributable to two trends: on the one hand, the business volume of these insurers rose slightly while at the same time, a smaller proportion of claims expenditures was covered by reinsurers. On the other, extraordinary factors reduced these undertakings' own funds. However, this sector's own funds are still at a very high level and significantly higher than the minimum capital requirements.

Reinsurers

Highly satisfactory solvency margin ratio.

The solvency margin ratio for the supervised reinsurers in Germany was highly satisfactory in 2009. The supervisory solvency requirements of €6.1 billion were more than exceeded by the reinsurers' own funds of €69.3 billion. As a result, the solvency margin ratio of these undertakings increased again growing, from 1,079% to 1,145%.



The reason for this high level of solvency margin surplus coverage is that a number of large reinsurers in Germany are also holding companies for an insurance group or financial conglomerate. A considerable proportion of these reinsurers' own funds serves to finance their holding company function, rather than covering their reinsurance activities. Eliminating the figures relating to the holding company function produces an average solvency margin ratio of 302% (previous year: 277%) for reinsurers supervised in Germany, which is thus well above the target supervisory ratio.

Pensionskassen

The forecast contained in the model scenario puts the solvency margin ratio of the *Pensionskassen* at 126%, roughly in line with the figure for the previous year. According to the estimates, three Pensionskassen were unable to meet the solvency margin ratio in full as at 31 December 2010. Measures were agreed with these undertakings to eliminate the shortfall. Approved solvency plans are now in place for two of these undertakings, while another company was prohibited from acquiring new business a number of years ago.

Pension funds

The required solvency margin at the vast majority of the 30 pension funds equalled the minimum guarantee funds of €3 million. Once again, pension funds had sufficient available uncommitted assets in 2010. According to the projection, the average solvency margin ratio for the pension funds at the balance sheet date was approximately 200%.

2.5 Stress test

BaFin conducted a stress test in 2010 as at the 31 December 2009 balance sheet date.

As in the past, the stress test scenarios addressing assumed equity price losses were rule-based, with the applicable mark-down based on the level of the EuroStoxx 50 share price index.

The index level at the reference date resulted in a 22% mark-down for the stand-alone equities scenario, and a 15% mark-down for the equity component of the combined scenarios (equities/bonds and equities/real estate). The mark-down for both the bond and the real estate components was unchanged, at 5% for bonds and 10% for real estate. The stand-alone bond scenario was also unchanged, with a 10% mark-down.

All life insurers…

94 life insurers submitted a stress test. BaFin exempted three insurers from the duty to submit a stress test because of the low-risk nature of their investments, although one of these insurers voluntarily submitted the stress test. Taking into account the measures implemented to safeguard their solvency and the specific characteristics of individual undertakings, all 94 life insurers reported positive results in all four stress test scenarios.

…and all health insurers reported positive results.

BaFin included 41 health insurers in its analysis of the sector, and exempted seven companies from the duty to submit a test because of the low-risk nature of their investments. All of the undertakings would have had sufficient assets to cover their technical provisions and statutory capital requirements, even when faced with significant price losses or interest rate hikes.

Six property/casualty insurers…

BaFin requested 179 property/casualty insurers to submit their stress test results. 39 undertakings were exempted from this requirement. Of the total figure, 173 property/casualty insurers reported positive stress test results in all four scenarios. Three insurers disclosed negative results in all four scenarios, two insurers in two scenarios and one insurer in one scenario.

The principal reason for the negative results was the greater extrapolation of the target values required by the stress test model. The increase in the liabilities to be covered, such as the provision for claims outstanding, is attributable to special factors at the individual insurers. These included declining premiums and

unusually high business growth. Nevertheless, even those undertakings with negative stress test results are assumed to have sufficient risk-bearing capacity, based on their current situation.

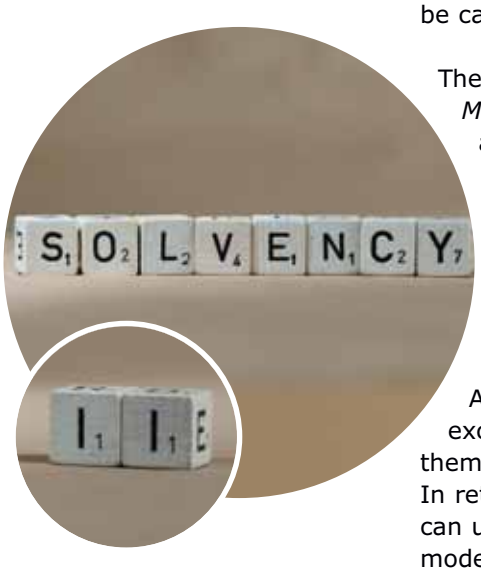
…and six Pensionskassen reported negative stress test results.

BaFin exempted 22 of the 153 *Pensionskassen* it supervised at the end of 2009 from their obligation to submit stress tests because of the low-risk nature of their investments. Of the 131 *Pensionskassen* subject to the stress test, 125 reported positive results in all four stress test scenarios. The six *Pensionskassen* with negative results generally reported minor shortfalls. These companies instituted measures to restore their risk-bearing capacity in the course of the year under review.

2.6 Risk-based supervision

Internal Models Working Group.

The new Solvency II supervisory regime is expected to come into effect in 2013. Solvency II allows solvency capital requirements to be calculated using an internal model approved by the supervisor.



The Internal Models Working Group (*Arbeitskreis Interne Modelle* – AKIM) has been meeting twice a year since 2006 and is chaired by BaFin. The latter invites to its meetings both representatives of the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e.V.* – GDV) and of the insurance undertakings that are involved or interested in the development of an internal model, as well as their supervisors. As a rule, BaFin gives an overview of the current state of European legislation and then discusses topical issues with the industry representatives. All participants at the AKIM meetings benefit from this exchange of information: the insurers are able to better prepare themselves for the future requirements of the Solvency II regime. In return, the supervisors receive valuable information that they can use in the course of the pre-application phase for the internal models, or in the expert groups at European level, for example in the Internal Models Expert Group at the European Insurance and Occupational Pensions Authority (EIOPA).

Current issues in the AKIM.

The main issues addressed by the AKIM in the year under review were the "future application procedure for internal models as part of the approval process" and "expert judgement in internal models". BaFin presented the stages in the process, from application through to approval of the internal model, and explained the particular features to which attention must be paid in each case. Specifically, BaFin explained the procedure in the case of full or partial internal models at insurance group level and addressed the involvement of EIOPA.

On the topic of "expert judgement in internal models", BaFin started by explaining its understanding of what "expert judgement" means, and then described the requirements that must be met before it can be applied. The representatives of the insurance undertakings provided interesting examples used by the speakers to explain the planned guidelines.

Pre-application phase for internal models.

BaFin will be responsible for approving internal models under the new supervisory regime. The period from application to decision should take no longer than six months.

In advance of the official application, BaFin is offering the insurers an opportunity to participate in a non-binding pre-application phase, which aims to help participants assess the extent to which their models are sufficiently robust. At the same time, BaFin can obtain a picture of the strengths and weaknesses of the internal model before the application is actually filed, allowing the strict timetable of a maximum of six months subsequently available for assessment to be used more efficiently. BaFin held talks with around 10 interested insurers in 2010 to evaluate whether and in what form they could be included in a pre-application phase.

New questionnaire for admission to the pre-application phase.

Insurers interested in the pre-application phase can use a new BaFin questionnaire on internal models to conduct a self-assessment about the progress made towards implementing the Solvency II requirements at their company.[16] Using this data, BaFin can then decide, in consultation with the insurer, whether the pre-application phase can begin and how it should be structured. In the year under review, six insurers returned the completed questionnaire, although not all of them were interested in participating in BaFin's pre-application phase in 2011.

Three large German insurance groups whose internal model had already reached a certain level of maturity were admitted to the pre-application phase in 2010. This phase is planned to start at another German group in 2011. For the first time, German subsidiaries of foreign parents were also included in the pre-application phase in 2010.

In the year under review, BaFin examination teams spent an average of between five and twelve weeks on site for supervisory interviews and on-site inspections.

Notifications of risk concentrations at group level.

Since the third quarter of 2009, insurance groups have been required to notify BaFin each quarter of all significant risk concentrations at group level, i.e. including subsidiaries in the EU, EEA and third countries, in accordance with section 104i VAG. Only groups that are exempted from the requirement to submit insurance group solvency data (adjusted solvency) are not required to notify BaFin in accordance with section 104i VAG.

[16] Erhebungsbogen für die Zulassung zur Vorantragsphase eines internen Modells, www.bafin.de » Unternehmen » Versicherer & Pensionsfonds » Solvency II » Vorantragsphase (only available in German).

The new duty of notification was introduced in 2009 by the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector (*Gesetz zur Stärkung der Finanzmarkt- und der Versicherungsaufsicht*). It is designed to create transparency about internal group links with non-group counterparties and thus enable BaFin to identify potential risks to the group as a whole at an early stage. This relates to situations where the credit or investment volume relating to a single counterparty, individually or in the aggregate, reaches or exceeds 10% of the required solvency margin at group level. Together with the reports on insurance group solvency and internal group transactions, the risk position of each insurance group can now be more accurately assessed.

BaFin evaluated the reports in accordance with section 104i VAG in 2010 and developed a best-practice model for these reports after reviewing the current status of the future Solvency II reporting regime. This best-practice model is expected to be published in 2011.

Risk classification

BaFin allocates insurers to risk classes.

BaFin allocates the insurance undertakings it supervises to risk classes that it uses to define how closely the insurers are supervised. Insurers are allocated to classes using a two-dimensional matrix that reflects their market relevance. The market relevance of life insurers, *Pensionskassen* and death benefit funds, and pension funds is measured on the basis of their total investments. The key parameter for health insurers, property/casualty insurers and reinsurers is those undertakings' gross premium income. Market relevance is measured on a three-tier scale of "high", "medium" and "low".

The quality of the insurers is based on an assessment of their

- Net assets, financial position and results of operations,
- Growth and
- Management quality.

The first two criteria are assessed using insurance-specific indicators, while management quality is assessed using qualitative criteria. The rating system adds together the ratings of the individual criteria to form an overall rating on a four-tier scale from "A" (high quality) to "D" (low quality).

BaFin's most recent risk classification was as at the 31 December 2010 reference date:

Table 10
Risk classification results for 2010

Undertakings in %		Quality of the undertaking				
		A	B	C	D	Total*
Market relevance	high	1.0	5.8	2.6	0.0	9.4
	medium	4.1	12.2	2.9	0.2	19.4
	low	12.2	42.9	14.3	1.3	70.7
	Total*	17.3	60.9	19.8	1.5	100.0

* Figure includes four insurance undertakings (0.5%) that were not classified.

Modest rise in the number of good-quality insurers.

In the course of the risk classification, BaFin rated 78.2% of the insurers as "A" or "B". This means that the proportion of insurance undertakings in the upper quality ratings increased slightly compared with the previous year. The proportion of insurers with both "C" and "D" ratings declined year on year. As in the previous years, BaFin did not rate any insurers with high market relevance as "D".

The risk classification process reflects the general economic situation and the specific circumstances affecting the insurance sector. A more positive economic climate naturally influences BaFin's risk assessment. As a result, fewer insurance undertakings were rated "D" in 2010 than in 2009.

Improved insurance undertaking quality also evident in the individual classes.

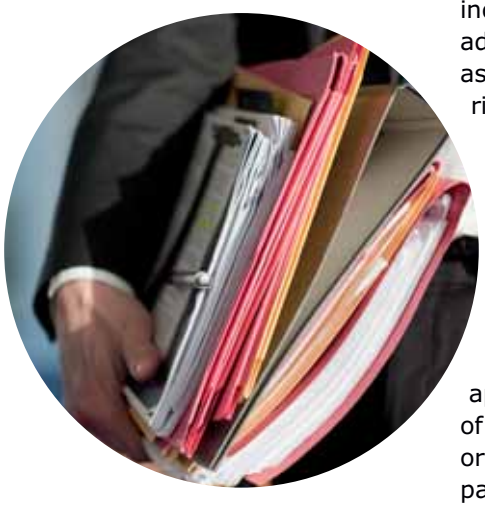
In terms of the individual classes, the proportion of life insurers and death benefit funds rated "A" and "B" each rose by approximately 2.5 percentage points. Pension funds and *Pensionskassen* also improved their ratings.

80% of property/casualty insurers and health insurers were rated "A" or "B" (+2% year on year). By contrast, there were no significant shifts for reinsurers.

No change in market relevance.

As in recent years, there were no significant changes in the allocation of insurance undertakings to the three ratings for market relevance.

Classification of insurance groups.



As well as classifying the risks associated with individual insurance undertakings, BaFin additionally classified the largest insurance groups at group level for the first time in 2010. In contrast to the purely mathematical aggregation of the classification results of the individual companies in the groups, this quality assessment uses additional qualitative and quantitative group-specific inputs, such as profit transfer and control agreements. The annual group-level risk classification is based on the concept of insurance group supervision. It provides additional information for BaFin and is used as an additional tool for assessing insurers' overall position.

On-site inspections

On-site inspections are planned on the basis of a risk-based approach. As well as the results of the risk classification, one of the factors that BaFin takes into account is whether an insurer or pension fund was subject to an on-site inspection in the recent past. BaFin also conducts on-site ad hoc inspections. During the year under review, BaFin conducted 63 on-site inspections, increasing its inspection activities for the second year in succession. A significant proportion of on-site inspections were related to the pre-application phase for internal models.

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

Table 11
Breakdown of on-site inspections by risk class in 2010

On-site inspections		Quality of the undertaking					
		A	B	C	D	Total	Under-takings in %
Market relevance	high	2	17	2	0	21	33.3
	medium	2	8	1	0	11	17.5
	low	7	15	8	0	30	47.6
	Total *	11	40	11	0	63	100.0
	Under-takings in %	17.5	63.5	17.4	0.0	100.0	

* Total figure includes one on-site examination at an undertaking that was not classified.

2.7 Risk reports

Section 64a (1) sentence 4 no. 3 letter d VAG requires insurers to establish a risk reporting system that provides relevant and detailed reports to management. The reports should serve as a source of information to support management in its corporate management activities. They comply with the statutory requirements if they present the principal risk management objectives and explain the methods used to assess risks and how those risks are subsequently mitigated. The risk reports must also show what the impact of risk mitigation measures has been and how the objectives were met and managed.

The insurers are required to file the risk reports submitted to their management with BaFin. BaFin issued a guidance notice for filing risk reports in the year under review in order to simplify the way the reports are processed when they are received.[17] For the first time, requirements are now being imposed for the cover letter to be filed with the risk reports. In addition, the guidance notice contains information about how the risk reports can be filed electronically with exempting effect.

Sector evaluation and risk analysis

The risk reports are not only evaluated in terms of form and substance at the level of the individual insurance undertaking, but also at sector level. The main objectives of the sector evaluation are firstly to identify and assess new risks that are relevant for the sector, and secondly to monitor known risks. General information about reporting practice is also obtained.

In addition to the ongoing evaluation, BaFin analysed and compared the risk reports filed by the 14 largest insurance groups. This indicated that the following risks are particularly relevant at sector level for the class in question:

Table 12
Particularly relevant risks in 2010

Class	Risks			
	Operational	Insurance-related	Market	Credit
Life insurers	Court rulings on instalment payment surcharges	Phase of structurally low interest rates	Interest rate risk	Issuer risk/ spread risk
Health insurers	Social policy environment		Interest rate risk	Outstanding premiums
Property/casualty insurers	Court rulings on instalment payment surcharges			Issuer risk/ spread risk
Pensionskassen and pension funds		Phase of structurally low interest rates	Interest rate risk	Issuer risk/ spread risk
Reinsurers		Natural disasters		Issuer risk/ spread risk

[17] www.bafin.de » Veröffentlichungen » Merkblätter » Versicherungsaufsicht (only available in German).

By contrast, the other risk categories in accordance with the Minimum Requirements for Risk Management in Insurance Undertakings (*Aufsichtliche Mindestanforderung an das Risikomanagement* – MaRisk VA)[18], i.e. strategic risk, concentration risk, reputational risk and liquidity risk were only of minor importance in the year under review.

Evaluation of statistical information

The evaluation of statistical information, e.g. the use of value-based indicators, traffic light systems, or limit systems, serves primarily to obtain information about the key content and quality of the reports and to provide the sector with the results. The following table provides such an overview:

Table 13
Statistical data from the 2010 risk reports

Class	Reporting cycle				Application of			
	Annual	Half-yearly	Quarterly	Other	Value-based indicators	Risk matrix	Traffic light system	Limit system
Life insurers	26%	10%	60%	4%	64%	30%	57%	71%
Health insurers	41%	5%	54%	0%	67%	39%	57%	74%
Property/casualty insurers	47%	9%	41%	3%	53%	53%	62%	81%
Pensionskassen and pension funds	69%	5%	20%	6%	28%	41%	46%	65%
Reinsurers	59%	4%	33%	4%	60%	52%	67%	74%

The insurers are increasingly using value-based indicators in the course of their risk reporting. BaFin views this in a positive light in view of the preparatory work needed for Solvency II.

Risk reporting requirements

If the insurance undertaking required to file reports is included in the risk report of the insurance group, filing the group report is sufficient (section 55c (2) VAG). In such cases, both the risk position of the individual companies included in the report and the risk position of the group as a whole should be evident from the group report. This requirement was not met in all of the group reports.

BaFin welcomes management summary.

Some of the companies preface their risk report by a management summary highlighting particularly relevant information and risks. BaFin welcomes this trend, because it supports the function of the risk report as a management tool and emphasises the current risk situation.

[18] Circular 3/2009 (VA), www.bafin.de » Publications » Circulars » Insurance supervision.

Presentation of risks needs improving.

The undertakings are required to report on the material risks within the meaning of item 5 no. 2 MaRisk VA[19], and most of them do actually meet this requirement. In the case of some insurers, however, BaFin has established that the risks are consolidated into the risk types with the result that concrete individual risks are not mentioned. At a minimum, the risk report should specifically address the largest individual risks and those risks that are typical for the sector.

BaFin would like to see coverage of ad hoc reports.

Ad hoc reports are required in special situations (item 7.3.4 no. 6 MaRisk VA). Ad hoc reports are not risk reports within the meaning of section 64a (1) sentence 4 no. 3 letter d VAG and do not therefore have to be filed with the BaFin. As part of an end-to-end risk analysis, however, it makes sense to address intra-year ad hoc reports in the regular risk reports, and hence to present a comprehensive picture of the risk trends.

Report on relationships with insurance special purpose entities.

Risk reporting must also include information about all contractual relationships with insurance special purpose entities. However, only a small number of insurers met this requirement.

Even if there are no contractual relationships with insurance special purpose entities, this fact should be mentioned in reports so that the formal requirements are complied with. From a risk perspective, information about the non-existence of such contractual relationships is also relevant.

Formal risk reporting requirements.

The formal requirements for risk reports, in particular the methods of addressing the material risk categories, presenting the principal risk management objectives and describing the methods used to assess and manage risks were met in the majority of cases.

2.8 Group supervision

Extended insurance group supervision.

Insurance group supervision will be significantly more comprehensive under Solvency II. For cross-border insurance groups, BaFin already draws on the cooperation and expertise of relevant EU and EEA supervisory authorities. In the case of insurance groups that also operate outside the EEA, however, cooperation with supervisory authorities in non-EEA countries is based solely on bilateral agreements. This is the only way to ensure that confidentiality and non-disclosure obligations are observed.

During the year under review, the supervisory colleges met for all significant cross-border groups of undertakings for which BaFin is responsible for group supervision. Cooperation exclusively using electronic communication media has only been used to date for four very small insurance groups. The supervisory colleges will meet in 2011 for these insurance groups. This means that BaFin complies with the relevant requirements in advance of Solvency II coming into force.

[19] Circular 3/2009 (VA), www.bafin.de » Publications » Circulars » Insurance supervision.

BaFin continued to step up its cooperation with the other European insurance supervisors both quantitatively and qualitatively. This is reflected firstly in the greater number of working meetings of the individual supervisory colleges, and secondly in the more extensive cooperation. Particular challenges here include designing the pre-application phase for insurers wishing to apply for approval of an internal model, enhancing the mechanisms for preventing crises and monitoring preparations by insurers for Solvency II.

In addition to its activities as group supervisor, BaFin is also involved in supervisory colleges that are hosted by other supervisory authorities.

2.9 Agents

BaFin has further extended its supervision of the sales channels used by the insurance undertakings. The activities of insurance agents, for example, were one of the areas of emphasis for three on-site inspections in 2010. BaFin also conducted a supervisory visit concerned solely with the sales network of the insurance undertaking in question. This involved examining in particular compliance with the statutory and supervisory requirements applicable to cooperation with agents.

Section 80 VAG requires insurance undertakings to cooperate only with those insurance brokers and multi-firm agents who are licensed by the relevant chamber of industry and commerce. Insurance undertakings may only cooperate with tied agents if the agents are reliable and have an adequate financial position. In addition, the insurers must ensure that their tied agents are suitably qualified to act as agents for the insurance product in question. Circular 9/2007 (VA) provides application guidance on section 80 VAG. BaFin also examined the sales-related risk management of the insurance undertakings.

BaFin also conducted an on-site inspection of the work of the Information Office on the Insurance Industry/Building and Loan Association Sales Network and Insurance Brokers in Germany (*Auskunftsstelle über Versicherungs-/Bausparkassenaußendienst und Versicherungsmakler in Deutschland e.V.* – AVAD) in the year under review. It exchanged information regularly with the AVAD as well as with the department of the Association of German Chambers of Industry and Commerce responsible for trade law and with the chambers of industry and commerce.

BaFin also plans an in-depth analysis of insurance sales networks in 2010, in particular in conjunction with on-site inspections.

2.10 Developments in the individual insurance classes[20]

Life insurers

Situation continues to ease thanks to equity market recovery.

The life insurers supervised by BaFin generated gross premiums of approximately €86.2 billion in their direct insurance business in 2010, a year-on-year increase of around 7%. The aggregate investment portfolio increased by approximately 3.8% to around €734 billion. The life insurers' financial position in the year under review was stable. Their valuation reserves profited from the continued significant recovery in the equity markets, coupled with low interest rates. Based on preliminary figures, the sector had net hidden reserves of approximately €30.6 billion across all investments at the end of the year, corresponding to roughly 4.2% of the aggregate investments (previous year: 3.6%).

All life insurers withstand defined projections.

BaFin surveyed the life insurers using two projections in the year under review as at 30 June and 31 October. These projections simulate the impact of stable and adverse capital market developments on the insurers' performance. They are an additional risk-based supervisory tool above and beyond BaFin's stress tests. For these projections, the insurers had to simulate the impact of a 20% drop in equity prices and a 50 basis point rise in interest rates on their profit for the year. The projections indicated that all of the life insurers included in the test would also have been able to meet their obligations in the worst-case scenario.

Net investment return of 4.15%.

Preliminary figures put the average net investment return at 4.15% in 2010, on a level with the prior-year figure of 4.2%.

Low interest rate environment.

BaFin's activities focused on developing measures to support insurers' risk-bearing capacity by ensuring that they can cope with the low interest rate environment as well as possible. In this process, BaFin drew largely on the findings of the projected interest guarantees in life insurance in 2009.

Capital market rates fell further in the course of 2010. BaFin will continue to monitor the situation closely and will take further measures if necessary.

Measures to improve medium- and long-term risk-bearing capacity in the life insurance sector

In the medium and long term, the risk-bearing capacity of the life insurance sector will be affected primarily by capital market developments. The BMF, the GDV and BaFin are discussing the following measures to improve this sector's risk-bearing capacity:

[20] The 2010 figures are only preliminary and are based on the interim reporting as at 31.12.2010.

- Increasing the premium reserve to reflect lower interest rates at an early stage (*Zinszusatzreserve*),
- Partial collectivisation and modification of the existing limit on distributable provisions for bonuses and rebates (*Rückstellungen für Beitragsrückerstattungen* – RfB); the objective is to safeguard their role as a safety buffer,
- Modifying the rules for participating in valuation reserves and
- Modifying the rules governing surrender values.

Work on the "*Zinszusatzreserve*" has recorded the most progress. Following the amendment of section 5 of the Regulation on the Principles Underlying the Calculation of the Premium Reserve (*Deckungsrückstellungsverordnung*), all life insurers must establish a "*Zinszusatzreserve*" in several stages, starting in financial year 2011.[21] The level of each stage is based on the average interest rates for the past 10 years and the technical interest rates used by the insurer in its portfolio as at the balance sheet date. Depending on the composition of the portfolio, the resulting expense to the insurer may be appreciable, though insurers should be able to finance it from income in most cases. Without this amendment, the premium reserve would probably only be increased in financial years when the earnings position is less strained, which could result in losses.

BaFin also developed an additional alternative to the existing supervisory limit on distributable RfB, which it published in an interpretative decision.[22] In this alternative, the limit depends on the net investment return. This means that insurers are no longer forced to distribute high surpluses from the RfB in the event of persistently low capital market rates and the associated decline in additions to the RfB. This alternative allows insurers to respond better and more flexibly to the prevailing situation on the capital markets. Once BaFin has approved their business plan, they can use the alternative for their existing portfolio in financial year 2011.

Work on the other measures listed above was ongoing at the time this Annual Report went to print.

Life insurers reduce profit participation.

In light of the low interest rates obtainable for new investments, many life insurers cut their profit participation for 2011. The current total return (the sum of the guaranteed technical interest rate and the interest bonus) for the tariffs available in the market for endowment insurance policies is an average of 3.95% for the sector. This figure was 4.13% in 2010 and 4.23% in 2009.

[21] Regulation on the Amendment of the Regulation on the Principles Underlying the Calculation of the Premium Reserve and of the Regulation on the Principles Underlying the Calculation of the Premium Reserve of Pension Funds, Federal Law Gazette (BGBl.), I 2011, p. 345.

[22] www.bafin.de » Veröffentlichungen » Auslegungsentscheidungen » Versicherungsaufsicht (only available in German).

Policyholder participation in the valuation reserves experienced the opposite trend in 2010. Because of the declining capital market rates, life insurers' net valuation reserves were up significantly year on year in the year under review, and policyholder participation in these reserves was correspondingly higher.

Investments by life insurers in the PIIGS countries

BaFin conducted two surveys of life insurance undertakings in May and October 2010 to identify country risk in their investments. The surveys focussed in particular on Portugal, Ireland, Italy, Greece and Spain (the "PIIGS" countries), as well as countries with elevated credit default swap (CDS) spreads.

The October survey revealed that the insurers had invested 8.9% of their total investment assets measured at fair value in the PIIGS countries. Investments in the individual PIIGS countries were in single digits for all insurers. At 61.9% of all investments, Germany was the largest destination for insurers' investment activities. It was evident from the survey that the insurers actively manage these risks and are only holding a limited amount of these exposures.

First appropriateness reports filed.

For the first time, the appointed actuaries were required in 2010 to explain the appropriateness of the proposed policyholder bonuses in a report to the executive board. The life insurers filed the appropriateness reports with BaFin in accordance with the requirements VAG. The new requirements derive from an amendment to section 11a (3) no. 4 sentence 2 and subsection (4) no. 2 VAG introduced by the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector.

The appropriateness report is a new form of instrument that will be enhanced in the coming years on the basis of practical experience gained. In individual cases, BaFin has already indicated the additional aspects that should be incorporated into the appropriateness report. For example, Circular 8/2010 (VA) states that single-premium life insurance policies should be specifically addressed.

Private health insurance

Moderate new business with premium growth estimated at over 6%.

The 48 private health insurers supervised by BaFin generated premium income of approximately €33.3 billion in 2010, representing year-on-year growth of more than 6%. The market for private health insurance remained difficult. The perpetual debate on modifications to the German healthcare system has probably prompted potential customers to await further developments rather than take out private health insurance. Effective 2 February 2007, salaried employees who were voluntarily insured in the statutory health insurance system

were only able to switch to private health insurance if their income was higher than the income limit for compulsory statutory insurance for three consecutive calendar years. This three-year limit was abolished by the Act on Establishing Sustainable and Socially Balanced Financing of the Statutory Health Insurance System (*Gesetz zur nachhaltigen und sozial ausgewogenen Finanzierung der gesetzlichen Krankenversicherung* – GKV-Finanzierungs-gesetz)[23] at the turn of 2010/2011. As a result, salaried employees can again opt to switch from the statutory health insurance system at the end of the year in which their salary exceeds the income limit for compulsory statutory insurance, provided that it is expected to remain above this limit in the following year. Additionally, insurance premiums have been tax-deductible to a greater extent since the beginning of 2010. BaFin is therefore expecting new business to recover slightly, especially starting in 2011.

Rising initial commission costs for private health insurers

BaFin criticised the increase in average initial commissions in recent years in a press release dated 9 December 2010. BaFin believes that management of the insurers is under an obligation to ensure that acquisition costs do not escalate. Sales activities must be organised in such a way that there is no incentive for excessive profit-seeking by agents and brokers. This presupposes firstly that acquisition costs are not unreasonable, even in individual instances. Secondly, insurers should agree recovery of an appropriate amount of the commission from the agent/broker in the event of early transfer.

In some cases, private health insurers made commission payments to agents and brokers that were far in excess of average commission payments. In addition, there were often transfers during the initial years of the policy, meaning that agents or brokers enticed customers to another insurer in order to generate additional commissions. One consequence of this is that acquisition costs have risen appreciably across the sector. This trend runs counter to the interests of the insured persons, because the commissions have to be funded via the insurance premiums.

In 2011, BaFin will conduct special examinations at individual insurance undertakings where there are grounds for suspected excessive commissions, and will investigate cooperation with agents and brokers.

Stable earnings and reserve position expected.

The health insurers increased their investment portfolio by 7.7% in 2010 to approximately €176 billion. The effects of the financial market crisis continued to be felt in 2010. Although the EuroStoxx 50 fell by just under 6% since the beginning of the year to 2,792 points, the DAX improved by 16% to 6,914 points.

[23] Federal Law Gazette (BGBl.), I 2010, p. 2309.

Nevertheless, it is likely that there has been no significant change in the volume of write-downs of investments compared with 2009. BaFin expects the earnings position of the health insurers to remain stable. The modest rise in securities prices and the decline in interest rates saw a slight improvement in the sector's reserve position. As at 31 December 2009, net hidden reserves in health insurers' investments amounted to €6.3 billion, rising by 13% in 2010 to €7.1 billion.

All health insurers withstand defined scenarios.

As at 30 June 2010, BaFin requested 37 health insurance undertakings to prepare a projection and report the results. 11 insurers were exempted from the requirement to submit a projection due to the low-risk nature of their investment portfolio or because they only offer non-substitutive health insurance.

The projections are an additional risk-based supervisory tool on top of BaFin's stress tests. They simulate the impact of adverse capital market developments on the insurers' performance. BaFin's 2010 projection defined four different scenarios based on market developments. Two scenarios exclusively addressed the impact of equity price risks on the insurers' earnings, while the other two also included interest rate risk in the projection. The results of the projection indicated that all of the health insurers were able to withstand the defined scenarios financially.

Net investment return of over 4% expected for 2010.

The projections indicate that net investment income will remain stable because of the continued moderate recovery in the capital markets. BaFin believes that the sector will generate a net investment return in excess of 4%. All health insurers would have been able to meet their guaranteed return obligations in all four scenarios. In a small number of cases only, net investment income fell slightly short of the level needed to finance the technical interest rate for the premium reserve. However, the companies would have been able to generate sufficient surpluses from other sources (e.g. safety loading) to guarantee the necessary addition to the ageing provision.

Federal Administrative Court rules that a tariff structure surcharge on tariff changes is inadmissible

The Federal Administrative Court ruled in June 2010 that private health insurers are not entitled to charge a general tariff structure surcharge on top of the basic premium to policyholders who switch from an existing tariff to a new tariff.[24] The Court ruled that the Insurance Contracts Act (*Versicherungsvertragsgesetz* – VVG) and the supervisory requirements do not establish any legal basis for charging a flat-rate risk surcharge in the case of tariff changes that are not linked to the individual risk of the insured person. The tariff structure surcharge runs counter to the legislative objective of the right to switch tariffs set out in section 204 (1) VVG. Moreover,

[24] Judgement dated 23.6.2010, case ref.: 8 C 42.09.

policyholders wishing to switch tariffs would always have to pay a higher premium than new customers because of this surcharge, which is not compatible with the supervisory principle of equal treatment. The Court ruled that a tariff structure surcharge linked solely to a switch in tariff is therefore inadmissible as it is a special surcharge not provided for by law.

In 2008, BaFin had prohibited an insurer from charging a newly introduced flat-rate risk surcharge when an insured person switched from an old to a new tariff. This tariff structure surcharge was payable by any insured person switching tariffs, regardless of whether there were any pre-existing medical conditions. BaFin believed that charging this flat-rate surcharge was an attempt to erode the statutory right to switch tariffs and constituted the objectively unjustified unequal treatment of existing and new customers. The Administrative Court in Frankfurt am Main, as the court of first instance, initially allowed the insurer's appeal against BaFin's prohibition order.

The insurer has now recalculated the tariffs affected so that no insured person switching tariffs is charged the tariff structure surcharge.

Property and casualty insurers

Further increase in claims expenditures accompanied by premium growth.

Business performance by property and casualty insurers was satisfactory overall in 2010. Premiums rose at a slightly higher rate than in the previous years, a trend that also applied to the traditionally important motor vehicle business following declines in the previous years. The lower price competition offset the effects of policyholder migration to lower-cost segments and lower no-claims classes. With the exception of minor premium decreases in transport insurance and general liability insurance, most of the other classes reported an increase in premium income.

Claims expenditures increased compared with the previous year. One reason for this increase was the greater number of natural disasters and the resulting higher claims expenditures. Comprehensive household insurance was particularly affected by this trend.

The estimated combined ratio for the direct insurance business is likely to have increased again year on year, but will probably still be well below 100%. In line with this, underwriting profit declined accordingly compared with 2009.

Reinsurance

Reinsurers' share of insured losses often low despite a string of natural disasters.

A string of severe earthquakes and a series of other natural disasters resulted in global economic losses of around €57.1 billion in the first six months of 2010 alone. In terms of losses, the first quarter of 2010 was one of the most severely impacted quarters in

recent years. Although only losses of around €18.0 billion were actually insured, insured losses in the first half of 2010 still exceeded the aggregate insured losses in full-year 2009.

Total economic losses worldwide in the year under review amounted to €97.3 billion. Because a number of major losses occurred in regions with a low insurance density (e.g. the earthquake in Haiti, the floods in Pakistan), insured losses only accounted for a small portion of the losses incurred, at around €27.7 billion. With 950 natural disasters, 2010 was a record year characterised by severe major losses. The North Atlantic hurricane season was also one of the most severe in the past 100 years in terms of both the number and the intensity of the storms. However, because the paths of the hurricanes mainly bypassed areas with significant assets (and hence large insurance densities), the high losses expected did not materialise.

Winter storm "Xynthia", which also hit the Iberian peninsula, France and parts of Central Europe, was the severest loss event in Germany, with insured losses of approximately €2.3 billion. The most expensive insured single event was the earthquake in Chile, with insured losses of around €6.0 billion.

According to the figures available to BaFin, gross premiums generated by the German reinsurers in financial year 2010 are expected to be slightly less than €43 billion, with own funds estimated at just under €67 billion.

Reorganisations now subject to approval.

Following the entry into force of the 2010 Annual Tax Act (*Jahressteuergesetz*)[25] on 14 December 2010, section 121f VAG now provides for an approval obligation for reorganisations of reinsurance undertakings in cases where reinsurance contracts are among the assets affected by the reorganisation. In other respects, the notification obligation under section 121a (3) VAG remains in force.

Reinsurance business of mixed insurers domiciled in third countries permitted without the need for BaFin's approval.

The 2010 Annual Tax Act also saw changes for "mixed insurers" domiciled in a third country. These undertakings can now conduct reinsurance business in Germany from their home state through a branch office without having to seek approval from BaFin. The revised principles contained in section 105 (2) VAG are based on those applying to pure reinsurers in section 121i VAG. The conditions for conducting this business are firstly that the insurance undertakings are authorised to conduct reinsurance business in their home state, and that their head office is also located there. Secondly, they must be supervised in their home state in line with internationally accepted principles, and a satisfactory level of cooperation between the relevant authorities of the home state and BaFin must be assured.

[25] Federal Law Gazette (BGBl.), I 2010, p. 1768.

First equivalence tests for supervisory regimes in third countries planned for 2011.

In addition to the equivalence test for third-country supervisory regimes already provided for in section 121i VAG, Articles 172, 227 and 260 Solvency II Directive also explicitly require the application of this approach.[26] The objective of such equivalence tests is to ensure that the solvency rules and supervisory regimes in third countries assure a level of protection for policyholders that is comparable to that offered by the Solvency II Directive. If they are deemed to be equivalent, reinsurers from the third country in question are, in principle, permitted to conduct reinsurance business in Germany through a branch office or by providing cross-border services from their home state. In addition, reinsurance contracts with insurance undertakings from these countries should be treated in exactly the same way as reinsurance contracts with EU/EEA insurers.

In 2011, the European Commission is planning to define criteria that the national supervisory authorities can use to assess whether the supervisory regime for the reinsurance activities of undertakings domiciled in a third country, as well as group supervision, are equivalent to the requirements of the Solvency II Directive. CEIOPS (EIOPA since 1 January 2011) communicated a corresponding list of technical criteria to the European Commission on 1 April 2010 (the former consultation paper No. 78).[27] Under the CEIOPS proposals, the criteria for assessing equivalence with Articles 172, 227 and 260 of the Solvency II Directive are, in particular:

- The existence of a supervisory authority with the necessary expertise and sufficient staff and other resources that is also in a position, when supervising insurance groups, to obtain a comprehensive overview of the group so that it can institute necessary supervisory measures if required,
- An authorisation procedure,
- An adequate organisational structure that provides for an adequate risk management system, compliance, internal audit and an actuarial function, and that ensures the publication of reports on the undertaking's financial performance,
- Adequate capital resources of the insurance undertaking or insurance group,
- Cooperation with other supervisory authorities and
- Mechanisms to safeguard confidential information (guarantees of professional secrecy).

The supervisory regimes in Switzerland, Bermuda and Japan are expected to be tested for equivalence with the requirements of the Solvency II regime in 2011.

[26] Directive 2009/138/EC dated 25.11.2009, OJ no. L 335 dated 17.12.2009, p. 1.
[27] CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical criteria for assessing 3rd country equivalence in relation to art. 172, 227 and 260, www.eiopa.europa.eu » Consultations » Consultation Papers » 2010-2009 Closed consultations.

Pensionskassen

Slight overall decline in premium income.

Based on the projections as at 31 October 2010, premium income at the *Pensionskassen* competing on the open market (*Wettbewerbspensionskassen*) that have been established since 2002 was on a level with the previous year, illustrating that the market is now largely saturated. In the case of *Pensionskassen* funded largely by employers, premium income trends depend on the headcount at the sponsoring company. The projections indicate that the premium income of these *Pensionskassen* declined slightly.

The aggregate investment portfolio of the 152 *Pensionskassen* supervised by BaFin increased by around 1.5% in 2010 to approximately €110 billion.

Higher premium reserves will result in higher expenditures.

In addition to the investment risks reflected in the stress test, *Pensionskassen* are especially exposed to the longevity risk of the insured persons. This may result in the need for Pensionskassen to adjust their calculation bases and to top up their premium reserves in the coming years. The persistent low level of interest rates is making it increasingly difficult for the *Pensionskassen* to generate the surpluses needed to finance these adjustments, because only assets offering relatively low yields are available for new investments.

Pensionskassen in a stable financial position.

BaFin requested 134 *Pensionskassen* to prepare projections as at 30 June and 31 October 2010 in which they projected their profit for the financial year subject to four equity and interest rate scenarios. 19 Pensionskassen were exempted from this requirement due to the low-risk nature of their investments. The projections revealed that, although the solvency margin ratio declined slightly overall compared with the previous year, the sector's short-term risk-bearing capacity remained adequate. The projections also showed that the difference between the return on investments and the average technical interest rate for the premium reserve is narrowing. This reduces the ability of the *Pensionskassen* to finance increases in their reserves dictated by the need to reinforce their biometric calculation bases.

Pension funds

At €5.96 billion, pension funds recorded an overall increase in gross premium income compared with the previous year (€2.89 billion). 87% of total sector income was attributable to single premiums at one pension fund during the year under review. Benefit payouts increased from €764 million to €1,199 million. The number of beneficiaries increased to 757,388 persons at year-end, of whom 292,166 were current beneficiaries.

The sponsor must make supplementary contributions if the value of the investments for the account and risk of employees and employers falls below the minimum unguaranteed premium reserve to be established by the pension fund. No pension funds were forced to ask sponsors to make these supplementary contributions in the year under review.

Projection indicates stable financial position.

In accordance with section 55b VAG, BaFin requested the pension funds to submit their annual projection as at 30 June 2010. Information was requested on the capital market situation at the reference date for the projection, an equity scenario and these two scenarios combined with an increase in the yield curve, in each case as at year-end 2010. All of the pension funds withstood the four assumed scenarios financially at the reference date. In particular, in light of the generally low ratio of equities held in pension fund portfolios, only a few pension funds have any hidden liabilities in the own-account investments recognised at cost. The high level of own funds at the pension funds concerned would in itself be sufficient to ensure that future write-downs in the amount of these hidden liabilities can be funded.

V Supervision of banks, financial services institutions and payment institutions

Sabine Lautenschläger, Chief Executive Director of Banking Supervision

1 Bases of supervision

1.1 Implementation of CRD II

In 2009, European lawmakers amended the EU Banking Directive and Capital Adequacy Directive, by issuing three amending directives referred to together as the Capital Requirements Directive II (CRD II).[28] In Germany, CRD II was transposed into German law by the Act Implementing the Amended Banking Directive and the Amended Capital Adequacy Directive of 19 November 2010 (*Gesetz zur Umsetzung der geänderten Bankenrichtlinie und der geänderten Kapitaladäquanz-richtlinie* – CRD-II-Umsetzungsgesetz) and the Regulation Further Implementing the Amended Banking Directive and the Amended Capital Adequacy Directive of 5 October 2010 or CRD II Amendment Regulation (*Verordnung zur weiteren Umsetzung der geänderten Bankenrichtlinie und der geänderten Kapitaladäquanz-richtlinie* – CRD-II-ÄnderungsVO)[29], both of which entered into force on 31 December 2010.

CRD II draws on lessons learned from the financial crisis.

In addition to technical provisions intended to ensure uniform application of the existing Banking and Capital Adequacy Directives, CRD II contains provisions to promote sounder risk management practices by credit institutions with regard to the composition of own funds, the large exposures regime and securitisation. It also incorporates rules intended to improve international cooperation, particularly in the event of a crisis. CRD II thus reflects the outcome of international discussions on the need for improvements in banking supervision legislation revealed by the financial crisis.

Changes to large exposure regime.

In order to limit the systemic effects caused by distressed institutions in the banking sector, the previous discretionary exemptions for interbank loans under the large exposure regime have been repealed. In future, an institution must count all exposures to another institution towards the large exposure limit in full, irrespective of their maturities. To assist smaller institutions, however, the large exposure limit for interbank loans has been raised. In addition, exemptions are provided for the settlement of payment and securities transactions and the underlying

[28] Directive 2009/27/EC, OJ EU no. L 94 dated 8 April 2009, p. 97-99; Directive 2009/83/EC, OJ EU no. L 196 dated 28 July 2009, p. 14-21; Directive 2009/111/EC, OJ EU no. L 302 dated 17 November 2009, p. 97-119.

[29] Federal Law Gazette (BGBl.) I 2010, p. 1592; Federal Law Gazette (BGBl.) I 2010, p. 1330.

correspondent banking business. Under the provisions, overnight loans arising from these transactions and correspondent banking loans granted until the close of business will in future be exempted from the definition of an exposure from the outset.

In a further lesson from the financial crisis, the rules governing the formation of borrower units (especially as a result of economic dependencies) have been tightened. Previously, only mutual dependencies resulted in borrowers being aggregated, but now unilateral dependencies are sufficient. Institutions must therefore examine whether the default of one borrower would result in the default of the other borrower and, if applicable, view the two clients as a single borrower unit. However, institutions may initially assess possible dependencies at their own discretion.

Significant changes also relate to the definition of borrowers in structures whose underlyings are assets such as securitisations or investment funds. Until now, only the structure itself was regarded as a separate borrower; the underlying assets were disregarded. Now an institution must be more sensitive to risk when identifying the borrower and must consider both the overall structure and – by adopting a look-through approach – the underlying assets.

Retention requirement for securitisations.

Under the securitisation rules introduced in CRD II, an institution may only invest in a securitisation transaction if it has confirmation from the originator, the original lender, or the sponsor that that party will retain at least 10% of the securitised credit risk. Securitisation transactions effected in the period to 31 December 2014 are subject to a minimum retention requirement of 5%. Retention is intended to ensure that entities that use securitisations for refinancing purposes retain an adequate interest in the quality of the securitised exposures. The aim here is to counteract adverse incentives underlying the originate-to-distribute model. Institutions must also build a comprehensive picture of the risks associated with the investment in securitisation transactions. To do so, they must be able to document their analyses for each investment and demonstrate that they have adhered to the necessary processes. At the same time, originators and sponsors are required to inform investors about the retention and all relevant data relating to the securitised portfolio and the specific securitisation structure.

Securitisation

In a securitisation transaction, the risk that the borrowers of a credit or securities portfolio, for example, will no longer meet their obligations towards the creditor is allocated among at last two securitisation tranches, with the tranches ranked by the order of priority in which payment obligations will be met. Payments to investors in such securitisation tranches therefore depend on the ranking of the tranche in question and the occurrence of defaults within the securitised portfolio as a whole. Higher-ranking tranches do not share in any losses until lower-ranking tranches have been fully exhausted by defaults.

There are usually three parties to a securitisation transaction: the originator, the sponsor and the investor. While the investor invests in the securitisation tranches, the originator is the institution whose portfolio is the source of the assets in the securitised portfolio. A sponsor is an institution that initiates and manages a securitisation scheme without itself being the originator of the underlying exposures.

Uniform principles for the recognition of hybrid capital components as Tier 1 capital.

Section 10 Banking Act (*Kreditwesengesetz* – KWG), the core provision of German law governing own funds, has for some time contained specific rules on the eligibility of certain hybrid capital components for recognition as regulatory own funds in the form of the rules on the recognition of capital contributions by silent partners and liabilities under profit participation rights. At a European level, on the other hand, CRD II has established uniform criteria for the recognition of hybrid Tier 1 capital components for the first time. The list of criteria in CRD II therefore prompted the removal from the KWG of the previous link to specific forms of capital in favour of a principles-based rule. The revised section 10 (4) KWG for the first time contains requirements for the recognition of hybrid capital as Tier 1 capital that are purely qualitative and therefore do not specify particular forms of capital. The rule takes into account differences in the features of capital instruments, for example related to their permanence or ability to absorb losses, by introducing tiered limits on the eligibility of those instruments. However, even hybrid Tier 1 capital of the highest quality may at no time amount to more than half of the institution's Tier 1 capital. In future, whether and in what amount hybrid capital that has been raised is eligible as Tier 1 capital will therefore depend solely on whether it meets the qualitative requirements and not on whether it comprises capital contributions by silent partners or liabilities under profit participation rights.

For institutions, this means a greater degree of flexibility in raising hybrid capital, as they will not be forced to use particular equity instruments. At the same time, they will still be able to use established capital contributions by silent partners and liabilities under profit participation rights, provided they meet the qualitative requirements.

Hybrid capital

The term "hybrid capital" refers to capital components combining both debt and equity features. Due to its ability to absorb losses, this form of capital is extremely important from a supervisory perspective. Until now, hybrid capital has been created by issuing profit participation certificates and through silent partner contributions. In future, hybrid capital will have to meet certain qualitative requirements, regardless of its form.

Cooperation among European supervisory authorities strengthened.

The financial market crisis highlighted the importance of information sharing and cross-border cooperation among supervisory authorities to efficient prudential supervision of cross-border banking groups. CRD II therefore provides for supervisory colleges as instruments of cross-border cooperation which will be established and used to a greater extent in future. The aim of those supervisory colleges, which are made up of the authorities involved in supervising a particular banking group, is to coordinate overall supervisory activity more effectively, increase information sharing and help mitigate systemic risk. The authorities represented in the colleges will make joint decisions on the group's capital adequacy, for example. CRD II also provides for supervisory colleges to be set up for credit institutions that operate in other member states using branches only rather than subsidiaries.

Sharing information on significant branches.

If a branch is significant, the home member states will in future have to provide the host member states with information with regard to the systemic importance of the branch that is material to the host member state, especially in the event of a financial crisis. This is intended to reduce the information deficit between home and host member states. Under section 53b (8) KWG, a branch is regarded as significant, if for example, its market share as measured by deposits exceeds 2% or if, measured by the number of clients, it has a certain size and importance within the banking and financial system of the host member state. The authorities concerned agree jointly whether to classify a branch as significant. If they are unable to reach an agreement, the authority of the host member state has the right to make the final decision.

CRD II Amendment Regulation.

Many of the changes under CRD II – and some of the changes under CRD III requiring to be implemented as of 1 January 2011 – also affect the Regulation Governing the Capital Adequacy of Institutions, Groups of Institutions and Financial Holding Groups (*Solvabilitätsverordnung* – SolvV) and the Regulation Governing Large Exposures and Loans of €1.5 Million or More (*Groß- und Millionenkreditverordnung* – GroMiKV). For these areas, the Federal Ministry of Finance (BMF) has transferred the authority to issue statutory regulations to BaFin. BaFin implemented the CRD into German law by way of the CRD-II-ÄnderungsVO dated 5 October 2010.

In addition to extensive changes to the provisions on large exposures, the CRD-II-ÄnderungsVO provides for changes to the securitisation rules, for example in relation to the recognition of significant risk transfers and to the conversion factors for certain liquidity facilities. It also contains changes relating to the recognition of life insurance policies as collateral and the risk weighting of investment fund units belonging to IRBA institutions in the event that the IRBA is not applicable. In addition, the CRD-II-ÄnderungsVO incorporates further amendments designed to correct and optimise the CRD's implementation to date with the SolvV and the GroMiKV. To the extent that this affects the provisions on large exposures, the regulation primarily reflects the clarifying guidelines on the large exposure rules published by the Committee of European Banking Supervisors (CEBS).

1.2 Restructuring Act

Act adopted in light of the financial market crisis.

German lawmakers adopted the Restructuring Act of 9 December 2010 (*Restrukturierungsgesetz*) in light of the financial failure of several systemically important credit institutions in the course of the financial market crisis.[30] The Act establishes procedures that enable institutions whose viability as a going concern is threatened to be restructured and reorganised at an early stage with the involvement of the owners. Orderly liquidation is also given consideration as a realistic alternative during this process. The financial burden must be borne primarily by the institution concerned, its creditors and the financial sector as a whole. Government support is a last resort and is limited to the amount absolutely necessary to stabilise the financial market. It also gives the government considerable influence over the institution concerned. The Restructuring Act is therefore an important step towards imposing discipline on the financial industry and resolving the too-big-to-fail problem, but only at a national level. At a European and international level, uniform principles are required in order to help harmonise national liquidation procedures and ensure better coordination of cross-border interventions. The necessary groundwork is being laid by the European Commission with its proposal for a European crisis management framework, as well as by international bodies such as the Financial Stability Board (FSB).[31]

Section 1 of the Restructuring Act introduces the new Act on the Reorganisation of Credit Institutions (*Kreditinstitute-Reorganisationsgesetz* – KredReorgG), which sets out a crisis management procedure tailored specifically to credit institutions. Section 2 implements more effective instruments for crisis prevention and management in the KWG. The Restructuring Fund Act (*Restrukturierungsfondsgesetz*) introduced by section 3 provides for the financial sector to share in the cost of a crisis. Finally, further sections extend the remit of the Federal Agency for Financial Market Stabilisation (FMSA) and the limitation period for the liability of members of governing bodies under the Stock Corporation Act (*Aktiengesetz*).

Two-stage procedure for restructuring and reorganising institutions.

The KredReorgG provides for a two-stage procedure to resolve serious financial problems at credit institutions. In the first stage, the institution concerned initiates a restructuring procedure by notifying BaFin that it is in need of restructuring and applying for the procedure to be carried out. A credit institution is assumed to be in need of restructuring if its current circumstances indicate that it is unlikely to be able to meet regulatory liquidity and capital requirements on an ongoing basis. The institution then draws up a restructuring plan and proposes a restructuring adviser. The measures are implemented after being examined by BaFin and the court of jurisdiction, the Higher Regional Court (*Oberlandesgericht*) in Frankfurt am Main. The restructuring procedure allows the

[30] Federal Law Gazette (BGBl.) I 2010, p. 1900.
[31] FSB press release dated 12 November 2010, "G20 Leaders endorse Financial Stability Board policy framework for addressing systemically important financial institutions".

institution to improve its financial position by taking a broad range of measures at an early stage and under the protection of an organised judicial procedure. At this stage, however, no measures may be taken that affect the rights of third parties.

These only become possible in the second stage, the reorganisation procedure. If a credit institution believes that a restructuring procedure has no prospect of success or if such a procedure fails, it can apply to BaFin for a reorganisation procedure to be implemented. For this, the institution must propose a reorganisation adviser and submit a reorganisation plan consisting of a descriptive section and a constitutive section. The descriptive section sets out the measures planned to avert the threat to its viability as a going concern, which may now also provide for actions that affect the rights of third parties. For example, payment of the institution's liabilities may be deferred or reduced, or its capital may either be reduced or increased while disapplying pre-emptive rights. It is also possible to convert debt into equity (debt/equity swap) or transfer some or all of the assets to another entity. The constitutive section then describes the actual procedure in detail and how the planned measures are to be implemented. If BaFin believes that the institution's viability as a going concern is threatened and if this in turn could pose a threat to the financial system as a whole, it forwards the application, the reorganisation plan and the proposal for a reorganisation adviser to the Higher Regional Court in Frankfurt am Main, which then takes the final decision on whether there is a threat to the institution's viability as a going concern and, as a result, to the system. If the Court orders the reorganisation procedure to be carried out, the creditors – divided into groups – and the shareholders vote on the reorganisation plan. If the plan is accepted, its constitutive effects take effect on confirmation by the Court and the reorganisation procedure comes to an end.

New KWG rules allow early intervention by BaFin.

The changes to the KWG that were introduced by the Restructuring Act and that came into force on 1 January 2011 also strengthened BaFin's powers in the area of crisis prevention. For example, BaFin can now require that an institution take steps to restructure its activities, and enforce such steps, earlier on. In addition, the instruments available to it to ensure effective supervisory intervention when an institution is in difficulty have been expanded and enlarged; for example BaFin can appoint a special representative as a separate measure. Previously, this was only possible when sanctions were imposed on senior managers.

Transfer orders – a last resort.

If a systemically important institution is in distress and it is feared that this poses an acute threat to the financial market as a whole, BaFin may issue a transfer order under sections 48a et seq. of the KWG as a last resort in order to safeguard the stability of the financial market. If, for example, a reorganisation plan is not accepted by creditors, BaFin may transfer some or all of the assets and liabilities of a bank whose viability as a going concern is threatened to another legal entity. The same applies if it appears that such a reorganisation procedure cannot be carried out quickly enough to effectively avert the threat of a systemic crisis.

Requirements for transfer orders.

A transfer order requires that the credit institution's viability as a going concern is threatened (going concern risk) and that this in turn poses a threat to the stability of the financial system (systemic risk). According to section 48b (1) sentence 1 KWG, going concern risk is the risk of the credit institution collapsing as a result of insolvency if no corrective measures are taken. Systemic risk exists if it is feared that this threat to the credit institution's viability as a going concern could have a significantly negative impact on other financial sector enterprises, on the financial markets, or on the general confidence of depositors and other market participants in the proper functioning of the financial system (section 48b (2) sentence 1 KWG). Besides this, the transfer order must represent the least severe remedy. This is the case if the systemic risk resulting from the going concern risk cannot be eliminated just as safely other than by means of the transfer order.

Consideration for the transfer order.

The transfer order must provide for appropriate consideration to be paid for the assets represented by the business. The consideration can take the form of an equity interest in the transferee entity or a cash settlement. To stabilise the financial market, it will usually be necessary to also provide the other legal entity with capital or guarantees. The ratio of additional funds to the value of the transferred assets then determines the size of the equity interest. If the value of the transferred assets is negative overall, the transfer order will provide for a compensation payment by the institution to the other legal entity instead of consideration.

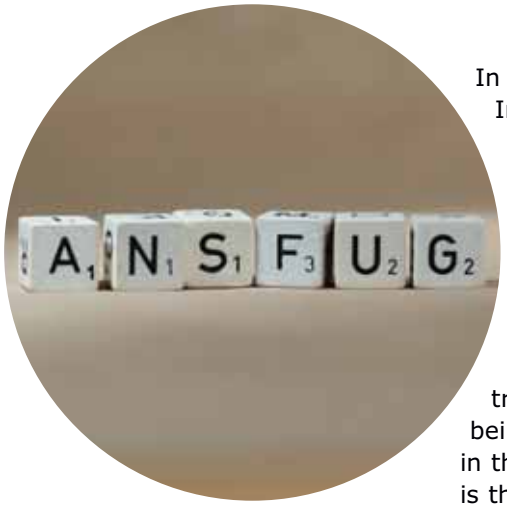
Establishment of a restructuring fund under the FMSA.

Fresh capital and additional guarantees are usually required in order to avert a threat to the stability of the financial market. In future, the resulting costs are also to be borne by all credit institutions. To achieve this, a restructuring fund has been established under section 3 of the Restructuring Act. All credit institutions must contribute to this fund via the Bank Levy, the amount of which is based on the business volume, size and interconnectedness in the financial market of the credit institution required to make the contribution and which thus reflects the varying degrees to which individual credit institutions are systemically important. The restructuring fund is administered by the FMSA under the legal and technical oversight of the Federal Ministry of Finance and the aim is for it to provide the support funds required under a transfer order, for example. At the same time, the FMSA is being given a wider remit. In future, it will not only be entrusted with the administration of the restructuring fund, but will also be involved in executing restructuring measures in the banking sector.

Extended limitation period.

Another change introduced by the Restructuring Act affects the limitation period for liability for breaches of duty by members of a credit institution's governing bodies. In future, such liability claims will become statute-barred after a uniform period of ten years. This means that it will now be possible to bring claims for compensation even if a breach of duty comes to light at a late stage.

1.3 Act to Increase Investor Protection and Improve the Functioning of the Capital Markets



In a further response to the financial crisis, the Act to Increase Investor Protection and Improve the Functioning of the Capital Markets (*Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts* – AnsFuG) was promulgated in the Federal Law Gazette on 7 April 2011.[32] Some of the new provisions established by the AnsFuG take effect immediately, while others take effect up to 18 months after the Act's promulgation. The Act is intended to boost confidence in the integrity and functioning of the capital markets, for example by increasing market transparency and better protecting private investors against being wrongly advised. The losses incurred by many investors in the course of the financial crisis have shown how important it is that investment services enterprises provide comprehensive information and advice on financial market products. The Act therefore provides for several changes to the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG) for investment services enterprises.

Product information sheet for customers.

When providing investment advice, investment services enterprises will in future have to provide their customers with a product information sheet before a transaction is concluded. This should contain a clear and concise summary of the key information on the financial instrument being recommended. On no more than two to three pages, it should describe the nature of the financial instrument, how it works and the risks involved, including the prospects for repayment and returns. In the information sheet, the institution must also inform the customer of the costs associated with the investment. The legal changes are intended to improve the basic information provided to investors: experience shows that a brief and precise overview of the opportunities and risks associated with an investment is more likely to be absorbed than the comparatively very detailed information contained in the prospectus.

Registration and qualifications of investment advisers and other persons.

The AnsFuG requires investment services enterprises to inform BaFin about the staff engaged in providing investment advice, their sales representatives and their compliance officers. Such persons also have to meet specific requirements with regard to their reliability and professional qualifications. In addition, the AnsFuG requires investment services enterprises to report customer complaints and extends the range of possible sanctions available to BaFin. This is intended to ensure that the Supervisory Authority receives indications of possible irregularities at particular institutions or branches. BaFin enters this data in an internal database that enables it to better monitor legal compliance during the provision of investment advice. The list of administrative offences subject to a fine has been extended in order to ensure the

[32] Federal Law Gazette (BGBl.) I 2011, p. 538 et seq.

new notification requirements are implemented effectively. BaFin can fine enterprises not only for reporting a complaint late, incorrectly, or not at all, but also for unlawfully engaging employees who do not have the qualifications necessary to meet the legal requirements or who do not possess the necessary reliability.

1.4 Amendment to the Pfandbrief Act

Position of cover pool administrators strengthened to benefit Pfandbriefe.

On 25 November 2010, the amendment to the Pfandbrief Act (*Pfandbriefgesetz* – PfandBG) entered into force. The changes are aimed primarily at further improving the quality of Pfandbriefe by strengthening the legal position of cover pool administrators. One key change relates to the potential scenario in which the issuing bank becomes insolvent: in order to better ensure in cases of insolvency that a cover pool administrator's cover pool with the related Pfandbrief claims – the solvent part of the otherwise insolvent Pfandbrief bank – can be provided with liquidity at all times, this cover pool will continue to exist as a "Pfandbriefbank with limited business activities". This allows the cover pool administrator to offset any temporary shortfalls in liquidity related to the cover pool by obtaining liquidity both directly from the European Central Bank (ECB) and through the capital market by issuing Pfandbriefe. In addition, the lawmakers worded the central provisions governing the separation of the cover pool from the insolvent estate in section 30 (1) PfandBG more clearly and introduced the clarifying wording "segregation principle in the event of the Pfandbrief bank's insolvency" and "insolvency-free estate" for the cover pool.

New provisions governing limitations of liability and remuneration for Pfandbriefe trustees.

The limitation of trustee liability and the provision on trustee remuneration were also amended. The latest amendment defines more precisely the limitation of trustee liability established by the 2009 amendment to the PfandBG by capping the compensation required to be provided in the event of gross negligence at €1 million (section 7 (5) PfandBG). The new provision also allows the Pfandbriefbank to take out appropriate insurance for the trustee and pay the premium. A further change relates to trustees' remuneration, which was previously payable by BaFin and only in a second step had to be reimbursed to BaFin by the Pfandbrief bank. In future, the remuneration will be payable by the Pfandbriefbank directly; however, BaFin will continue to set the amount of the remuneration. In addition, the Pfandbriefbank can now refund the trustee's necessary expenses, such as travel costs, directly. The aim of these new provisions is to make the role of trustee more attractive.

Transparency provisions also revised.

In addition, the transparency provisions contained in section 28 PfandBG have been tightened further. Cover pool values and Pfandbrief liabilities must now be published within a period of one month; for the fourth quarter, a period of two months applies.

Further changes introduced by the Restructuring Act.

Further important clarification regarding the separation of the cover pools and the role of cover pool administrator was provided by the Restructuring Act, which introduced the new section 36a PfandBG. Section 36a (1) explains that the parts of a Pfandbrief-bank that would continue to exist as a Pfandbriefbank with limited business activities in the event of insolvency are not included in any reorganisation procedure under the KredReorgG. Rather, sections 30 to 36 PfandBG apply accordingly as special provisions. In addition, BaFin's ability to appoint a temporary cover pool administrator of its own motion ensures continuity in the reliable administration of cover pools. However, the special provision is not designed to rule out the possibility of the cover pool administrator's measures being included in a reorganisation plan, provided the Pfandbrief holders are not adversely affected as a result.

Section 36a (2) PfandBG contains a further special provision for the event that a transfer order under section 48a KWG transfers some or all of the Pfandbrief business to another legal entity. The transfer of this part of the Pfandbrief bank is not performed in accordance with section 48g (2) no. 1 KWG, which requires universal succession with regard to the assets covered by the transfer order. Rather, it is the task of the cover pool administrator – who must also be appointed in this case as well – to perform the transfer in accordance with sections 30 to 36 PfandBG, but only to the extent that the Pfandbrief holders are not adversely affected as a result.

1.5 Remuneration Regulation for Institutions

The Act on the Supervisory Requirements for the Remuneration Systems of Institutions and Insurance Undertakings (*Gesetz über die aufsichtsrechtlichen Anforderungen an die Vergütungssysteme von Instituten und Versicherungsunternehmen*) of 21 July 2010 introduced the Remuneration Regulation for Institutions (*Instituts-Vergütungsverordnung* – InstitutsVergV) and its insurance industry counterpart, the Remuneration Regulation for the Insurance Industry (*Versicherungs-Vergütungsverordnung* – VersVergV) among other things.[33] Both regulations entered into force on 13 October 2010. They complete a three-stage package of measures by the Federal Government to implement in Germany international requirements for remuneration systems, and in particular the FSB Principles for Sound Compensation Practices and the standards that build on them.[34] The previous steps comprised a voluntary commitment to comply with the FSB requirements given by eight large banks and the three largest insurance undertakings in December 2009, and circulars 22/2009 (BA) and 23/2009 (VA) issued by BaFin on 21 December 2009 regarding the regulatory requirements for remuneration systems. These circulars were repealed when the InstitutsVergV and the VersVergV entered into force.

[33] Federal Law Gazette (BGBl.) I 2010, p. 950, 1374, 1379.
[34] FSB Principles for Sound Compensation Practices dated 2 April 2009 and Implementation Standards dated 25 September 2009.

Germany leads the way in implementing the FSB requirements.

The FSB principles and standards aim to ensure maximum convergence in the remuneration rules applicable to banks that operate worldwide. The thrust of the requirements is to counteract any adverse incentives that may lead to excessive risk-taking, the aim being to promote a remuneration culture based on a sustainable business strategy. The FSB monitors the implementation of its requirements in national legal systems and at institutions. An initial peer review was conducted in the first quarter of 2010 and the results published.[35] This report shows Germany leading the way in implementing the FSB requirements. The FSB has scheduled the next peer review for the second quarter of 2011.

CRD III introduces European remuneration requirements.

Requirements for remuneration systems have also been drawn up at a European level. Back in April 2009, for example, the European Commission published recommendations on remuneration policies in the financial services sector. At the same time, the Committee of European Banking Supervisors (CEBS) drew up initial remuneration principles. However, the key development came on 14 December 2010 with the publication of CRD III, which amended the Banking Directive and the Capital Adequacy Directive not only with regard to the capital requirements for the trading book and re-securitisations, but also with regard to the supervisory review of remuneration policies.[36] CRD III also tasked CEBS with drawing up guidelines on the remuneration requirements under CRD III, which CEBS published on 10 December 2010 – before CRD III was issued. The CEBS guidelines define the concepts contained in CRD III in more detail so as to ensure that the Directive's requirements are implemented as uniformly as possible in national legal systems and at institutions across Europe.[37] Like the FSB, the successor organisation to CEBS, the European Banking Authority (EBA), will also track implementation of the European requirements through peer reviews. The German InstitutsVergV already reflects the requirements of CRD III and the CEBS guidelines.

Remuneration rules incorporate double proportionality.

In implementing the international requirements, the heterogeneous banking structure in Germany with its many small institutions was taken into account by issuing rules that apply on a proportionate basis. General requirements comprising a number of basic provisions for all institutions have been established. Special requirements over and above those general requirements apply only to major institutions. However, they do not affect all employees of major institutions, as these also employ a large proportion of "normal employees" with a moderate level of pay. In particular, they affect those employees whose activities have a material impact on the institution's overall risk profile. This ensures that the exacting special requirements only apply to those institutions and employees that are relevant from a remuneration and risk perspective.

Scope of the InstitutsVergV.

The InstitutsVergV is aimed at institutions as defined in the KWG, i.e. credit institutions and financial services institutions in particular. The Regulation must also be observed by all legally

[35] FSB Thematic Review on Compensation: Peer Review Report dated 30 March 2010.
[36] Directive 2010/76/EU, OJ EU no. L 329/3 dated 14 December 2010, p. 3-35.
[37] CEBS Guidelines on Remuneration Policies and Practices dated 10 December 2010.

dependent branches of enterprises domiciled outside Germany within the meaning of section 53 (1) KWG. Due to the principle of home supervision, the InstitutsVergV does not apply to branches of enterprises domiciled in another European Economic Area state (section 53b KWG). However, these branches are also required to observe the requirements of CRD III and the CEBS guidelines through the legal system of the member state in which the enterprise is domiciled.

Classification as a major institution.

The question of when an institution should be classified as major depends, firstly, on its total assets and, secondly, on a risk analysis to be performed by the institution itself and documented in writing. This risk analysis must be performed at all institutions whose total assets reached or exceeded an average of €10 billion at the balance sheet dates of the last three completed financial years. Institutions with total assets of €40 billion or more are usually regarded as major. The risk analysis must take particular account of the size of the institution, its remuneration structure and the nature, scope, complexity, risk exposure and international scale of the business activities it conducts, with particular significance being attached to its business activities. The analysis must be plausible, comprehensive and comprehensible to third parties. If the risk analysis is implausible and (deliberately) enables the institution to avoid being classified as major, the entire range of banking supervisory measures available for contraventions of section 25a KWG apply.

General requirements for remuneration systems.

All institutions, employees and senior managers are subject to the general requirements, but again the proportionality principle applies, meaning that the risk management set-up will depend on the nature, scope, complexity and risk profile of the institution. Smaller institutions with comparatively conservative business models do not, of course, have to apply the same standards as, say, large banks that operate internationally. Probably the most important general requirement is contained in section 3 (1) sentence 3 InstitutsVergV, according to which remuneration systems must be geared to the attainment of the objectives set out in the institution's strategies. Strategies are defined primarily as a sustainable business strategy and the risk strategy consistent with that business strategy within the meaning of the Minimum Requirements for Risk Management (MaRisk). The need to align remuneration systems with the institution’s strategies is a logical one, as remuneration systems, at least in reality, are also a tool for corporate management. Aligning remuneration systems with the institution’s strategies is intended to help ensure that objectives relevant to remuneration are sufficiently ambitious and that remuneration systems can make an effective contribution towards attaining the objectives set out in the corporate strategies. At the same time, this underscores the role of remuneration systems in general and variable remuneration components in particular in managing risk.

Special requirements for major institutions.

If an institution is regarded as major, it must carry out its own risk analysis to identify those employees whose activities have a material impact on its overall risk profile. The criteria used for the risk analysis may include size, the nature of the business activities (e.g. investment banking), business volume, risk levels and an organisational unit's revenues. Other possible criteria are an employee's activity (e.g. as a trader), position and remuneration to date and a distinctly competitive labour market. Under section 5 (2) InstitutsVergV, employees and senior managers identified as a result of this analysis are subject to special rules that go significantly beyond the general requirements.

Special requirements for major institutions.

One important requirement is that institutions take into account risks and their time horizons as well as the cost of capital and liquidity. An institution can do this ex ante, for example by using risk-adjusted performance measures to assess performance relevant to remuneration and choosing assessment periods spanning several years. Risks can also be taken into account ex post when remuneration is paid out. In this regard, the InstitutsVergV contains a number of detailed provisions based on the equally detailed international requirements, and particularly CRD III. For example, the Regulation requires longer payment and deferral periods and the possibility of a malus arrangement. It is important in this context that the malus arrangement is not based on "alibi" criteria that are unlikely to occur. Malus arrangements must take effect in the event of negative financial performance both by the institution as a whole and by just one of its organisational units. In addition, a portion of the variable remuneration must consist of equity-based remuneration instruments linked to the institution's long-term value performance, in particular shares or share-based instruments such as share appreciation rights. At institutions which do not have any shares for use as a remuneration instrument, this can also include hybrid capital or similar forms of capital. These remuneration instruments must be subject to a deferral period during which the remuneration components may not be accessed.

Remuneration committee at major institutions.

In addition, major institutions are required to establish a remuneration committee (section 6 InstitutsVergV), although it may also make sense to do so at institutions that are not regarded as major. The task of the remuneration committee is to monitor the appropriateness of the remuneration systems. The remuneration committee may also help to design and enhance the remuneration systems. In addition to employees from the human resources department, the members of the committee must also include employees from organisational units responsible for initiating business and performing control functions, such as the front office, trading, back office, risk management, compliance, or internal audit units. Bringing the human resources department together with an institution's other units helps to improve both the quality of the remuneration system and its acceptance among employees. For example, the committee can identify any deficits in the remuneration systems early on and thus act to prevent undesirable developments.

1.6 Minimum Requirements for Risk Management amended in 2010

On 15 December 2010, BaFin published the revised Minimum Requirements for Risk Management (MaRisk) in circular 11/2010 (BA).[38] After publishing a revised version of MaRisk back in August 2009, it amended and extended the requirements for risk management by credit institutions again in 2010. This time too, the main reason for the revision was to reflect international work in the area of risk management, driven forward by CEBS and the Basel Committee on Banking Supervision. CEBS in particular had published a series of new guidelines addressing diverse aspects of banks' risk management. Those requirements had to be transposed into the national regulatory framework. In some areas, BaFin also made changes based primarily on lessons learned from supervisory and audit practice. The new MaRisk requirements must be implemented by institutions by 31 December 2011 at the latest.

Focus of the changes resulting from international developments.

The amendments to MaRisk resulting from CEBS's work to achieve convergence centre mainly on risk concentrations, stress tests and liquidity buffers. In some cases, BaFin was able to build on existing requirements by supplementing and clarifying their content in greater detail. Above all, greater emphasis was placed on the inter-risk nature of certain risk concentrations in an effort to overcome the "silo" problem in risk management and monitoring that emerged during the financial crisis. This problem is characterised by the isolated management of individual types of risk, which therefore form a type of "silo"– among other things due to the frequent lack of communication between the individual risk management units. As a result, the overall risk management system fails to capture the interdependencies between individual risk types and drivers. By addressing the issue of inter-risk concentrations and clarifying that these also need to be identified and managed, the new MaRisk makes institutions aware of the problem.

New requirement: reverse stress tests.

The new MaRisk obliges institutions to extend their stress-testing programme to include reverse stress tests for the first time. In these stress tests, institutions are required to analyse which stress scenarios could result in a given stress test outcome – in other words that could render their own business model unviable. While conventional stress tests are based on a particular scenario that is used to identify an outcome, reverse stress tests start by defining the outcome and working back to identify the stress scenario concerned. Even though such reverse stress tests are seldom found in practice at present, from a banking supervisory perspective they can make a useful contribution towards answering the question of which scenarios would threaten an institution's survival. It is particularly interesting to analyse which interactions

[38] www.bafin.de » Publications.

among which risk drivers could rock an institution's business model. At the same time, these stress tests enable institutions to gain an alternative, unbiased view of their own risk position and the risk drivers that could pose a particular threat to their own business activities. Moreover, as a side effect, they can also be used to examine whether the regular stress tests are sufficiently rigorous and therefore sufficiently focused.

Requirement for liquidity buffers.

As required by CEBS, BaFin also set out the qualitative and quantitative requirements for liquidity buffers in more detail. The CEBS guidelines require institutions to hold liquidity buffers composed of highly liquid, recoverable assets that can be sold in private markets within a very short time and therefore ensure the provision of liquidity both in the very short term (one week) and over a longer time horizon (at least one month). The institutions are themselves responsible for determining the size of these buffers on the basis of their own stress tests. Here, CEBS has stipulated certain issues that the institutions must include when defining the underlying stress scenarios. The emphasis on recoverability means that equities and other assets whose market prices exhibit a certain level of volatility are not eligible as liquidity buffers.

Experiences during the financial crisis demonstrated that those institutions that mainly obtain funding in the money and capital markets are particularly susceptible to shortages of liquidity. In this context, the CEBS guidelines refer to "money centre banks". BaFin has taken account of this basic idea by restricting the new requirements for liquidity buffers to publicly traded institutions. These are institutions which have issued securities that are traded on a stock exchange. This also ensures that sufficient weight is given to the proportionality principle.

Lessons learned from supervisory and audit practice.

The new MaRisk also reflects experiences drawn from supervisory and audit practice. For example, BaFin has rewritten the requirements with regard to drawing up strategies to reflect weaknesses identified in practice: in some cases in the past, significant internal and external influences were not given sufficient consideration in defining strategic objectives; in others, the strategic objectives themselves were too vague to be able to assess whether they had been met. A further weakness was the occasional lack of alignment between the business strategy and the risk strategy. On this point, the new MaRisk therefore focuses on a consistent strategy planning process that requires institutions to take a more structured approach to setting, implementing, reviewing and amending strategic objectives. In particular, it now clarifies that objectives should be worded in such a way that a meaningful assessment of whether they have been met is possible.

Additionally, BaFin has for the first time drawn up detailed requirements for including diversification effects in institutions' internal risk-bearing capacity concepts. This is intended to counteract all too progressive assumptions by institutions about those effects, to the extent that these do not adequately reflect their individual circumstances. In the new MaRisk, BaFin has drawn

up requirements that focus on determining inter-risk diversification effects in an appropriately conservative manner. Crucially, the data used must capture the institution's individual business and risk structure. In addition, it must be considered whether the effects also prove to be sufficiently stable in economic upturns and downturns or in times of unfavourable market conditions for the institution. Institutions are required to demonstrate that the effects they have included are stable, that they were determined in a conservative manner and that the data are applicable to their individual circumstances.

Although some requirements in the new MaRisk have been set out in more specific terms, BaFin has deliberately retained the tried-and-tested principles-based approach. The proportionality principle also continues to play a major role in MaRisk, thereby ensuring that smaller institutions still have the scope they need in implementing the requirements. BaFin will continue to adopt the same basic approach going forward.

1.7 Minimum Requirements for Compliance

On 7 June 2010, BaFin published its circular entitled Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 et seq. Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG) for Investment Services Enterprises (MaComp). MaComp brings together BaFin's interpretations of the above-mentioned requirements in a single regulatory document and therefore serves as a compendium. It consists of a General Part and a Special Part: the General Part comments, in particular, on the scope of application and purpose of the Circular, the responsibility of management and general organisational requirements for investment services enterprises. The Special Part consists of various modules clarifying the individual provisions of sections 31 et seq. WpHG in greater detail. These MaComp modules include the previously separately-published circulars on the monitoring of personal account dealing of employees, marketing and financial analysis as well as new modules on the status and tasks of the compliance function and the best execution of client orders.

New modules on compliance…

The information provided on compliance is aimed at strengthening the status of the compliance function in investment services enterprises. BaFin makes clear that the compliance function should both monitor and assess the policies and procedures established by the enterprise and advise the operating units. It also clarifies in greater detail the professional requirements for compliance function staff and explains their tasks, powers and position within the enterprise's organisational structure, in particular discussing the relationship between the compliance function and the internal audit function. BaFin also stresses the preventive nature of the compliance function, which is intended to counteract any

undesirable developments at an early stage. For example, the compliance function should typically be involved in processes such as the new product approval process. With regard to the compliance function's monitoring activities, the circular makes clear that the compliance function must itself perform monitoring activities in operating units such as sales at least on a random sampling basis, which includes performing on-site inspections at branches, for example. Among other things, these inspections may cover marketing communications or records of investment advice. The Circular obliges investment services enterprises to inform BaFin of the appointment and removal of the compliance officer.

…and best execution.

The explanation regarding best execution serves to answer questions related to the interpretation of section 33a of the WpHG. This provision requires institutions to establish policies that ensure that client orders are executed at the stock exchange or execution venue where the best possible result can be obtained for the client. With this in mind, BaFin sets out in greater detail the criteria that an enterprise may use in selecting the best execution venue for client orders. Finally, the Circular explains how the regular reviews of execution policies by institutions should be performed and what precautions they should take in executing client orders using third-party institutions.

1.8 Revised reporting system

In 2010, BaFin and the Bundesbank drew up a joint concept paper on the modernisation of the prudential supervisory reporting system. The aim is to improve the basic information available to supervisors and thus strengthen micro- and macroprudential banking supervision. The full concept paper was published for public consultation in March 2011. Parts of it are to be implemented in the course of the year. The concept paper provides for changes in several areas.

FINREP and COREP guidelines to be taken into account.

Firstly, the content and frequency of reporting on interim financial data are to be improved and adapted in some areas to reflect the CEBS requirements (Revised Guidelines on Financial Reporting – FINREP). The Supervisory Authority's goal is to gain new opportunities for evaluation and a better overview of institutions' financial position. There are plans for a tiered reporting module based on the format of annual and consolidated financial statements in accordance with the German Commercial Code (*Handelsgesetzbuch* – HGB) and International Financial Reporting Standards (IFRSs). Accordingly, a common basic reporting system based on existing monthly reports is to be introduced at entity and group level for HGB-based reporting. Publicly traded parents that prepare IFRS consolidated financial statements must additionally meet more extensive reporting requirements under FINREP. Some FINREP users – systemically important institutions – will have to meet additional reporting requirements such as reporting income broken down by business line.

Secondly, the revised system reflects developments in the standardisation of solvency reporting requirements driven by the CEBS's Revised Guidelines on Common Reporting (COREP). COREP is intended to establish a standardised reporting format for solvency figures that is to be adopted as a European directive.

Common Reporting (COREP) and Financial Reporting (FINREP)

With its Guidelines on Common Reporting (COREP) and Guidelines on Financial Reporting (FINREP), the Committee of European Banking Supervisors (CEBS) – now the European Banking Authority (EBA) – aims to harmonise and increase convergence between supervisory reporting systems for capital requirements and financial reporting, which vary considerably at national level. The International Accounting Standards (IASs and IFRSs) provide the starting point for this. The COREP and FINREP guidelines for the first time establish uniform definitions and reporting formats, which serve as the basis for the national reporting systems. The content of these requirements is based on the proportionality principle: the scope and frequency of the reports is determined by the size and complexity of the institutions.

Reporting system for loans of €1.5 million or more is extended.

BaFin also plans to extend the reporting system for loans of €1.5 million or more under section 14 KWG. The aim is to gain a deeper insight into the nature, scope and quality of lending. To do so, the concept paper plans to extend the definition of a loan and lower the reporting threshold to €500,000 (until now €1.5 million). In addition, reports are to be submitted entirely electronically and their frequency is to be increased. This will substantially improve the quality and topicality of the data on loans of €500,000 or more. In particular, macroprudential supervision by the Bundesbank will benefit.

New format for ICAAP reporting.

Finally, in revising the reporting system, it is planned to include a format for submissions as part of the Internal Capital Adequacy Assessment Process (ICAAP reporting). The new reporting format gives the Supervisory Authority an in-depth yet up-to-date insight into banks' internal procedures for managing risk-bearing capacity. Reports are required to contain figures taken from institutions' internal risk management systems, backed up by qualitative data.

2 Preventive supervision

2.1 Supervision strategy

By passing the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector, which came into effect in summer 2009, lawmakers have considerably expanded the banking supervisors' powers of intervention. In addition to newly created measures, BaFin can also apply certain existing measures at an earlier point and thus play a more effective preventive role.

This makes the lawmakers' mandate clear: to prevent crises in the financial markets from intensifying, the banking supervisors must be able to counteract negative developments at the institutions at a much earlier stage. They should not merely start taking action when risks at institutions have turned into losses, but in advance, as soon as it is clear that institutions are failing to manage the risks to which they are exposed. This preventive approach is not limited to early intervention alone: the supervisors should also start acting earlier, i.e. including in cases that are less critical, and not just in extreme cases. To this end, the banking supervisors must focus more sharply than before on the business strategies of the institutions and factor the insights they gain into their activities.

Risk Committee for cross-sector assessment of the market environment.

Preventive supervision has been strengthened not only by the new powers that are now available, but also by the activities of the Risk Committee that BaFin established together with the Bundesbank in 2009. This committee's task is to link systemically relevant information – especially insights into macroeconomic trends, specific sectors and risks, as well as those gained from all of BaFin's supervisory areas – with the supervision of individual institutions. The Risk Committee scrutinises the institutions within their market environment. It analyses information on the market environment, such as macroeconomic trends and findings from cross-sectoral and peer group comparisons of the institutions, for the supervisors. The risks identified by the Risk Committee form the basis for strategic supervisory planning that sets out which measures are necessary for which institutions and banking groups from a systemic perspective.

2.2 Supervisory and administrative bodies

More than 4,000 new supervisory and administrative body appointments.

By the end of 2010, i.e. just over eighteen months after the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector first imposed minimum legal requirements for the personal expertise and reliability of members of supervisory bodies, BaFin had been notified of more than 4,000 new appointments. Some 2,500 notifications related to new administrative board members at public-sector savings banks appointed since 1 August 2009. An unusual feature of these savings banks is that municipal elections regularly lead to the appointment of a large number of new administrative board members. Validation of these notifications takes up considerable resources, especially because many of the documents to be enclosed with the appointment notifications are incomplete or contain errors. Overall, the content and scope of the documents revealed a certain degree of uncertainty at the institutions. As a consequence, in a number of cases BaFin could not adequately assess the expertise and reliability of the supervisory or administrative body member in question required by section 36 (3) KWG. In these cases, BaFin had to ask for additional documents and, ultimately, demand the dismissal of the member concerned in isolated instances because there was no evidence that these persons satisfied the minimum legal requirements.

Assessing whether a supervisory or administrative body member is reliable requires firstly information about whether the individual concerned has committed any (financial) offences or contravened any statutory instruments. Secondly, the question needs to be posed as to whether there are any conflicts of interest that could adversely affect the diligent and proper performance of the supervisory mandate. The risk of such a conflict exists, for example, if the member of the supervisory or administrative body of an institution is a borrower from that institution who is at risk of default. In such cases, BaFin examines the specific aspects of the case in question to decide whether supervisory intervention – for example in the form of a dismissal notice – is necessary.

Expertise is essential.

The expertise of members of such governing bodies is an important condition for their ability to properly perform their duties. They must be able both to understand the institution's business and to comprehend and assess the central rationale of the bank's business and risk strategy that sets the income to be generated by the institution against the risks it enters into to generate that income (section 25a (1) KWG). Where necessary, supervisory or administrative body members must be able to enforce changes to an institution's management. In doing so, the supervisory board should adopt a preventive approach. This means that it must continuously scrutinise the bank's strategic orientation and initiate corrective action whenever its orientation is not sufficiently sustainable. The interfaces this requires are set out in the revised Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk). In accordance with MaRisk, management must discuss the institution's strategic orientation with the supervisory body and ensure that the supervisory body can obtain information from the institution's internal audit function.

Continuing education and advanced training possible and necessary.

If there are gaps in or doubts about the expertise of supervisory or administrative body members, it is possible to obtain the necessary expertise through continuing education following appointment. However, this training should be completed within six months of the appointment and the certificate of completion must be sent to BaFin without delay. Over and above this, continuing education should not be a one-off event. BaFin also expects all supervisory or administrative body members to undergo further training continuously while performing their mandates.

Information from areas of emphasis of audits under section 30 KWG.

Typically, the reports on the audits of institutions' annual financial statements contain little information about the ongoing activities of the administrative and supervisory bodies. To obtain a comprehensive overview of the situation in selected institutions, BaFin specified corporate governance in relation to supervisory and administrative bodies as an area of emphasis in financial statement audits for the first time in 2010 (by way of an order issued in accordance with section 30 KWG). The institutions were selected using a risk-based approach by size criteria and the overall risk profile assessment. The audit content addressed issues such as the frequency of supervisory body meetings, adequate preparation for the meetings with an agenda and draft resolutions, and whether

members had the possibility to acquaint themselves with preparatory documents. Another subject of the audit was the discussion of the relevant issues in the supervisory body and proper recording of the minutes. In addition, the auditors were required to focus on whether the supervisory body is informed of the key matters to allow it to assess the current and expected future economic development and the risk situation of the institution. The audits also addressed the question of the extent to which the institutions comply with the requirements for adopting resolutions and obtaining supervisory board approval for governing body and related party loans (section 15 KWG), and how they deal with administrative and supervisory body members who are at risk of default. Finally, the audits also had to examine continuing education measures for governing body members, the establishment of committees and preparations for committee meetings. Because not all of the reports on the audits of the financial statements are available yet, the results of the audit areas of emphasis are also still outstanding.

Guidance notice and BaFin event provide assistance.

At the beginning of 2010, BaFin published a guidance notice that provides more detailed explanations of the requirements governing supervisory and administrative bodies in accordance with section 36 (3) KWG.[39] In addition, in October 2010, BaFin organised the "Forum for Supervisory Bodies of Credit Institutions" in response to general interest in deeper dialogue with the supervisor. Members of supervisory and administrative bodies, members of executive boards and representatives of associations used the event to learn about the new requirements for supervisory bodies of credit institutions and to share their experience with BaFin. In addition to various expert presentation on the legal requirements, in particular the many supervisory practice case studies elicited lively interest from the participants.

2.3 Guidelines

Guidelines on the uniform application of powers of intervention.

In cooperation with the Bundesbank, BaFin has developed guidelines for various new powers of supervision: these relate specifically to the ability to institute measures to rectify organisational deficiencies (section 45b (1) sentence 1 KWG) and increased own funds requirements in response to such organisational deficiencies (section 45b (1) sentence 2 KWG), or in response to interest rate risk (section 10 (1b) no. 1 KWG). BaFin uses these guidelines as a basis for exercising its discretion in relation to supervisory measures. They are designed to ensure that the technical supervisors exercise their new powers on the basis of standardised benchmarks. The guidelines also facilitate cooperation with the Bundesbank because they specify the information that BaFin needs from the Bundesbank. The two institutions are jointly preparing further guidelines on exercising other powers of intervention.

[39] www.bafin.de » Publications » Guidance Notice dated 22 February 2010.

Treatment of interest rate risk in the banking book.

Many institutions used the term structure of interest rates in the year under review to improve their earnings position through intensive maturity transformation. Such a business strategy can turn out to be potentially dangerous if there is insufficient cover for the interest rate risks that the institution has entered into. The current version of the Solvency Regulation does not specify any own funds requirements for interest rate risk in the banking book. On the basis of the revised section 10 (1b) no. 1 KWG, BaFin can now order additional own funds requirements as a preventive measure if an institution enters into inappropriately high interest rate risk in its banking book. The guidelines agreed with the Bundesbank serve as the benchmark on which BaFin bases its decision whether to issue such an order.

3 Institutional supervision

3.1 Authorised credit institutions

Number of supervised institutions falls below 2,000 for the first time.

The number of authorised banks in Germany again declined sharply. For the first time, less than 2,000 credit institutions and securities trading banks were subject to supervision by BaFin in the year under review (1,923), compared with 2,008 in the previous year. BaFin distinguishes between four groups of institutions among the banks that it supervises: commercial banks, institutions belonging to the savings bank sector, institutions belonging to the cooperative sector and other institutions. Commercial banks include the major banks, private commercial banks and subsidiaries of foreign banks. In addition to the Landesbanks, the savings bank sector includes public-sector and independent savings banks. Institutions are assigned to the savings bank or cooperative sector primarily depending on their economic ties. As a result, DZ Bank and WGZ Bank also belong to the cooperative sector, for example. Finally, the other institutions include building and loan associations, Pfandbrief banks and securities trading banks, as well as the development banks operated by the federal government and the federal states.

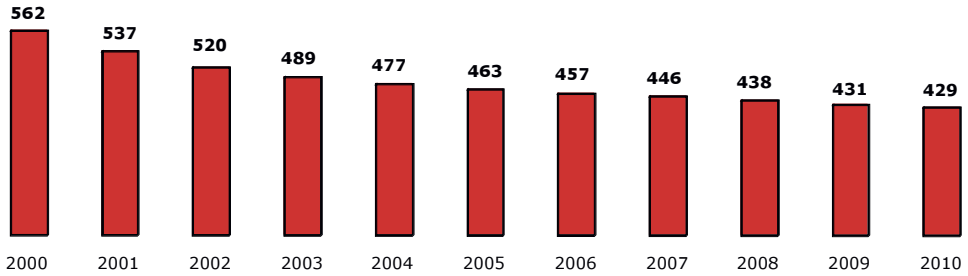
Table 14
Number of banks by group of institutions

Group of institutions	2010	2009
Commercial banks	189	204
Institutions belonging to the savings bank sector	439	441
Institutions belonging to the cooperative sector	1,145	1,208
Other institutions	150	155
Total	**1,923**	**2,008**

Slower pace of mergers in both the savings bank sector…

The pace of mergers in the savings bank sector continued to slow. At the end of 2010, 429 savings banks in Germany were supervised by BaFin. There were 431 institutions in the previous year, as against 438 in 2008. This means that the number of supervised savings banks decreased by 0.5%.

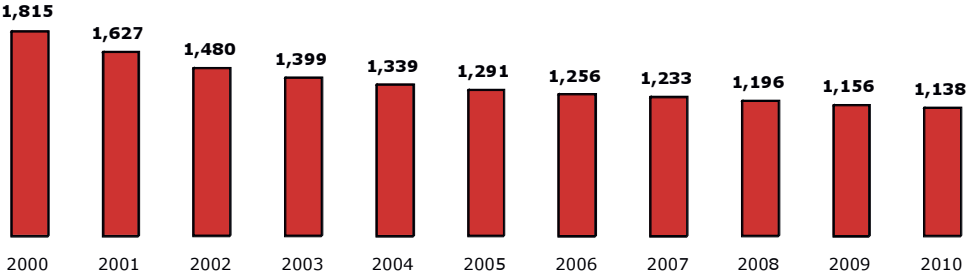
Figure 14
Number of savings banks



…and the cooperative sector.

In the cooperative sector, a total of 1,138 primary institutions, two central institutions, eleven related institutions providing specialist services and 46 housing cooperatives with a savings scheme (that also belong to the cooperative segment) were supervised by BaFin at the end of 2010. The number of primary institutions therefore dropped by 18 or 1.6%. This shows that the pace of mergers among cooperative credit institutions has also slowed compared with previous years.

Figure 15
Number of cooperative primary institutions



Despite the overall decline in the number of credit institutions, however, new licences are granted on a regular basis. The desire to establish a new institution is often due to the planned development of a special business area.

Siemens Bank GmbH receives a banking licence.

For example, the newly formed Siemens Bank GmbH was awarded a licence to conduct banking business in Germany in 2010. The Munich-based bank, which is a wholly owned subsidiary of Siemens AG, will mainly facilitate intragroup financing solutions. According to information provided by Siemens Bank GmbH, it plans to expand its sales financing activities and to support various operational sales areas run by its parent company. In addition, the Bank will optimise risk management within the group and extend group financing.

Establishing captive banks typically serves a group's strategic internal goals, such as expanding sales financing or increasing the flexibility of liquidity management. As individually responsible entities, these banks are also subject to the same comprehensive regulatory requirements as other credit institutions as defined by the KWG, regardless of whether they are part of an industrial group.

69 Pfandbrief banks and 23 building and loan associations in Germany.

The number of banks issuing Pfandbriefe again increased in the year under review, reaching a new high of 69 institutions (previous year: 66). Institutions' interest in Pfandbriefe is expected to continue in the future. By contrast, the number of building and loan associations declined to 23 (previous year: 24) following the merger of Allianz Dresdner Bauspar AG with Wüstenrot Bausparkasse AG in autumn 2010.

Table 15

Foreign banks in the Federal Republic of Germany*

As at 31 December 2010

Country	Subsidiaries of banks	Branches	EU branch offices*	Representative offices
Australia	1	1	2	-
Austria	2	-	14	6
Azerbaijan	-	-	-	1
Bahrain	-	-	1	-
Belarus	-	-	-	1
Belgium	3	-	2	1
Bermuda	1	-	-	-
Brazil	-	1	-	2
Canada	1	-	-	1
China	-	4	-	2
Czech Republic	-	-	-	1
Denmark	1	-	3	2
Egypt	1	-	-	-
France	10	-	24	11
Greece	1	-	1	-
Hungary	-	-	2	-
India	-	1	1	-
Iran	1	3	-	-
Ireland	-	-	3	1
Israel	-	-	-	4
Italy	7	-	8	1
Japan	4	3	2	3
Jordan	-	-	1	-
Latvia	-	-	1	1
Lebanon	-	-	1	-
Liechtenstein	1	-	-	-
Luxembourg	2	-	5	-
Mongolia	-	-	-	1
Morocco	-	-	1	-
Netherlands	7	-	13	-
Norway	-	-	1	-
Pakistan	-	1	-	-
Philippines	-	-	-	3
Poland	-	-	1	-
Portugal	-	-	-	5
Russia	1	-	-	4
Singapore	1	-	-	-
Slovenia	1	-	-	-
South Korea/Rep.	1	-	-	2
Spain	1	-	2	7
Sweden	2	-	3	-
Switzerland	12	-	4	2
Tajikistan	-	-	-	1
Turkey	4	-	4	4
United Kingdom	9	-	27	1
USA	17	4	25	2
Vietnam	-	-	-	1
Total as at 31 December 2010	**92**	**18**	**152**	**71**
Previous year	95	18	160	70

* Countries are allocated according to the Country of domicile of the parent company.

3.2 Economic development

14 German banks took part in the EU stress test in 2010.

In June 2010, the heads of state and government in the European Union (EU) resolved to publish the results of the EU-wide stress test. The stress test exercise was performed by CEBS together with the national supervisory authorities and the ECB. The objective was to transparently demonstrate the resilience of the European banking system in the event of an economic downturn and negative financial market developments (in particular, a drop in the value of European government bonds). BaFin and the Bundesbank published the results for Germany on 23 June 2010.[40]

Stress tests

Stress tests require institutions to perform hypothetical ("what if") analyses of highly adverse but unlikely developments in order to better assess whether their capitalisation is adequate from a supervisory perspective. As such, stress tests should not be confused with projections of future capital requirements. In addition, the markets' expectation that banks – depending on their business structure – will have higher Tier 1 capital ratios than those required for regulatory purposes refers to actual Tier 1 capital and not to notional capital ratios calculated according to a stress test.

The group of participating countries and banks was significantly expanded in 2010 compared with the first CEBS stress test in the previous year: a total of 91 credit institutions from 20 member states took part in the EU stress test exercise. Measured in terms of total assets, the stress test therefore covered 65% of the EU banking system.

Benchmark scenario and stress scenarios.

The EU's 2010 stress test subjected banks to a benchmark scenario and two stress scenarios: the macroeconomic benchmark scenario was based on the European Commission's spring 2010 forecasts for economic growth in 2010 and 2011, which are pessimistic from today's perspective. Among other things, the forecasts related to gross domestic product, unemployment and real estate prices in the EU. For example, the stress scenarios assumed an overall slowdown in the eurozone economy of 3.0 percentage points and as much as 3.3 percentage points in Germany (measured as a departure from the benchmark scenario). This restrictive assumption was underlined by the fact that the stress scenarios allowed for negative growth rates and therefore a double dip in both years for the eurozone as a whole and in 2011 for Germany. The supplementary stress scenario also assumed an increase in spreads for European government bonds.

[40] www.bafin.de » Companies » Banks & financial service providers » EU-wide stress tests.

EU stress scenarios in some cases tougher than 2009 US stress scenarios.

Overall, the assumptions relating to the macroeconomic shock in the EU stress scenarios were therefore tougher than those in the stress tests performed in the USA in the first half of 2009. In the US tests, the aggregate deviation in growth rates from the expected basic economic path for 2009 and 2010 amounted to 2.9 percentage points. All banks participating in the EU stress tests also had to take into account both the effects of financial market turbulence on their trading books and the consequences of an increase in spreads for European government bonds, while trading book losses were only additionally included in the US stress test at five banks that are particularly active in trading.

13 out of 14 German banks report a Tier 1 capital ratio of over 6%.

Credit institutions were deemed to have passed the test if their Tier 1 capital ratio did not fall below 6% even in the most severe stress scenario. Measured by this criterion, the German banking system has shown itself to be robust and proved its resilience even under extremely pessimistic assumptions: even in the most severe scenario, 13 of the 14 banks reported a Tier 1 capital ratio of more than 6%; nine of the banks participating in the stress test posted a Tier 1 capital ratio in excess of 8% – more than twice the regulatory minimum.

The average Tier 1 capital ratio of the 14 participating banks was 8.9% at the end of 2011 after the first stress scenario, or 8.5% including the increase in spreads for European government bonds. This amounted to a decline of 1.6 and 2.0 percentage points respectively compared with the starting situation at the end of 2009. Only one bank, Hypo Real Estate Holding AG (HRE Holding AG), posted a Tier 1 capital ratio of less than 6% in one of the two years considered in the supplementary stress scenario. However, the far-reaching restructuring process at HRE Holding AG, which is being closely supported by its sole owner, the Financial Market Stabilisation Fund (FMS), was not included in the stress test analysis.

Table 16

Results of German banks in the 2010 EU stress test

Bank	Tier 1 ratio			
	Actual	Benchmark scenario	Stress scenario	Stress scenario+
	End of 2009	End of 2011*	End of 2011*	End of 2011*
Bayerische Landesbank	10.9%	11.9%	9.1%	8.8%
Commerzbank AG	10.5%	10.5%	9.3%	9.1%
DekaBank Deutsche Girozentrale	9.8%	11.1%	9.5%	8.4%
Deutsche Bank AG	12.6%	13.2%	10.3%	9.7%
Deutsche Postbank AG	7.1%	7.9%	6.7%	6.6%
DZ Bank AG	9.9%	10.4%	9.2%	8.7%
HRE Holding AG	9.4%	7.8%	5.3%	4.7%
HSH Nordbank AG	10.5%	14.9%	9.9%	9.7%
Landesbank Berlin AG	13.3%	12.8%	11.3%	11.2%
Landesbank Baden-Württemberg	9.8%	9.8%	8.4%	8.1%
Landesbank Hessen-Thüringen	8.8%	8.9%	7.9%	7.3%
Norddeutsche Landesbank	7.5%	8.0%	6.4%	6.2%
WestLB AG	14.4%	12.4%	8.9%	7.1%
WGZ Bank AG	9.7%	10.8%	9.5%	9.1%

* Cumulative stress test results for 2010 and 2011.

German banks' Tier 1 capital ratios increase steadily.

The robust performance by German institutions is due primarily to the fact that their Tier 1 capital has been strengthened: since 2008, German banks have taken substantial measures to restructure their balance sheets and received capital injections from their owners and guarantors as well as from government bodies on the basis of the Financial Market Stabilisation Act (*Finanzmarktstabilisierungsgesetz* – FMStG). As a result, the overall German banking system's Tier 1 capital ratio increased from 9.0% at the beginning of 2008 to 10.8% at the time of the stress test.

Situation at the major private commercial banks

Improved earnings but unfavourable earnings composition.

Although the financial market crisis continued in 2010, the resulting negative effects for major private commercial banks declined overall and in most cases were not significant for their total earnings. Operating earnings improved in the year under review compared with 2009, although the banks were unable to maintain their extremely strong first-quarter net trading income over the rest of the year. However, the macroeconomic upturn meant that allowances for losses on loans and advances fell sharply, at least partially offsetting the slower growth in trading income recorded in the course of the year. Nevertheless, BaFin's attention was aroused by the fact that the major earnings components of net interest and net fee and commission income – which are generally regarded as being more stable – remained flat in 2010. It is therefore uncertain how sustainable the improvement in earnings seen in 2010 actually is. As a result, BaFin aims to gain a more detailed insight into key earnings components through the planned expansion of the reporting system.[41] In doing so, it is reflecting the risks of an unfavourable earnings composition.

Trend towards consolidation continues in the major bank segment.

The trend towards consolidation among major private commercial banks seen in the previous year continued in 2010 with Deutsche Bank's acquisition of a majority interest in Deutsche Postbank; in 2009, Commerzbank acquired Dresdner Bank, and Deutsche Bank took over the private commercial bank Sal. Oppenheim. BaFin monitors such deals closely because the acquisition of large market participants entails significant integration risks relating to factors such as IT, realignment of business models, or staffing levels.

Situation at the Pfandbrief banks

Trends on the Pfandbrief market (refinancing).

The number of issues fell significantly year-on-year in 2010, with Pfandbriefe worth a total of just under €87 billion being sold. New issues amounted to €110 billion in the previous year, and as much as €153 billion in 2008. Despite this trend, the market remains receptive to Pfandbrief issues. As in the previous year, sales of mortgage Pfandbriefe (€45.4 billion including ship Pfandbriefe) again exceeded public-sector Pfandbriefe, which recorded total issues of €41.6 billion.

[41] Chapter V.1.8

New issues of public-sector Pfandbriefe, excluding the most recent losses in the market value of various European government bonds (in particular the peripheral eurozone countries), have been declining sharply for many years. This is due to the fact that, following the abolition or modification of the institutional liability (*Anstaltslast*) and guarantor liability (*Gewährträgerhaftung*) for public credit institutions, less material that is eligible for cover has been available to institutions for many years, which is why volumes are gradually being reduced. In addition, government lending is traditionally considered to be a relatively low-margin business, with the result that a number of issuers have largely discontinued these operations in recent years. Sales figures have therefore decreased from €108 billion (2007) through €89.5 billion (2008) and €52.2 billion (2009) to the above-mentioned level.

By contrast, mortgage Pfandbriefe have recorded substantial sales growth in recent years. Issue volumes rose from €27.4 billion (2007) to €63.4 billion (2008) before declining again through €58.1 billion (2009) to the current figure of €45.4 billion. Nevertheless, the prospects for mortgage Pfandbriefe are regarded as positive. This product represents an attractive and cost-effective refinancing option for institutions that provide real estate finance. New applications for Pfandbrief licences, e.g. by savings banks, are primarily for permission to issue mortgage Pfandbriefe. The importance of mortgage Pfandbriefe for refinancing real estate loans is set to increase further in the coming years. 69 institutions currently have a licence to issue Pfandbriefe and therefore belong to the group of Pfandbrief banks.

Overall decrease in outstanding Pfandbriefe.

The total volume of outstanding Pfandbriefe continued to fall to around €640 billion in 2010 compared with €719 billion in the previous year, because new issues were again more than offset by maturing issues. At their peak between 1999 and 2004, volumes significantly exceeded €1 trillion, mainly due to the strength of public-sector Pfandbriefe at the time.

HRE Group transfers assets to liquidation agency.

The Hypo Real Estate Group (HRE Group), which remains solely owned by the FMS, continued its extensive restructuring measures in 2010. A key event in the year under review was the establishment of a liquidation agency named FMS Wertmanagement in accordance with section 8a of the FMStG, following the merger of the group's German subsidiary banks with Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG), which was completed in 2009. FMS Wertmanagement acquired risk exposures and operations regarded as no longer strategic in the amount of around €173 billion (excluding derivatives and repo transactions) from HRE Holding AG and its direct and indirect subsidiaries and special purpose entities – in particular Deutsche Pfandbriefbank AG and Depfa Bank plc (Dublin). FMS Wertmanagement will act according to a liquidation plan initially scheduled for ten years, under which it will run down the acquired securities in line with economic principles, while maximising their value.

In addition, FMS Wertmanagement acquired all the FMS-guaranteed securities in the amount of €124 billion issued by Deutsche Pfandbriefbank AG to ensure the entire HRE Group's liquidity at all times. These will now be gradually replaced by FMS Wertmanagement's own issues that are not guaranteed by the FMS. The guarantee facility totalled €15 billion at the end of 2010; the FMS-guaranteed securities will be run down in full by mid-2011.

No further FMS aid required to refinance the HRE Group…

The HRE Group is now again refinancing itself in full via the capital markets. Its main challenge in the future will be to permanently establish Deutsche Pfandbriefbank AG as the HRE Group's core bank on the market. The bank will focus on commercial real estate finance and government finance, especially in Germany and selected European target markets.

…but recapitalisation measures are maintained.

Following the transfer of the guaranteed securities, FMS's involvement with the HRE Group primarily entails the recapitalisation measures already extended. FMS's capital support currently amounts to €7.4 billion, and it has committed to an additional €0.5 billion tranche that has not yet been approved by the European Commission. The bank continues to put its final recapitalisation requirement at €10 billion, which will ensure a sustainable target Tier 1 capital ratio of 10% that meets investor demands, and also includes the necessary capital from FMS Wertmanagement.

The HRE Group's restructuring plan comprising both the transfers made to FMS Wertmanagement and the group's future business strategy is subject to the European Commission's approval as part of the current EU state aid proceedings. Depending on the level of state aid established, approval by the European Commission will probably be tied to corresponding conditions. The proceedings were ongoing at the time this report went to print.

Sale process for Karstadt affects Valovis Bank AG.

In financial year 2010, Valovis Bank AG attracted increased public attention due to the insolvency of the Arcandor Group (formerly the KarstadtQuelle Group). Although the Pfandbrief bank – which is relatively small compared with other market participants – was not directly affected by the Arcandor Group's insolvency, it played a significant role in the sale process for Karstadt Warenhaus GmbH (Karstadt), an Arcandor Group company. Valovis Bank AG, which operated as Karstadt Hypothekenbank AG until March 2007, financed the buildings used by Karstadt, such as department stores and connected car parks, among other things. At the time, the Arcandor Group sold these buildings to a consortium called Highstreet and immediately leased them back. If Karstadt had been wound up or broken up, Valovis Bank AG would therefore also have been affected. Following lengthy negotiations, however,

Karstadt was finally acquired by the investment company Berggruen, which is managed by the private investor Nicolas Berggruen. Among other things, Berggruen's restructuring plan aims to impose rent reductions for the leased properties used by Karstadt and ultimately financed by Valovis Bank AG. Reaching an agreement on this matter was one of the major hurdles in successfully completing the takeover process.

Situation at the private commercial, regional and specialist banks

Majority of institutions profit from economic growth.

Private commercial, regional and specialist banks continued to feel the effects of the financial market crisis in the year under review. This was reflected in an extremely mixed picture: while business at some institutions returned to levels recorded before the outbreak of the financial crisis, others found themselves in a difficult situation. In several cases, BaFin took temporary measures to avert risk in accordance with section 46 of the KWG. However, the majority of institutions profited from better than expected economic growth in Germany in 2010.

Large number of holder control proceedings in accordance with section 2c KWG.

Private commercial banks were involved in more holder control proceedings in accordance with section 2c KWG. Smaller private commercial banks in particular are seeing increasing interest from dubious prospective buyers. As a result, BaFin issued prohibitions on acquisition in several cases, and in isolated instances ordered measures to be taken against the owners of institutions. In one case, the purchasers attempted to avoid holder control proceedings by splitting the acquisition among eleven people who each purchased an interest of around 9% in the institution. However, holder control proceedings must also be conducted in such cases if cooperation between the purchasers has been established.

Judgment by HessVGH on the holder control proceedings at NordFinanz Bank.

In October 2010, the Higher Administrative Court in Hesse (*Hessischer Verwaltungsgerichtshof* – HessVGH) dismissed the appeal by Ukrainian steel traders against a judgment by the Administrative Court in Frankfurt am Main[42] that confirmed the legality of the prohibition on acquiring shares of NordFinanz Bank.[43] In the reasons for its judgment, the Senate concurred with BaFin's legal opinion in almost all legal issues that are relevant to the decision and, for the first time, gave a clear and detailed formulation in particular of the requirements for the onus of presentation when reviewing the reliability of potential shareholders. An appeal was lodged against denial of leave to appeal on points of law.

[42] Ruling dated 21 February 2008, case ref.: 1 E 5580/06.
[43] Ruling dated 6 October 2010, case ref.: 6 A 2227/08; discussed in-depth in BaFinJournal 02/11 (article only available in German).

Holder control in accordance with section 2c KWG

If a prospective purchaser intends to acquire a qualifying holding in a German institution, it must disclose its intention to acquire such a holding to BaFin in accordance with section 2c (1) KWG. A qualifying holding exists if an entity has acquired at least 10% of an institution's voting rights or capital. BaFin may prohibit the acquisition if there are grounds for prohibition. The main grounds are, for example, that the prospective purchaser is not reliable or is not financially sound. If this is the case, the acquisition may not be completed.

For the purpose of reviewing the reliability of the prospective purchaser as required by section 2c KWG, the notifying party is responsible for disclosing the information and documents of which it is aware and that originate from its own sphere insofar as they are significant for assessing reliability. Under this provision, an informative and complete presentation as well as suitable evidence of the existence and economic origin of the equity and debt that is to be used for the acquisition must be enclosed with the notification of intent. If the origin of the funds is unclear or economically implausible, the persons concerned must be assumed to be unreliable.

The overall effort involved in holder control proceedings should not be underestimated: the Holder Control Regulation (*Inhaberkontrollverordnung*), which supplements section 2c (1) KWG, contains an extensive programme of work for prospective purchasers and BaFin. This constitutes mandatory law from which BaFin cannot grant any exemption. In practice, problems are caused in particular by proving the origin of the funds and the prospective purchaser's income and financial circumstances, as well as by submitting a plausible business plan. In addition, prospective purchasers must ensure that they submit their notification of intent in good time, i.e. as soon as there is a firm intention to acquire a qualifying holding in an institution. After receiving the complete notification of intent, BaFin usually has an assessment period of up to 60 working days, which may be extended to up to 90 working days in special cases.

End of scrapping premium hits many automotive banks.

As specialist banks, automotive banks have been hit by the consequences of both the financial and the automotive sector crisis in recent years. For many of these banks, 2010 was dominated by the discontinuation of the scrapping premium and its incentive effects. There was also a decline in new business at individual automotive banks, which depends on demand for certain automotive brands and the proportion financed by the respective bank (penetration rate). On the earnings side, however, the drop in new business in some areas following the expiry of the scrapping premium was often offset by cost savings, slightly improved interest margins and lower risk costs. This was also helped by the fact that the number of insolvencies among automotive dealers was lower than expected in many cases.

Situation at the Landesbanks

Overall situation at the Landesbanks improves slightly.

The overall situation at the Landesbanks also improved slightly year-on-year due to the economic recovery that began in 2010 and to the fact that the difficulties on the financial markets eased somewhat as a result. Nevertheless, the individual Landesbanks are affected to varying degrees by the crisis in the GIIPS countries (Greece, Ireland, Italy, Portugal and Spain); however, no concrete effects on earnings have yet emerged.

EU state aid proceedings brought against four Landesbanks.

The EU state aid proceedings initiated in relation to WestLB AG, Bayerische Landesbank (BayernLB), Landesbank Baden-Württemberg (LBBW) and HSH Nordbank AG due to support received such as capitalisation measures or guarantees led to the continuation of restructuring measures in the year under review. The state aid proceedings against LBBW have now been closed. The European Commission gave its final approval to the aid subject to extensive conditions that LBBW must meet by the end of 2013. These conditions require that LBBW should be reorganised as an Aktiengesellschaft (German stock corporation) and significantly reduce its risk-weighted assets and the group's total assets. However, negotiations on the final approval of the state aid granted to HSH Nordbank are still ongoing. Nor has the European Commission taken any definitive decision on the EU state aid proceedings brought against BayernLB and WestLB.

Restructuring of WestLB continues

On 30 April 2010 (with retroactive effect as at 1 January 2010), WestLB transferred its main portfolio of non-strategic activities in the nominal amount of around €71 billion to Erste Abwicklungsanstalt (EAA), which was established in December 2009. Among other things, the bank did this in order to meet various conditions imposed by the European Commission. Together with the securities portfolio with a book value of around €6 billion that was hived off on 23 December 2009 (with retroactive effect as at 1 January 2009), WestLB therefore assigned risk positions and non-strategic assets totalling approximately €77 billion to EAA.

EAA received capital of around €3.1 billion from WestLB and a guarantee of €1 billion from its guarantors, who are also (indirect) owners of WestLB. In addition, FMS's equity investment in the WestLB core bank was completed by payment of a final tranche on 30 April 2010 in the form of a silent partnership contribution totalling €3 billion. Under the capitalisation measure, FMS has been entitled since 1 July 2010 to convert the silent partnership contribution into WestLB shares, although it has not yet exercised this right.

In December 2009, the European Commission provisionally approved the transfers and capitalisation measures for six months as rescue aid to ensure financial stability. At the same time, however, it also expressed doubts as to whether these measures

are consistent with state aid provisions and therefore initiated a formal investigation procedure. In June 2010, the Commission extended its provisional approval until the end of the investigations as the precise amount of the state aid had not been established.

In November 2010, the European Commission extended its investigation into the provisionally approved rescue aid because it concluded in September 2010 that the bank had received an estimated €3.4 billion in additional state aid. WestLB was required to present additional restructuring measures in relation to this amount or repay the sum in question. In the Commission's view, the measures implemented to date by WestLB to share the burdens and to limit the distortion of competition were wholly inappropriate given the total state aid granted.

The extended investigation by the Commission is continuing. WestLB was given until 15 February 2011 to prepare a revised restructuring plan that meets the state aid requirements. As a result, WestLB's owners and the German federal government presented three models for restructuring WestLB by the deadline. In addition to selling the entire bank and reducing its total assets by a third, discussions are focusing on spinning off WestLB. This would involve downsizing the Landesbank into a "Verbundbank" providing central banking services to savings banks in the region in which it is based, while the remaining parts would either be sold or transferred to EAA. On 15 April, a more detailed restructuring concept that is limited to the "Verbundbank" solution was presented to the European Commission.

No further consolidation in the Landesbank sector at present.

There was no further consolidation in the Landesbank sector during the year under review. Although BayernLB and WestLB began examining a potential merger, negotiations were discontinued after around six weeks at the beginning of November 2010. Other merger talks that were opened in isolated cases – for example between WestLB, Helaba and DekaBank – were also not pursued any further.

Situation at the savings banks

Savings banks profit from steep yield curve.

In 2010, the savings banks again profited from the steep yield curve, i.e. the substantial spread between short- and long-term capital market rates that enables these banks to generate higher margins. While the yield curve was flat and in some cases inverse in 2008, it has been consistently steep since the beginning of 2009. However, should short-term interest rates suddenly increase sharply due to the economic upturn, the positive earnings contribution from maturity transformation would be lost. As a result, local savings banks must also generate sufficient margins in their core customer business.

Sparkasse KölnBonn

Sparkasse KölnBonn's financial position and results of operations in 2010 continued to be dominated by the consequences of the economic and financial market crisis. In 2008, the savings bank recorded a substantial loss. To improve Sparkasse KölnBonn's capital situation, the other savings banks in the Rheinische Sparkassen- und Giroverband contributed profit participation capital in the amount of €300 million to Sparkasse KölnBonn between the end of 2008 and the beginning of 2009. The institution also received a silent partnership contribution of €350 million from Sparkasse KölnBonn's special purpose association. The European Commission subsequently initiated proceedings in February 2009 to examine whether these capitalisation measures constituted unlawful state aid.

At the end of September 2010, the European Commission approved the recapitalisation measures totalling €650 million. It concluded that the restructuring plan presented by the institution is suitable for restoring profitability and ensures that any distortion of competition caused by the state aid is adequately mitigated. The measures defined in the restructuring plan that runs until 2014 relate in particular to the management and supervision of Sparkasse KölnBonn (corporate governance) as well as the improvement of its capital resources. Equally, the European Commission obliged the institution to sell equity interests and reduce large exposures. In future, the savings bank will also focus on its core business – local retail and corporate banking with manageable risk – and continue to reduce non-strategic operations.

According to the bank's medium-term planning, which is part of its restructuring plan, Sparkasse KölnBonn expects to significantly improve its earnings in the coming years.

Increase in net interest income, decline in allowance for losses on loans and advances.

The increase in net interest income and the decline in the allowance for losses on loans and advances suggest better year-on-year results in 2010. In the year under review, operating profit/loss before loan loss provisions is expected to be more than 1.0% of average total assets. However, a large number of institutions in the savings bank sector will not achieve this ratio that is targeted by the association. In addition, the sector is expected to post an overall remeasurement loss in the securities business in 2010, having recorded reversals of impairment losses in this area in 2009. This was due to excessive valuation allowances charged during the financial market crisis in 2008, some of which were reversed in 2009.

Nord-Ostsee Sparkasse in need of support

In the year under review, Nord-Ostsee Sparkasse needed extensive support measures totalling €181 million from the savings bank organisation. The support fund of the Sparkassen- und Giroverband für Schleswig-Holstein contributed €86 million of this through a silent partnership contribution. The rest took the form of additional silent partnership contributions of up to €20 million and recoverability guarantees of up to €75 million by way of the Deutscher Sparkassen- und Giroverband's national compensation scheme. The support payments are part of an overall restructuring concept.

The support payments were caused by the need to recognise substantial valuation allowances that became apparent in the savings bank's lending business in the fourth quarter of 2009. This led to Nord-Ostsee Sparkasse closing financial year 2009 with a loss of €82.3 million, which it offset against the contingency reserve. As a result, the savings bank's risk-bearing capacity was no longer assured.

Nord-Ostsee Sparkasse's substantial remeasurement loss was due in particular to credit exposures that the institution had acquired from the former Flensburger Sparkasse in the previous year. The economic and financial crisis exacerbated the risks arising from this already extremely problematic loan portfolio.

Situation at the building and loan associations

Building and loan associations record positive new business.

Building and loan associations performed well in the year under review. One reason for this is the continuing low level of loan defaults that is due to the associations specialising in private mortgage lending. Overall, new business at building and loan associations was positive in the year under review. The ongoing period of low interest rates also allowed associations that used the capital markets to refinance their non-collective business to profit from low refinancing costs. At the same time, the attractive interest rate level was reflected in the lending conditions offered by building and loan associations. However, building and loan associations were exposed to competition from other providers of real estate finance and their conditions.

Situation at the credit cooperatives

Credit cooperatives continue positive trend.

Credit cooperatives continued their favourable earnings trend of the previous year, recording satisfactory results overall. This is mainly because these institutions are benefiting from an attractive yield curve, although maturity transformation accounts for a significant share of their earnings growth in the interest business. However, a sudden massive change in interest rates could impact a number of primary institutions. Nevertheless, the positive economic situation meant that defaults by retail and corporate

customers were limited. As a result, the sharp rise in allowances for losses on loans and advances that was feared at the beginning of 2010 did not materialise.

DZ Bank and WGZ move closer together.

The central institutions in the cooperative sector, DZ Bank and WGZ Bank, further intensified their cooperation in the year under review. In future, the two institutions will bundle their activities in the high net worth private clients business: since September 2010, DZ Bank's units in Luxembourg, Switzerland and Singapore have operated under the uniform corporate brand "DZ Privatbank". Branches in Germany have now been established to expand operations. In 2011, the two banks plan to merge their Luxembourg subsidiaries WGZ Luxembourg S.A. and DZ Privatbank S.A. and also to contribute WGZ Bank's private banking activities to the new company.

Other examples of close cooperation are the standardisation of securities settlement and the establishment of VR Unternehmerberatung GmbH, which is based in Düsseldorf and Frankfurt am Main. DZ Bank's M&A department and WGZ Corporate Finance Beratung GmbH have bundled their activities in VR Unternehmerberatung GmbH since 1 September 2010. The company aims to provide joint consulting services for middle-market companies, for example in the areas of succession and M&A.

Situation at securities trading banks, exchange brokers and energy traders

Business development depends on strategic focus.

In the year under review, securities trading banks and exchange brokers again profited from the continuing recovery on the financial markets. As in previous years, however, business development at the institutions depended heavily on their strategic focus. Those institutions that are active in bond trading in particular recorded a positive performance, with revenue from equities trading also slowly picking up. One of the beneficiaries of this trend was the multilateral trading platform Tradegate Exchange, which is under BaFin's supervision and has now been approved as the second regulated exchange in Berlin. In contrast, the environment for corporate finance remained weak, especially in the small and medium-sized enterprise segment.

Competition is continuing to grow due to the ongoing development of exchange trading, particularly with the upcoming reform of the Frankfurt Stock Exchange and the entry of more high frequency and algorithmic traders onto the market. This is forcing institutions to combine to form larger entities on the one hand, and to adapt their service offering to meet specialist client needs on the other.

The trading volumes recorded by the European Energy Exchange in Leipzig again increased. However, they continue to account for only a proportion of the transactions executed. Although the share of exchange transactions settled on the futures market rose sharply, interest in financial products remained relatively weak.

Nevertheless, in view of the loss of confidence caused by the financial crisis, clients are still interested in settling at least OTC transactions via European Commodity Clearing AG.

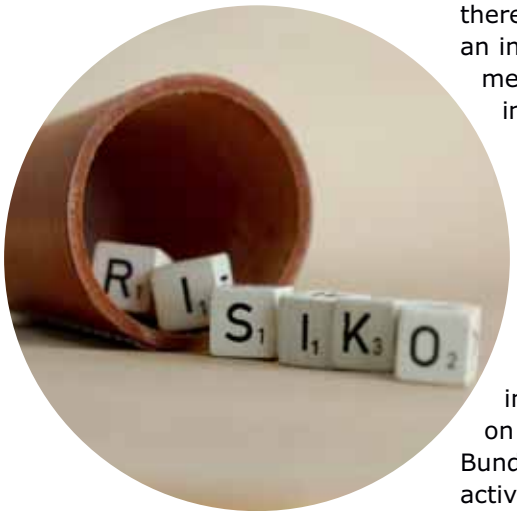
3.3 Risk classification

Risk classification and systemic importance.

BaFin's risk classification activities enable it to consolidate the findings and assessments it has gathered into two ratings. The first rating, which ranges from "A" to "D", assesses the quality of the individual bank. This grade bears no relation to the ratings awarded by rating agencies. Even a D-rated institution has not necessarily "failed" in the banking supervision sense. The second rating, systemic importance, reflects the impact on the financial sector if the bank were to experience distress. In other words, this relates to the institution's supervisory significance. The Bundesbank and BaFin use the classification of an institution or a group of institutions as systemically important for the purpose of organising supervision; this classification serves purely to define workflows. The criteria are size, intensity of interbank relationships and degree of international connections.

Systemic consequences in the event of a crisis.

These factors must be separated from the issue of whether an institution will cause systemic consequences if it were to experience distress and what measures should then be taken. This question cannot be answered before the event and must be assessed on the basis of the actual situation when distress occurs. Institutions that were not classified as systemically important according to BaFin's supervisory guideline may also require support to ensure financial stability.



BaFin has classified the systemic importance of credit institutions and securities trading banks since 2004. In the past six years, there has barely been any change in classification resulting from an increase or decrease in the institutions' importance. Bank mergers have the biggest effect on classification. Each subsidiary in a banking group is classified separately, so any changes in the consolidated group also led to slight variations. In addition, the method used to classify building and loan associations was changed in 2007.

Institutions are classified on the basis of a comprehensive risk profile. This reflects their risk situation and capital resources, their risk management system and the quality of their organisation and management. Risk profiles are prepared initially by the Bundesbank, with BaFin taking the final decision on these profiles and on an institution's classification. The Bundesbank and BaFin base the intensity of their supervisory activities on this classification. BaFin significantly steps up its oversight of institutions with high systemic importance. Its work focuses on in-depth analyses of risks and their potential effects on an institution's risk-bearing capacity. This is reflected in the close cooperation between BaFin and the Bundesbank.

The following matrix shows a summary of institution ratings with regard to quality and systemic importance.

Table 17
Risk classification results for 2010

Institutions In %		Quality of the institution*				
		A	B	C	D	Total
Systemic importance	High	0.2%	0.6%	1.1%	0.2%	2.1%
	Medium	3.5%	3.2%	1.9%	0.9%	9.6%
	Low	41.8%	35.1%	9.1%	2.4%	88.3%
	Low	45.5%	38.9%	12.1%	3.5%	100.0%

* Including the financial services institutions that are authorised to obtain ownership or possession of funds and securities of their customers or that perform proprietary business or trading.

Classification during the financial crisis.

The German banking sector as a whole performed extremely well four years after the beginning of the financial crisis. As a result, its overall quality rating is encouragingly stable. The effects of the financial crisis are more apparent at banks with medium and high systemic importance. Classifications in the latter category (first line of the matrix) again deteriorated compared with 2009. More than half of the banks with high systemic importance are classified as a source of concern (quality "C") or problematic (quality "D"). Once again, more institutions with medium systemic importance were victims of the global financial crisis.

3.4 Supervisory activities

Three types of special audit.

BaFin's special supervisory audits can be broken down into requested audits, audits initiated by BaFin and scheduled audits. In the first case, BaFin only conducts the audit at an institution's request; in the second case, the audit is based solely on BaFin's need to adequately clarify an issue. The third category comprises the audits performed by BaFin in accordance with a statutory audit schedule. This applies in particular to cover audits in the Pfandbrief segment, which must be performed at regular two-year intervals under the Pfandbrief Act (*Pfandbriefgesetz* – PfandBG).

Requested special audits/special audits initiated by BaFin.

Requested audits are in particular acceptance tests for internal risk measurement procedures used by institutions, e.g. for rating systems in the lending business in accordance with the IRBA (Internal Ratings Based Approach), advanced methods for measuring operational risk under the AMA (Advanced Measurement Approach), or internal procedures for measuring liquidity risk. Audits initiated by BaFin are conducted either for a specific reason – e.g. to follow up information in an auditor's report – or as part of routine random sampling examinations. These audits give BaFin its own detailed insight into an institution's risk situation.

In 2010, BaFin was again required to perform extensive audit activities. Of the total of 258 special audits (previous year: 258), 189 were initiated by BaFin, compared with 187 in the previous year. In addition, there were 53 requested audits (previous year: 43) and 16 statutory cover audits (previous year: 28).

Special audits in 2010.

Among the audits initiated by BaFin, the number of valuation audits increased to 22 as against the previous year (11). These covered not only valuation methods and results of the lending business (classic special loan audits), but also an increased number of valuations of financial products in the trading book. A further 166 special audits initiated by BaFin (previous year: 164) again focused on the implementation of the institution's organisational and risk management requirements (section 25a of the KWG) that were defined by BaFin in the Minimum Requirements for Risk Management (MaRisk).

Table 18
Number of special audits

	2010	2009
Impairment-related special audits	22	11
Section 25a (1) of the KWG (MaRisk)	166	164
Organisation*	0	8
Other	1	4
Cover audit in accordance with PfandBG	16	28
Market risk models	9	4
IRBA (credit risk measurement)	35	28
AMA (operational risk measurement)	7	8
Liquidity risk measurement	1	2
Other risk measurement	1	1
Total	**258**	**258**

* Only included as an audit category up to and including 2009.
These audits now fall under MaRisk audits (section 25a (1) of the KWG).

The following table shows a breakdown of audits by group of institution. It is noticeable that only 7.7% of institutions in the cooperative sector were audited. Firstly, the significantly higher percentage of commercial banks, other institutions and institutions in the savings bank sector reflects the greater systemic importance of these institutions in accordance with the risk matrix. Secondly, the figures for these groups of institutions continue to comprise requested IRBA and AMA audits, as well as statutory cover audits at institutions that are authorised to conduct Pfandbrief business. Both types of audit were again rarely conducted in the cooperative sector in 2010.

Table 19

Breakdown of special audits in 2010 by group of institutions

	Commercial-banks	Savings bank sector	Cooperative sector	Other institutions
Impairment-related special audits	1	6	12	3
Section 25a (1) of the KWG (MaRisk)	35	40	76	15
Other	0	0	0	1
Cover audits in accordance with PfandBG	2	6	0	8
Market risk models	5	4	0	0
IRBA (credit risk measurement)	20	8	1	6
AMA (operational risk measurement)	4	2	0	1
Liquidity risk measurement	0	1	0	0
Other risk measurement	1	0	0	0
Total	**68**	**67**	**89**	**34**
in %*	**20.1%**	**11.8%**	**7.7%**	**18.0%**

* Percentages relate to the total number of institutions in the respective group.

The groups of institutions listed in the table also comprise their respective central banks; the Landesbanks belong to the savings bank sector, while DZ Bank and WGZ Bank belong to the cooperative sector. The "Other institutions" group includes, for example, the former mortgage banks, the building and loan associations, special-purpose banks and guarantee banks. It also comprises a number of other specialist banks as well as the financial services institutions that are authorised to obtain ownership or possession of funds and securities of their customers or to perform proprietary business or trading.

Combining the audit figures with the classifying risk matrix reveals that the special audits by BaFin were risk-based. The following table contains only those audits initiated by BaFin. Only these audits – which were instigated by BaFin itself – relate to the risk classification of the supervised institutions.

Table 20

Breakdown by risk class of special audits initiated by BaFin in 2010

Special audits		Quality of the institution*					
		A	B	C	D	Total	Institutions in %**
Systemic importance	High	1	5	17	5	28	70.0%
	Medium	6	11	14	5	36	19.7%
	Low	34	67	30	10	141	8.3%
	Total	41	83	61	20	205	11.0%
	Institutions in %**	4.7%	11.2%	26.3%	29.9%	10.7%	

* Including the 16 financial services institutions that are authorised to obtain ownership or possession of funds and securities of their customers or to perform proprietary business or trading.

** Percentage of the institutions audited of the total number of institutions in the respective quality/importance category (e.g.: 4.7% of all A-rated institutions (green) were audited in the year under review).

Audit focus: Problematic institutions.

The more critical BaFin's rating of an institution's quality, the greater its need to examine the bank's actual situation in detail. As a result, the proportion of audits initiated by BaFin increased to almost 30% of problematic D-rated institutions. At 70%, the proportion of audits at banks with high systemic importance was even higher. This reflects a further shift in these banks' classification in the risk matrix.

In 2010, Banking Supervision again examined not only problematic institutions, but also those rated as good at least on a random sampling basis. A special audit was only conducted at approximately one in eighteen A-rated (green) institutions.

IRBA approval procedure.

At the end of 2010, 47 institutions and groups of institutions reported their capital requirements for counterparty risk based on internal rating systems and IRBA assessment approaches. 15 of them used the advanced IRBA (including one savings bank and two credit cooperatives). Since the entry into force of the Solvency Regulation (*Solvabilitätsverordnung* – SolvV), BaFin has confirmed the suitability of a total of around 520 internal rating systems and IRBA assessment approaches during approval procedures.

1,846 institutions and groups of institutions exclusively used the Credit Risk Standardised Approach, of which 164 were commercial banks, 428 savings banks and 1,141 credit cooperatives.

AMA approval procedure.

In 2010, a further two institutions received approval to use the Advanced Measurement Approach (AMA). As a result, 16 institutions and groups of institutions used a total of 17 Advanced Measurement Approaches at the end of the year. BaFin was responsible for the approval procedures in nine cases as home supervisor and in eight cases as host supervisor. The 16 institutions and groups of institutions that are permitted to use the AMA are mainly commercial banks, while one belongs to the group of "Other institutions". Two institutions are from the savings banks sector and one from the credit cooperative sector.

71 institutions used a standardised approach in the year under review, of which one institution was approved to apply an alternative indicator in the standardised approach. Use of the standardised approach remained below BaFin's expectations. In previous surveys, around 130 institutions stated their intention to apply the standardised approach. However, the other institutions use the Basic Indicator Approach instead.

BaFin performed follow-up audits at a number of AMA institutions in the year under review. These audits defined various improvements to procedures. However, there continues to be scope to enhance business environment and internal control factors, as well as the allocation procedure and validation.

Audit of internal risk models at credit institutions.

At the end of 2010, a total of 14 credit institutions held BaFin certification that their internal market risk model meets the supervisory requirements for determining capital adequacy. Five institutions selected the full use of internal market risk models, under which the model is used to present all market risk types (with the exception of other market risk positions).

The number of backtesting exceptions increased slightly to 22 (previous year: 14). This is due partly to greater market volatility – primarily in the area of interest rate risk. In 2010, BaFin performed a large number of follow-up audits that in most cases revealed an improvement in the internal market risk model compared with the required action established in 2009. However, new defects were also found in isolated cases.

CRD III erhöht Anforderungen an interne Markrisikomodelle.

In addition, CRD III includes requirements for reflecting additional default and migration risks relating to net interest positions (incremental risk charge – IRC) in internal market risk models. EU member states must transpose the new requirements into national law by 30 December 2011. The strictness of these supervisory rules poses major challenges for institutions. On-site checks for

compliance with the Directive's requirements have already been performed at four institutions whose internal market risk model has been granted supervisory approval for calculating the partial capital charge for the special price risk relating to net interest positions.

Table 21
Risk models and factor ranges

Year	New applications	Applications withdrawn	Rejections	Number of model banks	Minimum add. factor*	Maximum add. factor*	Median
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
2010	0	0	0	14	0.0	2.5	0.4

* Excluding the additional factor component due to backtesting exceptions in accordance with section 318 (2) of the SolvV (backtesting or quantitative additional factor; in accordance with Annex 1, Table 25 of the SolvV, this factor can be between 0.0 and 0.1).

Supervisory law objections and sanctions imposed.

In 2010, special audits and supervisory inquiries in particular provided findings that led to 187 supervisory law objections and sanctions (previous year: 152). Informal supervisory responses often produced the desired results in the case of sanctions against managers and members of administrative and supervisory bodies at institutions. This meant that, in these cases, there was no need for a formal dismissal requirement in the form of an administrative act. The following table shows a breakdown of the sanctions and objections by group of institution.

Table 22

Findings of supervisory law objections and sanctions in 2010

Type of sanction			Group of institutions				
			Commercial banks	Savings bank sector	Credit cooperative sector	Other institutions	**Total**
Serious violations			32	51	50	3	136
Sanctions against managers	Dismissal request	Formal	3	0	0	0	3
		Informal	8	1	0	0	9
		Through third party	0	0	0	0	0
	Cautions		0	4	4	0	8
Sanctions against supervisory/ administrative board members	Dismissal request	Formal	1	0	2	0	3
		Informal	2	4	6	0	12
		Through third party	0	2	1	0	3
	Cautions		0	0	0	0	0
Administrative fines			1	4	0	0	5
Sanctions in the case of danger (in accordance with section 46 KWG)			7	0	1	0	8
Total			54	64	66	3	187

Supervision of foreign institutions

Various forms of activity available to foreign institutions in Germany.

BaFin exercises its supervisory powers in relation to cross-border groups of institutions not only as a home supervisor, but also as a host supervisor. There are various ways for foreign institutions to do business in Germany. They can establish both subsidiary institutions with a German legal form and branches (that are independent for supervisory purposes). Institutions that are based in the European Economic Area (EEA) can also conduct business in Germany using a European passport as an EU/EEA branch or as a cross-border service provider. In addition, many foreign banks have representative offices in Germany, although these offices are prohibited from conducting banking business. Their operations are restricted exclusively to gathering information and maintaining contacts.

Unrestricted supervision of subsidiaries and branches.

Subsidiary institutions and branches are subject to unrestricted supervision in accordance with the KWG. In these cases, BaFin's powers are not limited by any competencies of home supervisory authorities. The only exception to this rule applies to branches as defined in section 53c KWG that are privileged due to bilateral government agreements in certain areas.

As in the previous years, BaFin monitored problem institutions particularly closely in 2010, imposing additional information requirements on these banks, for example. In individual cases – such as noa bank GmbH & Co. KG – it was forced to take serious supervisory measures. In addition to the general economic stabilisation of foreign institutions, BaFin is still seeing domestic entities being extensively integrated organisationally and financially with foreign group structures. This means that the domestic banks are existentially dependent on the solvency and liquidity of their group parent. BaFin therefore took initial steps to strengthen risk management at domestic entities to enable them to at least wind up their own business operations in an orderly manner if their group becomes insolvent. This goal is primarily supported by new legislative measures such as ringfencing (section 46 (1) sentence 3 KWG).

Insolvency of noa bank GmbH & Co. KG

In 2009, a Belgian company in which two Belgian private individuals held an equity interest acquired Bankhaus Zwirn GmbH & Co. KG, which was subsequently renamed noa bank GmbH & Co. KG (noa bank). noa bank conducted lending business and, as a direct bank, attracted a substantial volume of customer deposits within a short period. However, the institution's business activities resulted in it falling significantly short of the statutory capitalisation requirements in 2010. As a consequence, the institution was in danger of not being able to meet its obligations to creditors.

To counter this risk, BaFin issued a prohibition on deposit taking and lending against the institution on 23 June 2010 and also appointed supervisors. In addition, it stipulated adjustment items for the bank's Tier 1 capital on 5 July 2010. The bank's sister company noa Factoring AG filed an application for insolvency on 18 August 2010. noa bank's close business relationship with this company meant that it was also in danger of becoming insolvent or overindebted. On the same day, BaFin issued a moratorium against the institution to effectively prevent an outflow of assets and to ensure equal treatment of creditors.

After noa bank reported that it was overindebted, BaFin also filed an application for insolvency on 24 August 2010. On 25 August 2010, the Local Court in Düsseldorf opened preliminary insolvency proceedings on the institution's assets. At the same time, BaFin also determined that a compensation event had occurred, enabling noa bank's depositors to be compensated by Entschädigungseinrichtung deutscher Banken GmbH. On 1 October 2010, the Local Court in Düsseldorf opened the (final) insolvency proceedings on noa bank's assets, which are still ongoing.

BaFin ultimately revoked noa bank's licence by way of a notice dated 18 October 2010.

Restricted host supervision of branches.

As in previous years, credit institutions from the EEA again made extensive use of the opportunity to establish and maintain branches in accordance with section 53b KWG in 2010. These branches are only subject to limited host supervision by BaFin, which is restricted almost exclusively to monitoring compliance with liquidity requirements. In contrast to the Kaupthing Bank case in the previous year, no highly problematic cases resulted from BaFin exercising these powers in the year under review.

3.5 Non-performing loans

Methodological change affecting the definition of an NPL.

Until 2008, the volume of non-performing loans (NPLs) in the portfolios of German credit institutions was estimated on the basis of the gross volume of client loans requiring specific valuation allowances. The data were taken from the reports on the audit of the banks' annual financial statements. The new Audit Report Regulation (*Prüfungsberichtsverordnung* – PrüfbV), which was effective for the first time for the 2009 annual financial statements, has resulted in several changes. For example, delinquent loans for which no special valuation allowance has been recognised must now also be reported; in addition to loans for which specific valuation allowances have already been recognised, these also count as NPLs under the new definition. The methodological change has brought the German definition of an NPL much closer into line with standards in common use internationally. In itself, the broadening of the definition results in the disclosure of a higher volume of NPLs. The impact on the ratio of NPLs is unclear, however, as the definition of a loan taken as the point of reference was also broadened in scope and, under section 19 of the KWG, includes securities, equity investments and off-balance sheet transactions.

NPL market potential.

In 2009 – the reports on the audit of the 2010 annual financial statements were not yet all available at the time of writing this report – the volume of NPLs amounted to around €204 billion, or 3.2% of gross lending to non-banks (before deduction of allowances for losses on loans and advances). As a result of the break in the statistical series, the data are not comparable with those for previous years. However, the volume of NPLs is likely to have increased year-on-year in 2009, not only for purely methodological reasons, but also as a result of fundamental factors: large sections of the global economy have suffered the effects of the deep recession, as a result of which credit quality has in many cases deteriorated. It still remains to be seen in which direction NPL market potential trended in 2010. While the repercussions of the financial and economic crisis are still being keenly felt, the sharp economic upturn in Germany accompanied by a decline in insolvencies and unemployment points to a noticeable improvement in credit quality.

3.6 Securitisations

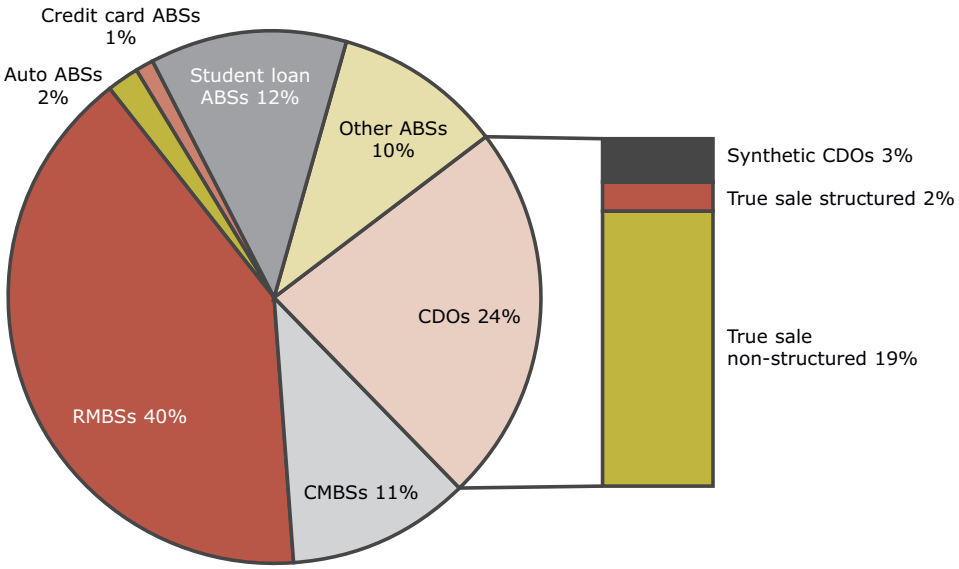
Decline in the securitisation volume of large German banks.

At the end of 2010, the securitisation positions held by 17 large German banks amounted to a total book value of around €164 billion, a significant decline compared with the previous year (€213 billion). The reduction in the securitisation positions is due mainly to the maturity and repayment of some of the securities held as well as to transfers to liquidation agencies, whereas changes in exchange rates in the reporting period had the opposite effect. It is important to bear in mind that this figure represents the positions before hedging. After deducting hedging positions, therefore, the banks' net exposure is lower.

Around half of the securitisation positions held by German banks comprised residential mortgage-backed securities (RMBSs) and commercial mortgage-backed securities (CMBSs). RMBSs made up almost four fifths of the mortgage-backed securities, a similar proportion to the previous year; the remaining fifth consisted of CMBSs. The securities held are very heterogeneous and cover a broad spectrum ranging from sound European securitisations through to heavily credit-impaired US subprime securities. At the end of 2010, around 70% of the mortgage-backed securities were rated AAA or AA. However, the rating structure has deteriorated in that the proportion of mortgage securitisations rated AAA has declined and the proportion of tranches rated sub-investment grade has increased.

Accounting for almost a quarter, collateralised debt obligations (CDOs) also had a significant weighting in the securitisation portfolio of German banks. Most of these were true sale transactions. At €22.2 billion, collateralised loan obligations (CLOs) formed the largest single category within this segment. The securitisation portfolio of the banks surveyed also contained student loan asset-backed securities (SLABSs) amounting to around €19 billion. By contrast, other forms of investment, such as auto loan and credit card asset-backed securities, played a minor role.

Figure 16
Securitisation positions by type of collateral

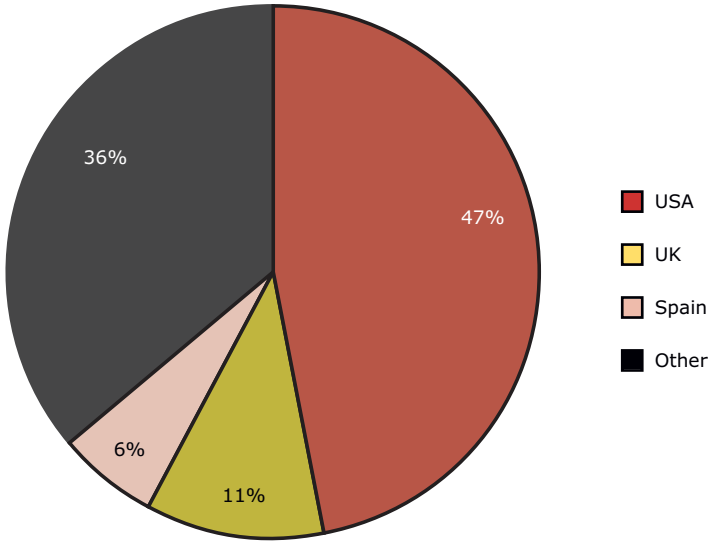


ABSs – asset-backed securities
RMBSs – residential mortgage-backed securities
CMBSs – commercial mortgage-backed securities
CDOs – collateralized debt obligations
Source: Deutsche Bundesbank, BaFin

Regional focus of the underlyings in the USA.

Viewed by region, most of the securitised loans again originated from the USA at the end of 2010. However, the regional breakdown varies considerably from bank to bank depending on the individual investment strategy. The proportion of securitisations backed by US collateral ranged from over 70% to 0% across the institutions. The regional breakdown by asset class was also heterogeneous.

Figure 17
Regional breakdown of underlyings



Source: Deutsche Bundesbank, BaFin

3.7 Financial services institutions

717 financial services institutions provided investment services.

At the end of 2010, BaFin was supervising a total of 717 financial services institutions (previous year: 710). 71 German branches of foreign institutions were also under its oversight (previous year: 73). 177 of the financial services institutions under supervision were engaged only in investment and contract broking and the provision of investment advice (previous year: 182). 521 institutions were authorised to conduct financial portfolio management (previous year: 508). As in the previous year, two financial services providers were authorised to obtain ownership or possession of client money or securities.

In the year under review, 58 enterprises applied for authorisation to provide financial services (previous year: 43). 10 financial services institutions applied to have the scope of their authorisation extended (previous year: 7).

Tied agents

Number of tied agents almost unchanged.

The number of tied agents was down slightly on the previous year to around 39,700 (previous year: approximately 40,000). The number of liable companies remained largely unchanged at around 190. Most tied agents operate on behalf of credit institutions.

Institutions that work with tied agents must ensure that these are reliable, have adequate professional qualifications and fulfil legal requirements when providing financial services. The liable companies must actively monitor their tied agents' activity. For this purpose, the institution's compliance function must carry out checks on the tied agent both at regular intervals and if there is cause to do so. The frequency and extent of those checks are determined in each case by the nature and scope of the agents' business activities, the product range and the operational structure.

Cooperation

Annual working group meeting with the Bundesbank...

The items on the agenda at the 23rd working group meeting between BaFin and the Bundesbank included the audits under section 9 Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz* – EAEG) for the Compensatory Fund of Securities Trading Companies (EdW), which the Bundesbank conducted for the first time in the year under review, and the requirements for supervisory boards. Before the EAEG was amended, audits under section 9 EAEG were usually combined with the audit of the annual financial statements, which is conducted by the external auditors engaged by the institution. A further focus were the changes to the KWG which the CRD II Implementation Act introduced for financial services institutions effective 31 December 2010. For example, section 2 (8b) KWG states that the large exposure rules no longer apply to financial

portfolio managers who are not authorised to obtain ownership or possession of client money or securities when providing financial services and who do not trade financial instruments for their own account. As a result, these institutions no longer have to submit reports on large exposures under sections 13 and 13a KWG. Previously, only investment advisers, investment and contract brokers, operators of multilateral trading systems and enterprises engaging in placement business were not bound by the large exposure rules contained in sections 13 and 13a KWG. Again, however, a condition is that these institutions do not obtain ownership or possession of client money or securities when providing financial services. In addition, they may not be authorised to trade financial instruments for their own account.

…and annual consultation with the IdW.

The annual consultation with the WpHG working group of the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer in Deutschland e.V.* – IdW) focused on auditor reporting on compliance with the requirement for investment advisers to prepare records of investment advice. BaFin expects appropriate samples to be taken during the audit and comments to be made regarding the use of free text fields. In addition, auditors should devote particular attention to the implementation of the Minimum Requirements for the Compliance Function (*Mindestanforderungen an die Compliance-Funktion* – MaComp) as well as compliance with the special organisational requirements if institutions work with a number of tied agents.

Workshop on audit practice in relation to business models.

In February 2010, BaFin held a workshop with the IdW, at which participants discussed problematic business models at investment services enterprises and their treatment in audit practice. BaFin's aim is to increase dialogue with auditors regarding indications of improper conduct by regulated enterprises and structures or business models considered dubious from a supervisory perspective, and to raise their awareness of its audit activity. For example, BaFin regards as problematic any structures or business models where the business processes are difficult to understand as a result of very complex and/or cross-border structures. The same goes for models where the organisational and operational structure of an investment services enterprise is not appropriate to the scope of its business activities or the associated potential for conflicts of interest.

Compliance workshop.

In addition, in December 2010, BaFin held a workshop with the Landesbanks and the cooperative central institutions to discuss current issues related to MaComp. Topics included the on-site inspections required to be performed by the compliance function, its annual report and its status in the investment services enterprise. BaFin takes a critical view of situations where the compliance officer responsible for the compliance function is connected to the legal department. As the compliance officer acts not only in the interests of the enterprise but also in the interests of clients, the potential for a conflict of interest between the compliance function and the legal department is immense.

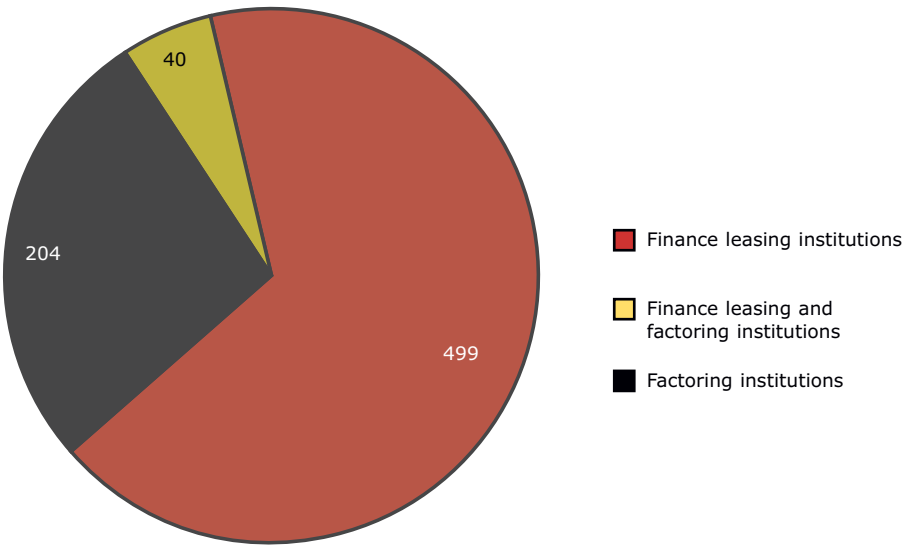
Consolidation in the leasing and factoring market.

Supervision of finance leasing and factoring institutions

31 December 2009 was the deadline under section 64j (2) KWG for finance leasing and factoring institutions ("Group V institutions") to provide notification of their engagement in these activities. If notification was provided in good time, Group V institutions already active before the introduction of the new regulatory regime were deemed to have been granted authorisation without the content of their activities being examined.

One frequent source of uncertainty in the industry was the question of the extent to which enterprises actually engage in finance leasing or factoring requiring authorisation under the KWG. This resulted in a number of applications for a decision under section 4 KWG on whether an enterprise was subject to the provisions of the Act. At the same time, the market started to show signs of consolidation. Many Group V institutions that had initially provided notification in accordance with section 64j (2) KWG returned their authorisation in the course of 2010. This was due, firstly, to the after-effects of the financial crisis and the resulting sharp decline in business volumes in 2009 and, secondly, to the time and expense associated with the new regulatory regime. At the end of 2010, 499 finance leasing institutions, 204 factoring institutions and 40 institutions engaged in both finance leasing and factoring were supervised by BaFin.

Figure 18
Breakdown of Group V institutions
as at 31 December 2010



Source: BaFin

Supervision with reasonable discretion.

In the year under review, ongoing supervision focused initially on the requirements of the KWG; above all on the implementation of MaRisk in relation to content and on the implementation of the reporting requirements with regard to form. For the first time, institutions across the board prepared their annual financial statements in accordance with the Regulation on the Accounting of Banks and Financial Services Institutions (*Kreditinstituts-Rechnungslegungsverordnung* – RechKredV) and had them audited by external auditors in accordance with the PrüfbV. In doing so, some missed the statutory submission deadlines by a wide margin, but in most cases without any regulatory consequences. 2010 was initially an opportunity for BaFin to gain an overview of the different business models in the respective sectors and of the extent to which the regulatory requirements have been implemented at the individual institutions. With a view to exercising reasonable discretion, BaFin has therefore largely refrained from imposing sanctions. Group V institutions were given until the end of 2010 to meet the MaRisk and anti-money laundering requirements.

Risk-based supervision

The risk classification performed by BaFin covered a total of 770 financial services institutions. High risks in the area of business of financial services providers arise primarily from the sale of particularly high-risk products, the deployment of large numbers of tied agents, a particularly large number of clients, or a strong international orientation. Financial services institutions are not generally regarded as systemically important, as they do not pose systemic risks comparable to those presented by credit institutions. Therefore, none are classified as of "high" systemic importance.

Table 23
Risk classification results for 2010

Institutions in %		Quality of the institution				
		A	B	C	D	Total
Systemic importance	High					
	Medium	3.8%	7.1%	1.7%	0.4%	13.0%
	Low	29.5%	50.1%	5.6%	1.8%	87.0%
	Total	33.3%	57.2%	7.3%	2.2%	100.0%

Audits and measures

More on-site presence at audits.

In the year under review, BaFin participated in 76 audits at financial services institutions (previous year: 57) and conducted 112 supervisory interviews with senior managers or management board members (previous year: 110). Participation in audits and supervisory interviews can concern issues related to both solvency and market supervision. BaFin aims to continue increasing its on-site presence at audits going forward.

44 authorisations ceased to be effective.

44 authorisations held by financial services institutions ceased to be effective, most of them as a result of being returned.

BaFin held one consultation with a financial services institution regarding the revocation of its authorisation, as it continued to fall below the required minimum initial capital of €50,000. It had also violated other supervisory regulations, such as reporting requirements that enable the monitoring of net assets and financial position. However, the institution anticipated the revocation of its authorisation by returning it voluntarily. Another financial services institution also returned its authorisation in 2010 after first contesting the legality of BaFin's withdrawal of the authorisation in an administrative court case. BaFin had withdrawn the authorisation back in 2009, in response to which the institution had filed an objection and requested interim relief. They key factor in BaFin's decision to revoke the authorisation was the fact that the institution had severely harmed the interests of its clients. In particular, it had not adequately explained to its clients the illiquid nature of the securities being marketed and the risks associated with them and had given several clients recommendations that resulted in inadequate risk diversification in their client portfolios. For example, the institution had brokered its clients both the shares of its parent company and various funds. In its capacity as an investment adviser, it had also recommended the parent company's shares to those funds. Many clients suffered heavy financial losses as a result of falls in the price of the securities. BaFin had cautioned the institution's senior managers back in 2008, but as sufficient measures were not then taken to protect clients' interests and deal with the existing conflicts of interest, BaFin had issued a notice of revocation.

Exercise of voting rights prohibited.

BaFin prohibited one party with a direct interest in an institution from exercising its voting rights and ordered that it may only hold the shares with BaFin's consent. This was because the shareholder had acquired a considerable amount of shares in the financial services institution without first fulfilling its obligations to notify and disclose information to BaFin. In addition, a final and absolute conviction for fraud cast considerable doubt on its reliability. The notification and disclosure requirements are intended to ensure that BaFin is able to check the reliability and financial soundness of a new shareholder before an interest is acquired. If the interest is acquired before this check can be carried out, BaFin is able to order the suspension of the shareholder's voting rights and also press for the shares to be sold.

Two cautions issued.

In two other cases, BaFin cautioned the senior managers of financial services institutions as, for a relatively long period of time and despite repeated reminders, they had failed to fulfil the notification and reporting requirements that enable the monitoring of net assets and financial position.

Cooperation with tied agents prohibited.

At the end of 2010, BaFin prohibited one institution from integrating tied agents into its own business organisation. 10 tied agents had most recently been operating on behalf of the financial services institution, to which the institution had outsourced all financial services brokerage. According to the information it provided, it did not carry on any other business activity itself. Cooperation was prohibited because a search coordinated with public prosecutors uncovered a number of significant legal violations at one agent. These included the unauthorised receipt of client money, violations of the ban on cold calling and breach of obligations to disclose and obtain information. It was clear from the number and severity of these violations that the liable institution did not have at its disposal a suitable set of tools with which it could perform checks on and monitor its tied agents in the required manner.

Integration of tied agents prohibited

In summary proceedings, the Administrative Court in Frankfurt am Main (*VG Frankfurt am Main*) confirmed the order issued by BaFin prohibiting the financial services institution from continuing to use tied agents.[44] The Court therefore agreed with BaFin's argument that, in light of the significant monitoring deficiencies identified at the institution, it was necessary to fully prohibit the integration of tied agents in order to avert the risk of further serious damage, as monitoring was unlikely to be carried out in a reliable and orderly manner in the future. BaFin had said that the violations identified at the tied agent showed that the institution was not willing or able to fulfil the monitoring obligations incumbent on it as a liable company. It obviously did not have a system in place to ensure the tied agents' compliance with all legal requirements. To ensure that the tied agent is reliable, has adequate professional qualifications and also meets the other requirements imposed on it by section 25a (4) sentence 1 KWG, the liable company must, for example, secure by contract the ability to obtain unrestricted access to all documents related to the tied agent's business activities and also make use of that option. If necessary, these rights to perform checks must be enforced by threatening termination subject to contract. Ensuring these obligations is an organisational obligation on the part of the liable company, requiring not only checks on the tied agent during the selection process, but also ongoing monitoring. In particular, these extensive duties of care include continuously checking and documenting reliability and professional qualifications and monitoring employees of both the tied agent and

[44] Case ref.: 1 L 3117/10.F.

the company itself. As the law transfers responsibility for monitoring tied agents to the liable company, the company must – if it wishes to make use of the option to employ tied agents – ensure compliance with all legal requirements without limitation.

Extensive duty of oversight.

It is the responsibility of the liable institution to implement the obligations to perform checks on and monitor tied agents, as the institution is best placed to assess, based on its field of business and size, how it can most effectively ensure that the tied agents meet the legal requirements. It is essential, however, that the liable institution secures by contract the ability to obtain unrestricted access to all documents related to its agent's business activities and makes use of that option. In addition, the liable institution must check on the tied agents at regular intervals – if necessary unannounced – so as to gain a direct impression of the agent's business activities on site.

This extensive duty of oversight on the part of the liable institution is the necessary corollary to BaFin's lack of direct oversight over the tied agent. Any organisational shortcomings at the liable company that encourage misconduct by the tied agent can affect the reliability of the institution's manager or even lead to the revocation of its authorisation. In addition, it is in the institution's own interest to have a monitoring system appropriately tailored to its business model, as the activity of the tied agent is attributed to the liable company.

3.8 Payment institutions

Supervision of payment services.

The Payment Services Oversight Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG), which governs oversight of payment institutions, entered into force at the end of October 2009. Since then, companies wishing to provide payment services have required authorisation and been subject to supervision by BaFin and the Bundesbank. Deposit-taking credit institutions do not have to apply for special authorisation under the ZAG.

First authorisations issued.

In 2010, BaFin authorised seven companies to operate as payment institutions. The current authorisation procedure attracted a number of preliminary enquiries about the obligation to obtain authorisation for certain services and details of the authorisation requirements. The applications for authorisation and preliminary enquires reflect the broad range of activities falling under the definition of a payment service. In addition to remittances in Germany and abroad, payment services also include card payment processing activities (acquiring), certain cash disbursement services and some online payment systems. As many of these activities were previously unregulated, further enquiries are expected once the companies concerned realise that they provide payment services requiring supervision within the meaning of the ZAG.

Problem areas in the authorisation procedure.

The requirement for institutions to protect client money against the institution's possible insolvency in accordance with the ZAG has often proven problematic during the authorisation procedure. Under the Act, this can be done through trustee accounts, safe liquid assets, a bank guarantee, or insurance. In doing so, payment institutions are reliant on appropriate bank or insurance products, for which a market is only just emerging. A further problem is that the companies concerned must provide an adequate and clear description of their business activities in their application for authorisation so that this can be properly examined. In the case of complex models, the description provided is often inadequate. Further difficulties arise in demonstrating fulfilment of general supervisory requirements, such as those in relation to the qualifications of senior managers or the detailed information under the Holder Control Regulation (*Inhaberkontrollverordnung* – InhKontrollV).

Provision of cross-border services in Europe.

Authorisation as a payment institution also entitles the company to provide payment services in other EEA countries. Conversely, payment institutions from other European countries may offer their services in Germany, either through an existing branch in Germany or on a cross-border basis through agents. In principle, supervision of these branches and agents remains the responsibility of the supervisory authority of the home EU member state. The agents and branches must merely be notified to BaFin. However, BaFin is responsible for ensuring that these institutions also implement and comply with the regulations to prevent money laundering and terrorist financing.

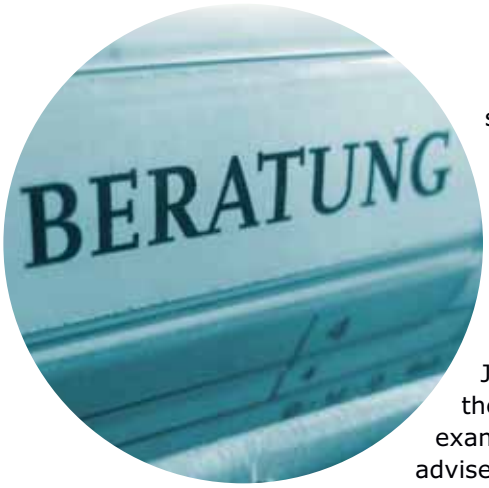
1,300 agents of foreign payment institutions in Germany.

By the end of 2010, BaFin had been notified of around 1,300 agents of foreign institutions, almost all of them agents of foreign remittance service providers. During checks, however, BaFin also identified around 110 remittance service agencies that were not operating as agents for a foreign institution. Rather, they had been recruited by such an agent and were operating as sub-agents. As the ZAG does not permit sub-agent relationships, BaFin prohibited those concerned from recruiting or operating such sub-agencies.

3.9 Market supervision of credit and financial services institutions

Market survey on the record of investment advice

Supervision of credit and financial services institutions pursuant to the WpHG focused on the provision of investment advice. In February 2010, BaFin conducted a market survey to find out how regulated credit and financial services institutions had implemented the regulations in force since the beginning of the year governing the documentation of investment advice provided to private clients. In an initial step, BaFin sent a request for information and documentation comprising 29 questions to all private banks that provided investment advice to private clients as well as to selected Landesbanks, savings banks, cooperative banks and financial



services institutions. In total, BaFin wrote to 316 institutions. BaFin's aim in requesting the information was to determine to what extent the institutions were affected by the new regulations and whether the institutions had already changed or intended to change their business model. The Supervisory Authority also wished to establish whether the institutions had in good time taken the precautions necessary to be able to fulfil the new requirements from January 2010 onwards. To do this, it asked them to submit the documents that had been used to train employees, for example. It also asked how the institutions tracked whether their advisers provided clients with a record satisfying the new legal requirements. In a second step, BaFin requested a sample of individual records of advisory interviews conducted by the institutions in January 2010.

● More than 1,000 records evaluated.

In total, BaFin evaluated 1,099 records from 192 companies as part of its market survey. It found that the record forms used to document investment advice were incomplete at 15 credit institutions and 37 financial services institutions. In particular, the forms contained only pre-formulated response options. They did not provide the option to supplement the mandatory client data with further information on the client's personal situation, the client's individual concerns, or their weighting. However, BaFin expects the record forms to contain not only text blocks, but also free text fields for individual client information, as only then is there a guarantee that any individual wishes expressed by the client will be adequately documented. However, BaFin also sees the need for improvement at institutions whose record forms contained free text fields for documenting individual information as, in around two-thirds of the records evaluated, these free text fields were not used. In this context, BaFin also found that the documents used for employee training contained examples illustrating the documentation of the client's individual information that were not particularly practical. In May 2010, BaFin therefore discussed the results of the market survey at a joint meeting with the associations of credit and financial services institutions, the Federation of German Consumer Organisations (*Verbraucherzentrale Bundesverband* – vzbv) and the IdW. In a letter, BaFin once again explained that investment services institutions must prepare a written record of each investment advisory interview with a private client. This requirement applies regardless of whether a transaction is concluded on the basis of the advice provided or whether the client merely received information during the interview. In addition, explanatory notes on the record of investment advice were released by BaFin for consultation until the end of March 2011.[45] These are to be integrated into MaComp as a new module.

[45] www.bafin.de » Unternehmen » Konsultation 3/2011 (only available in German).

Credit institutions

Record of investment advice for prospective investors as well.

As a result of the market survey, BaFin checked in the course of the audits under section 36 of the WpHG whether the credit institutions concerned had taken measures to bring about improvements in the provision of investment advice. A further focus was how advisers proceeded when investment advice was provided to a prospective investor. This question arises in particular when the investment advisory interview does not lead to a transaction, as in these cases the internal controls that come into play when securities transactions are executed do not apply. From the interviews conducted on site, BaFin gained the impression that advisers were sufficiently aware of the existing requirements to provide a record of investment advice. Usually, however, the institutions did not have any special internal controls in place for advising potential investors. BaFin therefore pointed out to the institutions that they must also implement appropriate internal controls in relation to the investment advice provided to potential investors in order to ensure compliance with the WpHG. In the year under review, BaFin did not carry out any special audits as a result of the extensive market survey on the record of investment advice.

Financial services institutions

In the case of financial services institutions that provided investment advice, the annual audits under section 36 WpHG likewise focused on the measures the institutions had taken to bring about improvements in the provision of investment advice.

One special audit in accordance with section 35 WpHG.

In 2010, BaFin also carried out a special audit at two tied agents of a financial services institution. This audit was prompted by indications that the liable institution had not fulfilled its obligations to perform checks on and monitor the tied agents sufficiently and that the outsourcing of services had had a negative impact on the proper provision of those services to clients. As a result of client complaints, it was also suspected that the tied agents were making cold calls. The special audit confirmed that the tied agents had contacted the clients by telephone without their prior consent. There were also substantial deficiencies in the organisational integration and monitoring of the tied agents by the liable institution. The tied agents were not being monitored by the compliance function of the institution itself. Instead, the institution was relying entirely on the activity of the compliance officer of the two tied agents. Internal procedures, training and checks on the qualifications of the tied agents' employees were not fully documented. In addition, the tied agents had not been integrated into the institution's organisational structure in accordance with the legal requirements. Monitoring measures designed to implement the contractually agreed rights to perform checks and prevent violations of the ban on cold calling were not being carried out by the institution. BaFin is currently examining various supervisory measures, including and down to the revocation of its authorisation.

Prohibition as a result of the ban on advance charging of costs.

After the Higher Administrative Court in Hesse (*HessVGH*) ruled in 2009 that the legal precept contained in section 125 Investment Act (*Investmentgesetz* – InvG) was also applicable to the sale of fund units by credit or financial services institutions[46], BaFin prohibited one financial services institution from continuing to use fund rules stipulating that 80% of the first monthly savings instalments would be used to cover costs when concluding savings contracts. Under the ban on charging costs in advance, no more than one-third of each of the payments agreed for the first year may be used to cover costs in cases where fund units are sold over a period of several years. An advance charge in the first year of 80% of the instalments is therefore not compatible with client interests within the meaning of section 31 (1) no. 1 WpHG. The enterprise has lodged an appeal against the prohibition order and filed a suit before the Administrative Court in Frankfurt am Main.

Audit exemptions

95 institutions exempted from annual audit.

BaFin exempted 95 credit and financial services institutions from the requirement under section 36 of the WpHG for an annual audit (previous year: 234). 60 exemptions were granted to credit institutions, including 51 cooperative banks and four savings banks, and 35 to financial services institutions. The decline in the number of exemptions brings the situation more closely into line with previous years. The sharp increase in 2009 was due to the fact that the exemption criteria had been relaxed. In addition, BaFin exempted 50 credit institutions (previous year: 202) from an audit of securities custody business.

Administrative fines

Three administrative fines imposed.

BaFin instituted 11 new proceedings for the imposition of administrative fines against banks and financial services institutions (previous year: 10). 11 proceedings from previous years were still ongoing (previous year: 4).

In three cases, BaFin imposed administrative fines of up to €30,000 for violations of the reporting requirements under section 9 WpHG. One fine of €2,000 was levied for a violation of the requirement to report suspicious transactions (section 10 WpHG). BaFin suspended three proceedings, one for reasons of discretion, combining it with a caution. At the end of the reporting period, 15 proceedings were still ongoing (previous year: 10).

[46] Case ref.: 6 B 2322a/09; Annual Report 2009, p. 160.

VI Supervision of securities trading and the investment business

Karl-Burkhard Caspari,
Chief Executive Director
of Securities Supervision

1 Bases of supervision

1.1 Prohibitions on short selling and transparency rules

On 27 July 2010, the Act on the Prevention of Improper Securities and Derivatives Transactions (*Gesetz zur Vorbeugung gegen missbräuchliche Wertpapier- und Derivategeschäfte* – WpMiVoG)[47] entered into force in Germany, prohibiting naked short sales of shares and debt securities issued by central governments, regional governments and local authorities of eurozone countries insofar as these are admitted to trading on the regulated market of a German stock exchange (section 30h of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG)). Naked credit default swaps (CDSs) on the liabilities of central governments, regional governments and local authorities in the eurozone are also prohibited (section 30j WpHG). A CDS is a naked CDS if at least one reference liability is a liability of a eurozone country and it is not being used to hedge against the risk of default.

The Act largely mirrors the general decrees previously issued by BaFin in May 2010. After BaFin's general decrees of 19 and 21 September 2008 banning naked short selling in eleven financial stocks lapsed at the end of January 2010, BaFin again imposed a temporary ban on naked short selling in ten selected financial stocks in May 2010 due to deteriorating financial market conditions. For the first time, it also prohibited naked short sales of certain debt securities issued by eurozone countries and transactions in naked CDSs.

In addition to these prohibitions, the Act extends and sets out in greater detail BaFin's powers to enact measures to safeguard the financial system in the event of a crisis. In future, BaFin, in consultation with the Bundesbank, will be able to issue temporary orders that are appropriate and necessary to eliminate or prevent undesirable developments that may be disadvantageous to the stability of the financial markets or shake confidence in the proper functioning of the financial markets. In particular, BaFin may suspend or ban trading and introduce transparency requirements for further financial instruments, for example.

[47] Federal Law Gazette (BGBl.) I 2010, p. 945.

Transparency requirement for net short-selling positions extended.

At the end of January 2011, BaFin extended until 25 March 2012 the general decree through which it had introduced a transparency requirement for net short-selling positions in ten selected financial sector stocks in March 2010. Market participants must therefore continue to notify the Supervisory Authority of their net short-selling positions in those stocks if they reach or exceed a threshold of 0.2%. Net short-selling positions of 0.5% or more are also published on BaFin's website. Positions must then be reported and published if they reach, exceed, or fall below the threshold by a further 0.1%. The net short-selling positions and reportable thresholds under the transparency requirement are based on the proposals also published in early March 2011 by the Committee of European Securities Regulators (CESR) for a pan-European disclosure regime for net short-selling positions, in the preparation of which BaFin was heavily involved.[48]

Effective 26 March 2012, BaFin's general decree will be replaced by a statutory transparency regime with largely similar content. Through section 30i WpHG, the Act on the Prevention of Improper Securities and Derivatives Transactions introduces notification and publication requirements for net short-selling positions in all shares admitted to trading on the regulated market of a German stock exchange. The content of this provision also largely mirrors the CESR proposals of March 2010, supplemented by technical details of May 2010.[49]

1.2 Act to Increase Investor Protection and Improve the Functioning of the Capital Markets

In response to the financial crisis, the Act to Increase Investor Protection and Improve the Functioning of the Capital Markets (*Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts* – AnsFuG) also provides for significant changes in securities supervision.[50]

Voting rights notification requirements extended.

The transparency of major holdings in listed companies is to be substantially improved. In addition to directly held voting rights and unilaterally binding options on shares, other instruments that are comparable in economic terms will also be reportable in future if a threshold of 5% is reached or exceeded. The intention in extending the notification requirement to cash-settled instruments such as cash-settled equity swaps is to prevent or at least make it difficult for a shareholder to creep into a listed company unnoticed, as occurred in several takeovers in recent years. Written put option positions and rights of redemption under securities loans and similar transactions will also be subject to the extended reporting requirements in future. Finally, breaches of the notification requirement will be punishable by an administrative fine of up to €1 million instead of €500,000, as has been the case to date.

[48] Model for a Pan-European Short Selling Disclosure Regime (CESR/10-088).
[49] Technical Details of the Pan-European Short Selling Disclosure Regime (CESR/10-453).
[50] Chapter V.1.3.

Minimum holding period introduced for real estate funds.

The AnsFuG also contains the lawmakers' response to developments at open-ended real estate funds. Among other things, the AnsFuG provides for a one-year notice period for all investors. In addition, newly acquired units in open-ended real estate funds are subject to a minimum holding period of 24 months. However, investors will still be able to redeem the equivalent of up to €30,000 in any six-month period without having to comply with these requirements. These changes are intended to emphasise the long-term nature of an investment in open-ended real estate funds and to a great extent prevent relatively large amounts from being "parked" in these funds for only a short period without placing excessive restrictions on small investors.

In addition, the AnsFuG shortens the period between valuations of fund properties based on the frequency with which fund units are issued and redeemed. For example, if the asset management company continues to issue and redeem units on all trading days, it will have to have the properties valued on a quarterly basis; on the other hand, if it restricts itself to issuing and redeeming units on just one day a year, it will have to have the properties valued every twelve months, as has been the case to date.

Finally, the period of up to two years provided for the temporary suspension of the redemption of units under section 81 Investment Act (*Investmentgesetz* – InvG) has been extended by six months. In addition, the rules on the sale of properties for the purposes of obtaining liquidity are set out in greater detail and borrowing options restricted.

1.3 Act Implementing the EU Regulation on Credit Rating Agencies

On 15 June 2010, the Act Implementing the EU Regulation on Credit Rating Agencies (*Ausführungsgesetz zur EU-Verordnung über Ratingagenturen*) entered into force.[51] The EU Regulation on Credit Rating Agencies contains directly applicable provisions for undertakings wishing to publish ratings in the member states of the European Union as well as directly applicable provisions governing the use of ratings by credit institutions, insurance undertakings and asset management companies, for example. Initially the registration and ongoing supervision of rating agencies are the responsibility of the member states' national supervisory authorities. Under the Act Implementing the EU Regulation on Credit Rating Agencies, BaFin has been designated the competent authority and rules have been put in place governing supervisory powers and administrative procedures. In addition, the list of fines in the WpHG has been supplemented accordingly, making breaches of the EU Regulation on Credit Rating Agencies punishable as administrative offences. For example, if a rating agency issues a rating despite a conflict of

[51] Regulation (EC) no. 1060/2009 dated 16 September 2009, Federal Law Gazette (BGBl.) I 2010, p. 786.

interest or lack of reliable data, BaFin can impose a fine of up to €1 million. In the course of 2011, the monitoring of rating agencies will pass to the European Securities and Markets Authorities (ESMA).

1.4 Act Implementing the UCITS IV Directive

At the cabinet meeting held on 15 December 2010, the Federal Government adopted the draft version of the Act Implementing the UCITS IV Directive (*OGAW-IV-Umsetzungsgesetz*).[52] The Act will transpose Directive 2009/65/EC (UCITS IV Directive) into German law effective 1 July 2011. The amended and new provisions in the InvG are intended to improve the efficiency of investment fund business and create an attractive and competitive environment for providers of investment fund products. For fund investors, they establish consistently high standards of protection. This applies in particular to the merger of investment funds, which was not governed by the previous UCITS Directive and was permitted under national laws subject to different conditions. In some cases, the provisions also apply to investment funds not harmonised by the UCITS IV Directive, such as real estate funds, due to similar interests.

Cross-border portfolio management becomes possible.

In particular, investment fund business is intended to improve as a result of the fact that portfolio management is now possible on a cross-border basis as well. Originally, the first UCITS Directive required the asset management company to have its registered office in the same member state as the managed investment fund so that the two could be monitored by one supervisory authority. The provisions of the UCITS IV Directive abandon this principle and now enable asset management companies to manage investment funds on a cross-border basis. In this context, rules are also being introduced to improve cooperation between the authorities responsible for the authorisation and supervision of asset management companies and investment funds.

Master feeder structures introduced.

Assets can now be pooled on a cross-border basis as well. The introduction of cross-border master-feeder structures will allow a feeder fund to invest almost all its assets in a master fund where they will be managed cost-effectively. Risk diversification – a key investment objective – will thus be achieved indirectly at master fund level.

European harmonisation on the merger of investment funds.

For the first time, the UCITS IV Directive establishes European supervisory requirements for domestic or cross-border mergers of investment funds. Accordingly, the Act Implementing the UCITS IV Directive provides, among other things, for a formal approval procedure, compulsory content for merger agreements, certain audit procedures by the custodian banks involved and rules governing the costs associated with mergers. In addition, investors must be specifically informed about the merger.

[52] Bundestag publication 17/4510.

Notification procedure simplified.

Until now, an investment fund that wished to market its units in different European member states had to complete a separate notification procedure in each of those countries. Under the new rules, the fund only notifies the supervisory authority in its home country of its intention to market its units in another member state. The supervisory authority in the home country then forwards the notification letter and the related documents to the supervisory authorities in the member states in which the units are to be marketed. For asset management companies and EU management companies, this makes the notification procedure much simpler.

"Key investor information".

In future, the "key investor information" will replace the simplified prospectus. Investment companies will therefore have to set out the key features of the fund on no more than two DIN A4 pages. This information includes the fund's investment objectives and investment policy, an illustration of its past performance, a full list of the costs and charges, a description of its risk/reward profile and a warning in relation to the risks associated with the investment. The key investor information is intended to strengthen investor protection by enabling customers to more quickly and easily gain an overview of the investment and the risks associated with it.

Numerous obligations to provide information introduced.

In line with the requirements of the UCITS IV Directive with regard to mergers and master-feeder structures, the Act Implementing the UCITS IV Directive provides for new obligations to provide information to investors by means of a durable medium. For example, there was previously no requirement to inform investors in the event of the termination or merger of funds. In future, asset management companies will be obliged to inform investors about the termination or merger of funds by means of a durable medium (letter, e-mail).

1.5 Supervisory practice

InvMaRisk

In June 2010, BaFin published its circular "Minimum Requirements for the Risk Management of Investment Companies" (*Mindestanforderungen an das Risikomanagement für Investmentgesellschaften* – InvMaRisk). InvMaRisk is based on the Minimum Requirements for Risk Management of Credit Institutions, but reflects the different business model and the risk structure of investment companies. It sets out in greater detail the requirements for an appropriate organisational structure and in particular the organisation of the risk management system. The circular covers both the specific requirements for the risk management of individual investment funds and overall risk management at company level. In addition, InvMaRisk contains requirements with regard to outsourcing, compliance and internal auditing.

Custodian bank circular

In July 2010, BaFin also published a circular regarding the tasks and duties of custodian banks under sections 20 et seq. InvG. Among other things, the circular addresses the requirements for approval, the custody of fund assets and the control functions required to be performed by the custodian bank. It also explains to what extent the custodian bank may outsource activities to another entity or insource the tasks of the asset management company. Finally, the circular lists the points that should be governed by the custodian bank agreement. These include the scope of the custodian bank's duties and the obligation on the asset management company and the custodian bank to inform one another about measures that may affect the proper performance of the custodian bank function (e.g. the amendment of fund rules or the acquisition of new, very complex products). Custodian banks and asset management companies must implement the circular's requirements by July 2011.

Guidance notice on the notification of foreign investment funds

The new guidance notice on the notification of foreign investment funds under section 139 InvG of November 2010 combines the guidance notice in force to date and the accompanying addendum 2 and now reflects current legislation and administrative practice. For example, it now includes specific guidance on the notification of investment funds similar to "other funds" (*sonstige Sondervermögen*) and the notification of funds similar to "funds of funds with additional risks" (*Dach-Sondervermögen mit zusätzlichen Risiken*).

2 Monitoring of market transparency and integrity

2.1 Short selling

Naked short selling prohibited by law.

The Act on the Prevention of Improper Securities and Derivatives Transactions (in force since 27 July 2010) for the first time prohibits naked short sales of shares and debt securities issued by central governments, regional governments or local authorities of member states of the European Union whose legal currency is the euro (section 30h WpHG). This only applies to shares and debt securities that have been admitted to trading on the regulated market of a German stock exchange. Shares of companies that are domiciled abroad are not covered by the prohibition unless they are exclusively admitted to trading on the regulated market of a German stock exchange.

In addition, contracting credit derivatives or entering into a transaction in respect of such credit derivatives whose reference liabilities are the liabilities of central governments, regional governments or local authorities of member states of the European Union whose legal currency is the euro is also prohibited in those cases in which the protection buyer is not pursuing any hedging purposes of its own (§ 30j WpHG). This covers both credit default swaps (CDSs) and constructs in which CDSs are embedded in other instruments, e.g. credit linked notes or total return swaps. The prohibition only applies to protection buyers and relates solely to transactions entered into in Germany.

Exemptions to the ban on short selling

In order to guarantee financial market liquidity, transactions by market makers, lead brokers and comparable persons are not covered by the bans. The exemptions do not apply to all business activities but only to the extent that the underlying transaction concerned is needed to perform such activity. Where market makers execute naked short sales, they must notify BaFin of existing holdings or changes in holdings as at the last day of each quarter. In 2010, the relevant dates were 27 July (the date on which the Act came into force), 30 September and 31 December.

Notifications received from 83 market makers.

83 market makers notified BaFin of their activities, 47 of which are domiciled in Germany and 36 abroad. They submitted a total of 390 notifications for all reportable quarters, with each notification referring to multiple instruments. Of this total, 238 notifications related to shares, 110 to public-sector debt securities and 42 to CDSs.

Table 24

Notifications by market makers

as at 31 December 2010

	Lead brokers	Others	Total
Equities	**64**	**174**	**238**
27.07.2010	21	68	89
30.09.2010	22	53	75
31.12.2010	21	53	74
Debt securities	**23**	**87**	**110**
27.07.2010	7	32	39
30.09.2010	8	28	36
31.12.2010	8	27	35
CDSs	**5**	**37**	**42**
27.07.2010	2	14	16
30.09.2010	1	11	12
31.12.2010	2	12	14

Monitoring of the bans on short selling

171 suspicious transaction reports relating to naked short sales.

Section 10 WpHG requires credit institutions and operators of off-exchange markets on which financial instruments are traded to report not only potential violations of the ban on insider trading and market manipulation but also potential violations of the ban on short sales. In 2010, BaFin received a total of 171 reports of potential naked short sales of shares or debt instruments (section 30h WpHG). The large number of reports is primarily due to reports by Clearstream Banking AG relating to delays in delivery or settlement. Such delays may indicate a violation of the ban on short selling. The reports are currently being investigated.

Data on CDSs requested.

No suspicious activity reports relating to CDSs were received in the year under review. In order to check whether any violations of the ban on transactions involving naked credit derivatives had occurred, BaFin requested a clearing institution at the end of 2010 to provide it with data on CDS transactions in Portuguese and Irish government bonds. BaFin is examining whether the German companies involved in the transactions actually entered into the CDS positions for legitimate hedging purposes.

18 investigations relating to shares and debt securities.

BaFin launched 18 investigations of potential violations of the ban on short sales of shares and debt securities. The proceedings in four cases were discontinued. One case was referred to BaFin's administrative fines section for further processing. Violations of the ban on naked short sales in certain shares and debt securities and naked CDS transactions are punishable by fines of up to €500,000.

Notification requirement for net short selling positions

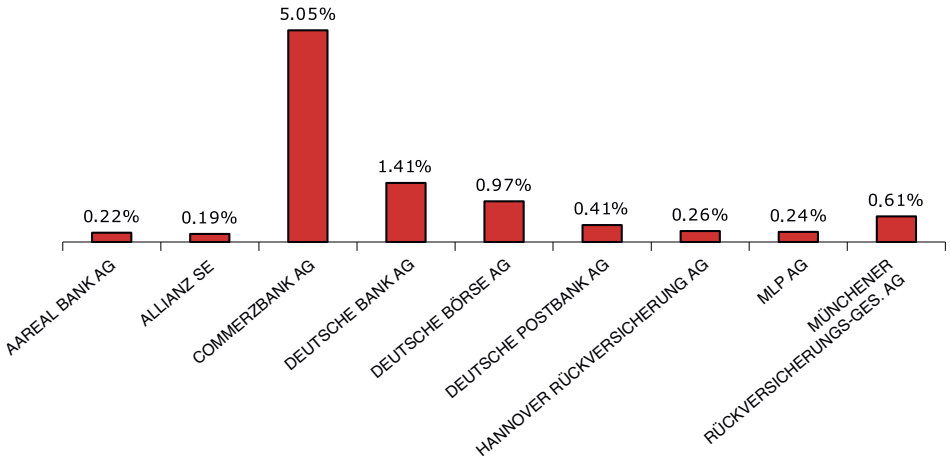
Since March 2010, all market participants have been obliged to report net short selling positions in ten selected financial stocks to BaFin: Aareal Bank AG, Allianz SE, Generali Deutschland Holding AG, Commerzbank AG, Deutsche Bank AG, Deutsche Börse AG, Deutsche Postbank AG, Hannover Rückversicherung AG, MLP AG and Münchener Rückversicherungs-Gesellschaft AG.

BaFin must be notified when net short selling positions reach, exceed, or fall below the threshold of 0.2%. In addition, net short selling positions by a market participant that reach, exceed or fall below the threshold of 0.5% are published in anonymised form on the BaFin website.

203 notifications received.

BaFin received 203 notifications in the year under review, or on average almost one per trading day. 56 reports were published. They related to all financial stocks covered by the general decree with the exception of Generali Deutschland Holding AG. A total of 33 companies reported net short selling positions, in some cases in up to four different stocks. The following figure shows the aggregate net short selling positions in existence at the end of 2010.

Figure 19
Net short selling positions in certain financial stocks
as at 31 December 2010



2.2 Market analysis

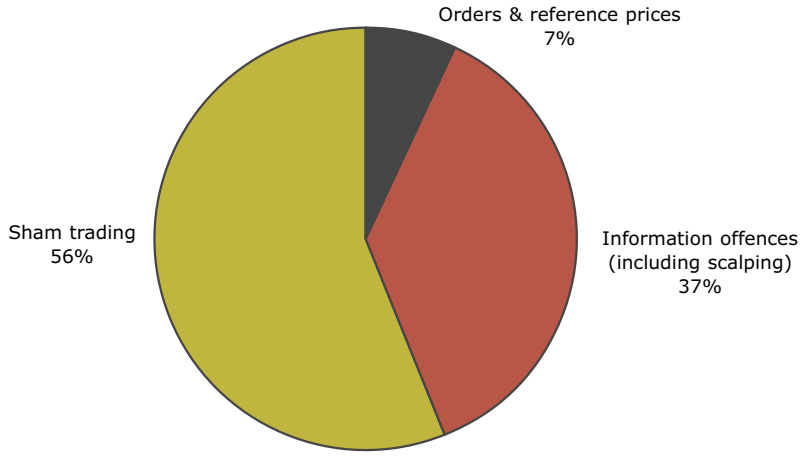
BaFin steps up risk-based focus of market analysis.

BaFin analysed 1,197 cases of possible market abuse (previous year: 441). The sharp rise was due primarily to the fact that BaFin extended the scope of its analysis process in 2010. This allowed it to filter out non-suspicious cases more quickly. 64 analyses (previous year: 77) ended with a recommendation that the matter be investigated further. 34 of these cases (previous year: 28) related to insider trading and 30 (previous year: 49) to market manipulation.

One of the key focuses of BaFin's activities in 2010 was on the markets for government bonds in the eurozone periphery, along with credit derivatives on such bonds. However, there were no indications of manipulation. BaFin also prepared comprehensive expert opinions for police authorities, public prosecutors and the courts; in a growing number of cases, these related to the gains from, or losses avoided by, insider trading that courts are required to confiscate.

In the case of market manipulation analyses, the focus was once again on collusive transactions and other sham activities (17, previous year: 28). Eleven analyses related to incorrect, misleading, or missing information and scalping – the improper failure to disclose conflicts of interest when recommending financial instruments (previous year: 15). These offences are particularly complex and difficult to investigate, and have the greatest potential to inflict damage. Only a very small number of analyses related to manipulation of the order situation and of reference prices (2, previous year: 6).

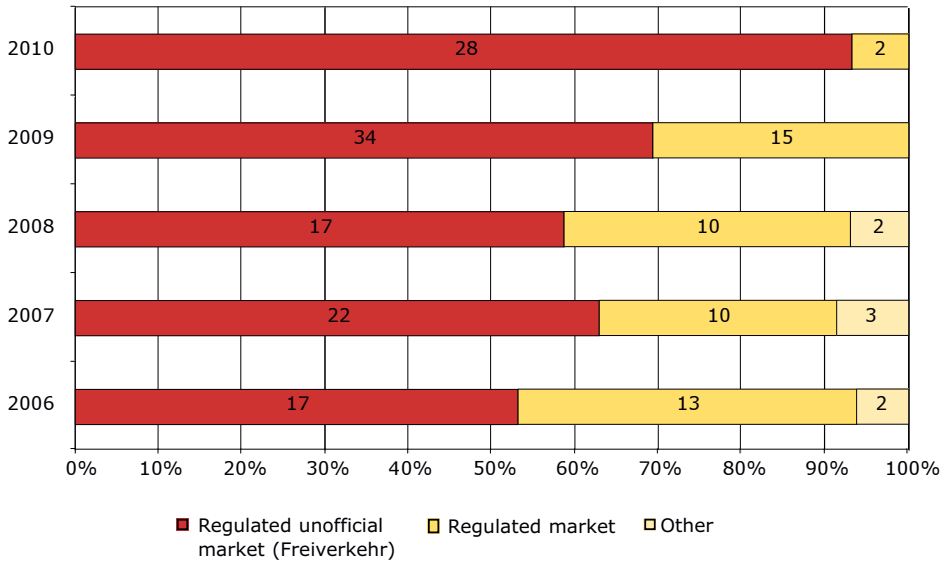
Figure 20
Positive manipulation analyses by issue involved



Instruments traded on regulated unofficial market frequent targets for manipulation.

The trend for manipulation to focus on the regulated unofficial market in particular continued to grow in 2010. More than 90% of the positive market manipulation analyses related to stocks from this market segment (previous year: 69%). The regulated unofficial market is run by the stock exchanges, but does not count as exchange trading. It is used primarily to trade small and in some cases highly illiquid stocks that are frequently of foreign origin. The conditions to be met for companies to be included are extremely lax compared with the regulated market. There is no serious examination of the issuers, nor must the companies comply with any reporting obligations. Even companies in respect of which it is completely unclear whether they have, or are planning, operational business activities can be included in trading extremely easily and used for manipulative purposes. Although Deutsche Börse AG introduced stricter inclusion requirements in 2009, this has yet to have any noticeable effect.

Figure 21
Positive manipulation analyses by segment



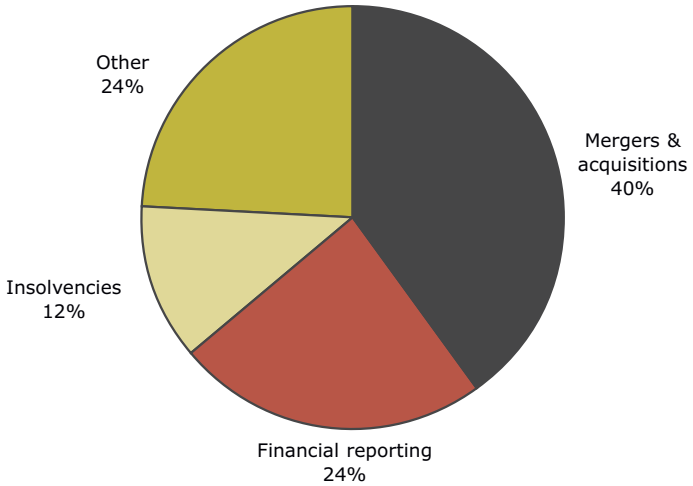
BaFin frequently observed the following scenario in cases in which stocks traded on the regulated unofficial market were manipulated in 2010: customers received aggressive, unsolicited buy recommendations by phone or fax for infrequently traded shares of foreign issuers traded on the regulated unofficial market in Germany. The reasons tipsters gave for their recommendations included fictitious impending share buy-backs or takeovers at significantly higher prices. In many cases, they supported their actions by entering into collusive transactions that gave the impression of trading activity and liquidity. As a result, the previous shareholders were able to sell large volumes of shares at a considerable profit. When the prices of the shares concerned subsequently collapsed, the purchasers who had been duped into buying the stocks experienced substantial losses, not infrequently having to write off their investments completely. The companies whose shares are marketed in this way often come from abroad; recently, there have been a growing number from Switzerland and the United Kingdom. In all cases, they are listed on the regulated unofficial markets of German stock exchanges. BaFin has reported a number of such offences and is working extremely closely with the prosecuting authorities.

Since the manipulation methods used are constantly changing, BaFin provides regular warnings about dubious providers on its website[53] as well as in brochures, and gives investors tips on how they can protect themselves. In individual cases, it warns banks or associations about the manipulation of specific stocks. As a result, some attempts at market manipulation fail due to increased awareness on the part of banks' advisory staff.

Positive insider analyses particularly common in connection with takeovers.

As in the past, the largest share of positive insider analyses (40%) related to mergers and acquisitions (previous year: 39%). Of the total number of cases, 24% (previous year: 32%) related to companies' earnings figures and 12% (previous year: 11%) to insolvencies. By far the largest group within the "others" category related to capitalisation measures. Whereas in recent years almost

Figure 22
Positive insider analyses by issue



[53] www.bafin.de » Publications » Notes to consumers.

90% of all insider analyses related to securities traded on the regulated market, the importance of the regulated unofficial market increased in 2010 (41%, previous year: 11%). In line with this, the share of analyses accounted for by the regulated market declined to 59%.

Credit industry reported 1,310 million transactions.

At 1.31 billion transactions, banks and financial services providers reported substantially larger numbers of financial instrument transactions to BaFin in 2010 than in the previous year (992 million). A total of 5.15 million reports were received each trading day (previous year: 3.9 million). The increased volume is due in particular to the fact that transactions solely involving securities traded on the regulated unofficial market have also had to be reported since November 2009; in addition, there was an overall increase in trading activity.

Reports can also be submitted by multilateral trading facilities (MTFs) and foreign exchanges. For example, BaFin supervises three MTFs operated by securities houses or exchanges (previous year: 3). Foreign exchanges from non-EU countries required approval from BaFin to set up trading screens in Germany if they provide German market participants with direct market access via an electronic system. In 2010, four foreign market operators were granted approval to permit German trading participants to perform exchange trading as remote members (previous year: 4).

In many cases, analyses are triggered by suspicious transaction reports (241, previous year: 194). 216 suspicious transaction reports related to equities, eight to warrants, seven to bonds, six to funds, three to certificates and one to a future. In 25 cases, BaFin received the suspicious transaction reports from a foreign supervisory authority.

2.3 Insider trading

Insider trading complaints filed against 33 people.

In 2010, BaFin launched 34 new investigations relating to cases of suspected insider trading (previous year: 30). Ten complaints (previous year: 28) involving a total of 33 people (previous year: 78) were referred to the public prosecutor's office. No evidence of insider trading was found in 17 cases (previous year: 37). 34 (previous year: 27) cases were still pending at the end of the year, some of which related to previous years.

Table 25
Insider trading investigations

Period	New investigations	Results			Pending
		Discontinued	Referred to public prosecutors		
	Insiders	Insiders	Cases	Individuals	Total
2008	44	54	27	67	62
2009	30	37	28	78	27
2010	**34**	**17**	**10**	**33**	**34**

Eleven people convicted.

German courts convicted a total of eleven people (previous year: 11) of insider trading in 2010, two (previous year: 7) following summary proceedings (*Strafbefehlsverfahren*). 69 cases (previous year: 53) were discontinued by the public prosecutors, 26 of them (previous year: 14) as part of out-of-court settlements (*Geldauflage*).

Table 26
Public prosecutors' reports on completed insider trading proceedings

Period	Total	Discontinued	Discontinued following out-of-court settlement	Final court decisions			
				Decisions by the court	Convictions following summary proceedings	Convictions following full trial	Acquittals
2008	102	84	12	0	3	3	0
2009	53	28	14	1	7	3	0
2010	**69**	**32**	**26**	**0**	**2**	**9**	**0**

International cooperation on insider trading cases.

BaFin cooperates closely with foreign supervisory authorities when pursuing cases of insider trading. In 2010, it received 28 enquiries from abroad (previous year: 17), with the largest number coming from France and Austria. BaFin itself contacted foreign authorities, and particularly those in Switzerland and the United Kingdom, 19 times (previous year: 40 times).

Information on selected completed cases is given below.

IMW Immobilien AG

On 27 July 2005, IMW Immobilien AG published an announcement that it had entered into an option agreement with a number of real estate companies to acquire 75 residential and commercial properties. It put the annual rental income for the properties at €6.7 million. As a result, IMW's share price rose by approximately 16%.

A governing body member at IMW had given the information in advance to an acquaintance, who opened a securities account and acquired 200 IMW shares at a price of €42.90 on the morning the announcement was made. This was the only purchase in the entire country to be made on 27 July 2005 before the announcement was published. The governing body member's acquaintance then sold the securities at the beginning of September 2005 at a price of €70, generating a gain of €5,420.

In February 2010, the Local Court (*Amtsgericht* – AG) in Würzburg imposed a fine of 90 daily units of €25 per day for illegal insider trading and ordered that the gain of €5,420 be forfeited. The court fined the governing body member 90 daily units of €125 per day for the unauthorised communication of inside information and the unauthorised recommendation of insider securities. Both the accused and the public prosecutor initially lodged appeals against the judgement handed down by the court of first instance, but later withdrew these appeals.

Heliad Equity Partners GmbH & Co. KGaA

On 3 April 2008, Heliad Equity Partners GmbH & Co. KGaA issued an ad hoc disclosure announcing that it had signed a contract for the sale of 50% of its portfolio of equity interests for €47.6 million. As a result, the price of Heliad's shares rose by 18% to €0.86.

A suspicious transaction report from a bank alerted BaFin to the unusual trading behaviour of one of the bank's clients. The latter had acquired a total of 168,580 Heliad shares worth approximately €120,000 in the period between 12 and 22 February 2008. At the same time, a third party had transferred the same amount of money to his current account. BaFin discovered that – as the bank had suspected – the money came from one of Heliad's governing body members. After the ad hoc disclosure was published, the bank's customer merely sold a portion of shares and retained the rest in his securities account. Due to the generally weak performance of the financial markets, Heliad's share price subsequently fell temporarily to €0.58. As a result, the bank's customer was unable to realise a profit.

The bank customer's father-in-law also acquired 25,600 Heliad shares worth €18,432 before the ad hoc disclosure was published. In May 2008, he transferred the securities to his son's securities account, which was subsequently closed. In addition, he took out a loan of €200,000 and made it available in full to a third party who, in turn, also acquired 274,645 Heliad shares worth €202,000 in February 2008 before selling them between mid-April and mid-June 2008, generating a gain of approximately €23,000.

The suspects also included another person who had previously advised Heliad on public offerings. The former adviser had bought a total of 50,000 Heliad shares worth €35,589 in the period from the beginning of February and the beginning of April 2008, before selling them on 3 April 2008 at a profit of €7,610.

BaFin filed a complaint against the five suspects with the public prosecutors in Karlsruhe. The latter discontinued the investigative proceedings against the governing body member, his acquaintance and the latter's father-in-law in September 2010 in accordance with section 153a (1) of the Code of Criminal Procedure (*Straf-prozessordnung* – StPO) in return for out-of-court settlements of €38,000, €17,000 and €40,000 respectively. The investigative proceedings against the father-in-law's acquaintance had already beendiscontinued in August 2010 in accordance with section 153 (1) StPO. The proceedings against the former adviser are still ongoing.

Schmack Biogas AG

On 26 July 2007, Schmack Biogas AG published an announcement that its earnings before interest and taxes for the first half of the financial year would be between €11 and €12 million. Consequently, the announcement said that the company was only expecting revenues of between €140 and €150 million for 2007

compared with the original forecasts of €150 to €170 million, and that earnings would be substantially impacted, at an estimated €–6 million. As a result, the price of the company's shares on the stock exchange dropped by 38.67% compared with the previous day, to €29.04.

In the knowledge of the company's true financial position, a governing body member had sold a total of 31,326 Schmack shares at the end of May 2007 at a price of €60 per share, generating approximately €1,879,560. He admitted this in November 2010 during his trial before the Regional Court in Regensburg. Nevertheless, the Court only sentenced him to a fine of 90 daily units of €120 per day for illegal insider trading and ordered €143,000 to be forfeited.

Calculating the forfeiture amounts for insider trading

In 2010, the Federal Court of Justice (*Bundesgerichtshof* – BGH) ruled that the special benefit generated from prohibited insider trading represents an "acquired amount" (*Erlangte*) within the meaning of section 73 (1) sentence 1 of the Penal Code (*Strafgesetzbuch* – StGB).[54] The decision was based on the following facts: On 9 August 2004, freenet AG issued an ad hoc disclosure on its quarterly and half-yearly results in which it announced substantial declines in revenues and earnings. Freenet's share price fell by approximately 25%. Shortly beforehand, two members of the company's Executive Board had sold a total of 124,300 shares at an aggregate price of approximately €2.36 million. The Regional Court (*Landgericht* – LG) in Hamburg had fined the two defendants 300 daily units of €1,000 and €500 per day respectively for illegally selling insider securities. In addition, the Court had ordered that the proceeds of the sales after taxes, which amounted to €705,352 and €699,838 respectively, should be forfeited.[55]

The defendants appealed against the decision. The Federal Court of Justice confirmed the charges brought but quashed the Regional Court's decision with respect to the penalty. It ruled that the amount imposed must mirror the economic benefit gained by the perpetrator as a result of his or her offence. Whereas the principle prohibiting the deduction of any losses is irrelevant when determining the amount acquired by a perpetrator from or for his or her offence, it must subsequently be taken into account when quantifying the "amount acquired", insofar as any deductions reducing the gain may not be taken into account. Ultimately, the benefit to be forfeited depends on what is actually subject to criminal sanctions. In this context, it is important to establish whether the transaction itself is prohibited – in which case the entire proceeds are forfeitable. Conversely, if only the manner in which the transaction was conducted is relevant for criminal law purposes, only the special benefit attributable to it is to be treated as "acquired" in this sense.

[54] Decision dated 27 January 2010, case ref.: 5 StR 224/09.
[55] 2009 Annual Report, p. 183.

In the concrete case in question, the special benefit to be taken into consideration does not include the purchase price for the shares. The defendants had acquired the latter as the result of a legal transaction and hence had not acquired them either as a result of, or for, their offence. When calculating the benefit gained, the Regional Court in Hamburg had multiplied the difference between the daily opening price and the daily low by the number of shares involved. The Federal Court of Justice considered that this method of calculation did not go far enough. In its opinion, the special benefit obtained could not be measured solely on the basis of a daily unit. Rather, it must be based on the price that would have arisen if the market had assimilated the inside information withheld. This requires the measurement to be based on an estimate going beyond the concrete trading day and taking the longer-term share price performance into account. In particular, the performance of the shares of direct competitors, the trends on the stock exchange and market around the time of the offence, and the normal volatility of the security in question all have to be taken into consideration along with the share price in the trading days following the publication of the inside information. The special benefit calculated in this way should be used as a basis for the measurement of the penalty, i.e. for its concrete amount. On this basis, another chamber of the Regional Court in Hamburg sentenced the two defendants in July 2010 to 300 daily units of €400 and 300 daily units of €250 per day respectively, and calculated the amounts to be forfeited at €327,000 and €324,000.[56]

2.4 Market manipulation

BaFin launches 116 market manipulation investigations…

In 2010, BaFin investigated 116 new cases of market manipulation (previous year: 150). In addition, public prosecutor's offices and the police authorities initiated 84 investigations (previous year: 54).

As in the past, scalping was a key focus of BaFin's activities in 2010. In many cases, this type of market manipulation is performed by networks in which the various entities play different roles. Ostensibly independent market letters collude to plug securities, giving investors the false impression that they are an attractive investment opportunity. In reality, though, the manipulators exploit the investors' interest to unload their own holdings at inflated prices.

…and filed complaints against 109 people with the public prosecutors.

BaFin found evidence of market manipulation in 62 of the cases it investigated (previous year: 60). As a result, it filed complaints against 109 suspects with the relevant public prosecutor's office (previous year: 120). In six other cases (previous year: 4) there was evidence that an administrative offence had been committed; these cases have been passed on to BaFin's administrative fines section for further processing. BaFin discontinued 29 investigations (previous year: 115). 90 cases were still pending at the end of 2010 (previous year: 71).

[56] Case ref.: 608 KLS 2/10.

Table 27
Market manipulation investigations

Period	New investigations	Results						Pending
		Discontinued	Referred to public prosecutors or BaFin's administrative fines section					
			Public prosecutors		Administrative fines section		Total (cases)	Total
			Cases	Individuals	Cases	Individuals		
2008	77	42	32	64	0	0	32	100
2009	150	115	60	120	4	6	64	71
2010	**116**	**29**	**62**	**109**	**6**	**9**	**68**	**90**

International cooperation in cases of manipulation.

The cases of market manipulation pursued by the German supervisory authority are becoming more and more international. For example, in the case of a stock promoter from Canada who was sentenced to six years in jail by a US court for market manipulation, BaFin worked with the Federal Bureau of Investigation (FBI) and the New York District Attorney via a state bureau of investigation in Germany. In another investigation, BaFin had submitted an enquiry abroad and obtained information on additional incidents of manipulation by the suspect. It transpired that the perpetrator had already commissioned other stock recommendations and benefited significantly from them via foreign securities accounts. Armed with this information, the US authorities were able to establish the perpetrator's true financial position, which he had previously misled them about. All in all, BaFin submitted 151 requests for assistance in 2010, more than double the number of enquiries to foreign supervisory authorities in the previous year (60). Foreign authorities requested assistance from BaFin in 22 cases (previous year: 12).

Seven market manipulators convicted.

In 2010, German courts convicted a total of seven people of market manipulation (previous year: 14), six of them (previous year: 5) in summary proceedings. One person was acquitted. The public prosecutors discontinued investigative proceedings in 43 cases (previous year: 27 cases), in 16 cases (previous year: 9 cases) as part of out-of-court settlements.

BaFin also initiated ten new administrative fine proceedings for attempted market manipulation (previous year: 6). Eights proceedings were still pending from previous years (previous year: 7). In one case (previous year: 3 cases) BaFin imposed an administrative fine of €20,000. In addition, another administrative fine of €16,000 was imposed because an institution had failed to report a suspicious transaction report on a case of potential market manipulation, in contravention of section 10 WpHG. Three proceedings were discontinued, two of them in line with the principle of discretion (previous year: 2). 14 cases were still pending at the end of 2010 (previous year: 8).

Table 28

Public prosecutor's and court reports, and reports by BaFin's administrative fines section on completed market manipulation proceedings

Period	Total	Decisions made by public prosecutors		Final court decisions in criminal proceedings			Decisions in administrative fine proceedings		
		Discontinued	Discontinued after out-of-court settlement	Discontinued by court after out-of-court settlement	Convictions following summary proceedings	Convictions following full trial	Acquittals	Discontinued	Final administrative fines
2008	23	12	5	0	2	3	0	1	0
2009	46	18	9	0	5	9	0	2	3
2010	**73**	**43**	**16**	**0**	**6**	**1**	**1**	**4**	**2**

Information on selected completed cases is given below.

CAA AG

CAA AG went public on the Neuer Markt of the Frankfurt Stock Exchange on 21 July 2000. At the time of the IPO, it had forecast revenue of DM 7.6 million for the third quarter of 2000 and DM 15.1 million for the fourth quarter of 2000.

At the time, two governing body members of CAA AG held 51% of the shares. As it became clear in September 2000 that the company would miss its targets for the third quarter by some margin, at DM 2.34 million, they began to pretend that they had made their numbers by artificially generating revenues. For example, they induced a former co-shareholder to buy a shell company, which subsequently bought software licences worth DM 5.96 million from CAA AG although it did not have any funds. Despite the fact that the software was not delivered, CAA AG reported the transaction in its quarterly revenue figures, announcing revenues of DM 8.3 million on 20 October 2000. This led to the share price jumping from €34 (closing price on 19 October 2000) to up to €38.40 (closing price on 20 October 2000). The governing body members adopted the same approach in the fourth quarter of 2000. In the knowledge that the revenue figures were incorrect, they sold a total of 119,300 CAA shares in the period from 31 January to 8 March 2001, generating proceeds of approximately DM 3.5 million. Then, on 6 April 2001, CAA AG published a profit warning that made the public aware of the incorrect revenue figures. As a result, the share price fell from €12.50 to €3.

On 10 August 2010, the Regional Court in Stuttgart sentenced the governing body members to jail terms of one year and six months and one year and three months respectively for two cases of market manipulation and five cases of insider trading. The sentences were suspended, and the judgement is final.

Searchgold Resources Inc. and others

In 2005 and 2006, the deputy editor-in-chief of a well-known specialist stock market magazine in Germany, who also published and acted as editor-in-chief for his own market letter, recommended in both publications buying a number of stocks in which he himself held large positions. He did not draw attention to this conflict of interests in the publications. As he had intended, the recommendations led to the share prices of the companies concerned rising, since a large proportion of the readers followed his recommendations. The journalist then took advantage of the price gains to liquidate his positions, making a profit of more than €150,000.

In May 2010, the Regional Court in Hof awarded him a total suspended sentence of two years in prison for twelve cases of market manipulation, taking another conviction for tax evasion into account.

DAX futures

In January 2009, three securities traders at a credit institution placed large-scale orders during the XETRA opening auctions. These trades had a significant effect on the indicative share prices. The traders cancelled the orders shortly before the minimum auction period expired, thus ensuring that no orders could be executed. In parallel to these trades, the traders placed offsetting DAX futures (FDAX) orders on the EUREX futures exchange, with the futures bought corresponding to the unlimited sell orders they had issued in the XETRA auction. They clearly placed the large orders on XETRA with the sole aim of modifying the indicative price of the 30 DAX stocks and hence the indicative DAX price, and so manipulate the FDAX price on EUREX to their advantage.

The public prosecutor's office in Frankfurt am Main provisionally discontinued the proceedings in October 2010 in return for payments of between €3,000 and €7,000 as part of out-of-court settlements. In doing so, they took into consideration that the perpetrators' employer had already sacked them, and that the Frankfurt Stock Exchange's Disciplinary Committee had already imposed another fine on two of them.

TDS Informationstechnologie AG

The subsidiary of a German holding company traded on German stock exchanges from Dubai. On 16/17 July 2008, a securities trader employed there issued a total of 16 offsetting buy and sell orders via a business securities account and his personal securities account. Using spread-based limits, he was able to ensure matched execution of his orders against each other on XETRA. In this way, the trader generated an economic benefit for the business

securities account for which he was responsible by selling the shares held in it at relatively high prices and then buying them back more cheaply. His personal securities account made a corresponding loss.

Since the manipulation involved XETRA – in other words a Deutsche Börse AG trading system – BaFin filed a complaint about the trader with the Frankfurt am Main public prosecutor's office. These were unable to establish a place of residence for the trader in Germany and provisionally discontinued the proceedings in October 2010 in accordance with section 154f StPO. The securities trader suspected of committing the offence is a German national, but resident in Dubai. The trading company is domiciled in a free trade zone in Dubai. This free trade zone is not covered by the agreements reached between BaFin, the Emirates Securities and Commodities Authority (ESCA) and the Dubai Financial Services Authority (DFSA).

Derivatives on Deutsche Telekom AG shares

Between March 2005 and November 2006, a Spanish national living in Berlin issued offsetting buy and sell orders in 20 different derivative products via his securities account. As a result, he generated a total of 88 manipulative transactions in the (largely illiquid) financial instruments on the Stuttgart and Frankfurt stock exchanges. The trading volume was approximately €1.25 million.

In May 2010, the Local Court in Stuttgart sentenced him following summary proceedings to a total fine of €35,000, payable in 350 daily units of €100 each. The conviction is not yet final.

BKN International AG

In September 2004, an experienced retail investor, who also wrote stock research reports for his own company, issued large sell orders in BKN International AG shares. He placed these orders both in floor trading on the Frankfurt Stock Exchange and via Xetra, the electronic trading system. In all cases he then cancelled the orders before they could be executed. He never intended to make large sales: What he was really after was to induce other market participants to place low-limit sell orders, which he could then use to buy the shares cheaply.

In December 2009, BaFin fined him €20,000 for these phantom orders, which constituted a prohibited trade-based market manipulation.

DR Real Estate AG and others

In May and December 2008, two investors placed a total of eleven offsetting buy and sell orders each for securities of DR Real Estate AG and other companies in quick succession. The orders were identical in terms of their volumes and limit.

During its investigation, BaFin established that the two investors were both registered as living at the same address, and that they therefore obviously know each other personally. Following summary proceedings, the Local Court in Stuttgart sentenced them to a total fine of €49,000, payable in 350 daily units of €140 each. In addition, the Court ordered that an amount of €101,498 be forfeited. The defendants appealed against the sentence handed down in the summary proceedings. In the trial that followed, one of the defendants said that he had executed the transactions for himself and the other defendant in order to generate tax loss carryforwards. Although BaFin and the public prosecutors considered the collusive transactions to be criminal market manipulation, the Local Court in Stuttgart merely treated them as a deliberately perpetrated administrative offence and fined the active perpetrator €20,000. The Court acquitted the other defendant, as it was not possible to prove his involvement beyond reasonable doubt. The judgement is not yet final.

Sunburst Merchandising AG (in liquidation)

The shell of Sunburst Merchandising AG, an insolvent company in liquidation, had been listed for some time without any turnover. From February 2007 to September 2008, a single market participant executed a total of 27 wash trades in the shares, giving the market the erroneous impression that they were being actively traded. The participant explained his trades by saying that he wanted to acquire a shell company and contribute his previously unlisted company to it (a process known as a "reverse IPO"). However, his purchases led other investors to buy the shares and the share price to rise, causing him to abandon his plan. The market participant did not comment on the charge that he had executed prohibited wash trades.

On 18 April 2011, the Local Court in Frankfurt am Main sentenced the defendant to a total fine of 90 daily units of €20 each. The judgement is final. The defendant had previously appealed against a judgement of the Court in the course of summary proceedings sentencing him to a total fine of €27,000, payable in 180 daily units of €150 each.

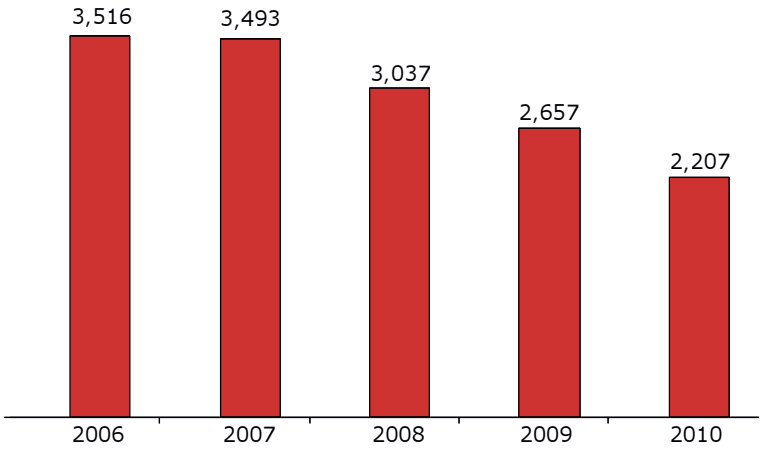
2.5 Ad hoc disclosures and directors' dealings

Ad hoc disclosures

Number of ad hoc disclosures continues to decline.

In line with the trend seen in previous years, listed companies again published fewer ad hoc disclosures in 2010 (2,207; previous year: 2,657). The number of exemptions also declined (177; previous year: 236). Issuers contacted BaFin particularly frequently with content-related questions regarding disclosure requirements in cases of insolvency and impending default. As these issues entail a significant risk of loss for investors, BaFin made investigating these cases one of the focuses of its work. Their examination is still ongoing.

Figure 23
Ad hoc disclosures



ECJ to decide on timing of disclosure requirement.

In the course of an action for damages brought by a shareholder of Daimler AG in relation to a belated ad hoc disclosure in November 2010, the Federal Court of Justice referred the question of when inside information, and hence ad hoc disclosure requirements, arise during multistage decision processes to the European Court of Justice (ECJ). The first question to be answered is whether, where a circumstance or an event is to be brought about over time in the course of multiple intermediate stages, individual intermediate stages of the process may also be subject to an ad hoc disclosure requirement. Secondly, the ECJ must examine whether the likely impact on the share price must be taken into account when the question of whether a future event is sufficiently probable is assessed.

The concrete case in question concerned the dismissal of a CEO. While it is true that this is the responsibility of the Supervisory Board, in BaFin's opinion inside information already exists before the latter passes the formal resolution. The fact that a CEO is actually going to be dismissed is already sufficiently probable at this stage. BaFin imposed an administrative fine of €200,000 on the company in administrative offence proceedings in 2007 because news of the dismissal was published too late. The company appealed against the decision and the Local Court in Frankfurt am Main subsequently repealed the administrative order imposing the fine. After the public prosecutors appealed on a point of law, the Higher Regional Court in Frankfurt am Main referred the case back to the Local Court. The company then withdrew its appeal before the Local Court could re-examine the case. Since the definition of inside information is derived from the Market Abuse Directive[57], the ECJ is responsible for its interpretation.

Nine administrative fines imposed.

BaFin initiated 23 new administrative fine proceedings (previous year: 22) because companies did not publish inside information in good time, correctly, or completely, or because they failed to publish it at all. In addition, 42 proceedings were still pending from previous years (previous year: 42). In nine cases BaFin imposed administrative fines of up to €120,000 (previous year: 8).
Ten proceedings were discontinued in line with the principle of discretion (previous year: 14). In five of these cases, BaFin made its discontinuation of the proceedings dependent on the parties concerned being informed of their legal position and their resulting duties. In a further case, the public prosecutor's office concerned discontinued the administrative fine proceedings in line with the principle of discretion after it had taken them over from BaFin because they were related to criminal investigations. 45 cases were still pending at the end of 2010.

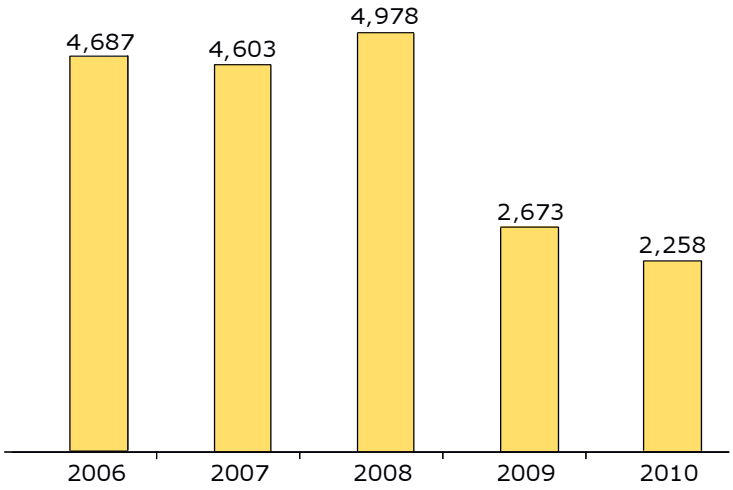
Directors' dealings

2,258 securities transactions reported.

The members of the governing bodies of listed companies and their related parties reported 2,258 securities transactions (previous year: 2,673). The 2010 figure continues the decline seen between 2008 and 2009, when the number of reported transactions almost halved. BaFin publishes all securities transactions reported within the past year in a database on its website. At the same time, all reported securities transactions relating to senior management can also be accessed in the companies' register.

[57] Directive 2003/124/EC, OJ. EU no. L 96 dated 12 April 2003.

Figure 24
Directors' dealings



Three new administrative fine proceedings initiated.

BaFin initiated three proceedings due to violations of the notification and publication obligations contained in section 15a WpHG (previous year: 4). Eleven proceedings were still pending from the previous year (previous year: 9). In 2010, BaFin imposed an administrative fine of €4,000 (previous year: 1 case) and discontinued three cases in line with the principle of discretion, with the parties concerned being informed of their legal position and duties in two cases. Ten cases were still pending at the end of the year.

2.6 Voting rights and duties to provide information to security holders

Voting rights

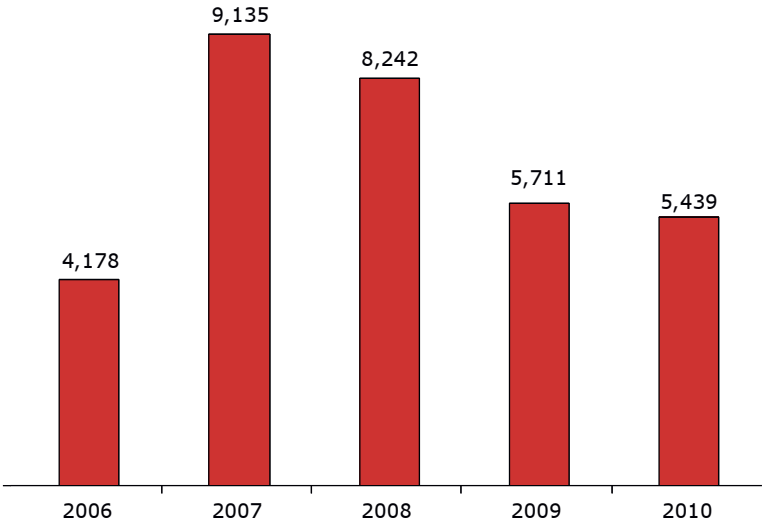
5,439 changes in voting rights reported.

Shareholders of listed companies reported a total of 5,439 changes in holdings of voting rights in 2010 (previous year: 5,711). In addition, BaFin received 57 notifications relating to financial instruments (previous year: 98) and 345 notifications relating to changes in voting share capital (previous year: 373). At the end of 2010, 908 companies had been admitted to trading in a regulated market (previous year: 947). Three REITs were listed on German stock exchanges (previous year: 2).

85 administrative fines imposed due to violations of reporting obligations.

BaFin pursued 196 new cases in which persons or entities subject to a duty of notification or publication did not discharge their obligations in good time, correctly, or completely, or because they failed to discharge them at all (previous year: 342). A total of 469 proceedings were still pending from previous years (previous year: 251). BaFin imposed administrative fines of up to €40,000 on 85 occasions (previous year: 21 times). It discontinued 77 proceedings (previous year: 103), 70 of them in line with the principle of discretion, with the parties concerned being informed of their legal position and duties in 24 cases. A total of 500 fine proceedings were still pending at the end of 2010.

Figure 25
Reports on voting rights



Duties of information to security holders

Issuers of listed securities reported a total of 284 planned changes in the legal basis of their activities (previous year: 458). For example, companies must inform BaFin if they are planning changes to their articles of association that must be resolved by the general meeting. The decline in the number of notifications is due to the fact that the Act Implementing the Shareholder Rights Directive (*Gesetz zur Umsetzung der Aktionärsrechterichtlinie* – ARUG) had led to numerous changes to companies' articles of association in 2009, and hence to an above-average number of notifications in that year.

Issuers reported 2,149 changes in the rights associated with securities admitted for trading, bond issuance, and the publication of material information in third-party countries (previous year: 3,083).

Other items of information requiring notification are listed in section 30b (1) and (2) WpHG. These subsections specify that rights of attendance, the agenda, and the total number of shares and voting rights must be published when convening the general meeting, and that the location, time, agenda and rights of attendance must be notified when convening the creditors' meeting. In addition, a large number of resolutions and issuer events must be published, such as new share issuance or dividend distributions. Until 31 December 2010, section 46 (4) WpHG also required this information to be published in a stock exchange journal of record as well as in the electronic Federal Gazette (*Bundesanzeiger*). This transitional provision has now expired.

42 administrative fine proceedings due to violations of duty to provide information.

BaFin initiated 42 administrative fine proceedings (previous year: 21) against issuers for failing to discharge their duty to provide information in good time, correctly, or completely, or for failing to

discharge it at all. 21 cases were still pending from 2009. In four cases BaFin imposed administrative fines of up to €9,500. It discontinued eight cases in line with the principle of discretion, with the parties concerned being informed of their legal position and duties in four cases. 51 cases were still pending at the end of 2010.

2.7 Rules of conduct for financial instruments analysis

Financial analysts process information about enterprises, sectors, or markets in a systematic manner, and their research culminates in recommendations designed to assist investors in making investment decisions. However, since research reports are aimed at a large, indefinite target group, they cannot reflect individual investors' personal risk appetites. This is the difference to investment advice. This means that investors who rely primarily on financial analysis must decide for themselves whether the financial instrument concerned is suitable for them personally.

In the year under review, 26 written inquiries relating to the interpretation of section 34b WpHG were received. The inquiries mainly related to the distinction to be drawn between advertising and financial analysis, as well as to new business models for disseminating research materials.

Credit institutions and financial services institutions

Fewer institutions conducting financial analysis.

At the end of 2010, BaFin supervised 293 institutions that either produced their own research or acquired third-party reports for their clients or for public dissemination (previous year: 419). The large majority of these were credit institutions; financial services institutions rarely produced or disseminated research reports. The sharp drop as against the previous year is due to three factors: First, a number of institutions that had previously bought in third-party research to provide to their clients discontinued this service. Instead, clients were offered general economic information and pure-play price data for financial instruments. Second, the number of institutions producing or disseminating financial research declined as a result of mergers, especially in the savings bank/cooperative banking sector. Lastly, certain authorised institutions hived off their research departments to specially formed subsidiaries. These are not credit institutions or financial services institutions in their own right, only produce research, and have notified BaFin of their activities in accordance with section 34c WpHG. They are classified separately as independent analysts.

BaFin did not discover evidence of any serious defects in compliance with the provisions of the WpHG and the Regulation governing the Analysis of Financial Instruments (*Finanzanalyse-verordnung* - FinAnV) on the part of credit institutions and financial services institutions.

Independent analysts

Continued focus on market letters.

BaFin supervised a total of 138 independent natural or legal persons who had notified BaFin of their activities in accordance with section 34c WpHG (previous year: 135). Financial analysts domiciled abroad are also required to notify BaFin of their activities to the extent that their publications relate to financial instruments that are traded on an exchange in Germany. Internet searches and investor complaints revealed a number of foreign market letters specifically targeting German investors. Their names were frequently similar to those of well-known market participants or international stock exchanges, apparently to give the impression that they were especially serious. However, investors should be extremely cautious when faced with a "Geneva Commodities Newsletter" published by a limited company in the United Kingdom whose domain owner is registered as being domiciled in Panama, for example. Incomplete or incorrect information in the legal section of websites also suggest a lack of probity on the part of the providers concerned. Generally, these market letters recommend infrequently traded securities that are unknown on the capital market and that stop being quoted at some point after the recommendation is made. If there are grounds for suspecting that financial analysts are involved in market manipulation, BaFin initiates the relevant investigations and informs the public prosecutor's office.[58]

Media

Section 34b WpHG contains special rules for journalists who produce research reports themselves or disseminate third-party research, due to the fact that the freedom of the Press is protected in the Basic Law. Where such journalists are covered by a self-regulation scheme comparable to the provisions of the WpHG (e.g. the German Press Council), BaFin is not responsible for their supervision. However, BaFin is in regular contact with the German Press Council. Issues discussed in 2010 included the distinction between editorial content and advertising and the planned MiFID review of the special rules for journalists.

Administrative fines

As in the previous year, BaFin initiated one new administrative fine procedure relating to suspected violations of the rules of conduct for financial instrument analysis. Another procedure was still pending from the previous year. This means that two cases were still pending at the end of 2010.

[58] Chapter VI.2.3.

3 Supervision of rating agencies

Since 7 September 2010, all credit rating agencies that are either active, or whose ratings are designed to be used, in the European Union have been obliged to register with the supervisory authorities. The basis for this is the European Regulation on Credit Rating Agencies, large parts of which took effect in September 2010 and which provides for the first time for state supervision of rating agencies in the European Union.[59]

Supervisory colleges established.

Under the current law, applications for registration must initially be submitted to ESMA, the European Securities and Markets Authority that is the legal successor to CESR in Paris. ESMA then informs the national supervisory authorities that perform the registration process and subsequently supervise the agencies. The complex registration process is implemented jointly by all affected authorities in the EU in supervisory colleges. The same applies to the subsequent supervision of the registered rating agencies; individual supervisory bodies are only supposed to take action in isolation during ongoing supervision in urgent cases. Once granted, the approval to conduct ratings is valid throughout the EU. All rating agencies that are already doing business had to submit an application for registration between 7 June and 7 September 2010. They are permitted to continue operations on a temporary basis until the registration process, which lasts several months, is completed and indefinitely once registration has been completed successfully. This means that companies wanting to set up as rating agencies for the first time may only start operations once the registration process has been successfully completed.

Three rating agency registered.

In the period up to March 2011, rating agencies throughout Europe submitted 25 applications for registration. Eleven of these applications were submitted by German rating agencies or – in the case of group applications – the German subsidiaries of international agencies. Three rating agencies in Europe were successfully registered in the period up to April 2011, with two of them coming from Germany. Two individual applications and one group application have since been withdrawn at European level. The aim is for the decisions on the outstanding applications to be made in the course of 2011.

Strict rules of conduct and organisational requirements.

Going forward, rating agencies must observe strict rules of conduct and organisational requirements. In particular, they must take extensive measures to prevent or minimise potential conflicts of interest in their activities. Assessing the suitability and appropriateness of these measures is an important part of the registration process. In addition, the agencies must provide detailed information on their rating activities, some of which must be made available to the supervisory authorities and some to the general public. A central data repository at European level is planned in order to track the accuracy of the ratings published by the rating agencies in the past and make this information available to the public.

[59] Regulation (EC) no. 1060/2009 dated 16 September 2009.

Starting in July 2011, responsibility was transferred from the national supervisory authorities to ESMA, in line with the amendments to the European Regulation on Credit Rating Agencies resolved by the Council and the European Parliament in December 2010. After this, the national supervisory bodies are only to be involved in ratings supervision when tasks are delegated to them by ESMA.

4 Prospectuses

4.1 Securities prospectuses

Continued decline in number of approval procedures.

BaFin examined 2,104 securities prospectuses, registration documents and supplements for completeness, comprehensibility and coherence (previous year: 2,480). It refused to grant its approval in two cases (previous year: 3).

Table 29
Approvals
as at 31 December 2010

	2009	2010
Equities/IPOs/capital increases	88	66
Derivatives	148	166
Bonds	197	220
Registration documents	28	32
Supplements	2,016	1,620
Total	**2,477**	**2,104**

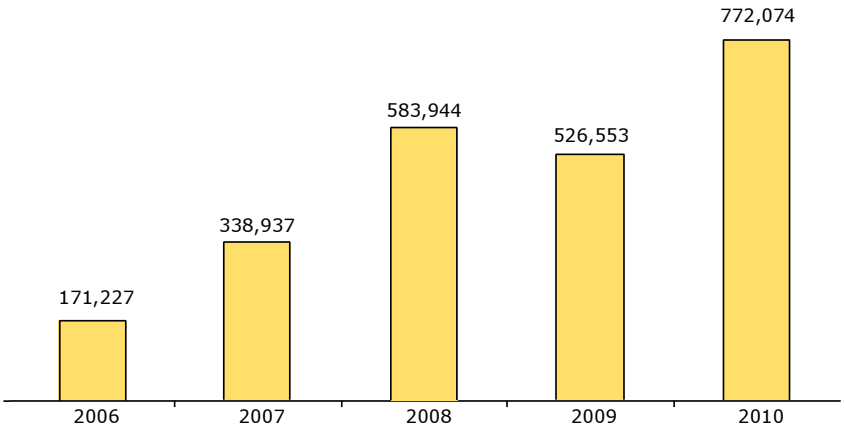
The aggregate number of approval processes declined by 15% year-on-year. The main reason for the renewed decrease is the drop in the number of supplements to 1,620 (previous year: 2,016); these had increased sharply as a result of the financial crisis. Supplements are needed more frequently in periods in which material new circumstances arise relatively frequently at issuers and in the overall market environment. In addition, the decline in IPO prospectuses, prospectuses for admission to a regulated market and prospectuses for capital increases continued (65; previous year: 88).

By contrast, the number of derivative and bond prospectuses increased slightly, although it was not yet able to match the strong figure of 466 prospectuses recorded in 2008. In total, however, BaFin approved 385 prospectuses in 2010 (previous year: 345). Issuers took the opportunity to include the information contained in the basic prospectus in a separate registration document in 32 cases (previous year: 28).

New record for total issuance.

The trend in total issuance reversed again after falling slightly in the previous year (526,553). At 772,074 full prospectuses, final terms and supplements based on the old legislation, the 2010 figure was the highest since the WpPG entered into force.

Figure 26
Total issue volume



Issuers submitted 763,763 final terms and 8,162 supplements based on the old legislation to BaFin in 2010 for new issues under base prospectuses. Base prospectuses can be used for multiple issues. They contain the information about the issuer and basic information on the securities, minus the final terms such as the duration, coupon, or underlying. These are only submitted to BaFin and published shortly before or on issue. The number of supplements governed by the old Sales Prospectus Act (*Verkaufsprospektgesetz* – VerkProspG) continued to decline, as was to be expected (previous year: 36,131). By contrast, the number of final terms rose sharply (previous year: 450,319). This is due to the increased number of base prospectuses issued, especially for derivatives and bonds, but also to the fact that issuers published more final terms on average per basic prospectus.

Less use of the EU passport scheme.

A large number of issuers also used the EU passport scheme in 2010, although the number was down somewhat on the previous year. BaFin issued notifications for EU countries other than Germany for 2,581 prospectuses and supplements (previous year: 2,721), with more than half of the notifications again being destined for Austria (1,402). Conversely, a large number of issuers from EU member states again obtained notifications for the German market for their prospectuses (1,105; previous year: 1,358). More than half of these notifications came from Luxembourg (633).

Table 30
Outgoing and incoming notifications in 2010

	Notifications issued	Notifications received
Austria	1,402	29
Belgium	49	5
Denmark	22	
Finland	21	
France	102	34
Ireland	25	42
Italy	114	3
Luxembourg	583	633
Netherlands	64	113
Norway	21	2
Portugal	21	
Spain	49	
Sweden	26	2
United Kingdom	74	242
Other	8	
Total	**2,581**	**1,105**

Change in securities prospectus fees.

An amended version of the Securities Prospectus Fees Regulation (*Wertpapierprospektgebührenverordnung* – WpPGebV) came into force at the beginning of 2011.[60] In the run-up to this move, BaFin had performed its regular assessment of its actual administrative effort and established that the schedule of fees payable for the administrative effort involved in official acts needed modifying. It is now cheaper (€1.55 instead of €25) to submit final terms for a base prospectus in accordance with the WpPG. Conversely, approvals of single and base prospectuses under the WpPG now cost €6,500 instead of the previous fees of €4,000 (for single prospectuses) and €2,500 (for base prospectuses).

Administrative fines.

In 2010, BaFin initiated seven new proceedings for suspected violations of the regulations governing the preparation and approval of securities prospectuses (previous year: 6). Twelve other proceedings were still pending from the previous year (previous year: 10). In one case BaFin imposed an administrative fine of €5,000 (previous year: 1 case). Proceedings in one case were discontinued in line with the principle of discretion after BaFin had informed the company concerned of the legal positions and its duties. In another case the public prosecutor responsible, who had taken over the administrative fine proceedings because they were related to criminal activities, discontinued the proceedings. Sixteen cases were still pending at the end of 2010.

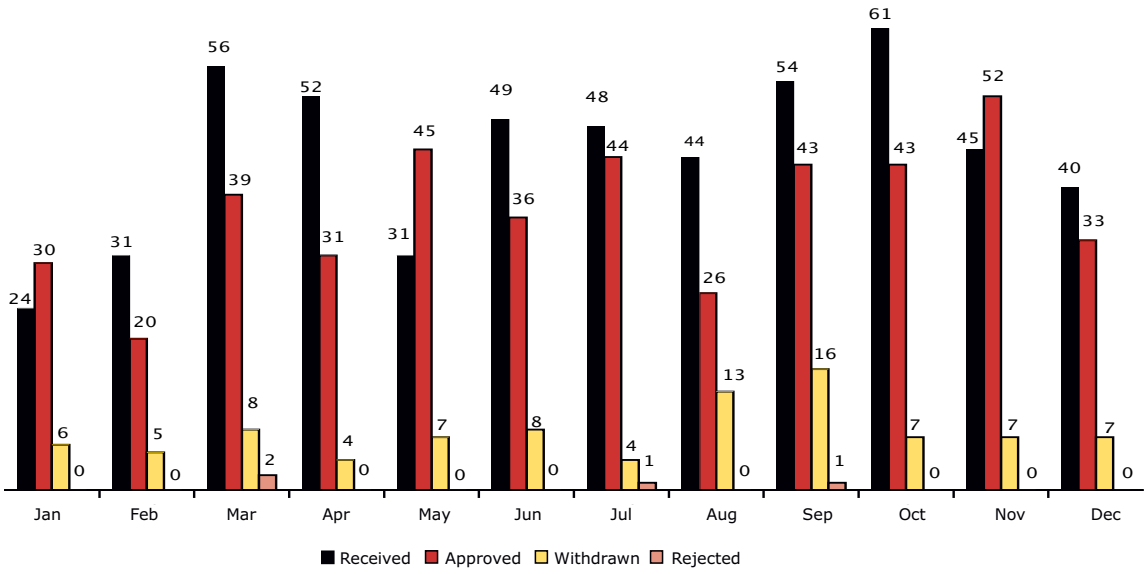
4.2 Non-securities investment prospectuses

Slight recovery in the market for non-securities investments.

The non-securities investment market recovered slightly. BaFin examined a total of 535 sales prospectuses (previous year: 515). It approved publication of 442 (previous year: 390) and rejected four offerings (previous year: 1). Providers withdrew their applications in 92 cases (previous year: 112). The funds offered were designed to attract around €7.4 billion of equity (previous year: €9 billion).

[60] Federal Law Gazette (BGBl.) I 2010, p. 1824 ff.

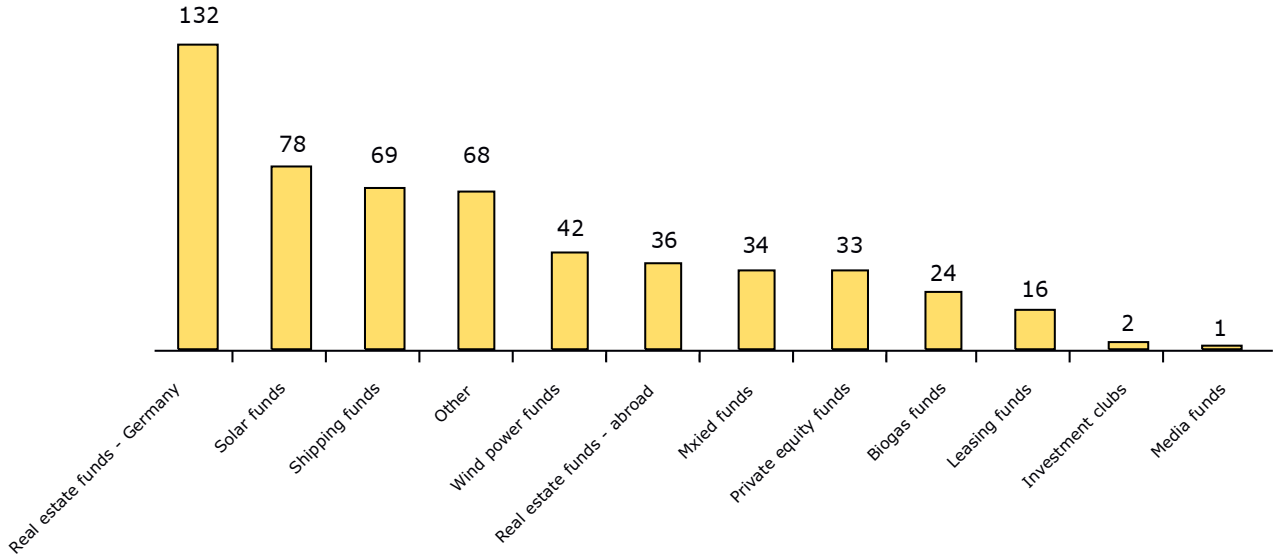
Figure 27
Prospectuses received, approved, withdrawn and rejected in 2010



Real estate and renewable energies remain popular.

Real estate funds remained the most common target investment (previous year: 29%). 25% of the funds were invested in domestic properties (previous year: 21%) and 7% in foreign properties (previous year: 8%). Renewable energy funds were also extremely popular, at around 27% (previous year: 15%); these can be broken down into solar power plants (15%, previous year: 10%), wind power (8%, previous year: 4%) and biogas plants (4%, previous year: 1%). Shipping funds remained constant, accounting for 13% of target investments in both years.

Figure 28
Prospectuses by fund type in 2010



Decline in supplements.

After reaching a record high (644) in the previous year, the number of supplements declined clearly again in 2010, to total 425. This, too, can be interpreted as a sign of a slight recovery on the market for non-securities investments; since issuers can now place issues more quickly again, there are fewer new situations requiring them to provide investors with supplements.

Revised fee schedule for non-securities investment prospectuses as well.

The Investment Sales Prospectus Fees Regulation (*Vermögensanlagen-Verkaufsprospektgebührenverordnung* – VerkProspGebV) was also revised at the beginning of 2011. The review of this area had revealed that the old fee schedule was too low. BaFin now charges a fixed fee of €2,000 per non-securities investment product instead of the previous €1,000 for approving the publication of sales prospectuses. The same fee also applies if the supervisors have to prohibit publication. Where providers withdraw applications for approval, the fee charged is between €500 and €1,500, depending on the effort involved, as opposed to the previous figure of €275.

Systematic Internet searches to identify failures to prepare a prospectus.

As in the past, BaFin systematically trawled the Internet looking for public offerings for which no prospectus had been prepared. It found a total of 29 suspicious cases, primarily for "Bürgersolaranlagen" (solar power plants operated privately by groups of local citizens). BaFin ultimately identified eleven unauthorised (and hence illegal) offerings and took measures to have them terminated immediately.

BaFin initiated two new administrative fine proceedings in relation to potential violations of the duty to prepare investment prospectuses (previous year: 5). Nine proceedings were still pending from previous years (previous year: 10). In one case BaFin imposed an administrative fine of €4,000 (previous year: 3 cases). It discontinued two proceedings in line with the principle of discretion (previous year: 3). Eight proceedings were still pending at the end of the year.

5 Corporate takeovers

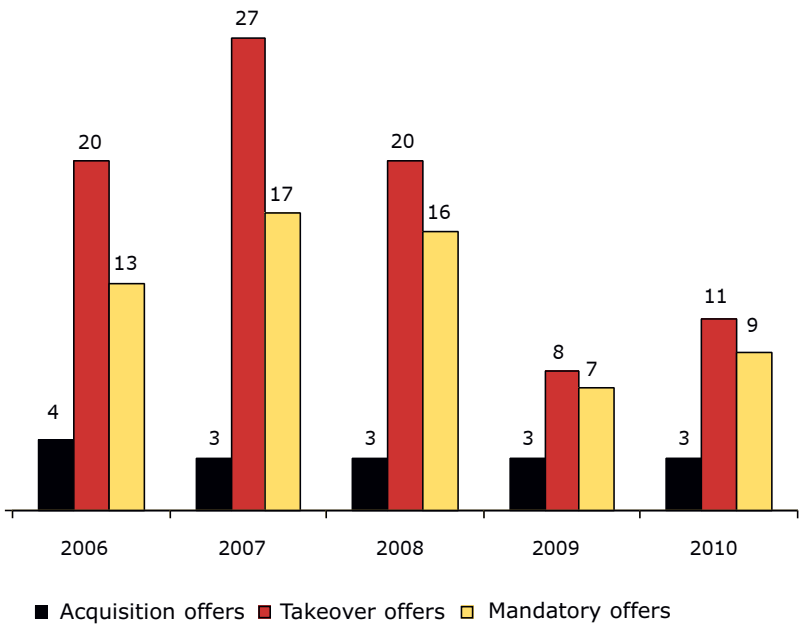
Further growth in offer procedures.

BaFin approved a total of 23 offers (previous year: 18), of which eleven were in the first six months (previous year: 11) and twelve in the second half of the year (previous year: 6). The increase as against 2009 is due to the revival in the M&A market, which had also suffered from the negative developments on the financial markets and the resulting difficulties in financing mergers and acquisitions. Despite the upward trend, the number of approved offers nevertheless remained below the average of recent years.

5.1 Offer procedures

BaFin's approval procedure aims to safeguard sufficient transparency for mergers and acquisitions and to ensure that offer procedures are implemented rapidly and that all shareholders are treated equally. Nine offers were mandatory offers that bidders are obliged to submit if they hold 30% or more of the voting rights of a target company and therefore control the company in question. A further eleven procedures related to takeover offers that were or are aimed at acquiring such a control position without the bidder already having control. Three offers were simple acquisition offers under which bidders either intend to purchase shares of a target company without gaining control, or already have control and want to increase their interest.

Figure 29
Number of offer procedures



Transaction volumes mostly below €100 million.

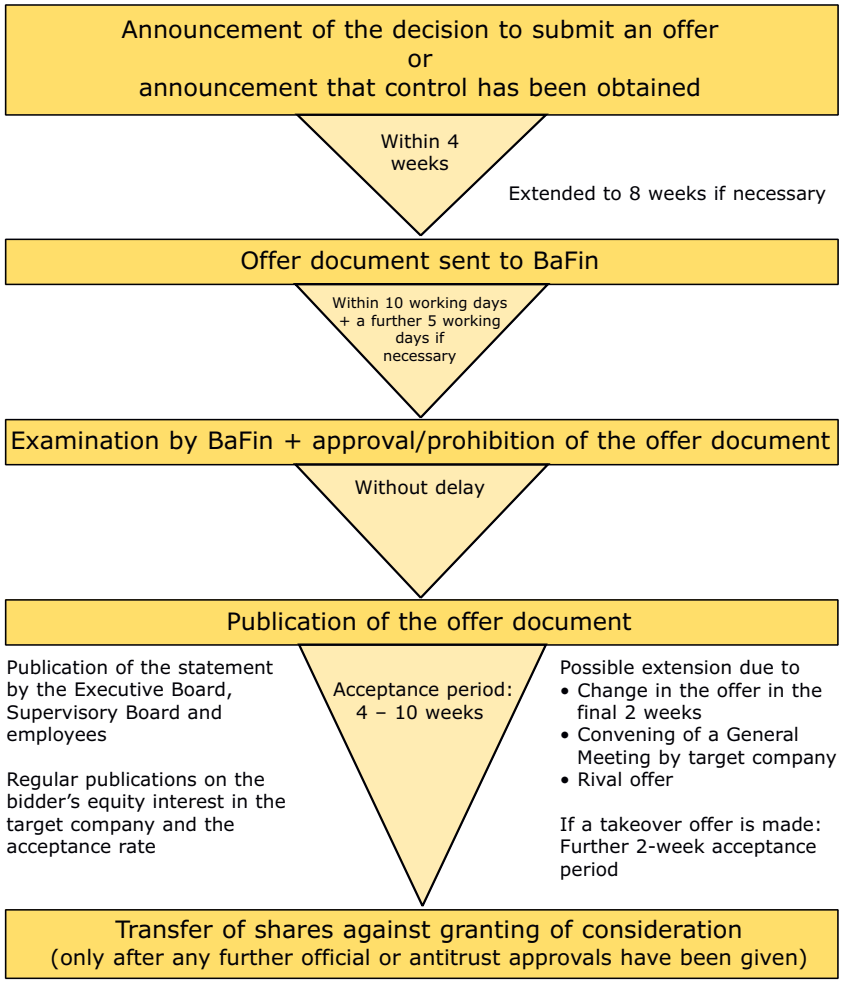
As in previous years, the transaction volume[61] of offers in 2010 was again predominantly below €100 million. At approximately €5.4 billion, Deutsche Bank AG's takeover offer to Deutsche Postbank AG's shareholders was the procedure with the highest transaction volume, followed by ACS, Actividades de Construcción y Servicios, S.A.'s offer to Hochtief AG's shareholders (approximately €3.6 billion). The mandatory offer made by Nordfrost GmbH & Co. KG to Kühlhaus Zentrum Aktiengesellschaft's shareholders had the lowest transaction volume (approximately €144,000).

[61] The transaction volume is calculated by multiplying the number of shares to be acquired by bidders by the amount of cash the bidder is obligated to pay per share as determined in the offer procedure. Incidental transaction costs are added to the result.

Acquisitions in the public spotlight.

Especially the takeover offers made by Deutsche Bank AG to Deutsche Postbank AG's shareholders and by ACS, Actividades de Construcción y Servicios, S.A. to Hochtief AG's shareholders met with substantial public interest in 2010. For the first time, joint mixed offers were also submitted by Thüga Holding GmbH & Co. KGaA, Stadtwerke Frankfurt Holding GmbH and Thüga Aktiengesellschaft to Mainova AG's shareholders, and by Wolfgang Dinkelacker and Sedlmayer Grund und Immobilien KGaA to Dinkelacker AG's shareholders.

Figure 30
Time line for the offer procedures



Takeover offer by Deutsche Bank AG to Deutsche Postbank AG's shareholders

On 12 September 2010, Deutsche Bank AG (Deutsche Bank) announced that it was submitting a voluntary public takeover offer to the shareholders of Deutsche Postbank AG (Postbank). At the same time, it revealed that it would not offer the shareholders more than the statutory minimum price, which BaFin quantified shortly afterwards as €25, as consideration. Finally, Deutsche Bank announced that it had adopted a decision in principle on a capital increase including pre-emptive rights from authorised capital against cash contributions in the amount of at least €9.8 billion (or 49.7% of the previous share capital).

Three-stage acquisition agreement in September 2008.

Deutsche Bank had previously increased its interest in Postbank to 29.95% of the share capital in the course of a three-stage transaction. On 12 September 2008, Deutsche Bank and Deutsche Post AG (Deutsche Post) reached an agreement that allowed for the progressive acquisition of Deutsche Post's entire interest in Postbank by Deutsche Bank:

Deutsche Bank initially purchased 50 million Postbank shares (or 22.9% of the voting rights conveyed by Postbank shares) by way of a non-cash capital increase from authorised capital. The acquisition of these shares became effective when the implementation of the capital increase was entered in the commercial register at the beginning of March 2009. In a second step, Deutsche Bank subscribed for a mandatory exchangeable bond issued by Deutsche Post that falls due on 25 February 2012, and which Deutsche Post is obliged to redeem on 27 February 2012 by transferring a further 60 million Postbank shares to Deutsche Bank (or 27.4% of the voting rights conveyed by Postbank shares) in addition to paying a cash component. Thirdly, the agreement to acquire around a further 26 million Postbank shares (or approximately 12.1% of the voting rights conveyed by Postbank shares) provides for a call option in favour of Deutsche Bank and a put option in favour of Deutsche Post. The strike price of the call option is €48.85 and that of the put option is €49.42; each of these is subject to the price adjustments stipulated in the option terms and conditions in the event of any corporate actions at Postbank. Both the call and the put option can be exercised at any time between 28 February 2012 and 25 February 2013. The earliest possible exercise date of the put option must be postponed by up to a year if requested by Deutsche Bank.

At the end of 2008, Deutsche Bank and Deutsche Post agreed to amend the contract they had entered into without materially modifying the transaction structure described above.

Contractual arrangement does not necessarily result in control.

The three-stage transaction relates to shares that in total represent more than 60% of Postbank's voting rights. Nevertheless, it cannot be assumed that Deutsche Bank had already gained control of Postbank when the agreement was entered into in September 2008 and was then obliged to submit a mandatory offer.

Control

Control exists when a company holds at least 30% of a target company's voting rights (section 29 (2) of the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG)). Under certain circumstances, additional voting rights are attributable to the bidder in accordance with section 30 WpÜG. Companies that – directly or indirectly – gain control of a target company are obliged to submit a mandatory offer in accordance with section 35 WpÜG.

It should be noted that the scheduled repayment of the mandatory exchangeable bond (second step in the transaction) does not mean that Deutsche Bank has gained control of Postbank. This is because Deutsche Bank could have transferred the mandatory exchangeable bond to a third party at any time prior to the bond's maturity in February 2012 or significantly reduced the interest in Postbank that it held at the time of the repayment. The same applies to the call/put options (third step in the transaction): in this respect, too, Deutsche Bank could have reduced its interest and therefore avoided gaining control when Deutsche Post exercises its put option.

No obvious attribution of voting rights.

In addition, BaFin had no evidence that voting rights conveyed by the Postbank shares that are held by Deutsche Post and that are the subject of the transfers or of Deutsche Bank's call option scheduled for February 2012 are attributable to Deutsche Bank. In particular, there was no evidence that Deutsche Post held shares for the account of Deutsche Bank for the duration of the mandatory exchangeable bond (section 30 (1) sentence 1 no. 2 WpÜG). Attributing the shares in accordance with section 30 (1) sentence 1 no. 5 WpÜG was also not appropriate because this provision only applies to contractual arrangements under which the bidder – unlike in the case of Deutsche Bank's increase in its interest in Postbank – can acquire shares in rem through a unilateral declaration of intent without the cooperation of the seller or a third party.

Finally, BaFin also had no evidence that Deutsche Bank and Deutsche Post had reached agreement on the exercise of voting rights or otherwise cooperated with the goal of permanently and materially changing Postbank's business strategy. As a result, the shares could not be attributed due to the parties coordinating their conduct in accordance with section 30 (2) WpÜG. BaFin approved

the publication of Deutsche Bank's offer document on 6 October 2010. Shareholders had accepted the offer for 22.02% of the share capital and the voting rights by the end of the additional acceptance period on 24 November 2010. Deutsche Bank's share of the voting rights therefore increased to a total of approximately 51.98%.

Takeover offer by ACS to Hochtief AG shareholders

On 16 September 2010, ACS, Actividades de Construcción y Servicios, S.A. (ACS) announced that it intended to submit a takeover offer for Hochtief AG (Hochtief) after the Spanish exchange supervisory authority CNMV had investigated rumours to this effect. Eight ACS shares were offered in exchange for five Hochtief shares.

Securing finance.

After publishing its decision to make a takeover offer, ACS should have submitted an offer document to BaFin within four weeks. However, at ACS's request, BaFin extended this period by four weeks until 11 November 2010. BaFin can grant an extension, for example if the offer requires the bidder to perform corporate actions. Before publishing the offer document, the bidder must take all necessary measures to ensure that it has the resources needed to fulfil the offer in full when the claim for the consideration becomes due (section 13 (1) sentence 1 WpÜG). ACS originally planned to secure the consideration through a combination of its own ACS shares and ACS shares that would only have had to be acquired via a securities loan. However, BaFin regarded this as insufficient because securities loans require the cooperation of private third parties and do not offer a comparable standard of protection, in light of the fact that exchange shares are otherwise created solely on the basis of court or sovereign decisions in the case of capital increases. Rather, a capital increase resolution is required for exchange offers. As a result, ACS was obliged to convene a General Meeting for November 2010 to resolve a sufficient capital increase that could also secure the consideration for the exchange in the form of ACS shares in the event that the takeover offer was accepted for all outstanding shares of Hochtief.

Incorporation of conditions.

During its examination of the offer document from 11 to 29 November 2010, BaFin objected to material rules and sections of the document so as to ensure that the risks arising from the capital increase for the accepting shareholders could be minimised as far as possible. Consequently, ACS had to include several conditions that had to be met for the offer to be effective. These included a requirement that no Spanish court may have ruled that the capital increase resolution was invalid at the end of the additional acceptance period and at the time when the last remaining condition for completion was fulfilled, or may have

prohibited the implementation of the capital increase. ACS also had to grant the accepting shareholders an unconditional right of rescission for seven bank working days after the publication of the acceptance rate for the additional acceptance period. BaFin then approved the publication of the offer document on 29 November 2010.

"Hostile" takeover bids

The WpÜG does not stipulate when a takeover offer is "hostile" or who decides this. The term "friendly takeover" exists in English-speaking jurisdictions and refers on the one hand to offers negotiated between the bidder and the target company's board (which corresponds to the Executive Board and the Supervisory Board in Germany), and on the other hand to offers that the bidder notifies to the target company's board in advance and where the board recommends acceptance following an examination. Such an examination is governed by the shareholders' best interests. By contrast, hostile takeovers are offers that are rejected by the target company's board but that are nevertheless pursued by the bidder. In Germany, takeover offers are considered "hostile" if the target company's governing bodies advise shareholders against accepting them and do not believe that they are in the target company's best interests. However, the appropriateness of the consideration must be the only factor taken into account by the Executive Board and Supervisory Board in their statement when assessing the shareholders' best interests.

Hostile takeover bid.

The Executive Board of Hochtief classified the takeover offer as hostile at an early stage and, with the approval of the Supervisory Board, increased the company's share capital by 10% in December 2010 by issuing new shares from authorised capital. These shares were acquired by an investment company operated by the Emirate of Qatar. As a result, ACS's interest in Hochtief was diluted to 27.25%. BaFin investigated whether the capital increase violated the prohibition on frustrating action (section 33 WpÜG). However, this was not the case.

Legitimacy of defensive measures

Actions that could prevent the success of the offer are generally not permitted under takeover law (section 33 (1) sentence 1 WpÜG). However, there are three exemptions from this prohibition on frustrating action: firstly, actions by a prudent and conscientious manager of a company that is not affected by an offer are permitted; secondly, the search for a competing offer (white knight); and thirdly, actions approved by the Supervisory Board.

Major investor changes its mind.

In December 2010, the US company Southeastern Asset Management, Inc. (Southeastern), which at the time held an interest of over 5% in Hochtief, criticised Hochtief for implementing its capital increase and called for the members of the Executive Board and Supervisory Board involved to resign. On 15 December 2010, ACS increased its swap ratio to nine ACS shares for five Hochtief shares. Nevertheless, this change in the offer did not lead to an extension of the acceptance period as the change was not made in the two weeks before the acceptance period expired (section 21 (5) WpÜG). The Executive Board and the Supervisory Board of Hochtief also rejected the increased offer. However, Southeastern accepted the increased offer for half of the Hochtief shares that it managed. This meant that, at the beginning of January 2011, ACS held over 30.34% of the voting shares of Hochtief at the end of the acceptance period on 29 December 2010, including the other shares accepted. As a result, BaFin examined whether Southeastern and ACS acted as persons acting in concert. If Southeastern had been such a person acting in concert with ACS, acquisitions of Hochtief shares by Southeastern would have had to be included in the calculation of the minimum price for the takeover offer made by ACS to Hochtief's shareholders (section 31 (1) and (4) WpÜG). However, BaFin was unable to prove a coordinated action.

Coordinated conduct and persons acting in concert

Persons acting in concert are natural or legal persons who coordinate with the bidder their conduct in respect of the acquisition of a target company's securities or their exercising of voting rights attached to a target company's shares on the basis of an agreement or in another manner (section 2 (5) sentence 1 WpÜG). There may be persons acting in concert with both the bidder and the target company. If a person acting in concert with the bidder acquires securities of the target company, the bidder – not the person acting in concert – must disclose these acquisitions. This information may be published either in the offer document or in the form of a disclosure in accordance with section 23 of the WpÜG (shareholding update – *Wasserstandsmeldung*). The acquisitions by a person acting in concert could affect the minimum price that the bidder must pay: if the person acting in concert with the bidder has purchased securities of the target company at a higher price than the offer price, the bidder is obliged to adjust the consideration accordingly or make a subsequent payment (section 31 (1), (4) and (5) WpÜG). Acquisitions by a person acting in concert could also affect the type of consideration (section 31 (3) WpÜG).

The use of the term "acting in concert" must be distinguished from the definition given in section 30 (2) WpÜG of the term "coordinated conduct". Under the latter definition, persons are deemed to coordinate their conduct when, in more than one individual case, shareholders reach a consensus on the exercise of voting rights or collaborate with the aim of bringing about a

permanent and material change in the target company's business strategy. The legal consequence here is the attribution of voting rights. If the control threshold of 30% is reached, a compulsory offer must be made (section 35 WpÜG) by each of the persons acting in concert, i.e. each one is a bidder.

At the end of the additional acceptance period for takeover offers on 18 January 2011, shareholders had accepted the offer for 4.34% of the voting shares. This meant that ACS's share of the voting rights in Hochtief was 31.59%. As it was not established until the end of the additional acceptance period whether the Hochtief shareholders who had accepted the takeover offer would receive ACS's own shares or ACS shares from the capital increase in exchange for their Hochtief shares, the takeover offer provided for an unconditional right of rescission that could be exercised until 1 February 2011. A substantial number of eligible Hochtief shareholders exercised this right of rescission, which ultimately reduced the acceptance rate for the takeover offer from 4.34% to 3.64% of the voting shares.

Joint (mixed) offer by Thüga Holding, Stadtwerke Frankfurt and Thüga AG to Mainova AG's shareholders

A mandatory offer...

On 2 February 2010, Thüga Holding GmbH & Co. KGaA (Thüga Holding) announced that it had indirectly gained control of Mainova AG (Mainova) effective 1 December 2009 as a result of an off-exchange acquisition. Since then, Thüga Holding's share of the voting rights has totalled 99.65%; 24.44% of this is attributable to Thüga Holding from a subsidiary (section 30 (1) sentence 1 no. 1 WpÜG) and 75.21% due to coordinated conduct (section 30 (2) WpÜG) with Stadtwerke Frankfurt am Main Holding GmbH (Stadtwerke Frankfurt). A mandatory offer would be submitted to the remaining free float shareholders immediately, according to Thüga Holding.

...and a takeover offer...

At the beginning of March 2010, Stadtwerke Frankfurt and Thüga Aktiengesellschaft (Thüga AG) announced their decision jointly with Thüga Holding to submit an offer to purchase the shares held by all remaining free float shareholders of Mainova. In the case of Stadtwerke Frankfurt and Thüga, this was a voluntary takeover offer.

...can become a joint offer.

On 18 March 2010, Thüga Holding, Stadtwerke Frankfurt and Thüga published an offer document in the form of a joint (mixed) offer. In the document, the bidders expressly pointed out that they are economically linked due to an existing consortium agreement under which the voting rights are mutually attributed in accordance with section 30 (2) WpÜG. All the bidders' interests were focused on at least preserving the amount of their equity interest in Mainova. In economic terms, the joint offer only targeted the small number of Mainova shares not already held by the bidders.

The bidders believed that if Thüga Holding alone had made a mandatory offer, this could have created the wrong impression that Thüga Holding had gained economic control and was interested in expanding this position, if necessary at the expense of Stadtwerke Frankfurt and Thüga. Another advantage from the bidders' point of view was the fact that the financing of the offer only had to extend to the small number of Mainova shares not already held by the bidders.

Requirements for a joint (mixed) offer

The criteria for making a joint offer are strict. Bearing in mind that the members of a bidding consortium need not have the same reasons for submitting an offer, the offer document must always meet the strictest of the relevant requirements. For example if, as in this case, the offer can be described as a (simple) takeover offer for one bidder and as a mandatory offer for the other bidder, the requirements for a mandatory offer must be fulfilled. Individual bidders would then be obliged to comply voluntarily with these stricter rules.

In addition, the legal position of the target company's shareholders may not under any circumstances be impaired by the submission of a joint offer. For example, it would not be permitted to include a (voluntary) bidder who is not obliged to submit a mandatory offer in the bidding syndicate if this would require official approval that would not otherwise be necessary (in particular due to reservations relating to antitrust law) and would therefore lead to a weaker bond between the bidders.

The members of a bidding syndicate that would like to assume responsibility for a joint mixed offer should also have a close relationship – as is the case in particular with persons who have a parent/subsidiary relationship with each other (section 30 (1) sentence 1 no. 1 WpÜG) or coordinate their conduct (section 30 (2) WpÜG).

Finally, in each case the bidding syndicate should ensure that a voluntary bidder does not reach a legal position that is reserved for a mandatory bidder in accordance with statutory requirements (e.g. the right to perform a squeeze-out). This clarification or assurance should be made explicitly clear to the target company's shareholders in the offer document.

In the reporting period, Wolfgang Dinkelacker and Sedlmayr Grund und Immobilien KGaA also took the opportunity to submit a joint (mixed) offer to Dinkelacker AG's shareholders.

5.2 Exemption procedures

BaFin received 78 applications for exemption.

In 2010, BaFin received 78 applications for exemption or non-consideration (previous year: 144). In eleven cases, holders of voting rights requested that voting rights should not be considered in accordance with section 36 WpÜG (previous year: 61), while 63 applications for exemption were made in accordance with section 37 WpÜG (previous year: 83). BaFin approved 50 applications. Eleven were withdrawn by the applicants and 13 were still being processed at the end of 2010. Significant exemption decisions in accordance with sections 36 and 37 WpÜG are available on BaFin's website.[62]

5.3 Administrative fines

In 2010, BaFin initiated a total of 16 new administrative fine proceedings due to suspected violations of the WpÜG (previous year: 28). In five cases (previous year: one), it imposed administrative fines of up to €25,000. These related, for example, to violations of the publication requirements when gaining control (section 35 (1) sentence 1 WpÜG) or of the disclosure obligations for subsequent purchases (section 23 (2) WpÜG). It suspended 26 proceedings for discretionary reasons (previous year: 14) and in ten cases the suspension was linked to a caution. Forty-one cases were still pending at the end of the reporting period (previous year: 56).

Purchase offer in the electronic Federal Gazette.

In one of the administrative fine proceedings, the bidder company published a purchase offer directly in the electronic Federal Gazette (*Bundesanzeiger*) without previously submitting an offer document to BaFin. This meant that, firstly, the decision to make an offer had not been published in the proper manner (section 10 (1) sentence 1 and (3) sentence 1 WpÜG). Secondly, the company had published an offer document that had not been reviewed beforehand by BaFin (section 14 (2) sentence 2 WpÜG). As a result, BaFin prohibited the offer and initiated administrative fine proceedings against the bidder. In the course of the proceedings, the bidder stated in its defence that the target company's stocks had been suspended at the time of the purchase offer. For this reason, the sole member of the Executive Board, who was not a trained lawyer, assumed that it was not necessary to comply with the WpÜG when making the purchase offer. According to the bidder, no legal advice had been sought on this matter.

Consequently, BaFin imposed a €25,000 fine on the bidder due to two negligent administrative offences committed concurrently. The bidder lodged an appeal against this decision. The Higher Regional Court in Frankfurt am Main, which was the competent court of first

[62] www.bafin.de » Unternehmen » Börsennotierte Unternehmen » Übernahmen » Veröffentlichte Entscheidungen nach §§ 36, 37 WpÜG (Befreiungen vom Pflichtangebot). (only available in German)

instance, confirmed BaFin's view and set a fine of €25,000 by way of a decision dated 28 January 2010.[63] In citing the grounds for its decision, the Court stated in particular that the misapprehension of the scope of the WpÜG was due to a gross violation of duty on the part of the sole member of the Executive Board. The Court took the view that it must have occurred to even a person with lay legal knowledge that the suspension of the target company's shares would not mean that the company was no longer listed. Against this background, there was clearly cause for the sole member of the Executive Board to verify whether the WpÜG was applicable and, if appropriate, to also seek legal advice. Failure to perform such verification led to the accusation of negligence, the Court found.

6 Financial reporting enforcement

6.1 Monitoring of financial reporting

915 companies subject to financial reporting enforcement.

The number of companies subject to financial reporting enforcement continued to decline in the year under review. Once again, there were only a few IPOs compared with the delistings. As at 1 July 2010, a total of 915 companies from 19 countries (previous year: 966 companies from 20 countries) were subject to the two-tier procedure performed by BaFin and the Financial Reporting Enforcement Panel (FREP). The 915 companies comprised 772 domestic firms, 107 other European companies (70 from EU member states) and 36 businesses from five non-European countries. When examining a foreign company, BaFin liaises with the supervisory authorities in the company's home country to avoid duplicate examinations, for example.

The FREP completed 118 examinations in the year under review (previous year: 118), of which 106 were sampling examinations, eight were examinations with cause and four were performed at BaFin's request.[64]

Table 31
Breakdown by country of companies subject to enforcement
As at 1 July 2010

Germany	772
Jersey	26
USA	24
Netherlands	23
Austria	13
Luxembourg	10
Switzerland	9
United Kingdom	8
Ireland	6
Japan	6
France	4
Israel	4
Finland	2
Italy	2
Spain	2
Guernsey	1
Iceland	1
Cayman Islands	1
Canada	1
Total	**915**

[63] Case ref.: WpÜG 10/09 (OWi).
[64] Source: FREP.

Errors found in 24 cases.

BaFin completed a total of 30 procedures (previous year: 39), with errors being identified and an error publication order being issued in 24 cases. The FREP identified errors in consultation with the relevant companies in 16 of the 30 cases. The remaining 14 cases were based on error identification procedures performed by BaFin, eight of which concluded with errors being identified. Seven cases were still pending at BaFin at the end of 2010 (previous year: 10).

BaFin performs its own error identification procedures if a company does not accept the errors identified by the FREP or refuses to cooperate with the FREP, or if BaFin has doubts about the accuracy of the results of the FREP's examination. The companies concerned did not accept the errors identified by the FREP in nine of the 14 error identification procedures performed by BaFin. BaFin identified errors at the end of six of these procedures, while three cases were completed with no errors being found. BaFin closed three other procedures with no errors being identified where the companies concerned had refused to cooperate with the FREP. Two procedures were completed with errors identified by BaFin after the FREP had previously found no errors in these cases. The procedures at BaFin related to a wide variety of accounting errors, such as the basis of consolidation, the measurement of receivables and notes disclosures on impairment tests.

Management reports are key source of errors.

Companies frequently made errors in their reporting in management, group management and interim management reports. The reporting requirements under sections 289 and 315 of the German Commercial Code (*Handelsgesetzbuch* – HGB) and sections 37w and 37y WpHG) stipulate a complete narrative explanation of the position of the company and the group that is understandable on a standalone basis and that appears separately alongside the financial statements. Not all company reports met these requirements. For example, BaFin objected to the fact that the performance of a company as shown in the figures in its financial statements was not reflected in its management report: if the consolidated financial statements indicate that a group's revenue declined by a third over a financial year compared with the prior period, the group must also comment on the drop in revenue in its group management report. Otherwise, it is breaching its obligation of enabling the users of the financial statements to obtain a true and fair view of the circumstances of the decline in revenue.

In other cases, although a description was given, the terminology used was so misleading that it allowed the capital markets to draw the wrong conclusions. This, too, breaches a company's obligation to provide a true and fair view.

The management report must also present the opportunities and risks of the expected future development of the company. As in the previous year, this was a frequent source of errors. As the Higher Regional

Court (*Oberlandesgericht* – OLG) in Frankfurt am Main ruled in 2009, it is in particular not sufficient to refer to the allegedly uncertain outlook caused by the financial and economic crisis in order to evade reporting requirements.[65] Specific future risks must also be explained and assessed, e.g. the extent to which the company's business model is especially dependent on certain events or individual persons. For example, if a company's business model relies heavily on again obtaining the licence for a particular product in the coming year, the company must point to the risk that it may be unsuccessful in purchasing the licence and explain the possible consequences of this in its management report. This requirement applies especially to risks that could endanger the continued existence of the company, such as a tight liquidity situation.

Error publication procedure further shortened.

In the year under review, BaFin ordered the errors identified in completed procedures to be published in all cases.

Compared with previous years, substantially fewer companies advanced reasons against publishing errors; in addition, there was only one case in which BaFin had to use coercive administrative measures to enforce the correct publication of errors. A further decision by the Higher Regional Court in Frankfurt am Main helped shorten the error publication procedure. It stated that the publication of errors is the normal consequence of identifying them and that any additional information that relativises the text describing the errors is prohibited in the interests of the information requirements of the capital markets.[66] In 2009, the Higher Regional Court in Frankfurt am Main found that the publication of errors is the key element of the enforcement procedure.[67]

Legal recourse and publication of errors I

It was previously unclear whether the Higher Regional Court in Frankfurt am Main is exclusively responsible for identifying errors and issuing error publication orders, or also for taking administrative coercion measures when enforcement decisions must be implemented. The Administrative Court in Frankfurt am Main and the Higher Administrative Court in Hesse (*Hessischer Verwaltungsgerichtshof* – HessVGH) have now agreed that the Higher Regional Court in Frankfurt am Main will also decide on the legality of the threat of a coercive fine.[68] According to the Courts, this is an administrative law dispute that would be assigned to the administrative courts without further definition (section 40 (1) sentence 1 of the Rules of the Administrative Courts (*Verwaltungsgerichtsordnung* – VwGO)). However, the negative exclusion of jurisdiction under section 37u of the WpHG in conjunction with section 48 (4) WpÜG for orders issued by BaFin also applies to administrative enforcement measures in enforcement proceedings.

[65] Case ref.: WpÜG 11 and 12/09.
[66] Case ref.: WpÜG 3/10.
[67] Case ref.: WpÜG 1 and 3/08.
[68] Case ref.: 1 L 70/ 10.F.; case ref.: 6 B 395/10.

This is because, in the Courts' view, BaFin's monitoring duties with regard to the legality of financial statements and financial reports also include enforcing the measures ordered. This avoids splitting the legal procedure for decisions on enforcement proceedings.

Legal recourse and publication of errors II

In the same proceedings, the Higher Regional Court in Frankfurt am Main confirmed BaFin's legal opinion that companies may not relativise errors identified when publishing them and also that they may not include any additional information on the status of the procedure.[69] BaFin had threatened to impose a coercive fine on a company by way of an immediately enforceable notice if the company did not comply with BaFin's order to publish the errors identified on time and in full. The company had previously published the errors in the report on expected developments that were identified by BaFin and confirmed in summary proceedings by the Higher Regional Court in Frankfurt am Main[70] in the electronic Federal Gazette. However, the formulation introducing the disclosure stated that BaFin had established that the management report and group management report "are defective". The company concluded by mentioning that it "…[has] lodged an appeal against the decision". BaFin believes that a statement that relativises the error in such a way does not meet the legal requirements for publishing errors, and therefore that the company did not comply with the publication order due to its chosen wording.

The Court found that the subjunctive formulation relativising the identified errors was not permissible. Furthermore, it stated that the additional information on the status of the procedure given in the publication was neither intended by the legislators, nor did it serve the purpose of the law and was therefore prohibited. It should be clear beyond doubt to the capital markets what the error was and why the financial reporting was regarded as defective. In particular, statements that contradict the errors identified or relativise and downplay them are not permitted, the Court said. The publication of errors must be restricted to the content requirements laid down in section 37q (2) sentence 1 WpHG, as additional information would dilute and therefore limit the information content for capital market participants. By ordering the immediate enforcement of the identification and publication of errors, legislators had consciously accepted the fact that identified errors must be published even though it is possible that subsequent objection or appeals procedures will find that the error already published was not in fact an error. In this respect, the legislators gave priority to the need to rapidly inform the capital markets and achieve the intended preventive effect on other companies subject to financial reporting enforcement.

[69] Case ref.: WpÜG 3/10.
[70] Case ref.: WpÜG 11 and 12/09.

The following table gives an overview of the results of the completed error identification and publication procedures.

Table 32
BaFin enforcement procedures from July 2005 to December 2010

	Error findings: no	Error findings: yes	Error publication: yes	Error findings: no
1) Company accepts FREP's findings		106	103	3
2) Company does not accept FREP's findings	5	22	20	2
3) Company refuses to cooperate with FREP	5	1	1	0
4) BaFin has considerable doubts as to the accuracy of the examination findings or the FREP procedure	0	3	2	1
5) BaFin takes over the examination (banks and insurance undertakings)	0	0	0	0
Gesamt	**10**	**132**	**126**	**6**

6.2 Publication of financial reports

Financial reports serve to regularly and reliably inform investors on an issuer's economic position. Publicly traded companies are therefore obliged to prepare and publish annual and half-yearly financial reports as well as interim management statements. They must publish all their financial reports on the Internet and publish a notice indicating from when and where they will be available online. In addition, companies must inform BaFin where and when they have published the notice and send the notice and the financial reports to the company register to be archived.

Coercive fines of up to €66,000 imposed.

In 2010, BaFin's supervisory activities again focused on issuers that had not met their financial reporting obligations – in some cases over several quarters. BaFin opened a total of 34 administrative procedures (previous year: 46) relating to the subsequent rectification of 200 unfulfilled publications or communications (previous year: 850). 31 administrative procedures were still pending from the previous year. BaFin closed 45 administrative procedures (previous year: 33) after the issuers subsequently met their financial reporting requirements. In almost half of these cases, it threatened coercive fines of up to €21,000 that were ultimately imposed in four cases. All issuers paid the coercive fine but did not fully meet their financial reporting requirements. BaFin therefore threatened further coercive fines of up to €27,000. In three of these cases, the issuers fulfilled their financial reporting requirements after being threatened with a second coercive fine. In one case, BaFin imposed a second coercive fine of €27,000 that was paid by the issuer, which finally met its financial reporting obligations.

Twenty administrative procedures involving around 350 rectification requirements were pending at the end of 2010. In twelve of these cases, BaFin threatened coercive fines of up to €27,500 that were imposed in seven cases. In two cases, it set a second coercive fine of up to €35,000, and in one case a third coercive fine of €66,000. After being threatened with a fourth coercive fine of €114,000, the company in question finally met its financial reporting requirements.

New area of emphasis: Internet publication.

In 2010, an area of emphasis of BaFin's examinations was the publication of financial reports on the Internet. In a total of around 1,150 cases, BaFin examined whether the financial reports were actually available to the public on the Internet immediately after the publication deadline expired. BaFin initiated administrative fine proceedings in 47 cases.

14 administrative fines imposed.

20 administrative fine proceedings relating to suspected violations of financial reporting requirements were still pending from the previous year. In 2010, BaFin opened 95 administrative fine proceedings (previous year: 21) and closed 19 proceedings. It imposed administrative fines of up to €39,000 in 14 cases. It suspended five cases, four for discretionary reasons. In three cases, the suspension of the proceedings was linked to a caution being issued to the company concerned. As a result, 96 administrative fine proceedings were still pending at the end of 2010.

7 Supervision of the investment business

The German fund sector was still fighting the fallout from the financial crisis in 2010. Real estate funds were particularly hard hit, and this also had a knock-on effect on real estate funds of funds.

In the year under review, BaFin performed 42 supervisory visits and annual interviews on site. On the one hand, supervisory visits provide an initial impression of asset management companies' current situation, while on the other the personal contact improves the necessary dialogue between BaFin and the companies concerned. In addition, acute problems at open-ended real estate funds were discussed in 14 ad hoc meetings.

BaFin used two workshops at the end of the year to inform custodian banks and asset management companies of the new regulations laid down in the Custodian Bank Circular (*Depotbank-Rundschreiben*) and the Minimum Requirements for the Risk Management of Investment Companies (*Mindestanforderungen an das Risikomanagement für Investmentgesellschaften* - InvMaRisk).

7.1 Asset management companies

In 2010, BaFin approved applications by three German asset management companies for licences to manage assets in accordance with the German Investment Act (*Investmentgesetz* – InvG). Three asset management companies were merged with other asset management companies. This meant that, at the end of the year, 73 asset management companies were licensed in accordance with the InvG (previous year: 73). Five asset management companies applied for the scope of their licences to be extended to include the "other funds" category in the year under review (previous year: 8).

2,210 mutual funds and 3,787 special funds.

At the end of 2010, asset management companies managed a total of 5,997 funds (previous year: 5,969) comprising assets worth €1,137 billion (previous year: €1,027 billion). Of this figure, 2,210 (previous year: 2,186) were mutual funds with assets of €339.6 billion (previous year: €311.7 billion) and 3,787 (previous year: 3,783) were special funds with assets of €797.4 billion (previous year: €715.7 billion).

A total of 110 funds were merged in the period under review, while the management rights for 20 funds were transferred to other asset management companies. A total of 33 funds were liquidated.

Aggregate (net) cash inflows into mutual funds and special funds at the end of the year – i.e. all cash inflows from the sale of fund units less all cash outflows from the redemption of fund units – amounted to €89.215 billion at the end of the year. (Gross) cash inflows totalled €281.989 billion, of which €126.064 billion was attributable to mutual funds and €155.925 billion to special funds.

In addition to mutual funds and special funds, there were 16 investment stock corporations with variable capital, which had launched a total of 78 subpools of assets (*Teilgeschäftsvermögen*). Total assets under management at these investment stock corporations and subpools of assets amounted to approximately €13.108 billion.

The number of new approvals rose slightly year-on-year to 153 (previous year: 147).

Risk-based supervision

Risk-based planning and management of the intensity of supervision.

In 2010, BaFin performed its second comprehensive review of risk structures at asset management companies. It uses the results to plan and manage the intensity with which individual companies are supervised, in line with the principle of risk-based supervision.

Risks are classified by grading them in line with fixed criteria. A distinction is made between three categories: "net assets, financial position and results of operations" (category 1), "management quality" (category 2) and "organisational quality" (category 3).

Their impact is quantified as "high"; "medium", or "low" using predefined threshold categories. The overall grading is produced by combining the quality assessment and the impact analysis. The resulting rating is summarised in a twelve-field matrix.

Table 33
Risk classification results for 2010

Investment companies		Quality				
		A	B	C	D	Total
Impact	High	27	6	2	0	35
	Medium	14	4	0	0	18
	Low	14	2	1	0	17
	Total	55	12	3	0	70*

* No classification has yet been performed for the three asset management companies that received licenses in 2010 to perform asset management in accordance with the InvG.

7.2 Investment funds

Financial and liquidity risks due to the crisis.

As in 2009, BaFin's work focused on examining financial and liquidity risks at German funds. In particular, BaFin asked for regular reports on investments in Greek and Portuguese government bonds, so as to be able to assess the impact on fund liquidity.

Another focus of activity was on the ongoing crisis at open-ended real estate funds, which was (one of) the reason(s) for the closure of a fund of funds at the end of September 2010. As a result of this, from the beginning of October 2010 onwards, BaFin request daily information on the portfolio structure and liquidity of those fund of funds holding units in real estate funds as target funds.

However, there were no further investment fund closures. One of the two profit participation certificate funds that were closed at the end of 2009 was still closed at the end of the year under review.

Number of outlier reports almost unchanged.

Notifications submitted under the Derivatives Regulation (*Derivateverordnung* – DerivateV) for the year under review revealed only isolated cases of increases in outlier reports year-on-year; in most cases the figures were unchanged.

Notifications submitted under the DerivateV provide indications of how asset management companies deal with the market risk associated with their funds. Asset management companies are obliged to calculate the potential risk of loss per fund and to report to BaFin if the actual daily loss exceeds the risk of loss (value at risk) previously calculated. By comparing the actual daily loss with the calculated risk of loss (backtesting), it should be possible to draw conclusions about the quality of the risk models used. However, an increased number of outlier reports is only an indication, rather than proof, of weaknesses in such models. Other reasons for deviations may include market volatility, such as was seen during the financial crisis.

Extremely large variations in results of operations.

The evaluation of the audit reports revealed that net fee and commission income, and hence results of operations, had declined further at a majority of asset management companies in comparison to the previous year, which was already hit by the financial crisis. At 14 asset management companies, the shortfall in income amounted in some cases to more than 20% of the prior-year figure for net fee and commission income. However, eight out of the total of 29 asset management companies that achieved an overall increase in net fee and commission income recorded a significant rise of 20% or more.

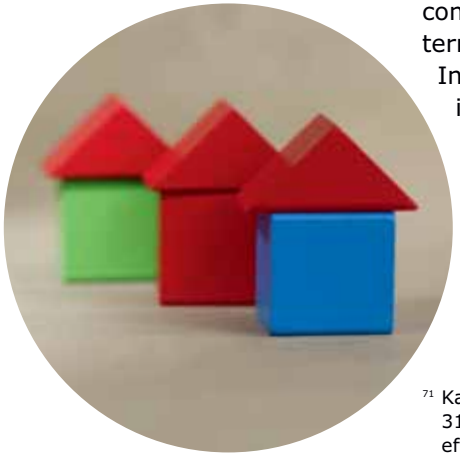
Number of complaints remains extremely high.

The number of complaints received in relation to the investment sector remained roughly at the prior-year level in 2010, at 242 (235). However, the majority again related to the performance of specific funds during the financial crisis. BaFin is unable to provide assistance in such cases, since investment fund performance depends decisively on the situation on the capital markets.

7.3 Real estate funds

Open-ended real estate funds liquidated for the first time.

Open-ended real estate funds had to continue their fight against massive unit redemptions in the year under review. At the end of 2010, redemption of units in 13 mutual real estate funds were still suspended at eight asset management companies. In the case of three of these funds, which had consistently not redeemed any units since the end of October 2008, the asset management companies concerned were unable to reopen the funds for the long term within the two-year statutory period laid down in section 81 InvG. They therefore terminated their management of the funds in the period up to the end of October 2010, giving notice periods of between 18 and 35 months, so as to be able to liquidate the funds in question.[71] The asset management companies aim as far as possible to sell all the funds' properties during the notice period. The proceeds are to



[71] KanAm US-grundinvest Fonds (notice of termination effective as from the end of 31 March 2012), Morgan Stanley P2 Value and DEGI EUROPA (notice of termination effective as from the end of 30 September 2013).

be distributed to investors at half-yearly intervals, to the extent that they are no longer needed to settle liabilities or to manage the remaining portfolio. The fund assets left at the end of the notice period will be transferred to the custodian bank for settlement and distribution to the investors.

High priority given to sales activities.

In the case of the remaining ten funds, the time left for the asset management companies to generate enough liquidity from property sales to resume unit redemptions is comparatively limited in some cases, since the two-year period is set to expire soon. In the case of three funds, the period will end in November 2011[72], whereas in the case of the other seven funds it runs out in the course of 2012.[73] BaFin expects that the market environment for property sales will continue to improve in the coming years, although the strength of the economic recovery will be different in the different geographical property markets.

Further increase in number of complaints.

At 106, the number of complaints and inquiries relating to open-ended real estate funds continued to rise, as was to be expected (previous year: 84). This was due to the ongoing suspension of unit redemption at 13 open-ended real estate funds. Together, these funds account for one-quarter of the volume of this entire fund segment.

Suspension of unit redemption

The large number of requests for unit redemptions made by investors in open-ended real estate funds during the financial crisis led to a number of asset management companies suspending the redemption of fund units in 2008 in accordance with section 81 InvG. Despite the suspension by the funds of unit redemption, a number of asset management companies continued to service redemption requests made by investors under regular withdrawal plans. In a judgement dated 30 September 2010, the Administrative Court in Frankfurt am Main ruled that this practice is impermissible and that it contravenes the principle that investors must be treated equally.[74]

Before this, BaFin had already forbidden this practice and instructed the asset management companies concerned to replenish the fund assets to compensate for the adverse effects caused by their servicing the withdrawal plans by the time the funds concerned reopen. The Administrative Court in Frankfurt am Main confirmed BaFin's instructions in all points. The Court agreed with the supervisory authority that the asset management companies' practice of continuing to service withdrawal plans despite closing the funds in accordance with section 81 InvG contravened the principle of investment law that all investors must be treated equally. The Administrative Court in Frankfurt am Main

[72] AXA Immoselect, DEGI GLOBAL BUSINESS and DEGI INTERNATIONAL.
[73] TMW Immobilien Weltfonds (02/2012), AXA Immosolutions, CS EUROREAL, KanAm grundinvest Fonds and SEB ImmoInvest (05/2012), UBS (D) 3 Sector Real Estate (10/2012) and DEGI GERMAN BUSINESS (11/2012).
[74] Case ref.: 1 K 1516/09.F.

did not consider that the difference involved – the withdrawal plans – in itself justified any unequal treatment of investors. Finally, the Court also confirmed BaFin's order that the fund assets should be put in the position when the funds reopened as if the withdrawal plans had not been serviced during the suspension period. It said that the measure was permissible at the least as a preventive measure as well, and that it also complied with the principle of certainty and clarity.

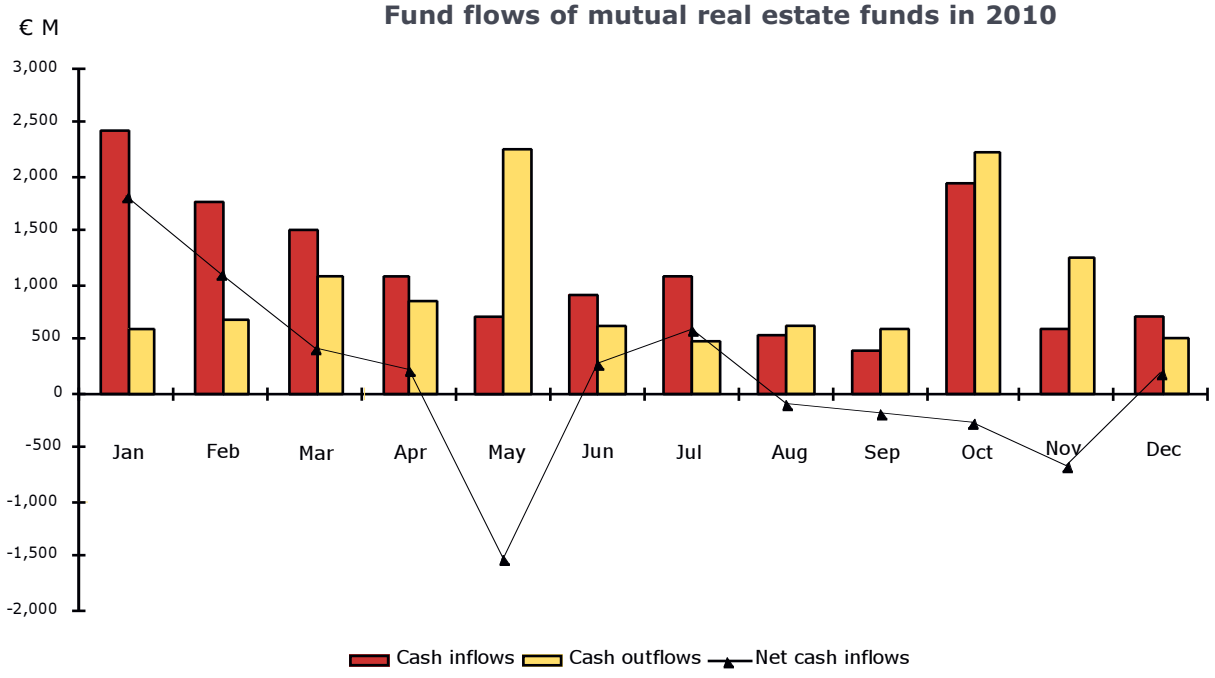
General trends in open-ended real estate funds

At the end of 2010, 21 German asset management companies managed 48 (previous year: 48) mutual real estate funds with an aggregate volume of €86.6 billion (previous year: €87.9 billion) and 153 (previous year: 136) special real estate funds with aggregate net asset values of €29.6 billion (previous year: €27.3 billion).

Positive net cash inflows in the fund segment overall.

The 48 mutual real estate funds generated net cash inflows of €1.9 billion, down year-on-year (2009: €2.7 billion). However, the funds recorded widely diverging cash inflows in some cases, both across individual months in the past year and in comparison with each other.

Figure 31
Fund flows of mutual real estate funds in 2010



Despite the positive net cash inflows in the past year, the aggregate fund volume at the 48 mutual real estate funds declined in the period up to the end of 2010. This was due, among other

things, to the initial repayments in December 2010 by the three funds that are currently being liquidated. However, the main driver for the decrease was the results of the market value appraisals of the individual fund properties that have to be performed at least once a year. In them, the independent Expert Committees arrived at values that in some cases were considerably lower than in the previous year. In line with this, the BVI's 2010 performance statistics for mutual funds recorded the first-ever negative average annual performance for the mutual real estate funds managed by its members and included in the survey.[75] The average performance at the end of 2009 had been positive, at 2.5%.

7.4 Hedge funds

Since the outbreak of the financial crisis there have been calls at national and international level to supervise hedge funds more closely than before so as to better control impacts that could potentially serve to exacerbate the effect of the crisis on the financial markets. Hedge funds can indirectly affect the stability of the financial system on the markets – by influencing trading liquidity, for example. In addition, hedge fund failures would have negative consequences for both investors and creditors.

German single hedge funds are relatively small, with an aggregate volume of less than €800 million (as at 30 September 2010) – a mere 1‰ of the global hedge fund market. There is therefore no indication that German hedge funds in particular are relevant for the stability of the German, let alone the European, financial system. This is also borne out by what are in international terms the substantially more conservative investment strategies pursued by German hedge funds. Equally, there is no indication to date that their market activities served to exacerbate the effects of the crisis.

Number of hedge funds picks up again.

At the end of 2010, there were a total of 34 authorised German single hedge funds (including one special fund) plus eight German hedge funds of funds (including one special fund) (previous year: 31 single hedge funds and 8 hedge funds of funds). This represents a slight rise in the total number of single hedge funds and hedge funds of funds issued under German law. Ten single hedge funds were liquidated in the course of 2010, while 13 new single hedge funds were approved in the same period – a clear increase in new approvals in comparison with the previous year, in which only five new licenses were issued. Ten of the newly licensed single hedge funds are investment stock corporations or their subpools of assets.

Moves to regulate fund managers and hedge funds at international level.

In the year under review, IOSCO performed an international survey of hedge funds with the goal of better identifying potential systemic risks associated with hedge funds and improving their ongoing monitoring. BaFin conducted the same survey in autumn 2010 for German hedge funds and came to the conclusion that,

[75] www.bvi.de » Statistikwelt (available in German only).

in view of their comparatively low market volume and defensive investment strategies, German hedge funds currently do not represent a systemic risk. Nevertheless, it intends to repeat the survey at regular intervals in order to identify any trend changes at an early stage.

On 11 November 2010, the European Parliament passed the Alternative Investment Fund Managers Directive (AIFM Directive), which when transposed into German law will lead among other things to new regulations for hedge funds. However, the InvG already contains extensive provisions regulating not only fund managers, but also the hedge funds themselves. The measures include strict conditions for authorisation and in-depth ongoing supervision by BaFin, which can take the form of supervisory interviews and annual audits, among other things. In line with this, BaFin conducted nine annual interviews and a number of on-site visits at hedge funds in 2010, including at companies that had been authorised to launch hedge funds during the year.

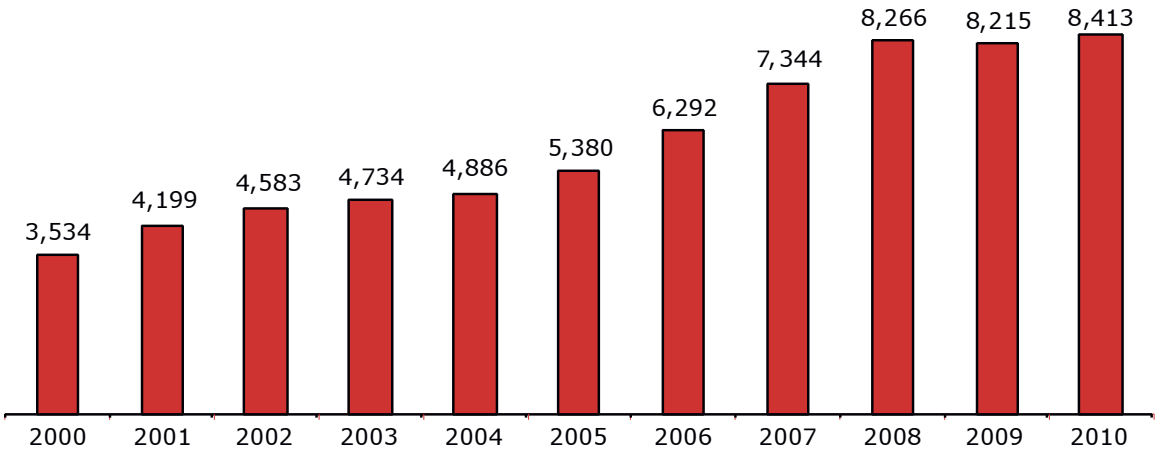
7.5 Foreign investment funds

UCITS

Increase in number of distribution notices.

In 2010, BaFin received 1,049 new distribution notices for UCITS (previous year: 995). The number of notices received rose sharply in the fourth quarter of 2010 in particular, following the marked decline in the previous year as a result of the financial crisis. Two-thirds of the new distribution notices related to Luxembourg-based funds, while Irish funds were also strongly represented, as in the past. Austria, France and Liechtenstein were other key originating countries. The total number of foreign UCITS authorised for distribution increased slightly to total 8,413 at the end of the year (previous year: 8,215).

Figure 32
UCITS



Non-UCITS

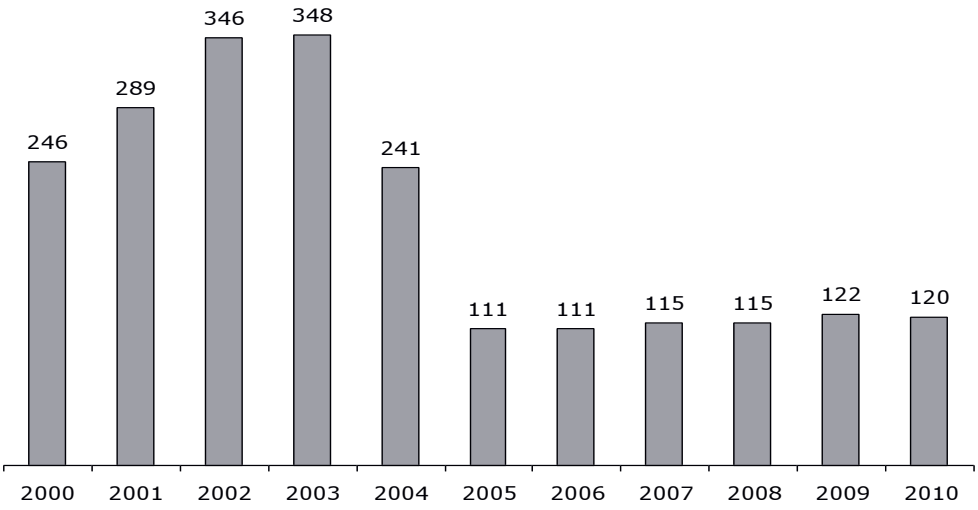
Number of non-UCITS declines again.

The number of non-UCITS authorised for distribution declined slightly year-on-year. At the end of 2010, 120 foreign funds, including three hedge funds of funds, were authorised for public distribution in Germany (previous year: 122). Five new funds notified BaFin of their wish to distribute foreign investment units in the Federal Republic of Germany. In two cases, BaFin prohibited ongoing public distribution during the notification procedure, since the investment units concerned had been advertised before the distribution authorisation had been obtained.

A total of eleven investment funds were authorised to commence public distribution in the Federal Republic of Germany in 2010. 13 funds discontinued public distribution in 2010, including three hedge funds of funds.

A large majority of the funds are domiciled in Luxembourg, although funds from Switzerland, the United States and Austria are also included.

Figure 33
Non-UCITS*



* From 2006 onwards, the statistics also contain foreign hedge funds of funds that have been authorised for distribution

VII Cross-sectoral issues

1 Deposit protection, investor compensation and guarantee schemes

Michael Sell,
Chief Executive Director Regulatory Services/Human Resources

BaFin's responsibilities include the supervision of the statutory compensation schemes and bank guarantee schemes governing banks and securities trading companies. In addition, it supervises the statutory guarantee schemes for life and substitutive health insurance. These responsibilities are based on the Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz* – EAEG), the Banking Act (*Kreditwesengesetz* – KWG), the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) as well as a wide variety of financing regulations used by BaFin to counter abuses that could pose a risk to the due performance of the tasks of these institutions or to their assets. Where compensation and guarantee schemes issue administrative acts, such as notices of contributions, BaFin also rules on any objections by member institutions of these schemes.

Supervision of the Compensatory Fund of Securities Trading Companies

Phoenix compensation event.

With respect to the compensation event involving Phoenix Kapitaldienst GmbH, the Compensatory Fund of Securities Trading Companies (*Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW) had decided by the end of February 2011 to award partial compensation in around 25,500 cases with a total volume of approximately €110 million. The EdW aims to decide on the claims of the around 3,900 eligible applicants who have not yet received any partial compensation by the middle of the year.

Fictitious profits and rights of separation of assets

In its judgement of 23 November 2010, the Federal Court of Justice (*Bundesgerichtshof* – BGH) confirmed the EdW's compensation practice, under which fictitious profits are generally ineligible for compensation.[76] In another case, which was based on declaratory proceedings by the insolvency administrator against a Phoenix creditor, the BGH also clarified that there are no rights of separation of the assets secured by the insolvency administrator.[77]

[76] Case ref.: BGH XI ZR 26/10.
[77] Judgement dated 10 February 2011, case ref.: BGH IX ZR 49/10.

This declaration by the BGH in particular made an important contribution to the final settlement of the Phoenix compensation event. As a result, the EdW can settle the compensation claims without these being subject to possible rights of separation, which are not eligible for compensation under the EAEG.

The EdW will apply this ruling in its upcoming notices and has already begun to assess whether the conditions for granting more far-reaching compensation claims have been met. This assessment is being made in close consultation with BaFin and the Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF). The EdW is planning to pay any further compensation quickly.

The only issues still outstanding are whether, when calculating the entitlements, the EdW had the right to deduct trading losses actually incurred and to what extent agreed administration charges have to be taken into account during the process. Until these issues are resolved by the courts, the EdW will retain its existing compensation practice.

Supervision of the Compensation Scheme of German Banks (*Entschädigungseinrichtung deutscher Banken GmbH* – EdB)

noa bank compensation event.

On 25 August 2010, BaFin declared a compensation event for noa bank GmbH & Co. KG (noa bank) because the bank was no longer able to repay all customer deposits. Before that, on 24 August 2010, BaFin had applied to the Local Court in Düsseldorf to have insolvency proceedings opened against the bank. The declaration of the compensation event created the legal basis for the statutory Compensation Scheme of German Banks (EdB), as the responsible entity, to compensate noa bank's depositors in accordance with the EAEG. The EdB therefore contacted the depositors and began on 17 September 2010 to transfer the deposit balances reported to it that are eligible for compensation under the EAEG to the total of 11,762 customers who were entitled to bring claims. The total compensation volume is €159.65 million, of which €159.31 million had already been paid out by the EdB as at 31 December 2010. In other words, 10,753 customers had been compensated as at that date. The deposits for which compensation has not yet been paid primarily comprise cases requiring detailed individual checks because the customers concerned believe that interest was calculated incorrectly or because the information necessary to pay compensation is incomplete. BaFin will continue to monitor the compensation process until it has been fully completed.

2 Authorisation requirements and pursuit of unauthorised business activities

The market for investment and pension products is large and complex. Customers face the challenge of choosing a suitable product and a reputable provider. To protect customers and Germany's position as a financial centre, BaFin examines whether these offerings require authorisation and pursues companies operating without the necessary authorisation.

2.1 Authorisation requirements

Before commencing operations, providers can ask BaFin to clarify whether their business venture requires authorisation under the KWG, the VAG, or the Payment Services Oversight Act (*Zahlungsdiensteaufsichtgesetz* – ZAG). This allows them to make sure that their intended activities comply with supervisory law. Where a statutory authorisation requirement exists, those responsible may only start doing business once they have obtained written authorisation from BaFin. Providers operating without such authorisation may be prohibited by BaFin from carrying on their business and ordered to liquidate the transactions (section 37 (1) sentence 1 KWG). In addition, unauthorised business is punishable by law (section 54 KWG).

937 enquiries about authorisation requirements.

In the year under review, BaFin examined 937 requests to examine whether an authorisation was required for planned business ventures, a significant increase over the previous year (784). The reason was a sharp rise in enquiries relating to the KWG (840) and the ZAG (79). Only 18 enquiries related to the VAG. The increase was due to new criteria for investment advice, factoring, finance leasing and asset management as well as the various payment services laid down in the ZAG, which came into effect on 31 October 2009.

New guidance notices.

Anyone wishing to conduct banking business or provide financial services in Germany commercially or on a scale which requires a commercially organised business undertaking needs written authorisation from BaFin (section 32 (1) sentence 1 KWG), although there are some exceptions (section 2 (1) and (6) KWG). BaFin published 16 detailed guidance notices on this topic on its website in 2010.[78]

[78] www.bafin.de » Publications.

For 2011, BaFin is planning to publish guidance notices on the payment services under the ZAG and on the key concept of financial instruments. Given the large volume of financial instruments, the aim is initially to explain only securities, money market instruments, foreign exchange and units of account and to deal with derivatives in the following year. The guidance notices are intended to make it easier for market participants to assess the supervisory relevance of planned business ventures at an early stage.

2.2 Exemptions

276 companies exempted.

In the year under review, BaFin exempted 19 companies from supervision for the first time; another six applications had been received as at the end of the year. This means that 276 institutions were exempt from the authorisation requirement in 2010.
An exemption is possible in individual cases if the nature of the business performed makes supervision unnecessary. This relates in all cases to low-level auxiliary or ancillary transactions associated with business activities that do not otherwise need authorisation. BaFin has published further details in a guidance notice.[79]

Providers from third countries outside the EU can also obtain an exemption from the authorisation requirement. They can apply for an exemption allowing them to perform cross-border activities in Germany if they are subject to comparable supervision in their home country. In the past year, BaFin exempted a total of ten foreign companies.

2.3 Illegal investment schemes

Illegal investment schemes comprise banking, financial services and insurance businesses operated without the authorisation required under the KWG, the VAG, or the ZAG. BaFin works together with the Deutsche Bundesbank to investigate the precise processes involved and the scope of the transactions as a prelude to taking action against the operators. In this area, BaFin also cooperates with the police and the public prosecutors, which have independent responsibility for prosecuting related criminal acts. This rigorous approach to combating illegal investment schemes is indispensable for retaining Germany's integrity as a financial centre and for protecting investors.

Cooperation with criminal prosecution authorities intensified.

In January 2010, BaFin established a co-ordination centre with the aim of expanding its cooperation with criminal prosecution authorities in combating unauthorised business and increasing the number of convictions. Concentrating such proceedings in key public prosecutors' offices is one way of achieving this aim. BaFin therefore actively contacted key public prosecutors' offices specialising in economic crime to discuss the possibility of concentrating proceedings against breaches of the KWG, VAG, or ZAG with them. The discussions with and presentations to the criminal prosecution authorities also addressed the purchase of

[79] www.bafin.de » Publications.

second-hand life insurance policies, a special focus area for the Supervisory Authority in 2010. In addition to questions relating to authorisation requirements, this business model often gave rise to indications of fraud.

In May 2010, BaFin has launched a central information platform for the public prosecutors' offices and police criminal investigation departments. The platform also provides a report grid, developed jointly by the Supervisory Authority and the public prosecutors, for information relating to criminal offences. BaFin receives additional information on current investigations under a cooperation agreement with the Federal Criminal Police Office. Information from the criminal prosecution authorities is important to BaFin since it helps it to take administrative action in its own right, as a specialist authority entrusted with averting risk, to ban unauthorised transactions as early as possible and independently of criminal proceedings. BaFin's powers to combat illegal investment schemes are similar to those of a public prosecutor's office. They include searching residential and business premises, confiscating evidence and recovering assets in favour of injured parties.

Three offerings to purchase second-hand life insurance policies prohibited.

In 2010, BaFin prohibited three offerings to purchase second-hand life insurance policies on the grounds of the unauthorised conduct of banking business. The providers had advertised the business as an investment for customers that would generate a higher return than the life insurance policy they had bought or other investment they had made. In other words, these offerings were not designed to pay out the purchase price to the policy holder in the short term and then to continue the acquired insurance policy as a financial investment. Rather, according to the logic of their offering, the providers were only able to promise a higher return by, for example, cancelling the life insurance policy and using the funds "released" to generate the promised return and a profit for their own account. However, by doing so the providers were conducting deposit business (section 1 (1) sentence 2 no. 1 KWG) without the necessary authorisation. The interests of the parties to the transaction correspond to those in the conventional deposit business: the providers accept pecuniary assets from the customers in the form of their life insurance policy or other financial investment and promise repayment in the form of the purchase price. The monetary value of the customer's assets can be specified as the surrender value in the case of life insurance policies, and as the current value where other investments are purchased. Although the providers do not ask customers for cash, or book money by way of a bank transfer, they do get them to assign a receivable to them, which is as good as the corresponding amount of cash. The purpose of the agreement entered into with the customer is therefore to lend money for a certain period of time.

The providers concerned pursued legal remedies to defend themselves against BaFin's prohibitions. However, the rulings in the interim relief proceedings handed down to date by the Administrative Court in Frankfurt am Main and the Higher Administrative Court in Hesse (*Hessischer Verwaltungsgerichtshof* – HessVGH) have confirmed the measures taken by BaFin.[80]

[80] Case ref.: 1 L 271/10.F and 6 B 818/10.

Frankfurt Financial Supervisory Authority is not a German supervisory authority.

Lance Futures, a bogus company claiming to be domiciled in Frankfurt am Main, made cold calls to customers offering trades in gold options. During these calls, the callers referred the potential customers to the website of the Frankfurt Financial Supervisory Authority (FFSA), saying that they could ascertain from it that Lance Futures was a financial services institution licensed by the German financial supervisory authority. BaFin had the websites www.lancefutures.com and www.ffsauthority.com closed down immediately. However, shortly afterwards the websites were accessible again under slightly modified web addresses. After closing down these websites as well, BaFin prohibited Lance Futures from conducting unauthorised investment broking and FFSA from assisting Lance Futures in initiating unauthorised transactions.

Criminal investigations against Helmut Kiener continue.

Helmut Kiener is still remanded in custody, but the Würzburg prosecutor's office has now charged him with aggravated fraud for commercial gain, document falsification and tax evasion. It alleges that Helmut Kiener failed to manage money amounting to several hundreds of millions of euros from investors, including foreign banks as agreed, but instead transferred it to K1 Global Ltd. and K1 Invest Ltd., which are domiciled in the British Virgin Islands, and used it for his own purposes. BaFin had already prohibited the companies from operating in the Federal Republic of Germany in 2003 and 2004, because it believed that they were engaged in principal broking services, which require authorisation. However, the HessVGH subsequently reversed these injunctions because the statutory definition of principal broking services had not been met. Even before his business operations had been relocated to the British Virgin Islands, the former Federal Banking Supervisory Office (*Bundesaufsichtsamt für das Kreditwesen* – BAKred) prohibited Kiener, who at that time was Managing Director of K1 Fonds GbR, Aschaffenburg, in 2001 from providing portfolio management services and in 2002 appointed a liquidator to wind up the unauthorised transactions. Kiener then attempted to escape supervision by establishing new companies, K1 Invest GbR and K2 Invest GbR, Mörfelden-Walldorf, and brought numerous legal remedy proceedings against BaFin's injunctions.[81]

Portfolio management by civil law partnerships

In its judgement of 24 February 2010, the Federal Administrative Court (*Bundesverwaltungsgericht* – BVerwG) confirmed BaFin's interpretation of the law, according to which K1 Invest GbR provides unauthorised portfolio management services (section 1 (1a) sentence 2 no. 3 KWG).[82] The BVerwG thus reversed the judgement of the HessVGH, which had ruled in favour of the actions against the prohibition orders. The Court recognised that, even though K1 Invest GbR was a civil law partnership (*Gesellschaft bürgerlichen Rechts* – GbR) with only partial legal capacity, it could be the addressee of measures taken by the Supervisory

[81] Annual Report 2009, p. 231 et seq.
[82] Case ref.: 8 C 10.09.

Authority because the authorisation requirement for banking business or financial services (section 32 (1) sentence 1 KWG) did not stipulate any particular legal form for operators. Before the ruling on 24 February 2010, there had been no highest-level ruling on whether a GbR that, unlike commercial partnerships or legal persons, has only partial legal capacity is itself the operator of banking and financial services business. The Court ruled that the protective purpose of section 1 (1a) sentence 2 no. 3 KWG required an interpretation that the managing director (the representative of the entity's governing body) was acting for "others" (i.e. the partners). With regard to K2 Invest GbR, the BVerwG referred the case back to the HessVGH for further hearings and decision because, as the court of appeal, it still had to ascertain certain other facts.

Supervisory and investigative measures

A total of 627 new investigations.

In 2010, BaFin launched a total of 627 new investigations (previous year: 515). Most of them related to unauthorised banking and financial services transactions; only 21 concerned the unauthorised operation of insurance business (previous year: 74). Payment services under the ZAG were the subject of investigation proceedings in nine cases (previous year: 1). The ZAG came into effect at the end of October 2009.

BaFin issued formal requests for information and the submission of documents to suspicious companies in 46 cases and imposed coercive fines (*Zwangsgelder*) in eight cases. It performed one on-site audit and seven searches of premises in the course of its investigations.

40 prohibition orders and 18 liquidation orders.

BaFin takes formal measures against providers that are not prepared to discontinue unauthorised business operations voluntarily. In the year under review, it issued 40 prohibition orders and 18 liquidation orders in such cases. In this context, BaFin can also take action against individuals and companies that are involved in the initiation, signature and settlement of unauthorised business transactions by third parties. This includes not only companies that are willingly involved in this business but also companies that assist unwittingly in the conduct of unauthorised business while conducting their normal business, such as internet or other telecommunication services providers. BaFin made use of these powers in ten cases in the year under review, to issue prohibition orders or instructions.

Legal remedies against BaFin measures.

In the year under review, individuals or companies against which BaFin had taken formal measures filed objections in 36 cases. In the same period, BaFin completed 198 objection procedures, 91 of them on the basis of objection notices.

In many cases the individuals and companies involved took legal action against BaFin. The courts handed down rulings in 33 cases in 2010; 31 of them in favour of BaFin and two in favour of the affected parties.

Fundamental decision on the liquidation of unauthorised deposit business

If unauthorised deposit business is not discontinued voluntarily, BaFin normally orders the immediate repayment of the money accepted to the customers concerned (section 37 (1) KWG). The BVerwG confirmed this administrative practice in its judgement of 15 December 2010.[83] In doing so, it reversed the ruling of the HessVGH, which had regarded the instruction by BaFin to liquidate an unauthorised deposit business as an error of discretion.[84] The HessVGH was of the opinion that section 37 (1) KWG, which gives BaFin the power to order the immediate cessation of unauthorised business and to liquidate these transactions without undue delay, serves in equal measure to protect the integrity of the financial system and to protect investors. However, by ordering the immediate repayment of the deposits, BaFin had not taken adequate account of the effective civil law agreements entered into between the operator and the investor and of the financial interests of the affected investors.

In its judgement, the BVerwG found that this interpretation by the HessVGH breaches Federal law. It ruled that, although the purpose of section 37 (1) KWG is both to ensure the integrity of the financial system and to protect investors, the investor protection intended by the provision is not aimed at taking individual investors' specific subjective interests into account. Rather, the purpose of the provision is to ensure the protection at an objectivised level of the investing public. Prudential supervision activities provide only indirect protection for individual investors – as a merely reflexive consequence of the measures taken in the public interest. In addition, the Court ruled that BaFin was entitled to assume that, by ordering the immediate repayment of the deposits, it was taking adequate account of this objectivised investor protection because waiting patiently and tolerating the continued performance of the contract was coupled with an increasing risk of default. On the contrary, BaFin was not obliged to take the investors' expectations of interest gains into consideration – especially as these were purely speculative.

The BVerwG left open the question of whether, since it infringes the authorisation requirement for banking business laid down in section 134 of the Civil Code (*Bürgerliches Gesetzbuch* – BGB), unauthorised deposit business is fully null and void, partially null and void, or fully effective. This question, which is discussed in the literature on civil law, was regarded decision-relevant by the lower courts.[85] The reason for the BVerwG's stance was that liquidation orders in accordance with section 37 (1) KWG are a public-law measure, which can be issued independently of the underlying civil law agreements between operators and customers.

[83] Case ref.: 8 C 37.09.
[84] Judgement dated 20 May 2009, case ref.: 6 A 1040/08.
[85] VG Frankfurt am Main, judgement dated 21 February 2008, case ref.: 1 E 5085/06; HessVGH, judgement dated 20 May 2009, case ref.: 6 A 1040/08.

3 Money laundering prevention

3.1 International anti-money laundering activities and national implementation measures

Result of the FATF country evaluation.

In February 2010, the Financial Action Task Force on Money Laundering (FATF) adopted the Mutual Evaluation Report on compliance with international standards for anti-money laundering and counter-terrorist financing measures in Germany. BaFin received the second-highest rating (largely compliant) for the central requirement relating to the supervisory regime in the financial sector. The auditors identified potential for improvement in this area with respect to the provision of more in-depth audit support by BaFin employees and to the greater use of sanctions in practice. BaFin already started to implement improvements in the course of 2010, for example by increasing its audits of whether institutions have met their obligation to notify suspicions of money laundering in good time.

In addition, the Act Implementing the Second E-money Directive (2009/110/EC) of 1 March 2011 resolves the points relating to the legislation governing the financial sector that were criticised in the Evaluation Report. It deals in particular with the internal safeguards to be implemented by credit institutions, financial services institutions, payment institutions and insurance undertakings. For example, more stringent legal provisions have been put in place defining the position and responsibilities of money laundering compliance officers. The Act also specifically requires the institutions to continuously develop suitable strategies and safeguards to prevent the misuse of new financial products and technologies for money laundering and terrorist financing.

Germany has to submit its first report to the FATF on the progress made on, and the measures taken to implement, the recommendations of the Evaluation Report in February 2012.

Active involvement at international level.

BaFin is also a member of a large number of anti-money laundering working groups at an international level, such as the FATF's International Co-operation Review Group (ICRG) and two of the latter's regional sub-groups. The ICRG's objective is to identify countries that pose a risk to the international financial system and to call on them to implement and comply with the international standards combating money laundering and terrorist financing. The Group can perform country evaluations to achieve this goal. In its publications, the FATF names countries that do not adequately comply with this. In addition, FATF member states can impose sanctions on the countries concerned.

Typologies report on new payment methods.

In December 2010, the FATF published a report on the risks of misuse for money laundering and terrorist financing purposes associated with new payment methods. BaFin had been a key initiator and driver of this project. The report deals with the risks posed by prepaid cards and internet and mobile phone-based payment systems, which are becoming increasingly widespread in Germany as well, and the resulting legal challenges for supervisory and prosecution authorities. It also presents case studies and shows national solution approaches adopted in individual countries. For BaFin, this issue is of fundamental importance and it intends to continue monitoring it closely in future.

Two key anti-money laundering documents from the Basel Committee on Banking Supervision.

In 2010, the Anti-Money Laundering Expert Group (AMLEG) set up by the Basel Committee on Banking Supervision produced two key documents for the latter that were designed to prevent money laundering and terrorist financing in the banking sector. The documents deal firstly with a risk-based approach to banking supervision and secondly with issues of cooperation among banking supervisory authorities in this area. The key documents were made available to the FATF in February 2011 to support the internal discussions currently being held at the FATF about revising its standards.

Joint working group comprising BaFin, BMF and banking associations.

The Federal Ministry of Finance, BaFin and the associations of banks belonging to the Central Credit Committee (*Zentraler Kreditausschuss* – ZKA) established a working group at the end of 2010. This group is tasked firstly with creating/revising interpretation and application guidelines for the anti-money laundering regulations. Secondly, the aim is to focus in particular on providing a permanent vehicle for, and intensifying, the consultation and co-ordination process with the banking industry associations in order to prevent money laundering and terrorist financing.

3.2 Anti-money laundering activities at banks, insurers, financial services institutions and payment institutions

Audits at EU branches.

BaFin conducted a total of 18 special audits to prevent money laundering and terrorist financing at credit institutions. Among other issues, these audits focused on branches in other EU countries: these countries are subject to home country supervision, which means that they do not have to undergo annual audits of their annual financial statements in Germany. Since these institutions still have to comply with German anti-money laundering regulations, BaFin can only establish whether they have taken the necessary anti-money laundering precautions on the basis of special audits.

AML risk analysis and fraud prevention.

Overall, AML (anti-money laundering)/CTF (counter terrorist financing) risk analysis is an area that still requires improvement in many institutions. Many banks are also having trouble

implementing uniform measures throughout the group. However, more and more banks are conducting thorough and systematic analyses of their exposure to fraud. It is therefore becoming increasingly important for institutions to take preventive measures, especially since legislators are set to expand requirements designed to prevent other criminal offences in 2011 – for example by conducting risk analyses or taking organisational measures in the institution.

Proof of identity frequently neglected on renewal of life insurance policies.

The Federal Financial Supervisory Authority conducted four special audits at insurance companies subject to its anti-money laundering supervision. There was evidence that the companies often failed to comply with the latest identification requirements, particularly in the case of renewal contracts for life insurance policies. The insurers take the personal data from the old contracts, even though they had collected this data before the Money Laundering Act (*Geldwäschegesetz* – GwG) came into effect, and in most cases not on the basis of the full identification required under current legislation.

Administrative offences.

2010 saw a sharp increase in the number of administrative offence proceedings launched by BaFin because of breaches of anti-money laundering obligations. The rise was in particular also a response to the new fineable administrative offence introduced in 2008 for delays in reporting or failures to report suspicious activity. BaFin imposed administrative fines in two cases.

4 Account information access procedure

BfDI audits account information access procedure.

In May 2010, the Federal Commissioner for Data Protection and Freedom of Information (*Bundesbeauftragter für den Datenschutz und die Informationsfreiheit* – BfDI) audited the automated account information access procedure. The audit focused on technical security aspects and on the workflows for the procedure. The BfDI explicitly stated that automated access to account information required under section 24c KWG was performed in accordance with data protection requirements. BaFin implemented without delay suggestions to clarify and make minor amendments to specific working instructions.

Further increase in use of account information access procedure.

In its eighth year of existence, the automated account information access procedure remains an important tool in pursuing unauthorised banking, insurance and financial services transactions and in pursuing and punishing money laundering and other criminal offences. This is confirmed by the increase in the total number of enquiries, which rose by around 15% year-on-year. The table below shows growth in enquiries and the recipients of the accessed account information.

Table 34
Account information recipients

Account information recipients	2010		2009	
	absolut	in %	absolut	in %
BaFin	1,371	1.3	547	0.6
Tax authorities*	13,673	12.9	11,691	12.7
Police authorities	58,477	55.4	52,367	57.0
Public prosecutors	23,765	22.5	20,915	22.8
Customs authorities*	8,054	7.6	6,198	6.7
Other	275	0.3	158	0.2
Total	**105,615**	**10**	**91,876**	**100****

* Tax and customs authorities are only authorised to request account information from BaFin in accordance with section 24c of the KWG in connection with criminal proceedings.
** Deviations in the total figures are due to rounding differences.

5 Consumer complaints and enquiries

In 2010, a total of 20,941 clients of insurers, credit institutions and financial services institutions contacted BaFin with complaints, enquiries, or information (previous year: 22,329). Complaints often provide important information on potential violations of supervisory provisions. In the event of such a violation, BaFin issues a warning to the institution or company and requires it to take measures to prevent future violations. If there are organisational defects, it works to ensure changes and monitors their implementation.

Unfortunately, it is impossible to provide total protection against insolvency or criminal offences. To protect themselves against fraud, dubious products, or the total loss of their investment, investors should therefore make their own extremely careful assessment of the reliability and economic plausibility of offerings that interest them.

Consumer hotline

The information and advisory service provided by BaFin's consumer hotline remained in strong demand in 2010. The hotline, which is available from 8 a.m. to 6 p.m. Mondays to Fridays, focuses on providing consumers with information on BaFin's supervisory activities, the basic complaints procedure and the status of their ongoing complaints. The telephone number for the hotline is +49 (0)228 - 299 70 299; from 1 March 2011, it can also be reached by dialling 115, the central number within Germany for contacting public authorities.

The consumer hotline received approximately 28,000 enquiries in 2010 (previous year: 26,599). The slight increase is probably due

to the moratorium on noa bank GmbH & Co. KG ordered by BaFin in August 2010: while the total number of calls was approximately 2,300 per month on average, this figure rose to over 2,800 enquiries in August. A large number of consumers obtained information about developments regarding the ban on sales and payments imposed on noa bank GmbH & Co. KG and wanted to know how and when they would get their deposits back from the institution.

Almost half the callers in the year under review asked questions relating to insurance. Around 35% of consumers contacted the hotline about banks and building and loan associations, while 10% of enquiries concerned securities supervision. At a general level, enquiries reflect all consumer-related topics affecting BaFin. In the year under review, these mainly included questions on the safety of deposits or increases in private health insurance contributions.

5.1 Complaints about credit and financial services institutions

In 2010, BaFin handled a total of 6,575 submissions on credit and financial services institutions, on a par with the previous year (6,546). The submissions comprised 5,912 complaints and 641 general enquiries. In 22 cases, BaFin issued statements to the Petitions Committee of the Bundestag (the lower house of the German parliament). The complaints were completely or partially upheld in 1,170 cases (including five petitions). More than half of the complaints related to private commercial banks, followed by savings banks and credit cooperatives.

Table 35
Complaints by group of institutions in 2010

Private commercial banks	3,254
Savings banks	1,133
Public-sector banks	167
Cooperative banks	684
Mortgage banks	24
Building and loan associations	293
Financial services providers	84
Foreign banks	222
Old banks	51
Total	**5,912**

Selected cases

As in previous years, client complaints covered all areas of banking business, although many focused on the lending business. For example, they included specific problems with loan administration, loan processing and coercive/enforcement measures. Clients also frequently complained about payment transactions. In addition to asking how long bank transfers could legitimately take, many

consumers objected to unauthorised direct debits, accounts being terminated and blocked as well as account management fees. In several cases, clients also criticised the handling of probate issues in inheritance cases.

Delayed dispatch of tax certificates.

However, one of the main criticisms was the delayed dispatch of tax certificates in 2010. In some cases, the certificates were sent several months late due to the delayed implementation of the flat tax legislation. A number of private commercial banks were particularly affected by this.

Acceptance of credit cards issued by certain direct banks.

Numerous clients of a number of direct banks contacted BaFin because they could no longer withdraw cash at other credit institutions' ATMs using their VISA credit cards. The credit institutions responded that the fee they received as ATM operators from the direct banks for cash withdrawals using VISA credit cards was not sufficient to cover the cost of installing and operating the ATMs. The courts have now ordered certain institutions to remove the block on these cards; the matter has yet to be clarified at the highest instance. Clients were able to use EC cards issued by direct banks at ATMs at all times without restriction.

Fees for returned direct debits.

The implementation of the EU Payment Services Directive into German law led to changes in banks' general terms and conditions of business. Certain credit institutions introduced a fee for notifying clients that a direct debit had not been honoured. This is based on the new provision in section 675o (1) sentence 4 Civil Code, which allows the payment services provider to agree a fee for notifying a legitimate refusal with the payment services user in the payment services master agreement. According to the BGH ruling handed down prior to the implementation of the Directive, such fees are not permissible.[86] This ruling stated that, as the debtor bank is obliged in any case under the direct debit procedure to notify the client without delay that a direct debit has not been honoured due to insufficient funds, it may not demand a separate fee for this. It remains to be seen whether this ruling will still be valid in light of the amendment to the legislation.

Account management for Internet scammers.

A large number of consumers complained that credit institutions are managing business accounts for operators of "subscription traps" on the Internet. The websites in question do not make it immediately clear that customers must pay for the services being offered. Users are only informed that they are entering into a long-term contract by registering for a particular offering in the conditions of participation or in inconspicuous footnotes. In addition, the annual subscription is often due in advance. The consumers concerned only become aware of the downstream costs when they subsequently receive an invoice and are requested to make payments to specific accounts. The consumers urged BaFin to call for the accounts to be closed and the balances to be repaid. This problem affects all sectors of the banking industry. As far as

[86] BGH, judgement dated 13 February 2001, case ref.: XI ZR 197/00.

possible, the banks have terminated their business relationships with the operators of these websites. In some cases, however, the courts issued injunctions forcing institutions to keep accounts open.

Termination of home savings contracts by building and loan associations.

A number of clients who had already saved the full amount or more than the full amount of the loans they agreed to take out under home savings contracts complained that their contracts had been terminated by public sector building and loan associations and the balance paid out. The contracts were entered into in the 1990s and provided for a comparatively high interest rate or bonus interest. In 2007, a number of consumers had already complained about their home savings contracts being terminated by a private building and loan association. However, the ombudswoman for the private building and loan associations regarded this practice as legitimate. She was of the opinion that building and loan associations may terminate contracts giving three months' notice because the actual purpose of home savings – obtaining a home savings loan – cannot be achieved by saving (more than) the full amount of the loan; a home savings contract is neither a savings contract nor an investment. BaFin also believes that it is generally acceptable to terminate home savings contracts in these circumstances. This matter has not yet been clarified by the courts.

5.2 Complaints about insurance undertakings

In 2010, BaFin processed slightly fewer complaints year-on-year, finalising 13,258 compared with 14,274 in 2009. The submissions received comprised 10,484 complaints, 802 general enquiries not based on a complaint and 85 petitions that BaFin received via the Bundestag or the Federal Ministry of Finance. In addition, it received 1,887 submissions that did not fall within its remit.

The complainants were successful in a total of 30.7% of the proceedings (previous year: 33.7%), while 55.1% of the submissions were unfounded and in 14.2% of the cases BaFin was not the competent authority.

Table 36
Submissions received by insurance class (since 2006)

Year	Life	Motor	Health	Accident	Liability	Legal expenses	Building/ household	Other classes	Other complaints*
2010	**3,512**	**1,640**	**2,326**	**606**	**755**	**763**	**1,118**	**413**	**2.125**
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	1,268	1,437	1,408	359	1,459

* Wrong address, brokers, etc.

At 29.6%, the most common complaint by consumers related to claims administration or the adjustment of life insurance benefits (previous year: 34.4%). These were followed by complaints on contract handling (24.3%; previous year: 26.6%), contract termination (14.6%; previous year: 17.8%) and contract negotiation (8.5%; previous year: 11.7%). 0.8% (previous year: 1.7%) of the submissions related to special features of the Pension Contracts Certification Act (*Gesetz über die Zertifizierung von Altersvorsorgeverträgen* – AltZertG). Within these general categories, the following reasons were the most commonly given:

Table 37
Reasons for complaints

Reason	Number
Amount of insurance payment	1,373
Claims handling	1,099
Coverage issues	1,081
Advertising/advice/application processing	800
Policy alterations and extensions	666
Changes and adjustments to premiums	602
Bonus payments/profit sharing	581
Termination	547
Complaints about agents/brokers	434
Contributions, dunning	422

Selected cases

No increase in guaranteed pension despite additional payment.

A policyholder paid an additional €5,000 into her existing pension insurance contract to increase her future pension. The provisions of the general insurance terms and conditions specified that an additional payment would lead to an increase in the insurance benefit. However, the guaranteed annual pension quoted by the insurer in the supplement to the insurance policy remained unchanged. The insurance undertaking stated that although the additional payment made by the policyholder increased the capital saved under the contract, this would not increase the guaranteed benefit. The additional payment only affected the other, non-guaranteed portion of the annual pension. However, BaFin took the view that the policyholder was entitled to conclude from the formulation used in the general insurance terms and conditions that the guaranteed benefit would increase. The insurer has now amended its general insurance terms and conditions accordingly. It ultimately offered the policyholder a separate backdated single-premium life insurance policy instead of the additional payment.

Miscalculation of the contribution period leads to offer of additional payment.

A life insurer offered contracts with an extremely long duration, e.g. up to the age of 85. However, the company agreed the mandatory early termination of the contracts with the policyholders, for example when they reached the retirement age of 65. The contributions were only to be paid up to the termination date. A large number of policyholders complained to BaFin because only the actuarial reserves accrued up to the early termination date are paid out when the contracts are terminated, instead of the agreed amount insured. BaFin has ensured that, in future,

the insurer's annual policy statements will explicitly mention the lower amount to be paid out at the termination date.

In one case, a policyholder had taken out an insurance contract with a duration of 53 years. The contract was subject to mandatory termination after 28 years. The contribution period also amounted to 28 years. On reviewing the submission, the company established that the insured amount of DM 100,000 could not be generated over the contribution period of 28 years given in the application. This required a contribution period of 53 years, a fact that was not made sufficiently clear to the policyholder in the contract documentation. Without admitting any legal obligation, the insurer therefore agreed to offer the policyholder an additional €10,000.

Retrospective admission to compulsory long-term care insurance for previously uninsured applicants.

In several cases, BaFin examined whether objections can be raised from a supervisory law perspective to demands by a private health insurance company for retrospective contributions due to the compulsory insurance requirement that has applied to private long-term care insurance since 1 January 1995. For example, one complaint involved a previously uninsured civil servant who was eligible for assistance and who applied to be admitted to the basic tariff. As a result, he was also asked to take out private long-term care insurance. The insurer took the view that the requirement to enter into a long-term care insurance contract could only be fulfilled retrospectively as from 1 January 1995. It claimed that the obligation to make contributions began on this date. BaFin informed the company that, in accordance with general civil law principles, the Eleventh Book of the Social Security Code (*Sozialgesetzbuch* – SGB XI section 110 (1) no. 1) and a comparison with the newly created insurance requirement under section 193 (3) of the Insurance Contract Act (*Versicherungs-vertragsgesetz* – VVG), policyholders themselves have the right to determine when their insurance technically begins. Even if a person eligible for assistance were to be obliged under section 23 (3) SGB XI to take out private long-term care insurance as from 1 January 1995, the policyholder would still have to submit an application for any insurance cover taken out subsequently to begin retrospectively from this date. If no retrospective effect has been agreed, it does not apply and there is no basis on which an insurer could demand premiums for the prior period. The policyholder's application alone determines the period for which any demands for premiums may arise. As a result, the company amended the beginning of the insurance policy to 1 May 2009 in line with the complainant's application and reimbursed the premiums that it had demanded for the prior period, which had already been paid.

Failure to notify contribution adjustment breached terms of contract.

In another complaint, BaFin objected to the fact that a motor insurer had failed to inform policyholders of an adjustment to their contributions. However, the motor insurer's underlying general contractual terms and conditions required that policyholders receive notification of increases in premiums at the latest one month before they take effect. Following BaFin's intervention, it emerged that a system error was responsible for the lack of

notifications. This affected notifications of increases in contributions of up to €5 for approximately 33,000 contracts. Consequently, the insurance undertaking agreed to make flat repayments of €5 to the policyholders concerned.

Unilateral contractual amendments by insurance undertakings.

Several complaints were directed at two insurance undertakings that unilaterally amended residential building and home insurance contracts and increased the contributions. The insurers informed the policyholders that their insurance cover had been extended to include damage caused by natural forces and that the insured amounts and premiums had been increased as from a specific date. The policyholders were told that they should simply add the enclosed conditions to their contract documents if they wished to accept the "offer". They were asked to call the insurer if they did not want to extend their insurance cover. Over 100,000 insurance contracts were affected by this measure. After BaFin informed the company that contractual amendments may not be made unilaterally by insurers and are not permitted without policyholders' express approval, the company gave in and is now keeping the contracts unchanged in the cases in which the policyholder's explicit consent was not given.

Insolvency of an EU motor insurer.

A large number of policyholders of a Dutch insurer that had also entered into roughly 50,000 motor insurance contracts in Germany contacted BaFin when the insurer ran into financial difficulties. A Dutch court had placed the insurer, which had insufficient liquidity, under emergency rules in accordance with the Dutch law on financial supervision. The rules concerned provided for special insolvency proceedings for insurance undertakings. Consequently, the insolvency administrator curtailed the duration of all insurance contracts so that they were subject to compulsory termination effective 31 August 2010. This meant that the policyholders had no insurance cover from 1 September 2010 and were forced to find another insurer – at least for their motor liability insurance – from this date at the latest. Motor liability claims under the contracts existing up to 31 August 2010 were settled by the Verein Verkehrsopferhilfe e.V. (Association for the Assistance of Road Accident Victims), the compensation scheme for German motor liability insurers. The association waived the option granted to it under the law to bring a claim against the policyholders for up to a maximum of €2,500 in each case. Rather, it claimed the full expenses from Warboorg, the Dutch protection fund, on the basis of a compensation agreement.

Failure to mention best-selling tariff when adjusting contributions

The Regulation on Information Obligations for Insurance Contracts (*Verordnung über Informationspflichten bei Versicherungsverträgen* – VVG-InfoV) requires insurers to inform policyholders of their option to switch tariffs (reclassification) in accordance with

section 204 VVG (section 6 (2) VVG-InfoV), enclosing the text of the statutory provision, in the event of any increase in premiums for substitutive health insurance as defined by section 12 (1) of the Insurance Supervision Act (*Versicherungs-aufsichtsgesetz* – VAG). Policyholders who have reached the age of 60 must be notified of tariffs that offer comparable insurance cover to the ones previously agreed and for which reclassification would result in reduced premiums. The notification must include tariffs that are considered especially appropriate for reclassification following a reasonable assessment of the policyholder's interests. The tariffs mentioned in section 6 (2) sentence 2 VVG-InfoV shall include at the least those tariffs that recorded the highest new intakes measured in terms of the number of insured persons in the previous financial year, with the exception of the basic tariff.

Over a specific period, BaFin examined all complaints received about contribution adjustments to private health insurance that took effect on 1 January 2010 with particular reference to whether the insurers met the above information requirements. It objected to the fact that some insurance undertakings used the old text of section 204 VVG. It also found that two insurers had not enclosed the text of section 204 VVG at all. Other insurers had not informed policyholders of the best-selling tariff in every case required or had only quoted other tariffs on request. However, the insurers have now confirmed that, in the event of future contribution adjustments, they will also inform policyholders of the tariffs that recorded the highest new intakes in the previous financial year.

5.3 Complaints relating to securities transactions

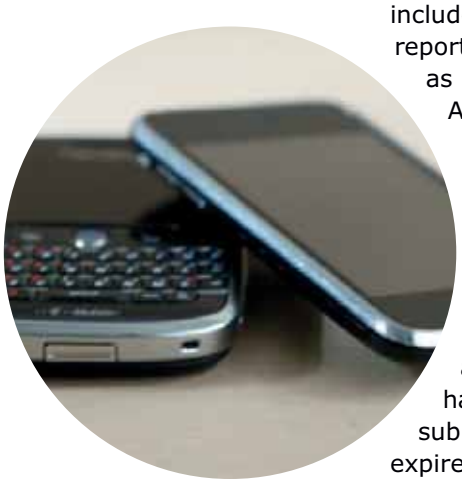
The number of complaints received by BaFin about credit and financial services institutions declined sharply from 1,238 in the previous year to 787 in 2010. In addition, there were 310 written enquiries by investors (previous year: 257). The greater number of complaints in the previous year was due primarily to the fact that, in the course of the financial crisis, numerous investors claimed that they had been misadvised in sales consultations.

Eleven investors complained about investment research (previous year: 14). As in 2009, the complaints focused largely on the manner in which the research was disseminated rather than on its content. Retail investors frequently received unsolicited recommendations by fax. In these cases, BaFin investigated both the suspicion of market manipulation raised and whether the publishers of the stock market newsletters met their disclosures requirements under section 34c WpHG.

Selected cases

Information in securities account statements.

Many banks offer their clients online securities account statements. These give investors an overview of their securities portfolio including (book) gains or (book) losses recorded up to the date in question. In one case, an investor sold the fund units in his securities account because he was expecting a promising gain on the basis of the bank's securities account statement. In fact, the realised gain proved smaller than he anticipated and was not consistent with the information in the securities account statement. Following a query by BaFin, the bank admitted that the information in the securities account statement was incorrect. A change in the bank's IT system had led to fund distributions being erroneously included twice, which ultimately led to a higher (book) gain being reported. The bank offered the customer an ex gratia payment as compensation for the incorrect information it had supplied. Although in this case the securities account statement constituted a voluntary service provided by the bank, all information that a bank makes available to its clients must be honest and clear, and must not be misleading.



In another case, a securities account holder complained that his custodian bank had deleted American Depository Receipts (ADRs) from his securities account without his approval. However, BaFin was unable to find that the bank had acted improperly in deleting the securities as the bank submitted a plausible case that the securitised rights had expired. If this is the case and the paper can therefore no longer be classified as a security, the securities account holder's approval is not required to delete the securities position from the account. Consent is not needed because the account holder's rights are not impaired by deleting the securities. Rather, the deletion reflects the existing fact that the ADRs are no longer considered to be securities.

5.4 Enquiries under the Freedom of Information Act

Large number of enquiries about Porsche/VW.

Porsche Automobil Holding SE's attempted takeover of Volkswagen AG triggered a significant number of applications under the Freedom of Information Act (*Informationsfreiheitsgesetz* – IFG) in 2010. As in the previous year, journalists and shareholders tried to obtain access to BaFin's files on these transactions. From October 2008 onwards BaFin has examined whether there were indications of market manipulation. The preliminary investigations of this matter by the public prosecutors in Stuttgart are continuing.

Number of new applications continues to decline.

The number of new applications under the IFG halved to 83 (previous year: 166). This is due in particular to the smaller number of class actions filed in which lawyers brought a claim on behalf of numerous clients. For example, only 21 applications were received in the area of banking supervision (previous year: 87).

Applications in the areas of securities supervision (59) and insurance supervision (3) remained roughly on a par with 2009 (66 and 2 respectively). As in previous years, BaFin had to reject most applications for access to information since there were grounds for exclusion. In the area of securities supervision, BaFin issued responses that were at least partially positive in more than half of cases and provided applicants with information that had been requested.

Table 38
Enquiries under the IFG in 2010

Supervisory areas	Number	Application withdrawn	Access to information granted	Access to information partially granted	Access to information denied	In process	Objection filed	Legal remedies pursued
Banking supervision	21	1	0	0	4	16	2	2
Insurance supervision	3	0	0	1	2	0	1	0
Securities supervision	59	4	21	6	21	7	9	3
Other	0	0	0	0	0	0	0	0
Total	**83**	**5**	**21**	**7**	**27**	**23**	**12**	**5**

Increasingly nuanced approach in court cases.

In 2010, the courts regularly requested BaFin to submit the documents requested to it by issuing orders to take evidence. Without these documents, the courts said that they were unable to decide whether a right to disclosure exists under the IFG or not. However, in BaFin's opinion, submitting such documents in court proceedings anticipates the outcome of the access to information that is the subject of the dispute without this having been definitively clarified by the court. In such cases it therefore asks the Federal Ministry of Finance to examine whether, as the supreme regulatory authority, it will issue a blocking order preventing the files being submitted to the court hearing the main proceedings. This means that the documents then do not have to be submitted. However, in such cases the plaintiff can bring interlocutory proceedings before the HessVGH requesting that the Court examines whether BaFin has the right to refuse to submit the requested files.

The issue of whether documents have to be submitted has not yet been definitively clarified by the HessVGH in main proceedings. In its orders to take evidence, however, the Court explicitly recognises that BaFin can in principle invoke the non-disclosure obligations under supervisory law.[87] The Administrative Court in Frankfurt am Main clarified that access to the information is precluded if disclosing the information could have an adverse effect on the implementation of preliminary criminal investigations by the public prosecutors.[88] The HessVGH shared the view that this inevitably leads to access to the information being denied.[89]

[87] Decision dated 2 March 2010, case ref.: 6 A 1684/08; Decision dated 24 March 2010, case ref.: 6 A 1832/09; Decision dated 30 April 2010, case ref.: 6 A 1341/09.
[88] Decision dated 30 August 2010, case ref.: 7 L 1957/10.F.
[89] Decision dated 27 October 2010, case ref.: 6 B 1979/10.

6 Certification of basic pension and retirement provision products

BZSt assumes responsibility for certification.

In addition to the certification of private pension contracts (Riester pensions), the 2009 Annual Tax Act (*Jahressteuergesetz* 2009) transferred the certification of basic pension products (Rürup pensions) to BaFin for a limited period. With effect from 1 July 2010, BaFin transferred all activities to the Federal Central Tax Office (*Bundeszentralamt für Steuern* – BZSt). BaFin gave the BZSt extensive support in the run-up to the transfer of responsibility to ensure that certification continued smoothly afterwards.

Certification requirement also applies to basic pension contracts.

Certification by the Certification Office is mandatory for tax assessment periods from 2010 onwards. This process provides the tax authorities with binding confirmation that the basic pension contract/the relevant sample contract meets the requirements laid down in the Income Tax Act (*Einkommensteuergesetz* – EStG) that are referred to in section 2 of the Act Governing the Certification of Contracts for Private Old-Age Provision (*Altersvorsorgeverträge-Zertifizierungsgesetz* – AltZertG). This means that contributions paid for a certified basic pension contract can be treated for tax purposes as special personal deductions within the meaning of section 10 EStG. The certification requirement for sample contracts as from the 2010 assessment year not only applies to new basic pension contracts taken out, but also to existing contracts entered into up to this period if their premiums are to remain tax-privileged as from the 2010 assessment year. Private pension products have already been required to be certified since 1 January 2002.

Certification of existing contracts.

After BaFin's Certification Office had initially certified the applications for new business in consultation with the central provider associations and the providers themselves, the focus in 2010 up to the transfer of responsibility was on certifying existing contracts. Existing agreements entered into in the past could be transferred to certified sample contracts. In 2009, BaFin approved exemptions for the certification of existing agreements in consultation with the Federal Ministry of Finance. After liaising further with the Federal Ministry of Finance and after involving the BZSt, it extended the deadlines for informing existing clients in this special certification procedure to 31 December 2010. In addition, BaFin clarified other key issues relating to the application of the special certification criteria and published all interpretations, special application forms, explanations and checklists relating to the certification procedure on its website.

High certification volumes.

BaFin certified over 250 basic pension contracts in 2010 until responsibility was transferred. It also granted more than 330 certifications for private pension products (Riester pensions). All in all, BaFin and the former Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen* – BAV) reviewed over 5,000 certifications for basic pension and retirement provision contracts and over 2,000 notifications of changes in the nine years in which they were responsible for these activities.

VIII About BaFin

1 Human resources and organisational issues

Human Resources

As at 31 December 2010, BaFin had 1,976 employees (previous year: 1,829) divided between its offices in Bonn (1,504) and Frankfurt am Main (472). Of the total headcount, 65% (1,293) are civil servants and 35% (683) are public service employees covered by collective wage agreements.

Women make up almost half of BaFin's workforce (935) and are also represented in senior management. Around 25% of management positions are held by women. Sixteen BaFin employees are on long-term assignment to international institutions and supervisory authorities.

Table 39
Personnel
Number of employees as at 31 December 2010

Career level	Employees			Civil servants ("Beamte")	Public service employees
	Total	Female	Male	Total	Total
Higher Civil Service	783	290	493	678	105
Upper Civil Service	686	312	374	546	140
Middle/ Basic Civil Service	507	333	174	69	438
Total	**1,976**	**935**	**1,041**	**1,293**	**683**

210 new staff recruited.

To manage its steadily growing workload, BaFin recruited 210 new members of staff in 2010 (previous year: 180). These included candidates for entry to the Upper Civil Service, vocational trainees and temporary staff. The majority were fully qualified lawyers, university of applied sciences graduates and holders of bachelor's degrees.

Table 40
Recruitment in 2010

Career level				Qualifications			
	Total	Female	Male	Fully qualified lawyers	Econo-mists	Mathemati-cians/Sta-tisticians	Other
Higher Civil Service	85	35	50	53	20	7	5
				Business lawyers	Econo-mists	IT specialists	Other
Upper Civil Service	57	22	35	12	34	4	7
Middle Civil Service	44	23	21				
Candidates for entry to the Upper Civil Service/ vocational trainees	24	12	12				
Total	**210**	**92**	**118**				

Vocational training at BaFin.

24 people started vocational training or preparation for the Civil Service with BaFin in 2010 (previous year: 23). In collaboration with Deutsche Bundesbank, BaFin prepares candidates for entry to the Upper Civil Service for their future responsibilities (36). BaFin also provides vocational training in three careers: IT specialist (1), office communication specialist (33), and media and information services specialist (1). At the end of 2010, BaFin thus had a total of 70 vocational trainees and candidates (previous year: 62).

Staff appointment scheme.

To perform new legal tasks and cope with a rise in the number of cases handled, BaFin's Administrative Council approved 140 additional staff positions and posts as part of the 2010 budget.[90] Of these, 78 were subject to a qualified freeze, meaning that BaFin was initially not allowed to fill them. In June 2010, the Administrative Council's Budget Control and Audit Committee lifted the freeze on 74 of the posts, most of which BaFin was able to fill by the end of the year. The Administrative Council has approved 244 new posts for 2011. Of these, 75 can be filled immediately, with the remaining 169 subject to a qualified freeze.

Organisation

New Chief Executive Director of Insurance Supervision.

Gabriele Hahn was appointed Chief Executive Director of Insurance Supervision in February 2011. Prior to this, she was Deputy President of the Federal Finance Office and, from 2008, President of the Federal Central Tax Office, its successor authority.

[90] The term 'positions' refers to posts for civil servant employees contained in the staff appointment scheme forming part of the budget, and broken down by department and pay grade. The term 'posts' refers to posts for public service employees covered by collective wage agreements in the staff appointment scheme.

Integrated financial supervision training programme launched for new employees.

During the first six months of 2010, BaFin launched the pilot phase of its integrated financial supervision programme, which was developed in 2009 for training new employees. The programme is designed to provide an integrated understanding of BaFin's activities among new recruits and ensure optimum links between the different areas. The new employees were trained by 150 lecturers from the areas of banking, insurance and securities supervision as well as the cross-sectoral departments. Once the pilot phase had ended, BaFin rolled out the programme at the beginning of 2011 as a permanent internal training measure.

Continous professional development (CPD).

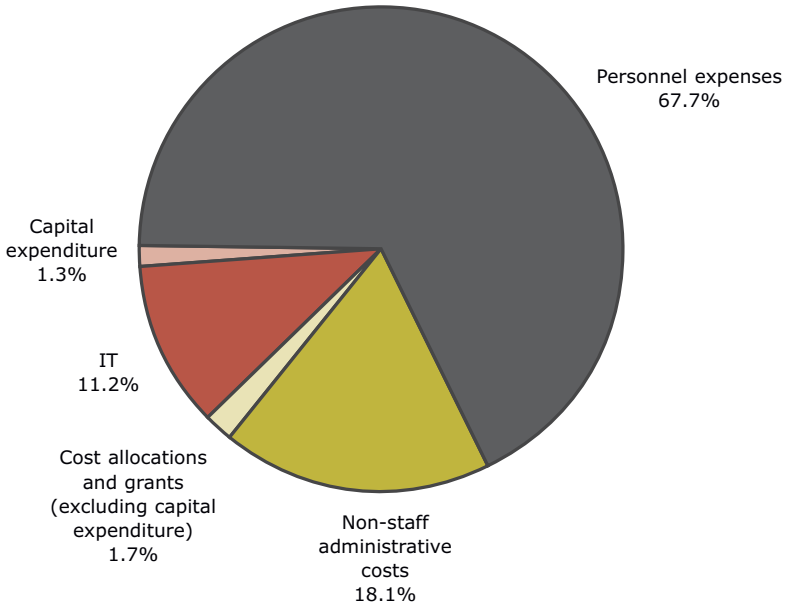
In 2010, 1,307 employees took part in at least one of a total of 569 CPD sessions offered (previous year: 1,145). Most of the offerings were specialist multipart seminars, for example on Solvency II, although they also included language courses and courses on soft skills. On average, each employee received 5.76 days of training (previous year: 3.85 days).

2 Budget

Budget of €143.25 million.

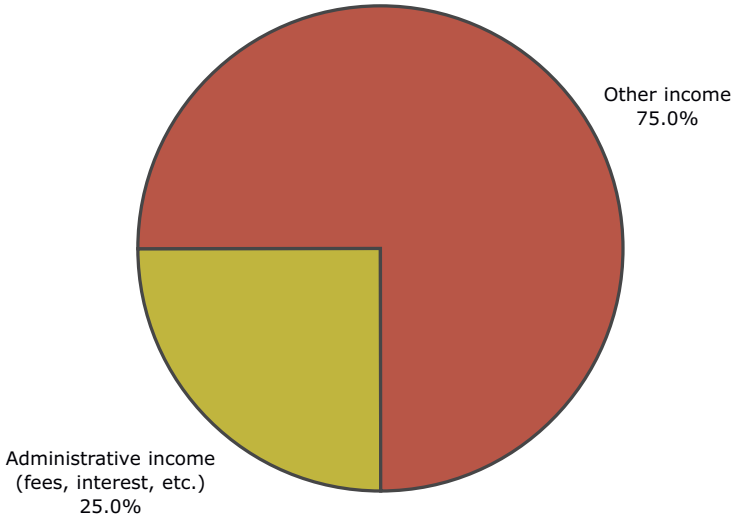
BaFin's Administrative Council approved a budget of €143.25 million for 2010 (previous year: €135.3 million). Personnel expenses accounted for around 68% of the projected expenditure (€97 million; previous year: €89.4 million) and non-staff costs for around 18% (€25.9 million; previous year: €25.6 million).

Figure 34
Expenditure 2010 budget



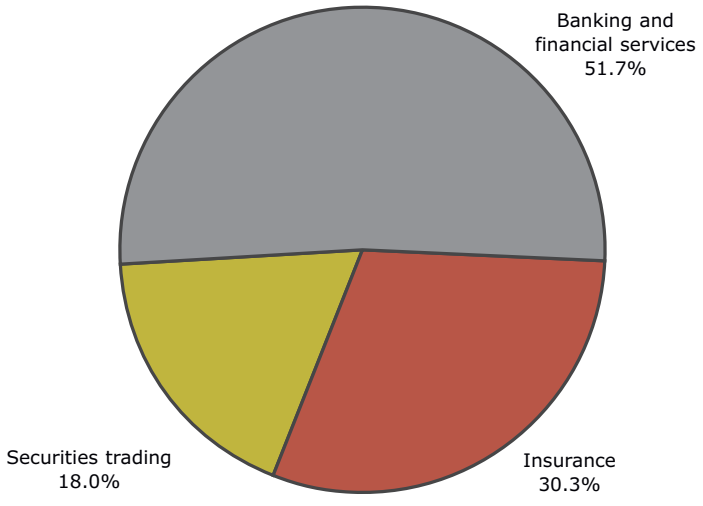
BaFin is fully financed by cost allocations levied on the companies it oversees (projected figure for 2010: €107.5 million; previous year: €105.9 million) and administrative income (projected figure for 2010: €35.8 million; previous year: €29.4 million). It does not receive any grants from the federal budget.

Figure 35
Income 2010 budget



The banking industry contributed slightly over half (51.7%) of the total income from cost allocations. The insurance sector financed 30.3% and the securities trading sector 18.0%. This breakdown corresponds to the final cost allocation for 2009; the cost allocation for 2010 will be finalised in the course of 2011.

Figure 36
Cost allocations by supervisory area in 2009



Case law on cost allocations

In three landmark decisions in September 2010, the Administrative Court in Frankfurt am Main dismissed the actions brought by a credit institution against the advance payment notices for the 2009 cost allocations, which included a 2% contribution to financing the costs of damages incurred as a result of an official liability claim.[91] The costs, BaFin has to meet in full from its own income in accordance with section 13 of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz*), included all expenditure and financial expenses incurred in discharging its duties. These also include expenses for official liability claims in accordance with section 839 of the German Civil Code (*Bürgerliches Gesetzbuch*) in conjunction with Art. 34 of the Basic Law (*Grundgesetz*). The Court emphasised that no assurance could be given that BaFin would not take incorrect decisions in individual cases when discharging its duties, pointing out that these were intrinsic to all businesses and could not be avoided completely, especially in the case of complex and complicated legal issues. The breach of official duty concerned – a demand to dismiss the manager of a credit institution that was ruled to be unlawful by the Administrative Court in Berlin in 2001 – was actually more indicative of slightly negligent behaviour by BaFin, the Court said. In addition, since the damages are relative low compared with BaFin's budget, including this loss in the cost allocation financing did not constitute an unreasonable or excessive burden on the institutions, the Court ruled. On account of the fundamental importance of the case, a leapfrog appeal to the Federal Administrative Court was permitted. The appeal proceedings there are still pending.[92]

In another case, the Federal Administrative Court ruled in September 2010 that the cost allocation for 1998, which was used to finance the activities of the former Federal Banking Supervisory Office, was lawful.[93] The Court ruled that the transitional provision laid down in section 9(2) of the Regulation on the Allocation of Costs Incurred by the Federal Banking Supervisory Office for the Banking and Financial Services Sector (*Umlage-Verordnung Kredit- und Finanzdienstleistungswesen*), which provided for allocations to be based on the statutory minimum initial capital, was effective and adequate as a basis for levying the cost allocation. It ruled that the provision lawfully took retroactive effect in 2004 by way of section 51(1) sentence 3 of the Banking Act (*Kreditwesengesetz* – KWG) as there was no principle of legitimate expectations applicable to the entities liable to pay the cost allocation. The Federal Administrative Court expressly approved the fact that certain entities liable for cost allocation were assessed on the basis of the statutory minimum initial capital applicable to them. It also concurred with the Federal Constitutional Court's view that the cost allocation was consistent with the requirements under constitutional law regarding special levies with a financing function.

[91] Case ref.: 1 K 1059/10.F (WM 2010, p. 2357), 1 K 1060/10.F, 1 K 1061/10.F.
[92] Case ref.: 8 C 20.10, 8 C 21.10, 8 C 22.10.
[93] Case ref.: 8 C 34.09.

Income of €142.8 million, expenditure of €136 million.

BaFin's actual expenditure in 2010 was approximately €136 million (previous year: €129.1 million). Its income amounted to approximately €142.8 million (previous year: €139 million). The Administrative Council still has to approve the annual financial statements.

Separate enforcement budget.

BaFin drew up a separate enforcement budget of around €8 million (previous year: €7.7 million). This included an allocation to the German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung) at the prior-year level (€6 million). Actual expenditure amounted to around €7.5 million (previous year: €7.1 million), while income (including advance allocation payments for 2011) stood at approximately €15.6 million (previous year: €15.8 million).

3 Public relations

BaFin in the press and the public eye.

BaFin answered some 4,800 press enquiries in 2010. In the banking sector, the main focus was on the results of the EU stress test for the 14 German credit institutions and the future international capital and liquidity standards (Basel III), as well as the revocation of the banking licence for noa bank GmbH & Co. KG and the decision that a compensation event had taken place. Decisions by Securities Supervision also generated considerable media interest – these included the approval of the takeover offer made by Spanish company ACS to the shareholders of Hochtief AG, the first registered rating agency and the ban on naked short sales of equities and debt instruments and on naked credit default swaps (CDSs) on eurozone government bonds. BaFin also received a large number of enquiries about the record of investment advice. Queries relating to insurance undertakings were mostly concerned with capital redemption products, which are playing an increasingly important role in life insurance and which may be used as short-term investments. In 2010, press representatives also enquired about the Federal Administrative Court's ruling on whether private health insurance companies are entitled to charge people switching providers higher contributions than new customers.

Joint press conferences with the Bundesbank and Federal Criminal Police Office.

Deutsche Bundesbank and BaFin invited media representatives to a joint press conference at the end of July 2010 to present the results of the EU-wide stress test for German credit institutions. In conjunction with the Federal Criminal Police Office (BKA), BaFin presented the annual report of the latter's Financial Intelligence Unit Germany to the press at the beginning of September 2010. The press conference, which was organised by BaFin, was the second of its kind. In June 2009, BaFin and the BKA had already reported jointly on their work to combat money laundering and terrorist financing.

Forum on White-collar Crime and the Capital Market.

BaFin held its seventh two-day Forum on White-collar Crime and the Capital Markets at the end of September 2010. Nearly 300 prosecutors and supervisors exchanged information about current developments on the capital markets. Since more and more capital market transactions take place at cross-border level, effective national and international cooperation is important. Representatives of the Austrian Financial Market Authority (FMA), a public prosecutor's office from southern Germany and BaFin showed how this can be achieved using a joint market manipulation case involving certificates as an example. Swiss representatives described how the Swiss Financial Market Supervisory Authority (FINMA) pursues market manipulation and insider trading as well as illegal financial transactions.

Another topic discussed at the event was the temporary seizure of assets, known as forfeiture. The Federal Court of Justice had issued a ruling on this matter in 2010. A presiding judge and a public prosecutor from Hamburg illustrated the effects of the ruling on ongoing cases. The participants discussed at length how to calculate the forfeiture in future.

Invest and Börsentag fairs.

In April 2010, BaFin once again participated in the "Invest" fair for investors held in Stuttgart. BaFin's stand focused on the details of the record of investment advice that all investment services enterprises have been required to prepare since the beginning of 2010, the financial crisis and its possible causes, and the future of BaFin. Visitors to the fair were also interested in general information on the channels for lodging complaints and in the information offered on the website, such as the databases. Last but not least, the question of the reputability of individual exhibitors at the fair was raised repeatedly. Here, BaFin took pains to point out that the fair organisers alone decide on who is allowed to exhibit, meaning that due care must be taken. In the official lecture programme, for example, a former stock exchange journalist again talked up commodity securities despite having been convicted of scalping (a form of market manipulation) some years ago.

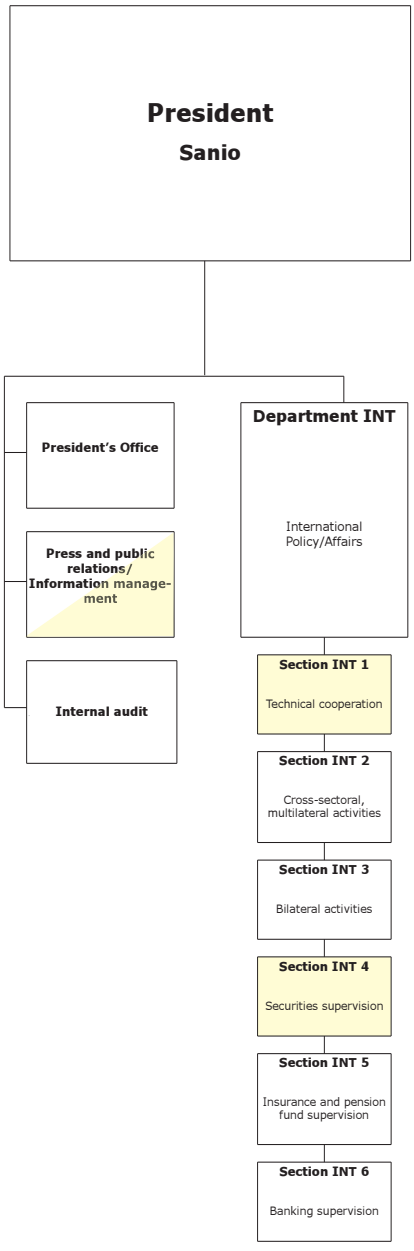
BaFin was also represented at the Börsentag fairs in Dresden, Hamburg, Munich, Frankfurt am Main and Berlin, answering more than 120 enquiries per event in some cases.

Brochure on securities prospectuses published.

In August 2010, BaFin published a brochure entitled "The securities prospectus – opening the door to the German and European capital markets".[94] Among other things, this brochure explains the aims of the legislation governing prospectuses, the legal framework and who is responsible for what. The brochure is available in both German and English.

Appendix

Organisation chart

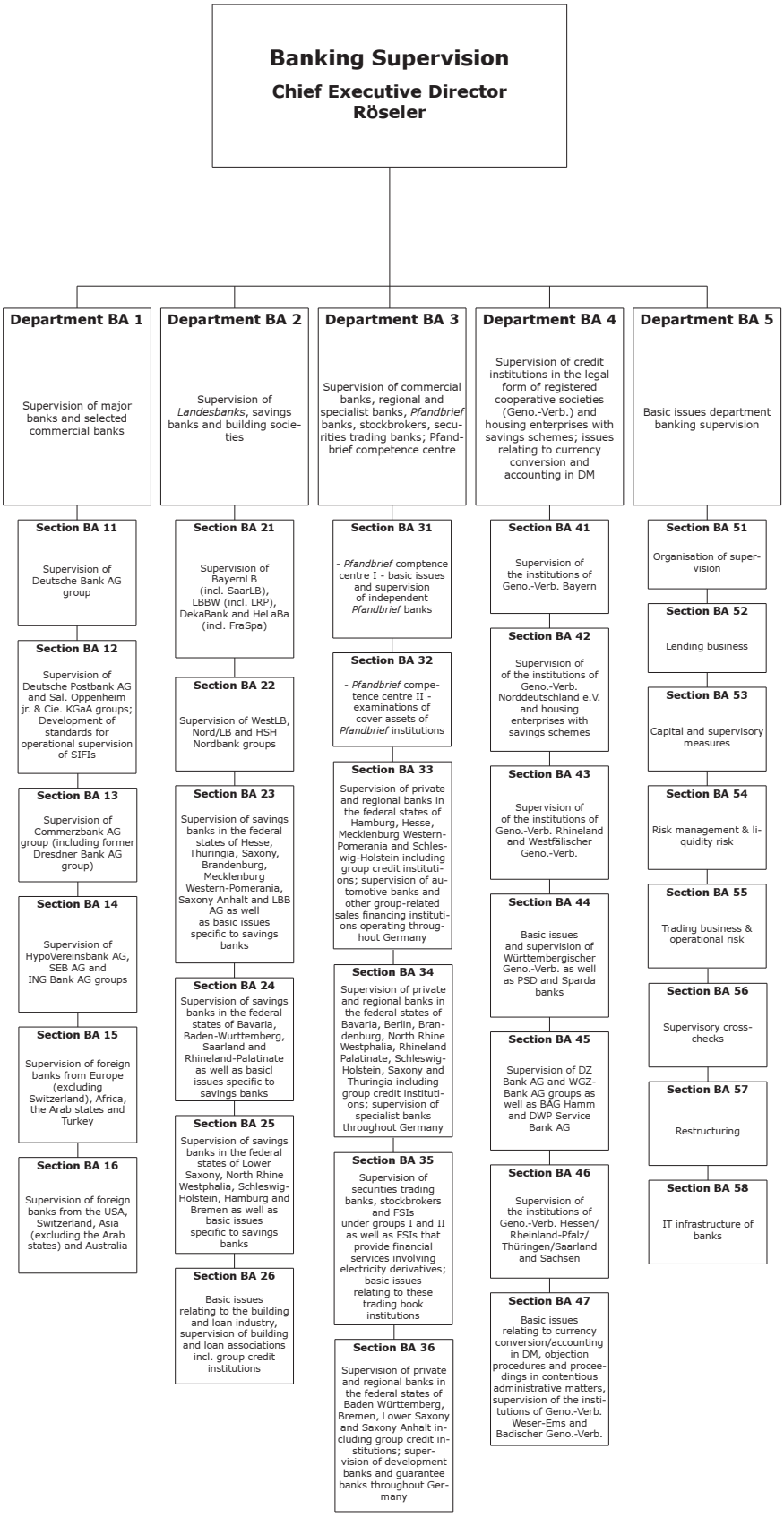


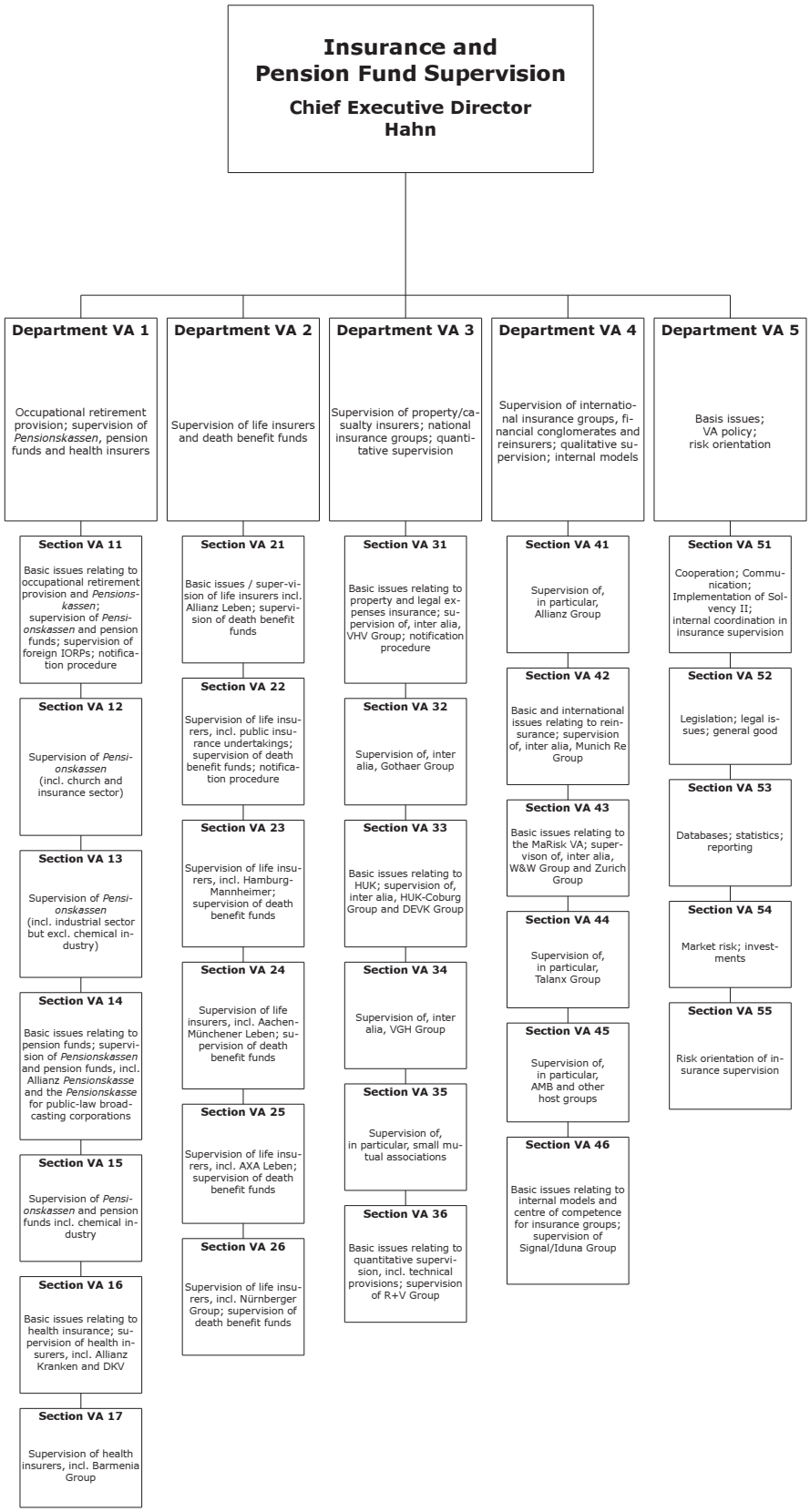
Bonn office

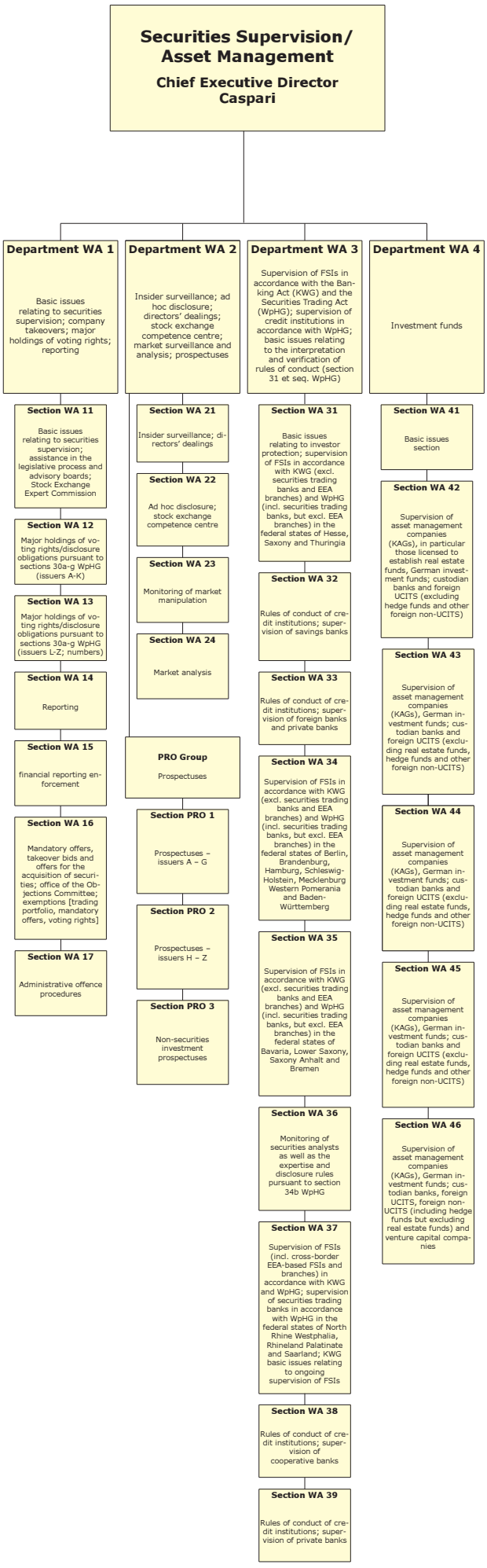
Frankfurt office

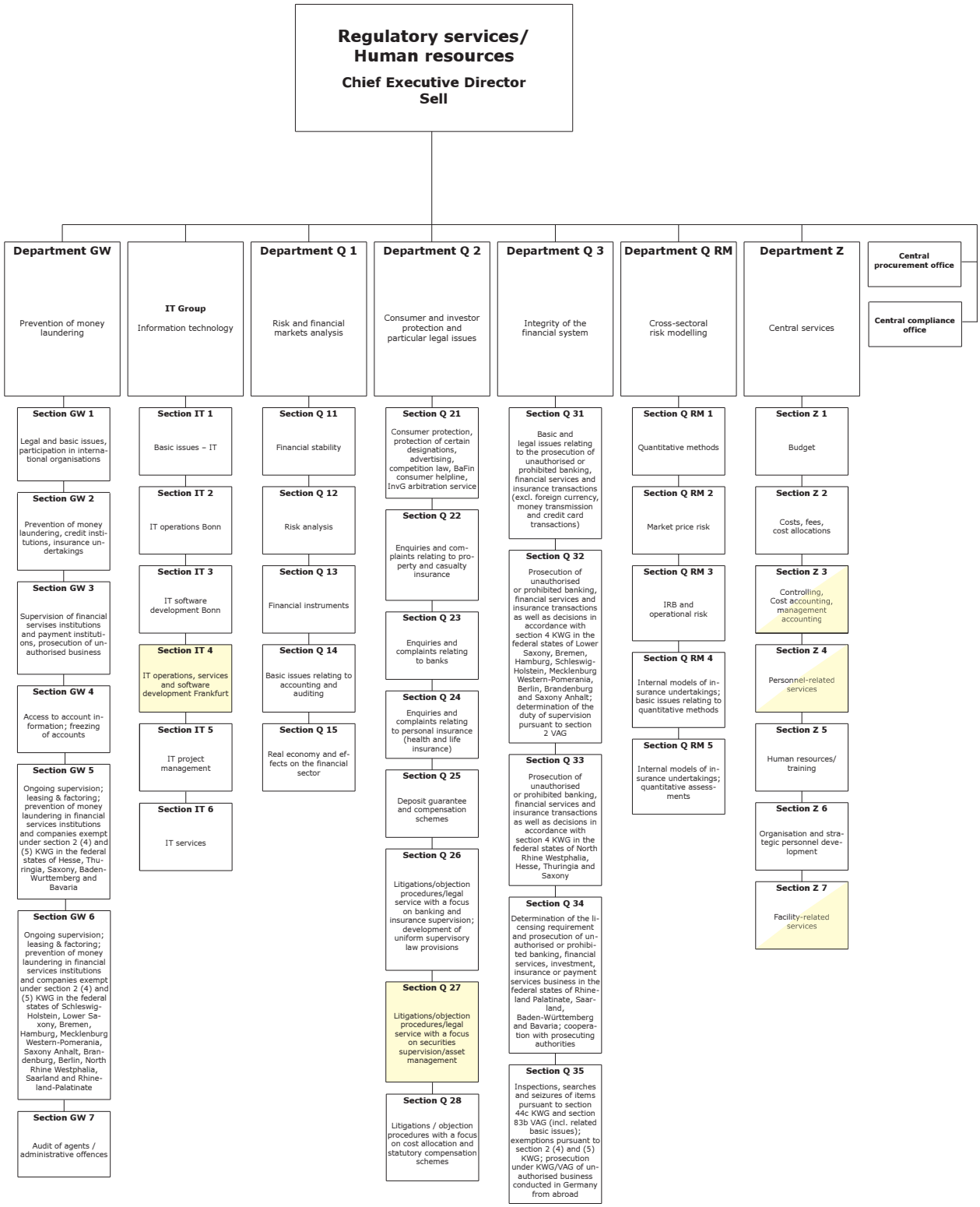
Offices in Bonn and Frankfurt

As at: December 2011


Banking Supervision
Chief Executive Director
Röseler
Department BA 1
Supervision of major banks and selected commercial banks
Section BA 11
Supervision of Deutsche Bank AG group
Section BA 12
Supervision of Deutsche Postbank AG and Sal. Oppenheim jr. & Cie. KGaA groups; Development of standards for operational supervision of SIFIs
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
Department BA 2
Supervision of *Landesbanks*, savings banks and building societies
Section BA 21
Supervision of BayernLB (incl. SaarLB), LBBW (incl. LRP), DekaBank and HeLaBa (incl. FraSpa)
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 LBB AG 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 basicl 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
Department BA 3
Supervision of commercial banks, regional and specialist banks, *Pfandbrief* banks, stockbrokers, securities trading banks; Pfandbrief competence centre
Section BA 31
- *Pfandbrief* comptence 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 and regional banks in the federal states of Hamburg, Hesse, Mecklenburg Western-Pomerania and Schleswig-Holstein including group credit instituti-ons; supervision of automotive banks and other group-related sales financing institutions operating throughout Germany
Section BA 34
Supervision of private and regional banks in the federal states of Bavaria, Berlin, Brandenburg, North Rhine Westphalia, Rhineland Palatinate, Schleswig-Holstein, Saxony and Thuringia including group credit institutions; supervision of specialist banks throughout Germany
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 36
Supervision of private and regional banks in the federal states of Baden Württemberg, Bremen, Lower Saxony and Saxony Anhalt including group credit institutions; supervision of development banks and guarantee banks throughout Germany
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
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.
Department BA 5
Basic issues department banking supervision
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
Section BA 56
Supervisory cross-checks
Section BA 57
Restructuring
Section BA 58
IT infrastructure of banks


Insurance and Pension Fund Supervision
Chief Executive Director Hahn
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. Aachen-Münchener 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/disclosure obligations pursuant to sections 30a-g WpHG (issuers A-K)
Section WA 13
Major holdings of voting rights/disclosure obligations pursuant to sections 30a-g WpHG (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 securities; 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; directors' dealings
Section WA 22
Ad hoc disclosure; 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 – G
Section PRO 2
Prospectuses – issuers H – Z
Section PRO 3
Non-securities investment prospectuses
Department WA 3
Supervision of FSIs in accordance with the Banking 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 of credit institutions; supervision of savings banks
Section WA 33
Rules of conduct of 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
Section WA 38
Rules of conduct of credit institutions; supervision of cooperative banks
Section WA 39
Rules of conduct of credit institutions; supervision of private banks
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 investment 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 (excluding 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 (excluding 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 (excluding real estate funds, hedge funds and other foreign non-UCITS)
Section WA 46
Supervision of asset management companies (KAGs), German investment funds; custodian banks, foreign UCITS, foreign non-UCITS (including hedge funds but excluding real estate funds) and venture capital companies


Regulatory services/ Human resources
Chief Executive Director Sell
Department GW
Prevention of money laundering
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 in the federal states of Hesse, Thuringia, Saxony, Baden-Wurttemberg and Bavaria
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 in the federal states of Schleswig-Holstein, Lower Saxony, Bremen, Hamburg, Mecklenburg Western-Pomerania, Saxony Anhalt, Brandenburg, Berlin, North Rhine Westphalia, Saarland and Rhineland-Palatinate
Section GW 7
Audit of agents / administrative offences
IT Group
Information technology
Section IT 1
Basic issues – IT
Section IT 2
IT operations Bonn
Section IT 3
IT software development Bonn
Section IT 4
IT operations, services and software development Frankfurt
Section IT 5
IT project management
Section IT 6
IT services
Department Q 1
Risk and financial markets analysis
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 economy and effects on the financial sector
Department Q 2
Consumer and investor protection and particular legal issues
Section Q 21
Consumer protection, protection of certain designations, advertising, competition law, BaFin consumer helpline, InvG arbitration service
Section Q 22
Enquiries and complaints relating to property and casualty insurance
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 28
Litigations / objection procedures with a focus on cost allocation and statutory compensation schemes
Department Q 3
Integrity of the financial system
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
Determination of the licensing requirement and prosecution of unauthorised or prohibited banking, financial services, investment, insurance or payment services business in the federal states of Rhineland Palatinate, Saarland, Baden-Württemberg and Bavaria; cooperation with prosecuting authorities
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
Department Q RM
Cross-sectoral risk modelling
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
Department Z
Central services
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
Central procurement office
Central compliance office

BaFin bodies

2.1 Members of the Administrative Council

Representing Federal Ministries
Jörg Asmussen (Chairman – BMF)
Dr. Rolf Wenzel (Deputy chairman – BMF)
Uwe Schröder (BMF)
Dr. Werner Kerkloh (BMF)
Christian Dobler (BMWi)
Erich Schaefer (BMJ)

Representing the Bundestag
MdB Klaus-Peter Flosbach
MdB Bartholomäus Kalb
MdB Manfred Zöllmer
MdB Frank Schäffler
MdB Dr. Axel Troost

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: April 2011

2.2 Members of the Advisory Board

Representing credit institutions
Dr. Hans-Joachim Massenberg (Chairman)
Dr. Karl-Peter Schackmann-Fallis
Gerhard P. Hofmann
Dr. Oliver Wagner
Dr. Hans Reckers
Andreas J. Zehnder

Representing insurance undertakings
N.N
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 the academic community
Prof. Andreas Hackethal
Prof. Fred Wagner
Prof. Isabel Schnabel

Representing the Working Party on Occupational Retirement Provision
Joachim Schwind

Representing consumer protection organisations
Stephan Kühnlenz (Stiftung Warentest)
Prof. Günter Hirsch (ombudsman for insurers)
Peter Gummer (DSGV ombudsman)

Representing liberal professions
Frank Rottenbacher (AfW)

Representing associations for SMEs
Dr. Peter König (DVFA)

Representing trade unions
Uwe Foullong (ver.di)

Representing industry
Folkhart Olschowy (Wacker Chemie AG)

As at: April 2011

2.3 Members of the Insurance Advisory Council

Dr. Helmut Aden	Member of the Executive Board, BVV Versicherungsverein des Bankverbandes a.G. Member of the Executive Board, aba
Prof. Dr. Christian Armbrüster	Higher Regional Court judge Freie Universität Berlin Faculty of Law
Dr. Alexander Barthel	German Confederation of Skilled Crafts *(Zentralverband des Deutschen Handwerks* – ZDH)
Beate-Kathrin Bextermöller	Financial services department Stiftung Warentest
Dr. Georg Bräuchle	Association of German Insurance Brokers Marsh GmbH (*Verband Deutscher Versicherungs-makler e.V.* – VDVM)
Lars Gatschke	Federation of German Consumer Organisations Financial services department (*Verbraucherzentrale Bundes-verband e.V.* – vzbv)
Ira Gloe-Semler	ver.di Financial services secretary
Norbert Heinen	Member of the Executive Board of German Actuarial Society (*Deutsche Aktuarvereinigung e.V.* – DAV)
Michael H. Heinz	President of Bundesverband Deutscher Versicherungskaufleute e.V.
Werner Hölzl	Auditor and tax adviser Member of the Executive Board of PricewaterhouseCoopers
Sabine Krummenerl	Member of the Executive Board, Provinzial Rheinland AG
Uwe Laue	Chairman of the Executive Board of Debeka Versicherungen
Dr. Ursula Lipowsky	Member of the Executive Board of Swiss Re Germany

Dr. Torsten Oletzky	Chairman of the Executive Board of ERGO Versicherungsgruppe AG
Prof. Dr. Catherine Pallenberg	Head of insurance studies at DHBW University, Stuttgart
Prof. Dr. Petra Pohlmann	Director of the Institute for International Business Law at the University of Münster
Prof. Dr. Heinrich R. Schradin	Managing Director of the Institute of Insurance Science at the University of Cologne
Reinhold Schulte	Chairman of the Association of Private Health Insurers (*Verband der privaten Krankenversicherung e.V.* – PKV) Chairman of the Executive Boards of 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	Insurance specialist, Consumer Centre NRW (Verbraucherzentrale NRW e.V.) Financial Services Group
Michael Wortberg	Insurance law specialist, Consumer Centre Rhineland-Palatinate (Verbraucherzentrale Rheinland-Pfalz e.V.)
Dr. Maximilian Zimmerer	Chairman of the Executive Board of Allianz Lebensversicherungs-AG, Private Krankenversicherungs-AG, Member of the Executive Board of Allianz Deutschland AG
Prof. Dr. Jochen Zimmermann	University of Bremen Faculty of Economics

As at: August 2011

2.4 Members of the Securities Council

Baden-Wuerttemberg State Ministry of Economics

Bavarian State Ministry for Economics, Infrastructure, Transport and Technology

Berlin Senate Department of Economics, Technology and Women's Issues

Ministry of Economic Affairs of the State of Brandenburg

Free Hanseatic City of Bremen Senator for Economic Affairs and Ports

Free and Hanseatic City of Hamburg Office of Economic Affairs and Labour

Ministry of Economics, Transport and Regional Development of the State of Hesse

Ministry of Economics, Labour and Tourism of the State of Mecklenburg-West Pomerania

Ministry for Economics, Labour and Transport of the State of Lower Saxony

Ministry of Finance of the State of North Rhine-Westphalia

Ministry of Economics, Transport, Agriculture and Viniculture of the State of Rhineland-Palatinate

Ministry of Economics and Science of the State of Saarland

Ministry of Economics and Labour of the State of Saxony

Ministry of Economics and Labour of the State of Saxony-Anhalt

Ministry of Science, Economics and Transport of the State of Schleswig-Holstein

Ministry of Finance of the State of Thuringia

As at: April 2011

Complaints statistics for individual undertakings

3.1 Explanatory notes on the statistics

For many years, BaFin has published complaints statistics in its annual report classified by insurance undertaking and class. The Higher Administrative Court in Berlin (*Oberverwaltungsgericht* – OVG) issued a ruling on 25 July 1995 (case ref.: OVG 8 B 16/94) ordering BaFin's predecessor, the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen* – BAV), to include this information.

In order to provide an indicator of the quality and volume of insurance business, the number of complaints that BaFin processed in full in 2010 is compared with the number of policies in the respective insurance class as at 31 December 2009. The individual undertakings report their existing business data. The information on existing business puts those insurers that recorded strong growth in the reporting period, often newly established undertakings, at a disadvantage because the new business generated in the course of the year that triggers complaints is not accounted for in the complaints statistics. Consequently, the statistics are of limited informational value in assessing the quality of individual undertakings.

In the life insurance class, the existing business figure specified for collective insurance relates to the number of insurance policies. Existing health insurance business is based on the number of natural persons with health insurance policies, rather than the number of insured persons under each premium rate, which is usually higher. These figures are not yet entirely reliable.

The property and casualty insurance figures relate to insured risks. The existing business figure increases if undertakings agree group policies with large numbers of insured persons.

Due to the limited disclosure requirements (section 51 (4) no. 1 sentence 4 of the Regulation on Insurance Accounting (*Verordnung über die Rechnungslegung von Versicherungsunternehmen* – RechVersV)), only the existing business figures for insurers whose gross premiums earned in 2009 exceeded €10 million in the respective insurance classes or types can be included. In the tables, no information on existing business (n.a.) is given for undertakings below the limit in the individual insurance classes.

The statistics do not include insurance undertakings operating within one of the classes listed that have not been the subject of complaints in the year under review.

As undertakings domiciled in other countries in the European Economic Area were not required to submit reports to BaFin, no data is given for the existing business of these insurers. The number of complaints is included in order to present a more complete picture.

3.2 Life insurance

Reg. no.	Name of insurance undertaking	Number of life insurance policies in 2009	Complaints
1001	AACHENMüNCHENER LEB.	5,491,895	108
1006	ALLIANZ LEBEN	10,244,339	230
1007	ALTE LEIPZIGER LEBEN	1,033,122	25
1035	ARAG LEBEN	334,231	25
1181	ASPECTA LEBEN	659,836	50
1303	ASSTEL LEBEN	338,522	34
1020	AXA LEBEN	1,848,546	65
1011	BARMENIA LEBEN	241,004	15
1012	BASLER LEBEN	164,233	9
1013	BAYER. BEAMTEN LEBEN	330,415	23
1015	BAYERN-VERS.	1,727,515	41
1122	CONCORDIA LEBEN	143,664	4
1021	CONDOR LEBEN	205,358	7
1078	CONTINENTALE LEBEN	643,473	9
1335	CONTINENTALE LV AG	n.a.	1
1022	COSMOS LEBEN	1,390,939	23
1146	DBV DEUTSCHE BEAMTEN	1,986,158	48
1023	DEBEKA LEBEN	3,328,388	31
1017	DELTA LLOYD LEBEN	558,213	28
1136	DEVK ALLG. LEBEN	714,814	11
1025	DEVK DT. EISENBAHN LV	744,520	2
1113	DIALOG LEBEN	249,674	1
1110	DIREKTE LEBEN	138,411	4
1148	DT. LEBENSVERS.	301,939	6
1028	DT. RING LEBEN	913,278	41
1180	DT. ÄRZTEVERSICHERUNG	196,220	7
1130	ERGO DIREKT LEBEN AG	1,272,350	27
1184	ERGO LEBEN AG	5,646,866	155
1107	EUROPA LEBEN	448,840	4
1310	FAMILIENFüRSORGE LV	279,723	8
1175	FAMILIENSCHUTZ LEBEN	115,693	1
1139	GENERALI LEBEN AG	5,139,468	145
1108	GOTHAER LEBEN AG	1,213,040	66
1040	HAMB. LEBEN	24,959	1
1312	HANNOVERSCHE LV AG	842,231	36
1114	HANSEMERKUR LEBEN	216,681	8
1033	HDI-GERLING LEBEN	2.059,448	100
1158	HEIDELBERGER LV	465,325	55
1137	HELVETIA LEBEN	129,807	7
1055	HUK-COBURG LEBEN	712,603	16
1047	IDEAL LEBEN	532,606	4
1048	IDUNA VEREINIGTE LV	2.062,999	48
1119	INTERRISK LEBENSVERS.	90,510	4
1045	KARLSRUHER LV AG	117,594	6
1054	LANDESLEBENSHILFE	21,086	1
1062	LEBENSVERS. VON 1871	710,833	21
1112	LVM LEBEN	765,684	12
1109	MECKLENBURG. LEBEN	162,275	3

Reg. no.	Name of insurance undertaking	Number of life insurance policies in 2009	Complaints
1064	MÜNCHEN. VEREIN LEBEN	145,634	2
1193	NECKERMANN LEBEN	64,942	1
1164	NEUE LEBEN LEBENSVERS	823,139	17
1147	NÜRNBG. LEBEN	3,032,110	127
1177	OECO CAPITAL LEBEN	24,324	6
1203	OERA OSTPREUSSEN I.L.	n.a.	1
1115	ONTOS LEBEN	44,065	3
1194	PB LEBENSVERSICHERUNG	364,553	23
1145	PBV LEBEN	941,112	51
1123	PLUS LEBEN	30,247	6
1309	PROTEKTOR LV AG	166,593	10
1081	PROV. LEBEN HANNOVER	851,185	6
1083	PROV.NORDWEST LEBEN	1,825,248	25
1082	PROV.RHEINLAND LEBEN	1,332,662	33
1141	R+V LEBENSVERS. AG	3,999,190	57
1018	RHEINLAND LEBEN	278,459	3
1168	SCHWESTERN VERS.	23,606	1
1157	SKANDIA LEBEN	367,829	25
1153	SPARK.-VERS.SACHS.LEB	455,070	4
1104	STUTTGARTER LEBEN	424,350	15
1091	SV SPARKASSENVERS.	1,723,756	24
1090	SWISS LIFE AG (CH)	948,843	23
1132	TARGO LEBEN AG	1,695,123	40
1152	UELZENER LEBEN	13,025	3
1092	UNIVERSA LEBEN	206,558	7
1140	VICTORIA LEBEN	2,260,940	100
1099	VOLKSWOHL-BUND LEBEN	1,278,243	32
1151	VORSORGE LEBEN	129,523	6
1160	VPV LEBEN	1,069,224	24
1103	WWK LEBEN	962,834	39
1005	WÜRTT. LEBEN	2,691,814	73
1138	ZURICH DTSCH. HEROLD	3,833,337	150

3.3 Health insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31 Dec. 2009	Complaints
4034	ALLIANZ PRIV.KV AG	2,425,665	169
4142	ALTE OLDENBURGER	145,233	3
4112	ARAG KRANKEN	420,435	36
4095	AXA KRANKEN	1,439,605	164
4042	BARMENIA KRANKEN	1,253,021	73
4134	BAYERISCHE BEAMTEN K	1,013,701	102
4104	BERUFSFEUERWEHR HANN.	1,336	1
4004	CENTRAL KRANKEN	1,796,836	133
4118	CONCORDIA KRANKEN	81,270	1
4001	CONTINENTALE KRANKEN	1,322,022	75
4028	DEBEKA KRANKEN	3,606,427	82
4131	DEVK KRANKENVERS.-AG	209,588	2
4044	DKV AG	3,193,688	248
4013	DT. RING KRANKEN	639,106	54
4121	ENVIVAS KRANKEN	258,650	1
4126	ERGO DIREKT KRANKEN	1,262,538	21
4053	FREIE ARZTKASSE	29,928	7
4119	GOTHAER KV AG	521,083	58
4043	HALLESCHE KRANKEN	603,697	59
4144	HANSEMERKUR KRANKEN_V	1,197,241	39
4122	HANSEMERKUR S.KRANKEN	4,123,787	6
4117	HUK-COBURG KRANKEN	859,182	42
4031	INTER KRANKEN	385,340	34
4011	LANDESKRANKENHILFE	409,988	22
4109	LVM KRANKEN	287,095	5
4123	MANNHEIMER KRANKEN	78,047	11
4037	MÜNCHEN.VEREIN KV	234,434	20
4125	NÜRNBG. KRANKEN	230,553	12
4080	OPEL AKTIV PLUS	100,709	1
4143	PAX-FAMILIENF.KV AG	153,170	2
4116	R+V KRANKEN	457,517	8
4002	SIGNAL KRANKEN	1,979,235	109
4039	SÜDDEUTSCHE KRANKEN	568,179	19
4108	UNION KRANKENVERS.	1,025,239	26
4045	UNIVERSA KRANKEN	360,836	32
4105	VICTORIA KRANKEN	1,232,486	30
4139	WÜRTT. KRANKEN	153,808	2

3.4 Motor vehicle insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5342	AACHENMüNCHENER VERS.	1,825,765	17
5135	ADAC AUTOVERSICHERUNG	691,095	19
5498	ADAC-SCHUTZBRIEF VERS	n.a.	2
5581	ADLER VERSICHERUNG AG	n.a.	1
5312	ALLIANZ VERS.	14,030,844	156
5441	ALLSECUR DEUTSCHLAND	793,286	21
5405	ALTE LEIPZIGER VERS.	477,149	3
5397	ASSTEL SACH	n.a.	11
5515	AXA VERS.	4,679,527	54
5593	BAD. ALLG. VERS.	155,653	3
5633	BASLER SECURITAS	448,089	16
5310	BAYER. BEAMTEN VERS.	246,287	5
5324	BAYER.VERS.VERB.AG	2,040,660	9
5146	BGV-VERSICHERUNG AG	n.a.	3
5098	BRUDERHILFE SACH.AG	385,541	8
5338	CONCORDIA VERS.	1,093,630	10
5339	CONDOR ALLG. VERS.	n.a.	1
5340	CONTINENTALE SACHVERS	402,928	3
5552	COSMOS VERS.	481,063	6
5529	D.A.S. VERS.	410,714	8
5343	DA DEUTSCHE ALLG.VER.	1,472,197	26
5311	DBV DT. BEAMTEN-VERS.	372,489	7
5549	DEBEKA ALLGEMEINE	714,122	2
5513	DEVK ALLG. VERS.	3,287,025	34
5344	DEVK DT. EISENB. SACH	973,335	2
5055	DIRECT LINE	684,187	40
5084	DTSCH. INTERNET	n.a.	1
5562	ERGO DIREKT	n.a.	6
5472	ERGO VERSICHERUNG	1,692,137	27
5508	EUROPA VERSICHERUNG	372,238	15
5470	FAHRLEHRERVERS.	305,315	3
5024	FEUERSOZIETÄT	206,594	13
5505	GARANTA VERS.	924,199	10
5473	GENERALI VERSICHERUNG	2,733,651	28
5589	GGG KFZ REPARATURVERS	n.a.	1
5858	GOTHAER ALLGEMEINE AG	1,166,322	10
5585	GVV-PRIVATVERSICH.	250,018	1
5420	HAMB. MANNHEIMER SACH	464,587	1
5131	HANNOVERSCHE DIREKT	n.a.	6
5085	HDI DIREKT	2,501,265	49
5512	HDI-GERLING FIRMEN	1,154,405	21
5096	HDI-GERLING INDUSTRIE	821,883	6
5384	HELVETIA VERS.	247,815	4
5375	HUK-COBURG	6,851,682	59
5521	HUK-COBURG ALLG. VERS	5,819,586	75
5086	HUK24 AG	1,883,874	31
5573	IDEAL VERS.	n.a.	1
5401	ITZEHOER VERSICHERUNG	785,941	4

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5078	JANITOS VERSICHERUNG	291,361	9
5058	KRAVAG-ALLGEMEINE	1,354,292	22
5080	KRAVAG-LOGISTIC	746,150	9
5362	LANDESSCHADENHILFE	n.a.	1
5402	LVM SACH	4,832,876	33
5412	MECKLENBURG. VERS.	776,331	7
5805	NEUE RECHTSSCHUTZ	n.a.	1
5426	NÜRNBG. ALLG.	213,932	8
5686	NÜRNBG. BEAMTEN ALLG.	283,066	4
5519	OPTIMA VERS.	n.a.	1
5787	OVAG - OSTDT. VERS.	n.a.	21
5446	PROV.NORD BRANDKASSE	686,409	1
5095	PROV.RHEINLAND VERS.	1,189,397	11
5438	R+V ALLGEMEINE VERS.	3,656,489	23
5137	R+V DIREKTVERSICHER.	n.a.	17
5798	RHEINLAND VERS. AG	215,584	6
5051	S DIREKTVERSICHERUNG	n.a.	7
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5125	SIGNAL IDUNA ALLG.	1,061,572	14
5036	SV SPARK.VERSICHER.	859,455	10
5462	UNITED SERVICES AUTO	n.a.	2
5463	UNIVERSA ALLG. VERS.	n.a.	1
5400	VGH LAND.BRAND.HAN.	1,832,686	7
5862	VHV ALLGEMEINE VERS.	4,194,983	53
5484	VOLKSWOHL-BUND SACH	107,201	3
5093	WESTF.PROV.VERS.AG	1,385,992	4
5525	WGV-VERSICHERUNG	781,534	7
5476	WWK ALLGEMEINE VERS.	300,381	3
5479	WÜRTT. GEMEINDE-VERS.	1,017,015	7
5783	WÜRTT. VERS.	2,338,557	35
5050	ZURICH VERS. AG	2,309,901	35

3.5 General liability insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5342	AACHENMüNCHENER VERS.	1,229,198	26
5581	ADLER VERSICHERUNG AG	n.a.	1
5809	ADVO CARD RS	n.a.	2
5370	ALLIANZ GLOBAL AG	2,979	2
5312	ALLIANZ VERS.	4,717,609	113
5405	ALTE LEIPZIGER VERS.	217,272	7
5455	ARAG ALLG. VERS.	21,242,959	6
5397	ASSTEL SACH	n.a.	5
5515	AXA VERS.	3,189,344	53
5316	BAD. GEMEINDE-VERS.	122,959	1
5792	BADEN-BADENER VERS.	n.a.	1
5633	BASLER SECURITAS	268,944	9
5310	BAYER. BEAMTEN VERS.	n.a.	1
5324	BAYER.VERS.VERB.AG	1,008,291	10
5338	CONCORDIA VERS.	340,086	17
5340	CONTINENTALE SACHVERS	319,571	10
5552	COSMOS VERS.	309,342	1
5529	D.A.S. VERS.	212,584	7
5343	DA DEUTSCHE ALLG.VER.	n.a.	4
5311	DBV DT. BEAMTEN-VERS.	442,790	6
5549	DEBEKA ALLGEMEINE	1,170,885	3
5513	DEVK ALLG. VERS.	1,056,544	7
5344	DEVK DT. EISENB. SACH	601,856	1
5350	DT. RING SACHVERS.	132,451	1
5582	DT. ÄRZTE-VERS. ALLG.	n.a.	1
5562	ERGO DIREKT	n.a.	2
5472	ERGO VERSICHERUNG	1,096,573	42
5508	EUROPA VERSICHERUNG	n.a.	1
5024	FEUERSOZIETÄT	135,815	3
5473	GENERALI VERSICHERUNG	1,911,573	26
5858	GOTHAER ALLGEMEINE AG	1,328,936	31
5469	GVV-KOMMUNALVERS.	2,856	5
5374	HAFTPFLICHTK.DARMST.	773,187	13
5032	HAMB. FEUERKASSE	n.a.	1
5420	HAMB. MANNHEIMER SACH	534,416	4
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI DIREKT	688,599	5
5512	HDI-GERLING FIRMEN	681,654	22
5096	HDI-GERLING INDUSTRIE	15,272	4
5384	HELVETIA VERS.	361,174	1
5375	HUK-COBURG	1,873,742	10
5521	HUK-COBURG ALLG. VERS	1,010,728	10
5086	HUK24 AG	269,918	2
5546	INTER ALLG. VERS.	133,390	6
5057	INTERLLOYD VERS.AG	n.a.	1
5080	KRAVAG-LOGISTIC	n.a.	1
5362	LANDESSCHADENHILFE	n.a.	1

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5402	LVM SACH	1,142,594	10
5412	MECKLENBURG. VERS.	271,395	4
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5414	MÜNCHEN. VEREIN ALLG.	65,919	2
5426	NÜRNBG. ALLG.	317,668	8
5446	PROV.NORD BRANDKASSE	391,444	3
5095	PROV.RHEINLAND VERS.	836,399	16
5438	R+V ALLGEMEINE VERS.	1,648,411	26
5798	RHEINLAND VERS. AG	97,976	5
5121	RHION VERSICHERUNG	107,789	2
5773	SAARLAND FEUERVERS.	86,081	1
5448	SCHWEIZER NATION.VERS	n.a.	1
5125	SIGNAL IDUNA ALLG.	550,523	16
5781	SPARK.-VERS.SACHS.ALL	n.a.	5
5586	STUTTGARTER VERS.	n.a.	2
5036	SV SPARK.VERSICHER.	815,408	6
5459	UELZENER ALLG. VERS.	160,341	1
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VERSICHERUNGSK.BAYERN	16,685	4
5400	VGH LAND.BRAND.HAN.	698,497	3
5862	VHV ALLGEMEINE VERS.	860,673	12
5484	VOLKSWOHL-BUND SACH	n.a.	2
5461	VPV ALLGEMEINE VERS.	n.a.	2
5093	WESTF.PROV.VERS.AG	803,891	7
5476	WWK ALLGEMEINE VERS.	n.a.	3
5479	WÜRTT. GEMEINDE-VERS.	268,611	2
5783	WÜRTT. VERS.	1,192,755	27
5050	ZURICH VERS. AG	983,527	18

3.6 Accident insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5342	AACHENMüNCHENER VERS.	1,652,018	21
5498	ADAC-SCHUTZBRIEF VERS	3,108,446	3
5581	ADLER VERSICHERUNG AG	224,659	1
5312	ALLIANZ VERS.	4,999,001	95
5455	ARAG ALLG. VERS.	20,499,570	7
5397	ASSTEL SACH	33,188	2
5515	AXA VERS.	1,000,968	12
5792	BADEN-BADENER VERS.	278,661	12
5317	BARMENIA ALLG. VERS.	126,415	3
5633	BASLER SECURITAS	149,499	3
5310	BAYER. BEAMTEN VERS.	166,638	3
5324	BAYER.VERS.VERB.AG	624,969	6
5338	CONCORDIA VERS.	301,856	8
5340	CONTINENTALE SACHVERS	699,996	6
5552	COSMOS VERS.	192,765	2
5529	D.A.S. VERS.	250,802	14
5311	DBV DT. BEAMTEN-VERS.	276,051	2
5549	DEBEKA ALLGEMEINE	1,775,135	3
5513	DEVK ALLG. VERS.	773,829	1
5344	DEVK DT. EISENB. SACH	264,260	1
5350	DT. RING SACHVERS.	369,202	8
5562	ERGO DIREKT	313,349	4
5472	ERGO VERSICHERUNG	882,698	73
5024	FEUERSOZIETÄT	49,140	2
5473	GENERALI VERSICHERUNG	2,927,509	23
5858	GOTHAER ALLGEMEINE AG	704,768	24
5420	HAMB. MANNHEIMER SACH	1,782,285	19
5085	HDI DIREKT	183,711	2
5512	HDI-GERLING FIRMEN	393,672	4
5384	HELVETIA VERS.	129,436	1
5375	HUK-COBURG	1,017,664	1
5573	IDEAL VERS.	22,642	1
5546	INTER ALLG. VERS.	137,935	1
5057	INTERLLOYD VERS.AG	56,251	2
5780	INTERRISK VERS.	394,298	2
5078	JANITOS VERSICHERUNG	127,186	2
5399	KRAVAG-SACH	16,378	4
5362	LANDESSCHADENHILFE	2,677	1
5402	LVM SACH	885,986	7
5412	MECKLENBURG. VERS.	139,064	5
5414	MÜNCHEN. VEREIN ALLG.	47,110	2
5015	NV-VERSICHERUNGEN	61,276	1
5426	NÜRNBG. ALLG.	615,641	27
5686	NÜRNBG. BEAMTEN ALLG.	102,224	1
5017	OSTANGLER BRANDGILDE	22,079	2
5074	PB VERSICHERUNG	45,340	1
5446	PROV.NORD BRANDKASSE	327,088	1
5095	PROV.RHEINLAND VERS.	1,014,146	11

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5583	PVAG POLIZEIVERS.	304,921	1
5438	R+V ALLGEMEINE VERS.	1,528,891	8
5798	RHEINLAND VERS. AG	73,308	1
5125	SIGNAL IDUNA ALLG.	1,802,216	25
5781	SPARK.-VERS.SACHS.ALL	70,713	2
5586	STUTTGARTER VERS.	484,037	15
5036	SV SPARK.VERSICHER.	286,106	1
5790	TARGO VERSICHERUNG	164,594	9
5463	UNIVERSA ALLG. VERS.	68,832	2
5511	VER. VERS.GES.DTSCHL.	109,243	1
5400	VGH LAND.BRAND.HAN.	5,509,978	1
5862	VHV ALLGEMEINE VERS.	306,084	1
5484	VOLKSWOHL-BUND SACH	180,760	2
5461	VPV ALLGEMEINE VERS.	155,025	1
5093	WESTF.PROV.VERS.AG	1,058,045	2
5525	WGV-VERSICHERUNG	75,897	1
5476	WWK ALLGEMEINE VERS.	218,815	9
5783	WÜRTT. VERS.	745,830	12
5590	WÜRZBURGER VERSICHER.	57,346	4
5050	ZURICH VERS. AG	2,441,268	10

3.7 Household contents insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5342	AACHENMüNCHENER VERS.	874,799	7
5312	ALLIANZ VERS.	2,735,402	42
5455	ARAG ALLG. VERS.	729,297	3
5397	ASSTEL SACH	n.a.	3
5515	AXA VERS.	1,238,950	9
5324	BAYER.VERS.VERB.AG	538,968	4
5338	CONCORDIA VERS.	216,491	2
5339	CONDOR ALLG. VERS.	n.a.	1
5004	CONSTANTIA	n.a.	1
5340	CONTINENTALE SACHVERS	160,903	2
5529	D.A.S. VERS.	132,441	3
5343	DA DEUTSCHE ALLG.VER.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	232,979	1
5549	DEBEKA ALLGEMEINE	707,370	4
5513	DEVK ALLG. VERS.	841,432	4
5472	ERGO VERSICHERUNG	662,817	16
5024	FEUERSOZIETÄT	n.a.	1
5473	GENERALI VERSICHERUNG	1,423,970	18
5858	GOTHAER ALLGEMEINE AG	732,936	10
5420	HAMB. MANNHEIMER SACH	395,071	4
5501	HANSEMERKUR ALLG.	n.a.	1
5085	HDI DIREKT	357,020	6
5512	HDI-GERLING FIRMEN	314,384	4
5375	HUK-COBURG	1,307,508	1
5521	HUK-COBURG ALLG. VERS	608,797	5
5362	LANDESSCHADENHILFE	n.a.	1
5404	LBN	n.a.	1
5402	LVM SACH	683,609	3
5061	MANNHEIMER VERS.	84,120	1
5412	MECKLENBURG. VERS.	169,731	1
5414	MÜNCHEN. VEREIN ALLG.	n.a.	1
5426	NÜRNBG. ALLG.	156,135	3
5446	PROV.NORD BRANDKASSE	296,777	3
5095	PROV.RHEINLAND VERS.	534,684	17
5438	R+V ALLGEMEINE VERS.	845,351	5
5125	SIGNAL IDUNA ALLG.	344,777	6
5586	STUTTGARTER VERS.	n.a.	2
5036	SV SPARK.VERSICHER.	427,749	1
5459	UELZENER ALLG. VERS.	n.a.	1
5862	VHV ALLGEMEINE VERS.	298,717	2
5461	VPV ALLGEMEINE VERS.	176,417	1
5093	WESTF.PROV.VERS.AG	2,411,924	3
5476	WWK ALLGEMEINE VERS.	n.a.	2
5480	WÜRTT. U. BADISCHE	n.a.	1
5783	WÜRTT. VERS.	789,276	12
5050	ZURICH VERS. AG	715,559	8

3.8 Residential building insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5342	AACHENMüNCHENER VERS.	338,918	2
5312	ALLIANZ VERS.	2,053,524	51
5405	ALTE LEIPZIGER VERS.	140,149	1
5397	ASSTEL SACH	n.a.	1
5515	AXA VERS.	675,044	10
5633	BASLER SECURITAS	162,912	3
5310	BAYER. BEAMTEN VERS.	n.a.	2
5043	BAYER.L-BRAND.VERS.AG	2,419,550	5
5324	BAYER.VERS.VERB.AG	585,310	1
5098	BRUDERHILFE SACH.AG	n.a.	1
5004	CONSTANTIA	n.a.	1
5340	CONTINENTALE SACHVERS	80,315	2
5529	D.A.S. VERS.	57,025	1
5771	DARAG DT. VERS.U.RÜCK	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	115,329	4
5549	DEBEKA ALLGEMEINE	220,496	3
5513	DEVK ALLG. VERS.	316,446	5
5472	ERGO VERSICHERUNG	347,876	6
5473	GENERALI VERSICHERUNG	573,532	8
5858	GOTHAER ALLGEMEINE AG	289,217	7
5485	GRUNDEIGENTÜMER-VERS.	67,705	1
5469	GVV-KOMMUNALVERS.	n.a.	1
5374	HAFTPFLICHTK.DARMST.	n.a.	1
5032	HAMB. FEUERKASSE	159,829	1
5420	HAMB. MANNHEIMER SACH	126,835	2
5085	HDI DIREKT	146,795	2
5512	HDI-GERLING FIRMEN	109,808	2
5384	HELVETIA VERS.	171,640	2
5375	HUK-COBURG	572,241	4
5521	HUK-COBURG ALLG. VERS	180,035	1
5546	INTER ALLG. VERS.	n.a.	1
5362	LANDESSCHADENHILFE	n.a.	2
5402	LVM SACH	479,619	9
5061	MANNHEIMER VERS.	54,196	1
5014	NEUENDORFER BRAND-BAU	n.a.	2
5016	NORDHEMMER VERS.	n.a.	1
5426	NÜRNBG. ALLG.	69,883	1
5017	OSTANGLER BRANDGILDE	n.a.	1
5446	PROV.NORD BRANDKASSE	321,471	4
5095	PROV.RHEINLAND VERS.	595,484	33
5438	R+V ALLGEMEINE VERS.	883,271	14
5798	RHEINLAND VERS. AG	n.a.	3
5773	SAARLAND FEUERVERS.	77,307	2
5491	SCHLESWIGER VERS.V.	n.a.	1
5448	SCHWEIZER NATION.VERS	n.a.	1
5125	SIGNAL IDUNA ALLG.	141,455	6
5781	SPARK.-VERS.SACHS.ALL	n.a.	1
5036	SV SPARK.VERSICHER.	2,259,238	15

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5463	UNIVERSA ALLG. VERS.	n.a.	1
5400	VGH LAND.BRAND.HAN.	476,793	2
5862	VHV ALLGEMEINE VERS.	86,682	1
5461	VPV ALLGEMEINE VERS.	63,858	2
5093	WESTF.PROV.VERS.AG	2,001,174	5
5525	WGV-VERSICHERUNG	62,956	2
5480	WÜRTT. U. BADISCHE	n.a.	3
5783	WÜRTT. VERS.	453,543	11
5050	ZURICH VERS. AG	390,832	3

3.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5826	ADAC-RECHTSSCHUTZ	2,618,701	6
5809	ADVO CARD RS	n.a.	62
5312	ALLIANZ VERS.	2,520,769	68
5825	ALLRECHT RECHTSSCHUTZ	252,426	6
5405	ALTE LEIPZIGER VERS.	413,996	32
5800	ARAG ALLG. RS	n.a.	59
5455	ARAG ALLG. VERS.	n.a.	3
5801	AUXILIA RS	n.a.	13
5515	AXA VERS.	n.a.	1
5792	BADEN-BADENER VERS.	n.a.	1
5838	BADISCHE RECHTSSCHUTZ	152,645	5
5310	BAYER. BEAMTEN VERS.	n.a.	5
5098	BRUDERHILFE SACH.AG	n.a.	4
5831	CONCORDIA RS	n.a.	12
5338	CONCORDIA VERS.	n.a.	3
5340	CONTINENTALE SACHVERS	77,914	2
5802	D.A.S. ALLG. RS	n.a.	92
5529	D.A.S. VERS.	n.a.	2
5343	DA DEUTSCHE ALLG.VER.	n.a.	3
5549	DEBEKA ALLGEMEINE	350,283	1
5803	DEURAG DT. RS	889,681	47
5513	DEVK ALLG. VERS.	n.a.	1
5829	DEVK RECHTSSCHUTZ	1,023,380	21
5129	DFV DEUTSCHE FAM.VERS	15,999	1
5055	DIRECT LINE	2,490	1
5834	DMB RECHTSSCHUTZ	771,841	13
5472	ERGO VERSICHERUNG	n.a.	2
5024	FEUERSOZIETÄT	n.a.	1
5858	GOTHAER ALLGEMEINE AG	n.a.	1
5828	HAMB. MANNHEIMER RS	414,937	8
5420	HAMB. MANNHEIMER SACH	n.a.	1
5512	HDI-GERLING FIRMEN	n.a.	1
5827	HDI-GERLING RECHT.	n.a.	19
5818	HUK-COBURG RS	1,524,879	19
5086	HUK24 AG	n.a.	1
5401	ITZEHOER VERSICHERUNG	43,697	1
5812	JURPARTNER RECHTSSCH.	n.a.	2
5362	LANDESSCHADENHILFE	n.a.	1
5815	LVM RECHTSSCHUTZ	712,701	12
5412	MECKLENBURG. VERS.	142,599	2
5805	NEUE RECHTSSCHUTZ	n.a.	20
5813	OERAG RECHTSSCHUTZ	1,278,640	46
5095	PROV.RHEINLAND VERS.	n.a.	2
5438	R+V ALLGEMEINE VERS.	n.a.	1
5836	R+V RECHTSSCHUTZ	637,069	9
5807	ROLAND RECHTSSCHUTZ	n.a.	54
5125	SIGNAL IDUNA ALLG.	n.a.	1
5586	STUTTGARTER VERS.	n.a.	1

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2009	Complaints
5459	UELZENER ALLG. VERS.	n.a.	2
5400	VGH LAND.BRAND.HAN.	175,693	1
5093	WESTF.PROV.VERS.AG	n.a.	1
5525	WGV-VERSICHERUNG	416,613	18
5479	WÜRTT. GEMEINDE-VERS.	n.a.	1
5783	WÜRTT. VERS.	641,520	17
5050	ZURICH VERS. AG	475,060	9

3.10 Insurers based in the EEA

Reg. no.	Abbreviated name of insurance undertaking	Complaints
5902	ACE EUROPEAN (GB)	6
9053	ADMIRAL INSURANCE(GB)	11
5636	AGA INTERNATION. (F)	22
5029	AIOI NISSAY (GB)	1
7239	ALLIANZ ELEMENT.L.(A)	1
7778	ALPHA INS. A/S (DK)	1
7671	ASPECTA ASSUR. (L)	2
7323	ASPIS PRONIA (GR)	3
5118	ASSURANT LEBEN (GB)	1
7203	ATLANTICLUX (L)	12
1324	ATLANTICLUX LEBEN (L)	16
5064	ATRADIUS KREDIT (NL)	3
7374	AXA ASSISTANCE (F)	1
5090	AXA CORPORATE S. (F)	6
1319	AXA LIFE EUR.LTD(IRL)	8
9146	AXA SUN LIFE (GB)	1
7760	BANK AUSTRIA (A)	1
7811	CACI LIFE LIM. (IRL)	3
1300	CANADA LIFE (IRL)	14
1182	CARDIF LEBEN (F)	5
5056	CARDIF VERS. (F)	23
5595	CHARTIS EUROPE (F)	10
5142	CHUBB INSUR. (GB)	1
7453	CLERICAL MED.INV.(GB)	18
7600	CMI INSURANCE (L)	1
7724	CREDIT LIFE INT. (NL)	25
7985	CSS VERSICHERUNG (FL)	12
5048	DOMESTIC AND GEN.(GB)	5
1161	EQUITABLE LIFE (GB)	1
5115	EUROMAF SA (F)	2
7813	FINANCELIFE (A)	1
5053	FINANCIAL INSUR.(GB)	5
7481	FORTUNA LEBEN (FL)	4
7814	FRIENDS PROVID. (GB)	1
9090	GROUPAMA PHOENIX (GR)	1
7270	HANSARD EUROPE (IRL)	2
5079	HISCOX INS. (GB)	1
5788	INTER PARTNER ASS.(B)	1
7587	INTERN.INSU.COR.(NL)	108
9031	LIBERTY EURO.(IRL/E)	8
7900	LIGHTHOUSE (GBZ)	2
7007	LLOYD'S OF LONDON(GB)	5
5054	LONDON GENERAL I.(GB)	4
5130	MAPFRE ASISTENC.(E)	2
7547	MONDIAL ASSIST. (NL)	2
7806	NEW TECHNOLOGY (IRL)	1
7723	PRISMALIFE AG (FL)	71
7455	PROBUS INSURANCE(IRL)	1
7894	QUANTUM LEBEN AG(FL)	1

Reg. no.	Abbreviated name of insurance undertaking	Complaints
1317	R+V LUXEMB. LV (L)	11
7415	R+V LUXEMBOURG L (L)	3
7730	RIMAXX (NL)	24
1172	SKANDIA LIFE (GB)	1
5127	SOGECAP RISQUES (F)	1
1320	STANDARD LIFE (GB)	11
7763	STONEBRIDGE (GB)	2
1311	VDV LEBEN INT. (GR)	13
7456	VDV LEBEN INTERN.(GR)	58
7643	VIENNA-LIFE (FL)	6
7483	VORSORGE LUXEMB. (L)	5
7929	ZURICH INSURANCE(IRL)	4

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List of abbreviations

A	**aba**	Arbeitsgemeinschaft für betriebliche Altersversorgung (Association of Company Pension Funds)
	ABS	asset-backed security
	ACP	Autorité de Controle Prudentiel (Prudential Control Authority)
	ACS	Actividades de Construcción y Servicios, S.A.
	AfW	Bundesverband Finanzdienstleistung e.V. (Federal Financial Services Association)
	AG	Aktiengesellschaft (German stock corporation)
	AGB	General Terms and Conditions
	AIFM	Alternative Investment Fund Managers
	AIG	American International Group
	AKIM	Arbeitskreis Interne Modelle (Internal Models Working Group)
	AltZertG	Altersvorsorgeverträge-Zertifizierungs-gesetz (Pension Contracts Certification Act)
	AMA	Advanced Measurement Approach
	AMLEG	Anti Money Laundering Expert Group
	AnlÄndV	Verordnung zur Änderung der Anlage-verordnung (Second Regulation Amending the Investment Regulation)
	AnlV	Investment Regulation
	AnsFug	Anlegerschutz- und Funktionsver-besserungsgesetz (Act to Increase Investor Protection and Improve the Functioning of the Capital Markets)
	AVAD	Auskunftsstelle über Versicherungs-/ Bausparkassenaußendienst und Versicherungsmakler in Deutschland e.V. (Information Office on the Insurance Industry/Building and Loan Association Sales Network and Insurance Brokers in Germany)
B	**BA**	Bankenaufsicht (Banking Supervision)
	BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
	BAKred	Bundesaufsichtsamt für das Kreditwesen (Federal Banking Supervisory Office)
	BAV	Bundesaufsichtsamt für das Versicherungs-wesen (Federal Insurance Supervisory Office)
	BAWe	Bundesaufsichtsamt für den Wertpapierhandel (Federal Securities Supervisory Office)
	BCBS	Basel Committee on Banking Supervision
	BdE	Banco de España (Bank of Spain)
	BdI	Banca d'Italia (Bank of Italy)
	BfDI	Bundesbeauftragter für den Datenschutz und die Informationsfreiheit (Federal Commissioner for Data Protection and Freedom of Information)

	BGB	Bürgerliches Gesetzbuch (Civil Code)
	BGBl.	Bundesgesetzblatt (Federal Law Gazette)
	BGH	Bundesgerichtshof (Federal Court of Justice)
	BIS	Bank for International Settlements
	BKA	Bundeskriminalamt (Federal Criminal Police Office)
	BMF	Bundesfinanzministerium (Federal Ministry of Finance)
	BMJ	Bundesjustizministerium (Federal Ministry of Justice)
	BMWi	Bundeswirtschaftsministerium (Federal Ministry of Economics and Technology)
	BO	branch office
	BSC	Banking Supervision Committee
	BT-Drs.	Bundestag publication
	BVerfG	Bundesverfassungsgericht (Federal Constitutional Court)
	BVerwG	Bundesverwaltungsgericht (Federal Administrative Court)
	BVI	Bundesverband Investment und Asset Management e.V. (German Investment and Asset Management Association)
	BVR	Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (National Association of German Cooperative Banks)
	BVV	Versicherungsverein des Bankgewerbes a.G.
	BZSt	Bundeszentralamt für Steuern (Federal Central Tax Office)
C	**C**	Circular
	CBS	cross-border provision of services
	CDO	collateralised debt obligation
	CDS	credit default swap
	CEBS	Committee of European Banking Supervisors
	CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
	CEIOPS FSC	CEIOPS Financial Stability Committee
	CESR	Committee of European Securities Regulators
	CFD	contract for difference
	CFTC	US Commodity Futures Trading Commission
	CI	capital investment(s)
	CLO	collateralised loan obligation
	CMBS	commercial mortgage backed security
	CNMV	Comisión Nacional del Mercado de Valores (National Securities Market Commission)
	CNSF	Comision Nacional de Seguros y Finanzas (National Insurance and Sureties Commission)
	Co.	Company
	COREP	Common Reporting
	CRD	Capital Requirements Directive
	CRSA	Credit Risk Standardised Approach
	CSA	Insurance Supervisory Commission
	CSRC	China Securities Regulatory Commission

D	**DAX**	Deutscher Aktienindex
	DeckRV	Deckungsrückstellungsverordnung (Regulation on the Principles Underlying the Calculation of the Premium Reserve)
	DerivateV	Derivateverordnung (Derivatives Regulation)
		Dubai Financial Services Authority
	DHBW	Duale Hochschule Baden-Württemberg
	Dir.	Directive
	DM	Deutsche Mark
	DNB	De Nederlandsche Bank
	DSGV	Deutscher Sparkassen- und Giroverband (German Savings Banks Association)
	DVFA	Deutsche Vereinigung für Finanzanalyse und Asset Management (Society of Investment Professionals in Germany)
E	**€**	euro
	EAA	Erste Abwicklungsanstalt
	EAEG	Einlagensicherungs- und Anlegerent-schädigungsgesetz (Deposit Guarantee and Investor Compensation Act)
	EBA	European Banking Authority
	EC	electronic cash/European Community
	ECB	European Central Bank
	ECJ	European Court of Justice
	Ecofin	Economic and Financial Council
	EdB	Entschädigungseinrichtung deutscher Banken (Compensation Scheme of German Banks)
	EdW	Entschädigungseinrichtung der Wertpapier-handelsunternehmen (Compensatory Fund of Securities Trading Companies)
	EEA	European Economic Area
	EFSA	Egyptian Financial Supervisory Authority
	EFSF	European Financial Stability Facility
	EFSM	European Financial Stabilisation Mechanism
	EG	Einführungsgesetz (Introductory Act)
	EIOPA	European Insurance and Occupational Pensions Authority
	ESCA	Emirates Securities and Commodities Authority
	ESFS	European System of Financial Supervisors
	ESMA	European Securities and Markets Authority
	ESRB	European Systemic Risk Board
	Est.	establishment
	EU	European Union
	e.V.	eingetragener Verein (registered association)
F	**FASB**	Financial Accounting Standards Board
	FATF	Financial Action Task Force on Money Laundering
	FBI	Federal Bureau of Investigation
	FDAX	DAX future
	FDIC	Federal Deposit Insurance Corporation
		et seq. and the following

	FinDAG	Finanzdienstleistungsaufsichtsgesetz (Act Establishing the Federal Financial Supervisory Authority)
	FinDAGKostV	Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem Finanzdienstleistungsaufsichtsgesetz (Regulation on the Imposition of Fees and Allocation of Costs Pursuant to the FinDAG)
	FINMA	Swiss Financial Market Supervisory Authority
	FINREP	Financial Reporting
	FinReq	Financial Requirements Expert Group
	FMA	Finanzmarktaufsicht (Austrian Financial Market Authority)
	FMS	Finanzmarktstabilisierungsfonds (Financial Market Stabilisation Fund)
	FMSA	Bundesanstalt für Finanzmarktstabilisierung (Federal Agency for Financial Market Stabilisation)
	FMStFG	Finanzmarktstabilisierungsfondsgesetz (Act Establishing a Financial Market Stabilisation Fund)
	FMStG	Finanzmarktstabilisierungsgesetz (Act Implementing a Package of Measures to Stabilise the Financial Market)
	FREP	Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung)
	FSA	Financial Services Authority
	FSB	Financial Stability Board
	FSC	Financial Stability Committee/ Financial Services Commission
	FSF	Financial Stability Forum
	FSI	Financial Stability Institute
	FSS	Financial Supervisory Service
G	**G20**	The Group of Twenty Finance Ministers and Central Bank Governors
	GbR	Gesellschaft bürgerlichen Rechts (German civil law partnership)
	GDV	Gesamtverband der deutschen Versicherungswirtschaft e.V. (German Insurance Association)
	GG	Grundgesetz (Basic Law)
	GM	General Meeting
	GmbH	Gesellschaft mit beschränkter Haftung (German private limited company)
	GroMiKV	Großkredit- und Millionenkreditverordnung (Regulation Governing Large Exposures and Loans of €1.5 million or More)
	GW	Geldwäsche (money laundering)
	GwG	Geldwäschegesetz (Money Laundering Act)
H	**HessVGH**	Hessischer Verwaltungsgerichtshof (Higher Administrative Court in Hesse)
	HFT	high-frequency trading
	HGB	Handelsgesetzbuch (Commercial Code)

I	**IADI**	International Association of Deposit Insurers
	IAIS	International Association of Insurance Supervisors
	IAIS FSC	IAIS Financial Stability Committee
	IASs	International Accounting Standards
	IASB	International Accounting Standards Board
	ICAAP	Internal Capital Adequacy Assessment Process
	ICPs	Insurance Core Principles
	ICRG	International Co-Operation Review Group
	IdW	Institut der Wirtschaftsprüfer in Deutschland e.V. (Institute of Public Auditors in Germany)
	IFG	Informationsfreiheitsgesetz (Freedom of Information Act)
	IFRSs	International Financial Reporting Standards
	IGSC	Insurance Groups Supervision Committee
	IGSRR	Internal Governance, Supervisory Review and Reporting Expert Group
	i.L.	in liquidation
	Inc.	incorporated company
	InstitutsVergV	Instituts-Vergütungsverordnung (Remuneration Regulation for Institutions)
	IntMod	Internal Model Expert Group
	InvG	Investmentgesetz (Investment Act)
	InvMaRisk	Mindestanforderungen an das Risiko-management für Investmentgesellschaften (Minimum Requirements for Risk Management in Asset Management Companies)
	IOPS	International Organisation of Pension Supervisors
	IOSCO	International Organization of Securities Commissions
	IP	investment portfolio
	IPO	Initial Public Offering
	IRBA	Internal Ratings Based Approach
	IRC	incremental risk charge
	IT	information technology
	IU	insurance undertaking
	IMF	International Monetary Fund
J	**JCFC**	Joint Committee on Financial Conglomerates
	JF	Joint Forum
K	**KAG**	Kapitalanlagegesellschaft (asset management company)
	KG	Kommanditgesellschaft (German limited partnership)
	KGaA	Kommanditgesellschaft auf Aktien (German joint stock company)
	KredReorgG	Kreditinstitute-Reorganisationsgsgesetz (Act on the Reorganisation of Credit Institutions)
	KWG	Kreditwesengesetz (Banking Act)
L	**LCR**	liquidity coverage ratio
	LG	Landgericht (Regional Court)
	LIBOR	London Interbank Offered Rate

	LKA	Landeskriminalamt (State Bureau of Investigation)
	Ltd.	Limited
	LI	life insurance
	LIU	life insurance undertaking
M	**M&A**	mergers & acquisitions
	MaComp	Mindestanforderungen an die Compliance (Minimum Requirements for the Compliance Function)
	MaRisk	Mindestanforderungen an das Risiko-management (Minimum Requirements for Risk Management)
	MAS	Monetary Authority of Singapore
	MCR	minimum capital requirement
	MdB	Mitglied des Bundestages (Member of the German Parliament)
	MFSA	Malta Financial Services Authority
	MiFID	Markets in Financial Instruments Directive
	MMoU	Multilateral Memorandum/a of Understanding
	MoU	Memorandum/a of Understanding
	MSCI	Morgan Stanley Capital International
	MTF	multilateral trading facility
N	**n.a.**	not applicable
	NPL	non-performing loans
	no.	number
	NSFR	net stable funding ratio
	NYSBD	New York State Banking Department
O	**OCC**	Office of the Comptroller of the Currency
	OECD	Organisation for Economic Cooperation and Development
	OIC	Office of Insurance Commission
	OIS	overnight index swap
	OJ	Official Journal
	OLG	Oberlandesgericht (Higher Regional Court)
	ORSA	Own Risk and Solvency Assessment
	OSFI	Office of the Superintendent of Financial Institutions Canada
	OTC	over-the-counter
	OVG	Oberverwaltungsgericht (Higher Administrative Court)
P	**p.**	page
	p.a.	per annum
	PfandBG	Pfandbriefgesetz (Pfandbrief Act)
	PF	pension fund
	PIIGS	Portugal, Ireland, Italy, Greece, Spain
Q	**QIS**	Quantitative Impact Study
R	**RechKredV**	Kreditinstituts-Rechungslegungsverordnung (Regulation on the Accounting of Banks and Financial Services Institutions)

	RechVersV	Verordnung über die Rechnungslegung von Versicherungsunternehmen (Regulation on Insurance Accounting)
	REIT	Real Estate Investment Trust
	RfB	Rückstellung für Beitragsrückerstattung (provision for bonuses and rebates)
	RMBS	residential mortgage backed security
S	**S.A.**	Société Anonyme
	S.a.r.l.	Société à Responsabilité Limitée
	SCR	solvency capital requirement
	SEC	US Securities and Exchange Commission
	SGB	Sozialgesetzbuch (Social Code)
	SIBs	systemically important banks
	SIFIs	systemically important financial institutions
	SoFFin	Sonderfonds Finanzmarktstabilisierung (Financial Market Stabilisation Fund)
	SolvV	Solvabilitätsverordnung (Solvency Regulation)
	S&P	Standard & Poor's
	SSG	Senior Supervisors Group
	StGB	Strafgesetzbuch (Criminal Code)
	StPO	Strafprozessordnung (Code of Criminal Procedure)
T	**Tacis**	Technical Assistance to the Commonwealth of Independent States
U	**UCITS**	Undertakings for Collective Investment in Transferable Securities
	UN	United Nations
	US	United States
	USA	United States of America
	USD	US dollars
	US GAAP	United States Generally Accepted Accounting Principles
V	**VA**	Versicherungsaufsicht (Insurance Supervision)
	VAG	Versicherungsaufsichtsgesetz (Insurance Supervision Act)
	ver.di	Vereinte Dienstleistungsgewerkschaft
	VerkprospG	Verkaufsprospektgesetz (Sales Prospectus Act)
	VerkProspGebV	Vermögensanlagen-Verkaufsprospekt-gebührenverordnung (Investment Sales Prospectus Fees Regulation)
	VermVerkProspV	Vermögensanlagen-Verkaufsprospekt-verordnung (Sales Prospectus Regulation)
	VersVergV	Versicherungs-Vergütungsverordnung (Remuneration Regulation for the Insurance Industry)
	VG	Verwaltungsgericht (Administrative Court)
	VGH	Verwaltungsgerichtshof (Higher Administrative Court)
	VO	Verordnung (Regulation)
	VwGO	Verwaltungsgerichtsordnung (Rules of the Administrative Courts)

	VVG	Versicherungsvertragsgesetz (Insurance Contract Act)
W	**WA**	Wertpapieraufsicht (Securities Supervision)
	WpHG	Wertpapierhandelsgesetz (Securities Trading Act)
	WpMiVoG	Gesetz zur Vorbeugung gegen missbräuchliche Wertpapier- und Derivategeschäfte (Act on the Prevention of Improper Securities and Derivatives Transactions)
	WpPG	Wertpapierprospektgesetz (Securities Prospectus Act)
	WpPGebV	Wertpapierprospektgebührenverordnung (Securities Prospectus Fees Regulation)
	WpÜG	Wertpapiererwerbs- und Übernahmegesetz (Securities Acquisition and Takeover Act)
Z	**ZAG**	Zahlungsdiensteaufsichtsgesetz (Payment Services Supervision Act)
	ZKA	Zentraler Kreditausschuss (Central Credit Committee)

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Federal Financial Supervisory Authority
Press and Public Relations Department
Graurheindorfer Str. 108, 53117 Bonn
Lurgiallee 12, 60439 Frankfurt am Main
Telephone: +49(0)228-4108-0
Facsimile: +49(0)228-4108-1550
Internet: www.bafin.de
E-Mail: poststelle@bafin.de

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