BaFin

'11

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

Preface

At the beginning of May 2012, BaFin can look back on its first ten years. The previously separate Federal Insurance, Banking and Securities Supervisory Offices merged in 2002 to form the integrated financial supervisor BaFin. The concept of integrated financial services supervision has proven its worth in practice. From today's perspective, the growing integration of the financial sectors is the most powerful argument in favour of a single supervisor.

For more than nine years of its ten-year history, BaFin was headed by Jochen Sanio. 2011 was the last year of his presidency. Jochen Sanio shaped BaFin. Both he and all other members of staff at BaFin deserve our gratitude and respect for what they have achieved for integrated financial services supervision in Germany – and hence for Germany as a financial centre. BaFin is based on solid foundations, which benefits the stability of the German financial system.

In its first ten years, BaFin adopted a path that will also serve it well for the future. It is a strong, effective supervisor that is also not afraid to make uncomfortable decisions. BaFin is quick to respond and – if required by the situation on the markets – flexible. In its supervisory activities, BaFin is predictable and creates transparency so that the entities it supervises can identify a clear, consistent approach and understand the supervisory decisions. As far as possible, BaFin adopts a preventive approach so as to contain risks in advance. And in the future, it will continue to exercise sound judgement in its supervisory activities and will champion the cause of judicious regulation in the international arena.

The underlying strategy has been clearly set out. Nevertheless, BaFin's work will undergo significant change. Since the financial crisis, supervision has become increasingly integrated at the international level. The European Union has taken far-reaching decisions in this respect; for Europe, it provides the legal framework that is missing at the global level. With its reform of the European supervisory architecture, culminating in the European System of Financial Supervision, the EU has taken a huge step in the right direction. BaFin is part of this system and will play a role in continuing its enhancement. BaFin is also represented in the global standard-setting bodies, such as the Basel Committee on Banking Supervision, that are formulating the global responses to the crisis, where it champions justified German interests.

The goal of all of BaFin's supervisory efforts is to ensure the sustainable stability of the financial markets – in Germany, Europe and across the globe.

BaFin can look back on another eventful year, and there will certainly be no shortage of challenges in the future, either. Basel III, Solvency II and EMIR are just three examples of many.

Bonn and Frankfurt am Main | April 2012

Dr Elke König
President

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I Introduction

Positive stress test results for German banks.

In the first half of 2011, the European Banking Authority (EBA) conducted a bank stress test in the member states of the European Union (EU) and Norway in cooperation with the national supervisory authorities, the European Central Bank (ECB) and the European Systemic Risk Board (ESRB). Stress tests subject institutions to hypothetical analyses of highly adverse but unlikely developments. They help with the assessment of whether the institutions' capitalisation is adequate, but do not represent a forecast of future capital requirements. Ninety-one banks, including 13 German institutions, participated in the stress test. All German participants who published their results in accordance with the EBA format achieved the minimum capital ratio required by the EBA. The average was considerably higher than the required Common Equity Tier 1 capital ratio of 5.0%.

ECOFIN calls for tougher capital adequacy standards.

To win back trust in the European banking sector, the ECOFIN Council decided at a special summit on 26 October 2011 to strengthen the capital position of the large, internationally active European institutions. The recapitalisation measure focused on building up a temporary capital buffer. The capital requirements for the 71 institutions selected by the EBA for its recapitalisation recommendation amount to a total of €114.7 billion. Around €13.1 billion of this total is attributable to the 13 German banks. Those institutions that need to recapitalise must reach this capital buffer by 30 June 2012 and then maintain it until further notice. They submitted their recapitalisation plans to the supervisory authority in January 2012.

Transposition of the Solvency II Framework Directive into national law.

The government draft for the Tenth Act Amending the Insurance Supervision Act (*Zehntes Gesetz zur Änderung des Versicherungsaufsichtsgesetzes*), which is designed to transpose the European Solvency II Framework Directive into German law, was published on 15 February 2012. Under this, the future Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) will cover three different supervisory regimes: in addition to rules for insurance undertakings that fall within the Solvency II regime, it contains provisions for undertakings that are not within the scope of Solvency II. On the one hand, these include funeral expenses funds as well as small insurance undertakings that will continue to be governed by the existing rules (Solvency I) because of their size. On the other, this relates to *Pensionskassen* and pension funds, which – as institutions for occupational retirement provision – are subject to their own directive-based regime. Consequential amendments to a range of regulations are necessary in addition to the amendments to the VAG.

The transposition is being made more difficult by the fact that adoption of the Omnibus II Directive (which will amend the Framework Directive) has been delayed. This largely affects the rules governing delegated acts and the technical standards, as well as the role of EIOPA. A further objective is to establish a legal basis for issuing the transitional provisions governing the Solvency II rules. The European Commission published the draft Omnibus II Directive in January 2011. A general consensus was already achieved in the Committee of Member States' Permanent Representatives (COREPER) on 28 September 2011.

In contrast to the original timetable, the "trialogue" – which is designed to reach agreement between the Council, the Commission and the European Parliament – did not start in 2011. The trialogue negotiations are now starting under the Danish Council Presidency with the goal of completing them while Denmark still holds the Presidency. For this reason, the Omnibus II Directive is not expected to be published before the autumn of 2012. The application of all aspects of Solvency II will probably be postponed to the beginning of 2014.

Germany's insurance industry remains stable.

The German insurance industry again remained stable in 2011. However, insurers are still operating in a difficult economic environment marked by low interest rates and a high level of government debt in Europe.

BaFin therefore conducted another survey of the impact of low interest rates at the life insurers in 2011. This indicated that the investment income of the sector in the defined low interest rate scenario would be sufficient to fund the guaranteed return for a total of 15 years, but that the simultaneous growth in the "*Zinszusatzreserve*" (an additional provision to the premium reserve introduced in response to the lower interest rate environment) and the participation of the policyholders in the valuation reserves will represent considerable additional burdens. A similar survey at the *Pensionskassen* indicated that they will probably be able to pay the promised benefits even if the period of low interest rates persists. Many of them have already responded to the declining interest rates and have initiated countermeasures.

In response to the high level of sovereign debt, BaFin decided in June 2011 to tolerate government bonds that are rated as "in default" in insurers' restricted assets for as long as the guarantee issued by the European Stability Mechanism is in force (2013). BaFin will also continue to tolerate exceedances by insurers of the 5% high-yield ratio resulting from downgrades of government bonds. The aim is to mitigate procyclical effects, bolster financial market stability and limit losses at the affected insurers. A survey of life insurers also indicated that the undertakings are actively managing their country risks by only investing to a limited extent in Portugal, Ireland, Italy, Greece and Spain (the "PIIGS" countries).

The fact that the individual sectors making up the financial market are not fully isolated from each other represents a further potential risk. Cross-sectoral and cross-border cooperation is therefore

becoming increasingly important for BaFin. The objective is to identify and monitor any potential risk of contagion.

New notification requirements for financial instruments.

The notification requirement for financial instruments was extended in February 2012. Among other things, it now also applies to retransfer claims under securities lending transactions and cash-settled financial instruments. This will further strengthen the upward trend in the number of voting rights notifications. In 2011, 5,929 voting rights notifications, i.e. changes in the shareholder structure of listed companies, were reported to BaFin. This was a considerable increase compared with the previous year (5,439). The number of notifications relating to financial instruments issued was 135, compared with 57 in 2010.

Deutsche Börse/NYSE merger collapses.

On 15 February 2011, Deutsche Börse AG and NYSE Euronext announced their intention to merge and form a joint stock exchange operator with a global reach. The related takeover offer by Alpha Beta Netherlands N.V. to the shareholders of Deutsche Börse AG attracted great public interest and occupied BaFin for several months. The European Commission prohibited the merger on 1 February 2012 for competition law reasons.

Large number of reports of suspected spam campaigns.

The number of suspicious transaction reports received by BaFin relating to market manipulation and insider trading also rose significantly: there were 473 reports in 2011, following 241 in 2010. Many of the reports related to spam campaigns. The institutions also filed a large number of reports on instruments such as warrants, certificates and funds, as well as cases of unauthorised order placement by telephone.

BaFin criticises product information documents for financial instruments.

Since 1 July 2011, investment services enterprises supplying investment advice to their retail clients have to provide them with a short, easy-to-understand information document for each financial instrument they recommend in good time before any transaction is executed. The information document must enable the client to understand the nature of the financial instrument and how it works. The client should be in a position to assess the associated risks, the prospects for repayment of the amount invested and the returns in different market conditions, as well as the costs associated with the investment, and be able to compare them with other financial instruments. BaFin examined the comparability of around 130 product information documents and identified deficiencies. In many cases, information was missing in its entirety, while in others, the descriptions of the products and how they work, the risks and the costs were only imprecise or abstract. BaFin criticised severe breaches at the institutions and associations; this prompted many companies to announce amendments to their information documents. BaFin will track implementation of the amendments.

Fund rules amended.

In addition to dealing with the fallout from the crisis, the fund sector's main focus in 2011 was on the transposition of the UCITS IV Directive into German law. BaFin was involved in the creation of the legal framework. It was able to approve the amended fund rules for UCITS funds in good time as at 1 July 2011. In addition,

BaFin used workshops and seminars to provide information about the new requirements at both national and European level.

Registration procedures for rating agencies.

BaFin was heavily involved in the registration of rating agencies in 2011. The registration procedures that have been mandated in the EU since 2010 have tied up considerable resources. BaFin approved eight of the 11 applications received from mid-sized German rating agencies; three applications were withdrawn. BaFin also dealt with enquiries and complaints about the activities of rating agencies and was involved at European level in the cross-border registration procedures for the large rating agencies. The European Securities and Markets Authority (ESMA) has been supervising the rating agencies since 1 July 2011. BaFin and the other European supervisory authorities are involved in the registration procedures and in the development of European regulatory technical standards through their membership of various internal bodies at ESMA.

Measures relating to the risks of exchange-traded funds.

A number of international institutions, including the Financial Stability Board (FSB) and the Bank for International Settlements (BIS), voiced criticism of exchange-traded funds (ETFs) in 2011 in view of the massively growing market for this form of investment. ETFs are listed, exchange-traded, predominantly passively managed investment funds that normally track the performance of an index. The criticism refers in particular to synthetic replication ETFs, which account for 64% of the market in Europe. Attention was drawn to the rapid growth and speed of innovation of newly created products, as well as to the growing complexity and the associated low level of transparency. The institutions also have concerns about additional counterparty credit risk.

ESMA was prompted by this trend to develop new European standards for ETFs. In September 2011, it initiated a consultation process by issuing an initial discussion paper; BaFin representatives were involved in drafting this discussion paper, whose primary goal is to improve transparency.

Oversight and regulation of shadow banks.

At the beginning of November 2011, the G20 heads of state and government approved the FSB's recommendations on strengthening the oversight and regulation of shadow banks. This involves a three-step approach. The first stage of monitoring involves using "macro mapping" to obtain a rough overview of the extent of activities. The purpose of the second step in the monitoring process is to more closely examine the individual risk factors derived from non-bank credit intermediation. In addition to assessing systemic risks, the competent authorities should also follow up indications of regulatory arbitrage. In the third step in the monitoring process, the potential negative impact of individual risks must be assessed. Among other things, the focus here is on an analysis of the links to the banking system, on the size and extent of individual shadow banking entities and activities, and on monitoring earnings indicators.

As regards the regulatory framework, the FSB opted for both direct regulation of shadow banks and indirect regulation, i.e. regulation of shadow banks' links to the banking sector. This combination

makes the regulation of shadow banks generally more robust and limits the opportunities for arbitrage. The Basel Committee on Banking Supervision will prepare recommendations on indirect regulation by the summer of 2012. The FSB is having recommendations on direct regulation drawn up by its own working groups. Additionally, the International Organization of Securities Commissions (IOSCO) will look into possible regulatory measures related to money market funds so as to reduce systemic risks and vulnerability to a run. In coordination with the Basel Committee, it is also examining the extent to which retention requirements for securitisations and measures to enhance the transparency and standardisation of securitisation products have been implemented at national level.

Collective forms of investment may be part of the shadow banking system.

Certain forms of collective investment such as hedge funds also play an important role in the debate over the regulation of shadow banks. Among other things, the European AIFM Directive[1] which came into force in mid-2011 and which must be transposed into national law by 22 July 2013 includes within its wide scope managers of funds that are not already governed by the UCITS Directive.[2] They are subject to extensive obligations to provide information, including to supervisory authorities. The AIFM Directive also contains detailed provisions on cooperation between the national supervisory authorities, ESMA and the European Systemic Risk Board (ERSB), thereby improving the information available for systemic supervision and the basis on which supervisors carry out their duties in this area. In addition, the new rules provide supervisory authorities with specific supervisory tools for enforcement, such as restricting leverage and trading in units, as well as withdrawing authorisation. The detailed rules on the AIFM Directive are currently being developed.

More supervision and new rules for systemically important banks.

One of the lessons learned from the recent financial market crisis is to fundamentally reorganise and institutionalise the oversight and regulation of global systemically important financial institutions (G-SIFIs). On behalf of the FSB, the Basel Committee therefore developed new requirements for global systemically important banks (G-SIBs) during the year under review that were endorsed by the G20 heads of state and government in November 2011.

These rules will see the Basel Committee selecting the 75 largest global banking groups each year; national supervisors may report further potential G-SIB candidates at their supervisory discretion. The Basel Committee will then assess the systemic importance of the institutions that are selected or reported and will classify them into five categories of systemic importance (buckets). In future, the G-SIBs will be subject to stricter supervision and regulation, including increased capital requirements that will depend on the category of systemic importance concerned. The member states will transpose the SIFI framework into national legislation in the coming years, though extensive transition periods will apply.

[1] Directive 2011/61/EU, OJ EU L 174/1.
[2] Directive 2009/65/EU, OJ EU L 302.

In November 2011, the FSB published a list of 29 banking groups currently classifiable as G-SIBs. The German institutions on this list are Deutsche Bank AG and Commerzbank AG. Under the FSB's plans, domestic SIFIs will also receive special regulatory treatment in future. The Basel Committee is currently working on this issue.

Dealing with potentially systemically important insurers.

In light of the G20 decisions on SIFIs and in consultation with the FSB, the Financial Stability Committee (FSC) of the International Association of Insurance Supervisors (IAIS) is currently developing a methodology for identifying potential global systemically important insurers (G-SIIs). One of the questions that must be addressed is whether there are in fact any globally systemically important insurers. The FSC issued a paper in November 2011 which concludes that insurers who concentrated on their core business do not represent a systemic risk. However, it stated that the crisis has shown that insurance groups and financial conglomerates that engage in non-traditional or non-insurance activities are particularly vulnerable.

At the same time as identifying any G-SIIs, the IAIS is currently working on a regulatory regime for such insurers that would then have to be implemented nationally so that it can be applied to the undertakings concerned. It must ensure that regulatory arbitrage is not possible – either within the insurance sector or between the banking and insurance sectors. The FSB and the national supervisory authorities are expected to take final decisions on insurers' G-SIFI status by the beginning of 2013. Until then, the IAIS will also draw up more detailed statements on the regulatory regime. Subsequent to that, the question must be addressed as to whether there are also SIIs at European or national level and how they should be treated by regulators.

Resolution of SIFIs.

At the beginning of November 2011, the G20 heads of state and government endorsed the twelve "Key Attributes of Effective Resolution Regimes" for Systemically Important Financial Institutions; these had been drawn up by the FSB and are primarily aimed at bank supervisors. Among other things, they contain guidance on crisis management and make it easier for the national supervisory and resolution authorities to collaborate more closely. The objective is to enable the resolution of financial institutions without severe systemic disruption and, at the same time, to protect vital economic functions of the institutions. Shareholders and creditors should shoulder part of the losses in the event of liquidation so as to minimise the taxpayers' exposure. The FSB expects the institution-specific recovery and resolution plans to be in place by the end of 2012; cross-checks of the measures introduced in the individual member states are due to be made in 2013.

The issue of resolution was also on the insurance supervisors' agenda in the year under review: in mid-2011, the IAIS published a general paper illustrating the problems related to resolution and outlining initial thoughts on possible solutions. The study is based on the above-mentioned FSB "Key Attributes".

Implementation of Basel III – CRD IV and CRR.

On 20 July 2011, the European Commission published its proposal for CRD IV in the course of the transposition of Basel III into European law. This represents the third set of fundamental amendments to the Capital Requirements Directive (CRD), which transposed the Basel II rules into European law in 2006. CRD IV differs from the two previous amending directives in two key points. Firstly, it not only amends individual provisions of the Banking Directive[3] and the Capital Adequacy Directive[4], which have so far made up the CRD, but rather completely replaces the existing rules. Secondly, significant elements will be transferred to a directly applicable EU regulation, the Capital Requirements Regulation (CRR). This will contain in particular requirements that apply directly to the institutions, such as the definition of own funds, the minimum capital requirements, the liquidity requirements and the leverage ratio. The directive component, on the other hand, contains the provisions addressed to the national supervisory authorities or that require them to intervene. In addition to the provisions on supervisory cooperation, these include the rules governing the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) under Pillar 2, as well as those governing the authorisation procedure, shareholder control, and supervisory measures and sanctions.

Under the draft published by the European Commission, CRD IV and the CRR will be supplemented by well over 100 binding regulatory and implementing technical standards covering regulation and reporting; these will be developed by the EBA and issued by the European Commission in the form of EU regulations. EU lawmakers thus aim to ensure that the provisions are applied consistently in all European states. Consultations with the banking industry to discuss the new reporting requirements are expected to be held as early as summer 2012. In principle, the new rules will take effect as at 1 January 2013; certain transition periods will apply until 1 January 2019. In Germany, in particular the Solvency Regulation (*Solvabilitätsverordnung* - SolvV) and the Regulation Governing Large Exposures and Loans of €1.5 Million or More (*Groß- und Millionenkreditverordnung* - GroMiKV), as well as the Banking Act (*Kreditwesengesetz* - KWG), will have to be aligned with the new European legislation. The directive component must be transposed into national law.

[3] Directive 2006/48/EC, OJ EU L 177/1.
[4] Directive 2006/49/EC, OJ EU L 177/201.

II Economic environment

1 Sovereign debt crisis

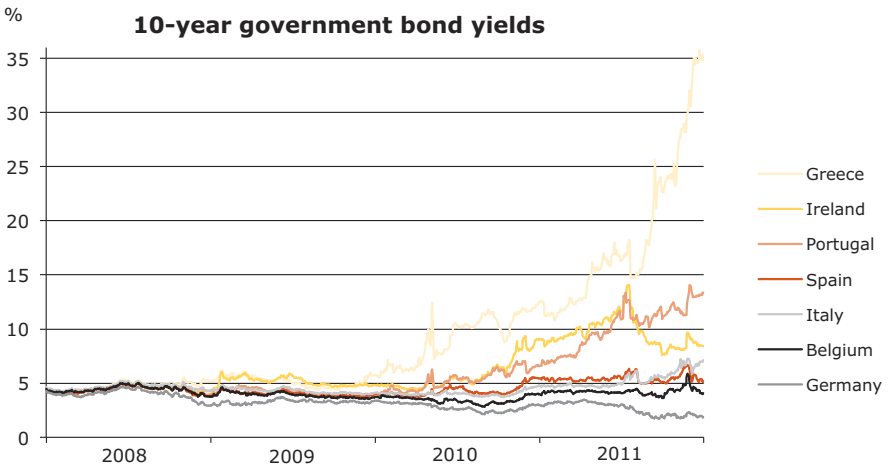
Government finances fuelling risk in Europe.

The sovereign debt crisis worsened in the second half of 2011, turning into the main risk to financial stability in Europe and adding a new dimension to the financial crisis, which had been smouldering since 2007. Public-sector debt securities issued by some highly developed industrialised countries – especially in the eurozone – have all but lost their status as a risk-free investment. At first, the focus was on individual eurozone countries. Greece and Ireland had already accepted financial aid in 2010 to guarantee their solvency. Portugal followed suit in spring 2011, after the markets had increasingly questioned the solidity of its public finances and spreads had risen sharply. In May, the European Union (EU), together with the International Monetary Fund (IMF), put together a €78 billion rescue package for Portugal.

The road towards Greek debt restructuring.

Shortly afterwards it emerged that Greece would need a second bailout package and would not be able to return to the capital market on its own in 2013, as had been planned. The yield on ten-year Greek government bonds shot up as a result, reaching 35% at the end of the year. The drastic increase reflected the market's expectation that debt restructuring entailing considerable losses for creditors would be unavoidable. During the negotiations, the private lenders initially agreed to participate voluntarily in a technical write-down of 21%. Soon, however, there was growing certainty that this amount would not be enough to put Greece's public finances on a sustainable footing. At a crisis summit in autumn 2011, the eurozone heads of state and government demanded that the private sector agree to voluntarily swap the bonds they held and to accept a write-down of 50% on the nominal value. In February 2012, representatives of the Greek transitional government and private creditors agreed on a 53.5% haircut. However, the actual amount of debt waived is significantly higher, because the new bonds have longer maturities and a lower coupon rate. This has put additional strain on the already stretched balance sheets of the banks and insurance companies affected.

Figure 1
Interest rate differentials in Europe



Source: Bloomberg

Mounting problems in Italy and Spain.

The financial problems in Spain and, above all, in Italy also increasingly took centre stage in the second half of 2011. The two countries' funding costs on the capital market increased sharply. Although the situation in Spain eased somewhat towards the end of the year, the spread for Italian sovereign bonds remained at an elevated level. At the end of 2011, the spread on ten-year bonds was more than five percentage points higher than the ten-year Bund yield.

The turbulence caused by Spain's and Italy's strained financial situation led to increasing concern that the European Financial Stability Facility (EFSF) might be underfunded if it had to deal with an emergency and that the financial strength of the remaining donor countries would not be sufficient to prevent the default of a major country. The EU heads of government therefore resolved in October to leverage the EFSF in order to multiply its firepower by giving greater incentives to private and public-sector investors. Against this backdrop, even some core eurozone countries temporarily became the focus of market attention. For example, the difference between the yields on French and German government bonds widened significantly in the autumn, before the situation eased again towards the end of the year.

Progress in Ireland.

However, the sovereign debt crisis did not intensify everywhere in Europe. Ireland made visible progress in consolidating its budget in 2011. In November 2010, it had become the first country to accept help from the EFSF, after rescuing its collapsed domestic banking sector had proved too much for it to cope with. Credible austerity measures and strong exports helped Ireland gradually to regain the confidence of the markets. The yield on ten-year Irish government bonds almost halved in the space of three months from their July 2011 level of 14% before rising again to over 8% towards the end of the year; nevertheless, this meant that funding

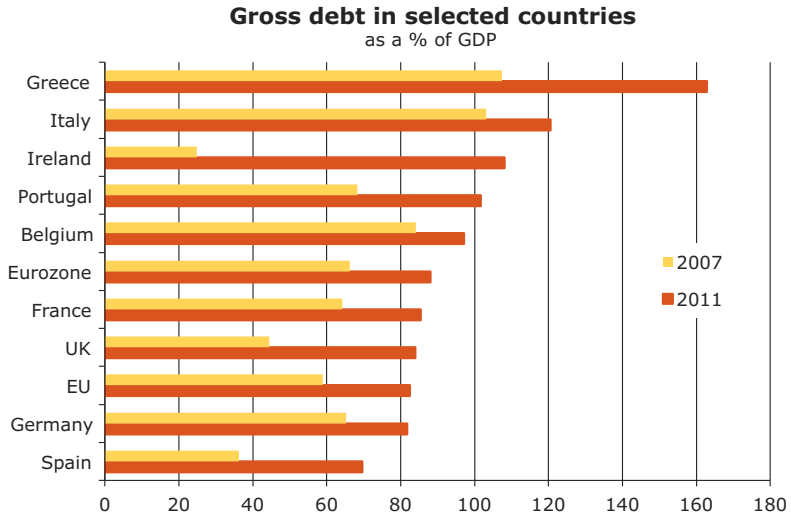
costs on the capital market were still too high to stabilise the country's budget at a sustainable level. Ireland therefore continued to depend on payments from the bail-out fund.

Increase in sovereign debt throughout the whole of Europe.

Since the start of the financial crisis, the sovereign debt ratios have increased in all EU member states, with the exception of Sweden. In the European Union as a whole, gross public-sector debt rose from 59% of gross domestic product (GDP) in 2007 to 82.5% in 2011. The eurozone crisis countries were particularly badly affected. In Ireland, whose government finances had been very healthy before the crisis, the debt ratio increased by a factor of more than four during this period. At over 160%, Greece was still at the top of the list by a wide margin in 2011. No country can cope with this level of public-sector debt in the long term. The debt restructuring, including private creditor participation, that has been resolved is intended to reduce this ratio significantly. However, even in the United Kingdom, which is not a member of the eurozone, the debt-to-GDP ratio almost doubled in the past four years, from 44% to 84%. The increase in sovereign debt was relatively moderate in Germany; it grew from 65% of GDP in 2007 to just under 82%. Nevertheless, this ratio is well in excess of the Maastricht criterion (60%). What is important now is that countries with overstretched public finances systematically continue the consolidation course they have embarked on and hence avoid the risk of losing the confidence of the capital markets altogether.

Figure 2

Sovereign debt ratios in Europe



Source: Eurostat/European Commission estimate (November 2011)

High sovereign debt levels also exist in other parts of the world.

As in the previous year, the main focus of the financial markets' attention in 2011 was on the sovereign debt crisis in Europe. However, the health of public finances in some other highly developed economies of the world is no better. For example, Japan's national debt was more than twice its gross domestic product, resulting in a leverage ratio substantially higher than that of Greece. Public finances in the United States, where the financial crisis had its origins in the subprime mortgage market, also deteriorated rapidly. In 2011, federal debt already accounted for 100% of economic output, around 38 percentage points more than before the outbreak of the crisis in 2007. A further sharp rise is inevitable since the extremely expansionary fiscal policy pursued in 2008 and 2009 to rescue the banks and stimulate the economy continues to have an effect and the political parties were unable at the end of 2011 to agree on a joint austerity package in the required amount of US$1.2 trillion to reduce the debt burden.

The economy is slowing down.

The measures to rebuild public finances taken in many crisis-hit European countries had an increasing impact on the economy in the course of 2011. Tax increases, redundancies in the public sector as well as wage and pension cuts dampened private consumption, especially in the peripheral eurozone countries. In addition, reduced public-sector expenditure led to a fall in government demand. Greece sank into a deep economic depression. Portugal's total economic output also contracted sharply. Several other eurozone countries faced recession in 2011. In Germany, too, the pace of growth slowed in the course of the year. The effects of economic support measures for the financial sector, which still had a significant impact in 2010 and at the beginning of 2011, began to wane again.

The German economy had recovered quickly from the sharp downturn in 2008/2009 that was triggered by the financial crisis. The recovery was buoyant. In the second quarter of 2011, gross domestic product had regained the level it had had before the deep recession set in. Against this backdrop, it is not unusual for growth to decelerate somewhat. On the whole, however, the state of the German economy was healthy in 2011. The number of corporate insolvencies and the unemployment rate continued to decline. However, exports started to weaken towards the end of the year as the economic environment at important trading partners deteriorated.

Flight to safety.

In spite of all the efforts to deal with the crisis, the capital markets remained highly nervous due to the fear that the worst-affected countries could be forced sooner or later to bow to the growing pressure from their populations and abandon their strict consolidation course. In addition, the concern that the sovereign debt crisis could spread to core European countries and would ultimately be impossible to contain weighed heavily on the markets. Investors restructured their investments. Gold and German government securities were particularly popular as safe havens. The ten-year Bund yield fell to a new all-time low of 1.689% in September 2011. During the remainder of the year, the

interest paid on long-term German government securities increased slightly. However, at the end of 2011, the yield on ten-year debt securities fell back below the 2% mark.

Crisis of confidence returns to the interbank market.

The close correlation between governments and the financial sector also fuelled doubts about risk-bearing capacity, especially with respect to the financial institutions that were already struggling as a result of the crisis. Banks and insurance undertakings hold considerable amounts of public-sector bonds. The risk that further write-downs of critical government exposures could bring down some institutions became a reality in October, when the Franco-Belgian Dexia Bank experienced distress. The confidence of financial institutions in each other declined rapidly. The mutual distrust reached levels similar to those experienced after the collapse of the US investment bank Lehman Brothers three years earlier. The interbank market dried up again. The European Central Bank (ECB) intervened by taking emergency measures and intensified its expansionary fiscal policy. For the first time, towards the end of 2011, it even provided liquidity to banks with a term of up to three years – in unlimited amounts and at the low interest rate of 1%. Thanks to this longer-term refinancing operation alone, the banks in the eurozone acquired central bank funds of €489 billion to boost their "warchests".

Financial crisis: a chronology of important events in 2011

January

The new **European Supervisory Authorities** – the EBA (European Banking Authority), EIOPA (European Insurance and Occupational Pensions Authority) and ESMA (European Securities and Markets Authority) – start their activities.

The first bond issued by the **European Financial Stability Facility (EFSF)** is placed successfully.

France makes the fight against volatility on the **currency and commodity markets** the central theme of its G8 and G20 Presidency.

February

The decision on the fate of the struggling **WestLB** drags on. Its owners submit three different plans for the future of the institution to the European Commission.

The G20 finance ministers agree on a catalogue of criteria to measure **economic imbalances**.

March

Hypo Real Estate's bad bank (**FMS Wertmanagement**) discharges all remaining government liquidity guarantees amounting to €15 billion.

A national stress test reveals that **Irish banks** require additional capital of €24 billion. The government becomes majority shareholder of all the country's institutions.

The planned permanent **European Stability Mechanism (ESM)**, which is designed to replace the interim EFSF bail-out facility in 2013, is launched. The aim is to achieve a lending capacity of €500 billion.

April

Commerzbank launches a large-scale capital increase to repay billions of euros of government aid.

After Greece and Ireland, **Portugal** also requests financial aid from the EU.

The Greek government announces another major **austerity package**.

The European Central Bank (ECB) raises its **key interest rate** for the first time since the middle of 2008.

May

Aareal Bank continues to repay the capital injections it received to the Financial Market Stabilisation Fund (Sonderfonds für Finanzmarktstabilisierung – SoFFin).

SoFFin reports a loss of €4.8 billion for 2010, of which €3.9 billion alone is attributable to provisions for the expected loss at **FMS Wertmanagement**.

Portugal agrees details of a €78 billion **aid package** with the EU and the International Monetary Fund (IMF).

Donors demand that **Greece** increase its consolidation efforts and speed up the privatisation of government property.

June

Greece's private creditors are called on to participate in a new rescue package on a voluntary basis. In spite of worsening **mass protests** by the population, the parliament in Athens approves a drastic **austerity programme** amounting to €78 billion, thus paving the way for further loan assistance.

July

All twelve participating German institutions pass the EU-wide bank **stress test**. Landesbank Hessen-Thüringen withdraws its participation because of a disagreement with the EBA about the definition of capital. Eight institutions fail the test in Europe as a whole.

A **second aid package** is resolved for **Greece**, amounting to €109 billion. In addition, private creditors are to forego €50 billion voluntarily.

Agreement to enlarge the capacity of the **EFSF** rescue facility.

The **rating agencies** are criticised sharply by politicians over their handling of the European sovereign debt crisis.

August

Spain and **Italy** are at risk of becoming embroiled in the worsening sovereign debt crisis and come **under pressure** from the financial markets.

After arduous negotiations, the **US** House of Representatives and Senate agree to raise the country's debt ceiling. Nevertheless, rating agency Standard & Poor's **downgrades** the country's **prime AAA rating**.

Stock markets around the world trend **lower** in response to growing sovereign debt problems and concern about the US economy. The central banks buy bonds and inject liquidity in an attempt to allay the financial markets' nerves.

September

The uncertainty on the financial markets prompts a **flight to safety**; ten-year Bund yields fall to an all-time low.

New austerity measures are resolved in **Spain**, **Italy** and **Greece**.

Due to the massive **appreciation** of the local currency, the Swiss National Bank announces that the **franc will be pegged against the euro** and sets a minimum target rate.

October

Franco-Belgian **Dexia Bank** becomes distressed because of its high holdings of bonds from European crisis countries and is broken up. The **crisis of confidence** on the interbank market worsens. The ECB carries out two longer-term refinancing operations for banks and continues its government bond purchase programme.

At a crisis summit, the EU heads of government put together a comprehensive package of measures. They resolve a **haircut for Greece's debt**; the plan is for private creditors to waive 50% of their receivables voluntarily. Two options to optimise the **EFSF's** lending volume are agreed to boost the strength of the rescue facility: partial risk protection for government bonds and the creation of co-investment funds to enable the participation of third-party investors. In addition, **major banks** have to increase their **Tier 1 ratio** to **9%** by mid-2012.

The EBA estimates provisional **recapitalisation requirements** for European banks at €106 billion, with German institutions needing €5.2 billion.

November

The G20 countries initially identify **29 systemically important banks** worldwide, including Deutsche Bank and Commerzbank; the institutions concerned will gradually have to meet higher capital adequacy requirements.

The ECB intensifies its expansionary policy and **reduces the key interest rate** from 1.5% to 1.25%. The world's leading central banks take concerted action, announcing that they will grant banks unlimited **liquidity in foreign currency** at a reduced interest rate.

Italy comes under severe pressure on the capital markets because of growing doubts about the country's ability to reform; the government resigns. A new **interim government** is also formed in **Greece**.

The sovereign debt crisis starts to **affect core eurozone countries**. The spreads on government bonds issued by France and some smaller eurozone countries over Bund yields rise.

Hungary asks the EU and the IMF for financial aid as a precautionary measure.

In the **USA**, Democrats and Republicans **fail to reach agreement** on the required savings of US$1.2 trillion.
Automatic budget cuts now loom from 2013 onwards.

December

The European Commission approves the **break-up of WestLB**.

On the basis of revised calculations, the **EBA** increases banks' EU-wide **recapitalisation requirements** to €114.7 billion. Six out of 13 German institutions now have to raise an aggregate of €13.1 billion of fresh Tier 1 capital by mid-2012, more than double the figure estimated as recently as October. In light of this, the Federal Government plans to reactivate **SoFFin**, the national bank rescue fund.

The ECB reduces its **key interest rate** to 1%. In addition, **523 banks** borrow **€489 billion** in **Central Bank** money for up to **three years**. Part of the liquidity, which was provided for the first time on such a long-term basis, is immediately injected into the **deposit facility**, which grows to €452 billion just before the end of the year – its highest level since the introduction of the euro.

The EU member states agree the first steps towards a **fiscal pact** with more closely coordinated budget and economic policies; the United Kingdom refuses to support the reorganisation of the EU. The planned launch of the permanent **ESM** rescue facility is brought forward to the middle of 2012.

2 Financial markets

Financial markets negatively impacted by the European debt crisis.

The financial markets were dominated in 2011 by the escalating European sovereign debt crisis. Although only a small number of countries had experienced marked declines in their bond prices in the previous year, the group of crisis countries expanded in the

course of 2011, resulting in a – in some cases dramatic – increase in their bond yields. The collapse in prices led to a loss of confidence in the European banking sector, because these credit institutions hold a significant amount of government bonds. To reduce the funding pressure on the institutions and thus mitigate the risk of a credit squeeze, the European Central Bank relaxed its monetary policy. The dramatically heightened uncertainty was also felt on the international stock markets in the second half of the year.

ETFs: a risk to financial stability?

Exchange-traded funds (ETFs) are listed, exchange-traded, predominantly passively managed investment funds that normally track the performance of an index. They are different from other exchange-traded products (ETPs) such as exchange-traded commodities (ETCs) or exchange-traded notes (ETNs), which are not funds, but debt instruments. Unlike traditional investment funds, investors normally buy and sell ETFs only on an exchange.

According to the **physical** replication (full replication) method, all components of the underlying index are held in the investment fund in accordance with the corresponding weighting. **Synthetic** index replication is a more recent technique under which the fund uses derivatives (swaps) to replicate the performance of the index.

Between 2000 and 2010, the assets managed in ETFs worldwide increased rapidly, at an average annual rate of 33%. At the end of 2011, there were around **3,000 ETFs** worldwide with a combined value of **US$1,351 billion**. With a volume under management of US$267 billion, the European market is still considerably smaller than the US market (US$940 billion). In Europe, ETF growth is driven above all by products that replicate the index by entering into derivatives (swaps). At the end of 2011, 61% of all European ETFs used synthetic replication. This corresponds to an investment volume of US$162 billion.

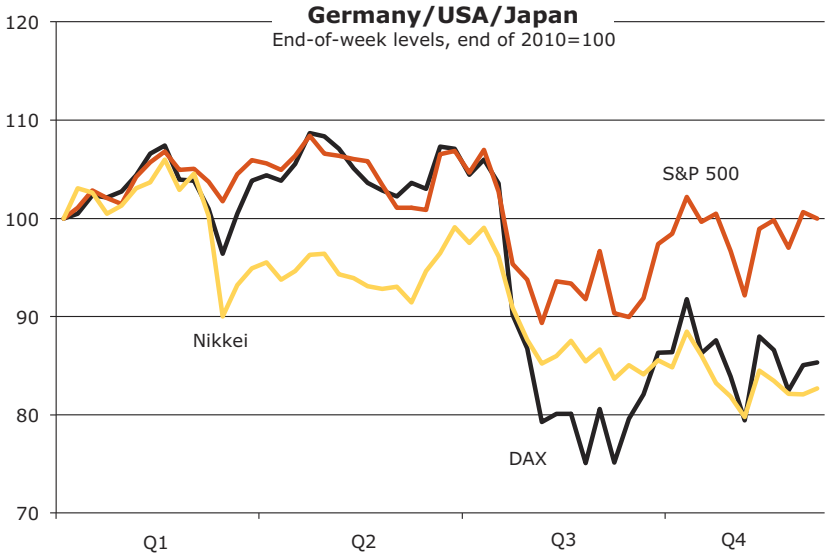
In 2011, leading European and international institutions engaged in financial supervision, such as the Financial Stability Board (FSB) and the International Monetary Fund, investigated the potential risk associated with these financial products and flagged possible implications for financial stability for discussion. ETFs are systemically important in as far as they are closely linked to their reference markets. Criticism was primarily levelled at counterparty and liquidity risk, securities lending and the fact that the transparency of these products decreases as their complexity increases. The supervisory authorities are focusing above all on synthetic, swap-based ETFs. In January 2012, the European Securities and Markets Authority (ESMA) presented a consultation paper with guidelines for ETFs. The final requirements are to be published in summer 2012.

Declines in international share indices.

Until March 2011, the international share indices continued their rally from the last two quarters of the previous year. Then the tsunami in Japan, which led to the nuclear disaster in Fukushima, caused the first major decline in share prices, which affected Japan's Nikkei index in particular. Unlike other leading global indices, the Nikkei failed to recover its losses in full in the subsequent months.

At the end of spring, uncertainty started to creep back into the markets, with rating agencies starting to downgrade a number of peripheral eurozone countries in April and Europe's debt problems worsening. At the beginning of August, the USA also lost its AAA rating from Standard & Poor's. Neither the G8 summit at the end of May nor several other eurozone summits produced any solutions that were regarded by the market participants as sustainable or convincing. Concerns that the debt crisis in Europe and the USA could have a negative impact on the economy sent stock markets around the world on a downward slide in the third quarter of the year.

Figure 3
Comparison of stock markets in 2011



Source: Bloomberg/BaFin calculations

DAX turns in poor performance.

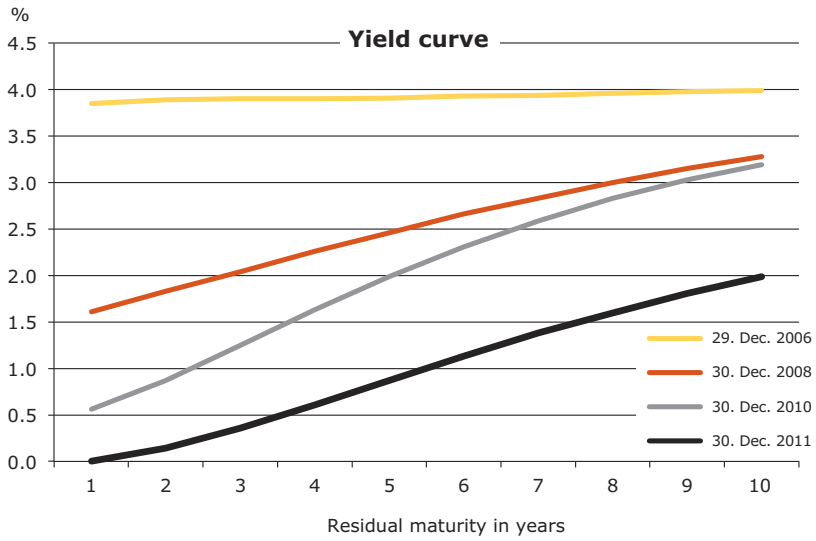
Germany's DAX share index, which had closely tracked the performance of the S&P 500 in the first two quarters of 2011, was hit significantly harder by the falling share prices in late summer than were other international share indices. However, the DAX held its ground compared with the EuroStoxx, because economic development in Germany was more stable than in most other European countries. The DAX closed the year at 5,898 points, having lost around 15% in the course of the year.

Yield curve shifts downwards and flattens.

The yield curve experienced major fluctuations in 2011. The yields for short and medium maturities rose until the middle of the year, causing the yield curve to flatten slightly. In the second half of the year, the European debt crisis led to such a surge in demand for secure investments that Bund yields fell sharply across all maturity bands. In addition, the short end of the curve was significantly affected by the ECB's two key interest rate cuts in November and December. Towards the end of the year, the yield curve was relatively steep in spite of low long-term yields, with a nominal interest rate of close to 0% for one-year bonds.

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 in crisis mode.

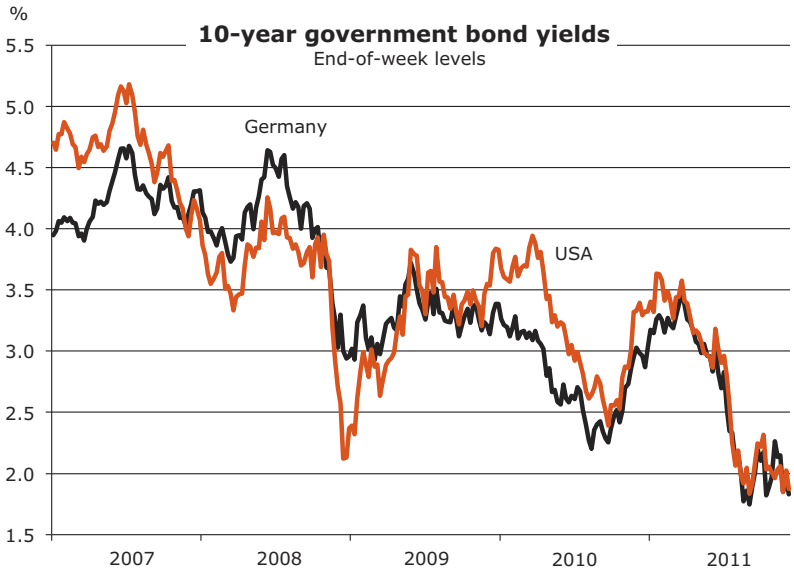
The key factors influencing the monetary policy environment in the eurozone in 2011 were increasing tension on the interbank market, several changes in key interest rates, and new special measures taken by the European Central Bank. Having set itself the objective in the previous year of toning down its expansionary policy, the ECB raised its key interest rate in two steps from 1% to 1.5% in April and July 2011. However, when the European debt crisis flared up again, the Central Bank responded by relaxing the monetary conditions again. In two further steps, it reduced the key interest rate back to 1%. In a coordinated campaign, the world's leading central banks granted banks unlimited amounts of foreign currency, after some European institutions had run into difficulty raising US$ liquidity on the market. In addition, to ease the worsening situation on the interbank market and to counter the crisis of confidence in the financial sector, the ECB found it necessary to issue a tender for three-year loans towards the end of the year, which drew high demand. This was the first time such a measure had been taken since the introduction of the euro. Moreover, the ECB stepped up its purchases of government bonds from peripheral eurozone countries, especially in the second half of 2011, a move over which opinions are divided among monetary

policymakers and scientists. According to the critics, in doing so the ECB is exceeding its mandate, which is to focus on price stability, and threatening its independence, because it opens the door to indirect government financing by the Central Bank.

Yields now at record lows.

At the beginning of 2011, German and US government bond yields initially continued their upward trend from the previous year. However, a downward trend began in the second quarter, which led to new record lows in the autumn. Thus ten-year bond yields at times fell significantly below the 2% mark in both countries. Meanwhile, heavily indebted eurozone countries experienced sharply higher spreads. The scramble by investors to find risk-free investment options in light of the resurgent crisis was a key cause of this development. The financial markets continued to regard Bunds and US government securities as safe havens in 2011.

Figure 5
Capital market rates

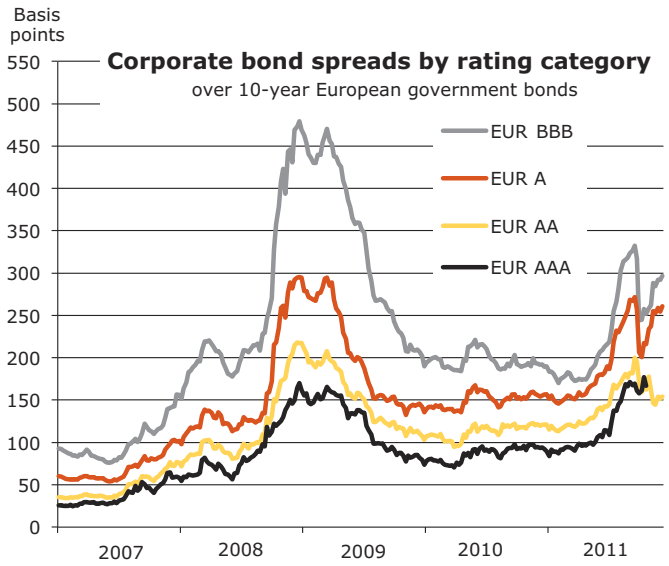


Source: Bloomberg

Significant rise in corporate sector spreads.

The spreads on European corporate bonds are one indication of how market participants perceive the downside risks to real economic development in the eurozone. They increased sharply across all rating categories in the second half of 2011.

Figure 6
Corporate bond spreads in Europe*

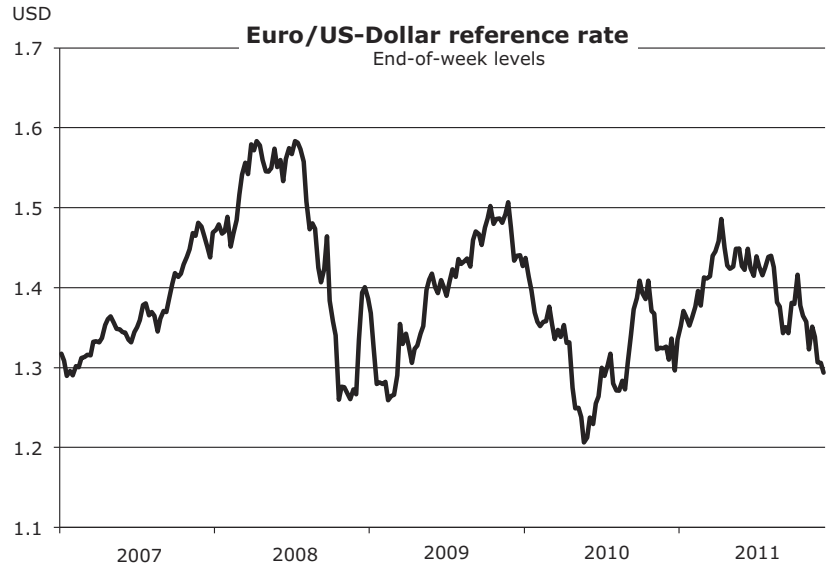


* Given the lack of representative data, it has not been possible to calculate bond spreads for the AAA rating category since November 2011
Source: Bloomberg

Euro loses ground towards the end of the year.

As in the previous year, the euro/dollar exchange rate in 2011 was dominated by the development of the European sovereign debt crisis in 2011. The common European currency started the year with significant gains. However, at the end of the year, the euro trended considerably weaker after market participants had come to the conclusion that the international and European summits had failed to produce any convincing plans to resolve the crisis. At the end of the year, the exchange rate stood at around US$1.30/€, virtually the same as one year earlier. However, in historical terms, this is not an unusually low value and is far removed from the all-time low reached in 2000 (US$0.83/€).

Figure 7
Exchange rate movements



Source: Bloomberg

3 Banks

Banks caught between sovereign debt crisis and fears of recession.

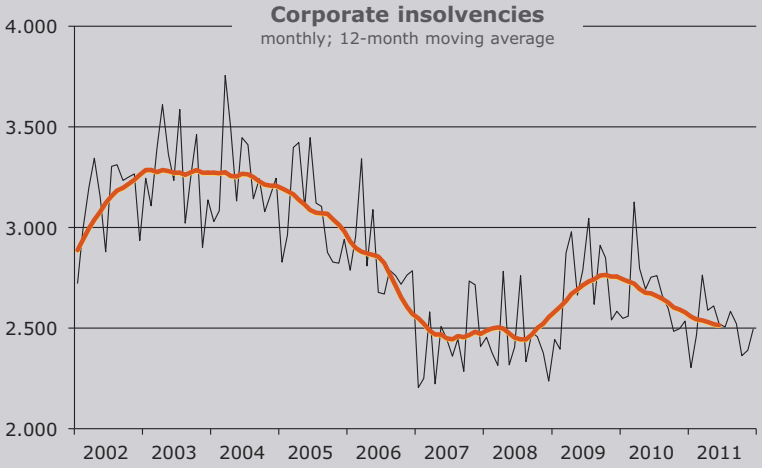
Once again, banks found themselves in a difficult situation in 2011. On the one hand, the bank balance sheets reflected the growing uncertainty in relation to the deteriorating European sovereign debt crisis and the resulting write-downs of government bonds. On the other hand, the continuing economic recovery in Germany, unlike other EU member states, led to an increase in business. Moreover, the continuing decline in the number of corporate insolvencies reduced the amount of write-downs banks had to recognise. The main winners in this environment were those banks that had been able to contain their losses during the crisis thanks to effective risk management and were thus able to take market share from their weakened competitors. Other beneficiaries were the traditional retail banks, which had been gaining customers from other institutions since the crisis and increasing their business volumes thanks to a growing aversion to risk. At the same time, they used the extremely low short-term interest rates to generate additional income from maturity transformation. By contrast, the situation worsened for those banks that had already reported heavy losses during the financial crisis. The economic upturn largely passed them by, because the capital and deposits needed to write new business are particularly expensive for them – to say nothing of additional/stricter banking supervision requirements.

Insolvency trend

The number of **corporate insolvencies** in Germany declined in 2011 for the second year in succession. German local courts reported around 30,100 corporate insolvencies, 6% fewer than in 2010. The amount of debt owed to creditors, a measure of the potential financial loss, fell from €27 billion to €20 billion. This renewed improvement is a result of Germany's stable economic upswing. The slowing pace of growth experienced in the course of the year did not yet have any noticeable impact on the frequency of insolvencies. Although some larger bankruptcies occurred towards the end of the year – for example at the printing press manufacturer manroland, where 6,500 jobs were affected, and in the solar industry – they were less attributable to a general economic slowdown than to specific structural shortcomings and overcapacity. The increased financial strength of companies is an indication that the number of insolvencies will continue to decline, unless the worsening sovereign debt crisis pushes the German economy into recession.

Figure 8

Number of corporate insolvencies in Germany



Source: Statistisches Bundesamt

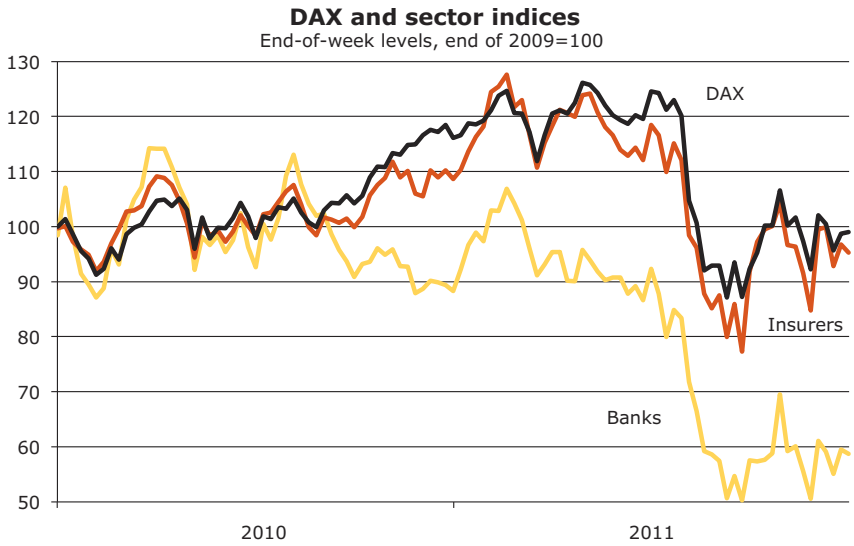
Around 103,300 **private individuals** filed for **insolvency** in Germany in 2011, 5% fewer than in the previous year, which had seen a new record of 108,000 cases. Although the robust economy and the continuing reduction in unemployment had a positive impact on the financial position of private households, the problems of over-indebtedness eased only slightly. The volume of outstanding debt declined from €6.3 billion in the previous year to €5.8 billion.

Bank stocks fall sharply from the middle of the year onwards.

The hopes that had arisen on the stock markets in 2010 of a quick end to the global financial and economic crisis were dashed in 2011. After a positive start to the year, Germany's DAX share index lost about one-third of its value in the third quarter, before recovering again slightly. It closed the year around 15% down on the previous year. Initially the German banking sector index also

rose moderately before losing ground substantially as the sovereign debt crisis worsened and closing 2011 down 34%. Because of their close correlation with the government sector, bank stocks suffered particularly heavy losses.

Figure 9
Share indices for the German financial sector



Source: Bloomberg/BaFin calculations

The banking index climbed by more than 20% in the few weeks up to the middle of February 2011 on the back of the brighter economic outlook and earnings prospects. However, it suffered a setback as early as March, when it became clear that it would hardly be possible to resolve the sovereign debt crisis in the near term and that banks would face large write-downs as a result. Unlike the DAX as a whole, bank shares continued losing value in the second quarter. This was due not only to the rating downgrades of some European countries, but also to the discussions of the controversial criteria applied as part of the EBA stress test. Although all participating German banks passed the EBA stress test, the German banking index almost halved in the third quarter. The contraction is partly due to the fact that banks were required to waive part of their receivables from Greece. However, the fact that the crisis had taken on a new quality thanks to the growing funding problems experienced by two large eurozone countries, Italy and Spain, seemed more significant. The banking index was highly volatile in the fourth quarter, due in particular to diverging opinions of the prospects for success of the crisis summits held by the eurozone countries and the measures taken by the ECB. An exacerbating factor was that the recapitalisation requirement for German banks calculated by the EBA increased from €5.2 billion in October to €13.1 billion in December because of a change in the calculation basis.

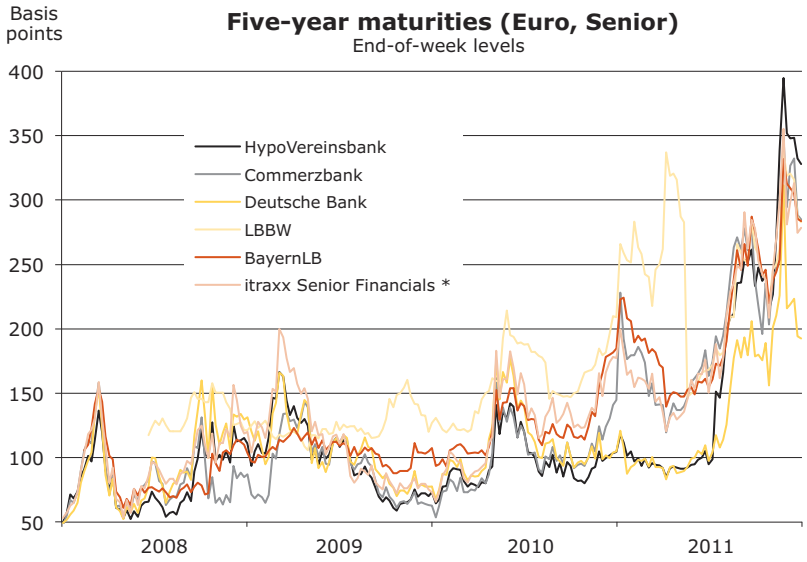
Rollercoaster ride for CDS spreads.

The sharp increase in credit default swap spreads was a clear indication of the growing uncertainty in 2011.[5] After their historic low of less than ten basis points at the beginning of 2007, CDS spreads for major German banks fluctuated between 50 and 200 basis points in the subsequent three years.

The observed CDS spreads improved slightly in the first quarter of 2011 except for Landesbank Baden-Württemberg (LBBW), reaching stable levels of between 100 and 150 basis points. However, risk exposure surged in the European banking sector in the third quarter as uncertainty grew in the southern eurozone countries. This development was mirrored, at least in approximate terms, by the performance of the iTraxx Senior Financials credit default index. For this reason, German bank spreads – which were highly volatile – also rose in the period up to the end of the year, reaching over 300 basis points at times. Being a subsidiary of a major Italian bank, HypoVereinsbank was particularly badly affected; its CDS spread tripled in the second half of the year. Only Deutsche Bank's spread recovered to below 200 basis points, because market participants expected that it would be able to implement the capital increase required by the EBA from its own resources.

Figure 10

Credit default swap spreads for major German banks



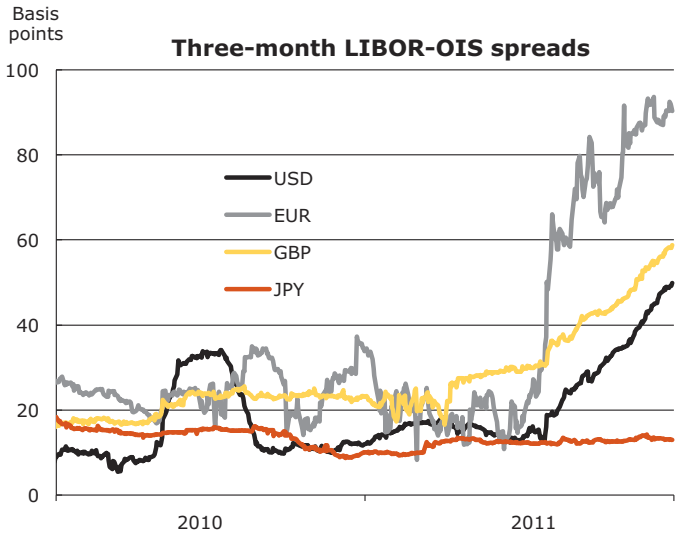
* Unweighted average of CDS spreads for 25 major European financial institutions (including 16 banks).
Source: Bloomberg/BaFin calculations

[5] CDS spreads are OTC market prices for accepting the default risk of a loan. A spread of 120 basis points, for example, 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 involved, the higher the spread.

Volatile interbank market.

The various measures taken by the central banks had already brought about a significant recovery of the interbank market and in the supply of liquidity in 2009, compared with the situation immediately after the collapse of the US investment bank Lehman Brothers in autumn 2008. This positive trend continued until the middle of the year under review. Although central money market indicators, such as the overnight funding rates and the three-month LIBOR money market rates rose in 2011 compared with the previous year, they did not come close to the heightened levels reached during the financial crisis roughly three years ago. The three-month LIBOR climbed to around 1.5% in the first half of 2011, and the overnight rate to around 1.3%. Overall, therefore, the LIBOR-OIS spread for Europe was marginally down on the previous year until the middle of the year, at around 20 basis points. The second half of the year saw above all a fall in the overnight rate to below 0.4% in anticipation of the cut in the ECB's key interest rate that was implemented at the end of the year, while the LIBOR only declined slightly to 1.3%. As a result, LIBOR-OIS spreads[6] ballooned – a sign that the interbank market was again not functioning properly.

Figure 11
Interbank market indicators



Source: Bloomberg

At the end of the year, the LIBOR-OIS spread for Europe jumped to almost 100 basis points. In addition to the cut in the key interest rate, this is due to the surplus liquidity established in the banking sector, especially in the last quarter of 2011. Banks had gone 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

[6] The Libor-OIS spread is the difference between the London Interbank Offered Rate and the overnight index swap rate. The spread between the three-month LIBOR and a three-month revolving overnight index swap can be taken as a pure-play indicator of the credit risk on the interbank market.

rather that they mainly affected peripheral eurozone countries or individual problem institutions.

Stable credit standards and rising demand for credit.

Given the improved general conditions, German banks slightly eased their lending standards for corporate clients – which had been tightened in 2008 and 2009 – between the third quarter of 2010 and the first quarter of 2011 and then left them largely unchanged for the rest of the year, according to the ongoing Bank Lending Survey conducted by Deutsche Bundesbank. In Germany, the lending conditions for corporate clients were more favourable in 2011 than in many other eurozone countries, where more restrictive lending criteria were applied sooner and to a greater extent. This development, which benefited the economy, was attributable to the fact that German banks were in most cases in a better solvency and liquidity position and enjoyed more stable financing conditions on the money and capital market. At the same time, demand for credit by German companies rose further in 2011, bucking the average of the eurozone as a whole.

Uneven consolidation process.

The German banking market is expected to see further takeovers in the medium term, despite the risks involved. The financial crisis allowed comparatively strengthened players to take over weakened competitors – assuming their capital base permitted this. Deutsche Bank's moves to strengthen its retail business by continuing its integration of Deutsche Postbank are particularly significant for the competitive situation in Germany. The situation is more problematic in the Landesbank sector, where planned mergers could not yet be implemented despite (or because of) economic difficulties and corresponding EU requirements. The European Commission has now approved the break-up of WestLB by the middle of 2012. As part of this process, all material business areas for which no buyer can be found are to be transferred to Erste Abwicklungsanstalt, the bad bank for WestLB that has already been established.

4 Insurers

Declining premium income.

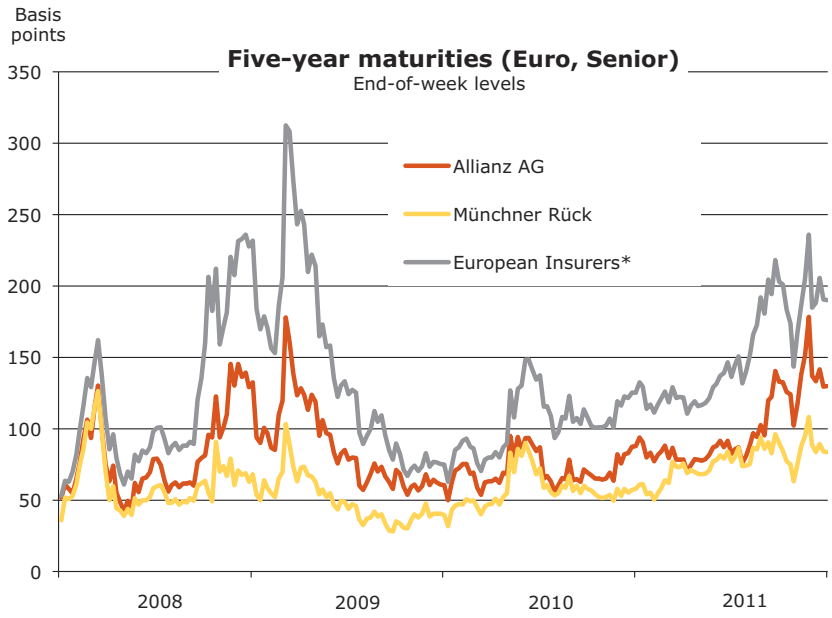
The German insurers performed robustly in 2011's extremely volatile financial market environment. Nevertheless, the insurance sector was not immune to the accelerating expansion of the European sovereign debt crisis and the first signs of a global economic downturn. After significant increases in premium income in the past few years, the German Insurance Association (GDV) expects this to decline by 1.2% to €176 billion in 2011. The decrease in the volume of premiums collected is primarily attributable to the normalisation of the extraordinary growth in the single-premium business.

Apart from the sharp correction seen immediately after the catastrophic earthquake in Japan, the German insurance sector equity index turned in an encouraging performance at the beginning of 2011. Around the middle of the year, however, it gave up almost all its previous gains in volatile trading. Burgeoning fears of a global recession and the risk that the European sovereign debt crisis could spread to the core of Europe drove the index down 25% at times in the third quarter of 2011 compared with its level at the end of 2010; however, it managed to contain its losses to 12% by the end of the year. For long periods of the year, the share prices of German insurers moved largely in line with the market as a whole. Insurance stocks performed significantly better in 2011 than banking shares, which lost 34% of their value in the course of the year.

Further increase in CDS spreads.

CDS spreads for insurers continued to widen in 2011. This trend accelerated in very volatile trading in the second half of the year, as the sovereign debt crisis worsened. However, the CDS spreads of the two German insurers, Allianz and Munich Re, were significantly below the average spread of other major European insurers throughout the entire year.

Figure 12
CDS spreads for selected insurers



* Unweighted average of the CDS spreads for the nine European insurers included in the iTRAXX Europe Series 16 index.
Source: Bloomberg/BaFin calculations

Rating agencies downgrade insurers.

The three big American rating agencies downgraded the ratings of some German insurers in 2011. In particular, the outlook was negative, because the agencies believed that the risks from government bonds and bank bonds from Europe's crisis countries and the expected economic slowdown would weigh on the financial strength of insurers.

Low interest rate environment intensifies – maximum technical interest rate reduced.

Long-term interest rates continued to decline in Germany in 2011. Ten-year Bund yields fell to a fresh all-time low (1.67%) in the autumn. Bunds were used by investors as a safe haven from the turbulence on the European bond market. The low interest rates are impacting insurers' revenue-generating opportunities. A protracted period of low interest rates presents a risk for life insurers in particular, because they may be unable to generate the guarantee payments promised to customers from fixed-income securities in the long term. To counter this problem, the Federal Ministry of Finance reduced the maximum technical interest rate for life and private pension insurance from 2.25% to 1.75% as from 1 January 2012.

2011 – a year of record losses for insurers.

2011 will probably go down as the most expensive year in the history of the insurance sector. The devastating natural disasters in Japan, Australia, New Zealand and Thailand caused losses running into billions. According to estimates, worldwide insured losses amounted to US$105 billion in 2011; that is more than in the previous record year of 2005, when cyclones Katrina, Rita and Wilma hit the US coast. The total insured and uninsured losses for 2011 are estimated at US$380 billion, two-thirds more than the previous record set in 2005 (US$220 billion). By far the worst disaster occurred in Japan, where an earthquake and subsequent tsunami caused total losses of US$210 billion, of which US$40 billion were insured.

Table 1

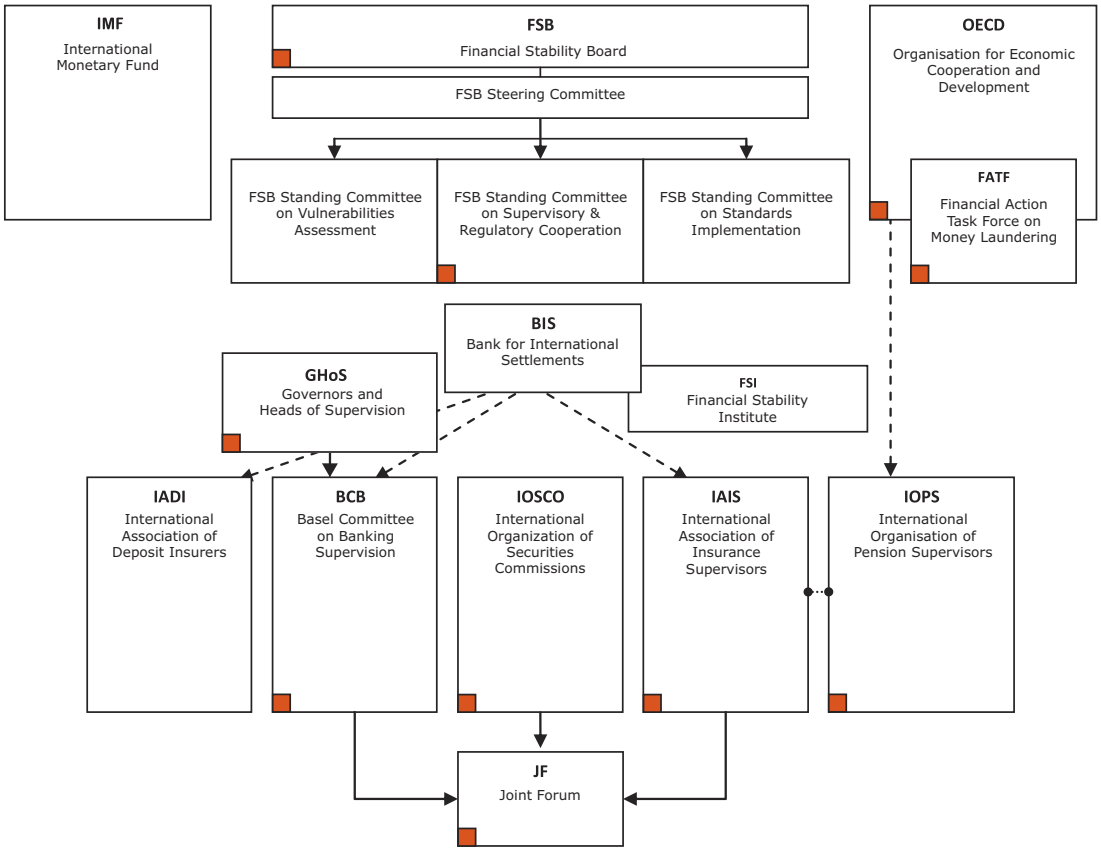
Overview of the German economy and financial sector*

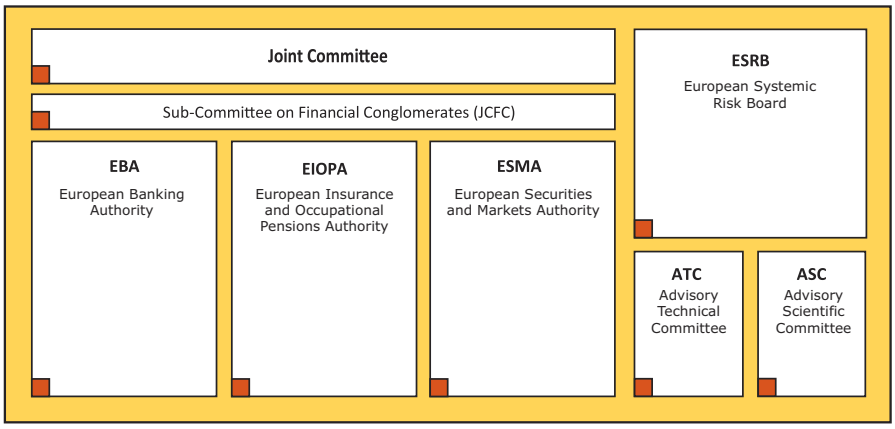
Selected economic data	Unit	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Economic growth [1]											
Global economy	%	2.9	3.6	4.9	4.6	5.3	5.4	2.8	- 0.7	5.2	3.8
USA	%	1.8	2.5	3.5	3.1	2.7	1.9	- 0.3	- 3.5	3.0	1.7
Eurozone	%	0.9	0.7	2.2	1.7	3.3	3.0	0.4	- 4.3	1.9	1.4
Germany	%	0.0	- 0.4	1.2	0.7	3.7	3.3	1.1	- 5.1	3.7	3.0
Corporate insolvencies	Number	37,579	39,320	39,213	36,843	34,137	29,160	29,291	32,687	31,998	30,099
DAX (end of 1987=1,000) [a]	Points	2,893	3,965	4,256	5,408	6,597	8,067	4,810	5,957	6,914	5,898
Money market rate [2]	%	3.32	2.33	2.11	2.19	3.08	4.28	4.63	1.22	0.81	1.39
Capital market rate [3]	%	4.81	4.08	4.04	3.36	3.78	4.27	4.09	3.27	2.77	2.67
Euro exchange rate	€1 = USD...	0.95	1.13	1.24	1.24	1.25	1.37	1.47	1.39	1.33	1.39
Gross sales of fixed-income securities [4]	€ bn	819	959	990	989	926	1,022	1,337	1,534	1,375	1,338
Credit institutions											
Individual institutions [a] [5]	Number	2,593	2,466	2,400	2,349	2,301	2,276	2,169	2,128	2,093	2,048
Branches [a] [5]	Number	50,868	47,244	45,467	47,333	40,332	39,817	39,565	38,881	38,183	
Lending volume [a] [6]	€ bn	2,241	2,242	2,224	2,227	2,242	2,289	2,358	2,358	2,353	2,415
Net interest margin [7]	%	1.20	1.16	1.18	1.17	1.15	1.12	1.09	1.14	1.14	
Net commission income	€ bn	24.3	24.4	25.3	27.8	29.9	31.7	29.7	27.4	28.6	
Administrative expenses	€ bn	78.3	77.3	75.8	78.8	81.5	81.6	78.7	82.2	80.2	
Risk provisions	€ bn	31.2	21.8	17.2	14.0	14.0	23.6	36.6	27.0	15,4	
Cost-income ratio [8]	%	67.2	66.5	65.5	61.0	62.3	64.9	73.4	65.1	63.7	
Return on equity (RoE) [9]	%	4.5	0.7	4.2	13.0	9.4	6.6	- 7.7	- 0.8	5.2	
Equity ratio [a] [10] [21]	%	12.8	13.4	13.3	13.1	13.3	12.5	14.0	15.0	15.9	16.5
Private commercial banks											
Lending volume [a] [6]	€ bn	594	579	575	580	587	627	662	654	642	670
Net interest margin [7]	%	1.34	1.17	1.25	1.27	1.33	1.30	1.20	1.20	1.14	
Cost-income ratio [8]	%	74.2	74.0	73.5	59.8	66.0	65.5	93.6	73.4	72.5	
Return on equity (RoE) [9]	%	1.0	- 6.2	- 0.4	21.8	11.2	19.1	- 15.5	- 5.8	3.0	
Equity ratio [a] [10]	%	14.4	14.5	13.7	12.7	13.7	11.8	14.8	15.0	14.6	15.6
Savings banks											
Lending volume [a] [6]	€ bn	572	577	573	574	576	578	589	598	612	625
Net interest margin [7]	%	2.38	2.40	2.35	2.30	2.23	2.06	2.00	2.13	2.20	2.17
Cost-income ratio [8]	%	66.5	66.4	64.9	66.0	65.8	69.5	68.8	66.6	62.8	60.6
Return on equity (RoE) [9] [22]	%	8.2	10.9	9.7	10.4	8.9	7.2	4.0	8.5	11.4	17.0
Equity ratio [a] [10]	%	11.2	11.5	12.1	12.6	13.1	13.1	14.4	14.7	15.1	15.8
Cooperative banks											
Lending volume [a] [6]	€ bn	335	338	342	348	353	360	369	382	398	416
Net interest margin [7]	%	2.49	2.51	2.51	2.46	2.30	2.15	2.06	2.23	2.33	2.28
Cost-income ratio [8]	%	73.1	69.6	68.7	70.0	64.3	70.5	68.3	68.3	63.7	66.0
Return on equity (RoE) [9]	%	9.7	10.6	10.3	13.8	11.0	8.1	5.5	9.0	12.1	12.4
Equity ratio [a] [10]	%	11.0	11.7	12.1	12.2	12.2	12.8	14.2	14.0	14.7	15.6
Insurance undertakings											
Life insurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	6.2	14.9	35.6	44.0	35.2	14.7	9.0	22.7	29.5	42.7
as a percentage of the IP carrying amount	%	1.1	2.4	5.5	6.5	5.3	2.0	1.2	3.0	3.7	5.7
Percentage of investment units in IP [12]	%	23.0	23.3	22.0	23.2	23.1	22.7	23.5	23.0	24.5	26.4
Percentage of promissory notes and loans in IP [12]	%	18.1	19.3	22.0	22.2	23.0	21.9	22.1	21.0	20.4	
Net rate of return on IP [13]	%	4.4	5.0	4.8	5.0	5.4	4.5	3.4	4.0	4.0	
Premium reserve	€ bn	502.8	520.6	536.2	551.2	566.5	586.1	599.6	621.0	647.2	
as a percentage of total assets	%	83.8	79.4	78.8	78.1	77.3	77.6	79.7	77.2	77.0	
Surplus [14]	€ bn	5.1	9.2	9.7	14.2	14.1	13.5	6.6	11.6	11.8	
as a percentage of gross premiums earned	%	7.9	13.6	14.1	19.5	18.8	17.8	8.6	14.1	13.6	
Eligible own funds (A+B+C)	€ bn	39.8	42.3	43.9	49.1	54.6	57.5	54.4	55.0	55.6	
Solvency margin [15]	€ bn	23.3	24.0	24.8	25.9	26.8	27.8	28.4	29.5	30.8	
Solvency margin cover [16]	%	170.4	176.2	177.4	190.0	203.8	206.8	191.5	186.4	180.9	
Return on equity [17]	%	3.4	5.7	5.8	9.7	9.5	8.8	7.4	9.6	9.8	
Property/casualty insurers											
Hidden reserves in the investment portfolio (IP) [11]	€ bn	22.3	26.0	26.6	27.7	29.8	28.9	21.4	24.6	26.1	28.8
as a percentage of the IP carrying amount	%	21.3	23.8	22.6	22.2	22.4	20.7	15.7	17.8	18.9	20.9
Percentage of investment units in IP [12]	%	27.0	27.3	26.5	29.8	30.5	31.0	30.7	30.5	31.9	31.8
Percentage of promissory notes and loans in IP [12]	%	13.2	14.1	16.6	18.3	15.6	19.4	20.2	19.6	18.0	
Net combined ratio [18]	%	103.2	94.7	92.2	92.6	90.6	92.7	92.0	95.0	99.0	
# Eligible own funds (A+B)	€ bn	25.0	27.1	24.1	22.5	27.4	28.3	26.8	27.8	29.0	
Solvency margin [15]	€ bn	7.4	7.8	8.4	8.8	8.8	8.8	8.5	8.6	9.0	
Solvency margin cover [16]	%	336.9	346.0	286.3	255.3	310.7	321.6	315.3	323.3	323.6	
Return on equity [17]	%	2.8	4.2	3.0	4.5	4.6	4.1	3.6	4.2	3.3	
Reinsurers											
Hidden reserves in the investment portfolio [11]	€ bn	35.8	34.3	37.2	49.9	57.7	63.6	33.7	33.4	35.4	35.8
as a percentage of the carrying amount	%	18.5	15.6	17.2	22.0	26.4	27.6	14.7	14.7	15.4	16.6
Net combined ratio [18]	%	101.6	92.8	93.5	93.8	89.2	94.1	94.1	94.0	101.1	
Eligible own funds (A+B)	€ bn	-	-	-	-	-	66.9	68.8	69.3	68.6	
Solvency margin	€ bn	-	-	-	-	-	6.2	6.4	6.1	6.2	
Gross technical provisions	€ bn	130.6	135.8	140.8	154.4	143.1	131.1	126.4	118.2	122.4	
as a percentage of gross premium income	%	244.0	264.4	298,5	340.0	330.3	329.7	328.4	289.7	295.4	
Net profit for the year [19]	€ bn	5.4	1.4	3.4	1.8	7.3	8.0	5.7	6.5	5.6	
Available capital [20]	€ bn	40.2	51.4	55.1	57.6	66.3	71.0	70.5	72.0	70.2	
Return on equity [17]	%	13.3	2.7	6.1	3.1	11.0	11.2	8.1	9.0	7.9	

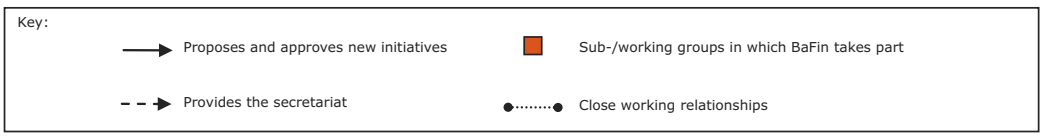
Sources: BaFin/Deutsche Bundesbank/Federal Statistical Office/Eurostat/IMF.
*) Annual totals or annual averages unless otherwise stated.
a) At year-end.
1) Year-on-year change in real GDP.
2) Three-month Euribor.
3) Ten-year government bond yields.
4) Domestic issuers.
5) Pursuant to section 1(1) of the KWG (the number of branches decreased by 560 in 2009 due to a change in classification); preliminary figures for 2011.
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. However, this figure does not include the large banks Deutsche Bank, Commerzbank and UniCredit Bank in particular. At group level these have an average overall capital ratio of 15.4%.
22) 10.8% was actually generated from market operations in 2011. The higher value is based on the reclassification of hidden reserves to recognised reserves.

III International issues

Figure 13
International institutions and committees







1 Financial stability

Implementation of the G20 decisions on regulation

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 Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO)) and major financial institutions (e.g. the International Monetary Fund, the World Bank, the Bank for International Settlements and the European Central Bank). 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 an indirect impact on it. The FSB's main tasks are to monitor the international financial system for vulnerabilities, to examine whether there is any need for action, and to coordinate and promote the exchange of information among the various authorities. The FSB is also to play a greater role in (cross-border) crisis management.

Work of the FSB.

The FSB is the coordinating body for the G20 heads of state and government and global standard-setters. In 2011, the FSB continued to drive forward implementation of the G20 decisions on the regulation of the global financial markets in close cooperation with those standard-setters. The FSB's prime objective is to make the financial system more stable, and to identify and to reduce global systemic risks.[7] In 2011, the focal points of the FSB's work included:

- regulation of over-the-counter derivatives markets
- addressing systemically important financial institutions (SIFIs) and global systemically important financial institutions (G-SIFIs)
- laying the foundations for the cross-border recovery and restructuring of G-SIFIs
- regulation of the shadow banking system
- developing a framework for macroprudential supervision and corresponding policy options.

The FSB also conducted various peer reviews. In 2011, reviewers focused on Canada and Switzerland. The FSB examined whether and to what extent international standards are being adhered to in the two countries. The FSB also conducted a thematic peer review on deposit insurance systems.

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

OTC derivatives

Founded in 1983, the **International Organization of Securities Commissions** (IOSCO) is the leading global forum for securities regulators. The Madrid-based body is recognised as being the international standard-setter for securities regulation. The standards and resolutions adopted by IOSCO are incorporated by its roughly 200 members from over 100 countries worldwide into their national regulatory frameworks.

Regulation of OTC derivatives markets makes headway.

In September 2009, the G20 heads of state and government had pledged to regulate the previously unregulated trading in OTC derivatives and to check the risks stemming from these trades. The FSB was consequently tasked with drawing up international recommendations. In October 2010, it adopted a report containing 21 recommendations on the future regulation of over-the-counter (OTC) derivatives. The implementation of those recommendations continued to gather pace in 2011. In the USA and the EU, the legislative processes to implement the original G20 regulatory goals in the form of the Dodd-Frank Act and the European Market Infrastructure Regulation (EMIR) are at an advanced stage. The latter is set to be published in the second quarter of 2012. By contrast, the technical standards that are to ensure a level playing field worldwide and close loopholes are still in the making. Due to the highly complex nature of the subject matter, however, the legislative processes in many countries are taking longer than expected. Some countries would prefer to wait until the new rules have been adopted in the USA and the EU. Agreeing on national rules and regulations has proven to be a challenge in this opaque and complicated situation and in light of the global nature of market structures.

G20 and FSB act as pacemakers in international standard-setting.

The FSB made a key contribution to the final form of the G20 agreements with the recommendations it adopted in October 2010 and has since been monitoring their implementation by international standard-setters, national lawmakers and the industry. Particularly noteworthy is a progress report published in October 2011, which not only contains a differentiated snapshot of the implementation efforts, but also lists challenges and proposes measures to overcome them. Some of these were implemented immediately; this applies in particular to the establishment of a coordination group comprising the chairmen of the standard-setters concerned (the Basel Committee on Banking Supervision (BCBS), the Committee on Payment and Securities Settlement Systems (CPSS), the Committee on the Global Financial System (CGFS) and the International Organization of Securities Commissions (IOSCO)).

Three pillars of future derivatives market law.

Based on the September 2009 G20 agreement, derivatives market regulation can be roughly divided into three strands:

- all OTC derivatives should be cleared through central counterparties;
- where appropriate, OTC derivatives should be traded on organised platforms; and
- transactions in OTC derivatives should be reported to trade repositories.

Mandatory central clearing.

The requirement to use central counterparties such as Eurex Clearing AG is intended to make derivatives trading safer by improving the provision of collateral and pooling settlement risk. In December 2011, IOSCO published international standards to be followed in formulating the statutory clearing requirement. Both these standards and the corresponding European and national laws and draft legislation exempt derivatives transactions used for hedging commercial risks from the clearing requirement due to the relatively low risks associated with them and in light of the real economy's acknowledged interest in cost-effective hedging. However, parties to derivatives transactions that are not centrally cleared must manage the risks arising from them. The draft European acts provide for further exemptions, such as for intra-group derivatives transactions, for example. Details to be are governed by technical standards that have to be drafted by the European Securities and Markets Authority (ESMA) and adopted by the European Commission.

New supervisory law for central counterparties.

At both global and European level, work to regulate central counterparties (CCPs) is in full swing as part of the reform of the regulation governing OTC derivatives markets. In the case of transactions in financial instruments, a central counterparty is interposed between the parties to the contract, becoming the buyer to every seller and the seller to every buyer. The central counterparty's involvement means that the parties to the contract no longer bear the risk of default by the other party to the contract. In this way, central counterparties should make a significant contribution to improving system stability.

On the basis of a mandate issued by the FSB, IOSCO and the Committee on Payment and Securities Settlement Systems (CPSS) – a joint committee of the central banks – published for consultation and then in early 2012 adopted the Principles for Financial Market Infrastructures. The 24 principles place strict requirements on central financial market infrastructures such as central counterparties, securities depositories, data repositories and payment systems. The key aspects are set out in the following provisions:

- principle 1 requires a robust, clear and transparent legal basis for business activities;
- principle 2 requires clear and transparent corporate structures;
- principle 4 contains requirements with regard to credit risk;
- principles 5 and 6 comprise requirements for margin systems and collateral;
- principle 7 sets out requirements with regard to liquidity risk;
- principle 14 demands that processes be set up to ensure the segregation and portability of collateral;

- principle 17 requires that adequate risk management processes and controls be set up for operational risks; the central financial market infrastructure itself must also contribute to greater transparency; and
- principles 23 and 24 provide for the disclosure of organisational information and market data.

In addition to BaFin, numerous supervisory authorities from Europe and the USA, among other places, are represented in the CPSS and IOSCO working groups that worked on the standards.

Regulation at European level.

At European level, central counterparties are the subject of the draft European Market Infrastructure Regulation (EMIR), which is currently going through the legislative process. Among other things, the provisions it contains define stringent requirements with regard to the central counterparty's management of credit and liquidity risk. On the basis of risk models, central counterparties must ask their members to post collateral that will secure the transactions cleared through them, even in difficult market conditions. Potential losses are to be absorbed by a guarantee fund, in which the central counterparty will participate along with the institutions which, as members, are authorised to clear transactions directly through the central counterparty. This is intended to make the central counterparty more stable.

Trading on organised platforms.

In February 2011, IOSCO published a report containing recommendations on implementing the requirement to trade OTC derivatives on organised platforms. The focus is on the requirements which, depending on market conditions, must be placed on trading platforms in order to strike an appropriate balance between high liquidity and transparent price formation. In December, IOSCO published a supplementary report on the characteristics of platforms which themselves function as the counterparty to all transactions and of those where multiple liquidity providers compete for the order volume. In the USA, the latter is a precondition for meeting the obligation to trade on organised platforms. In the EU, this obligation will be implemented in the Markets in Financial Instruments Regulation (MiFIR), the regulation that is to supplement MiFID 2, the planned amendment to the EU's Markets in Financial Instruments Directive (MiFID). At the end of October, the European Commission published an initial draft of MiFIR. This would require all centrally cleared derivatives to be traded as a rule on organised platforms, that is on organised trading facilities (OTFs), multilateral trading facilities (MTFs), or regulated markets.

All transactions in OTC derivatives to be reported to trade repositories.

In November, IOSCO published international recommendations on the regulation of trade repositories. These are privately operated databases that are supposed to store important data on all OTC derivatives transactions and make it available to the various stakeholders in aggregated or granular form. While transaction data primarily assist in pursuing cases of market manipulation, data on open positions and posted collateral allow the stability of both individual institutions and the financial system as a whole to be better assessed. The IOSCO report leaves important questions

unanswered, however, particularly regarding the protection of sensitive business data. It also lacks a precise description of the data that trade repositories are to make available to the various stakeholders (including market participants, micro- and macroprudential supervisors, market supervisors, central banks and industry professionals). In the EU, the law governing trade repositories will be set out in EMIR. Supervision of these enormously important service providers is likely to be performed across Europe by ESMA. ESMA will also develop technical standards setting out in greater detail the requirements for trade repositories, data content and formats, and the recognition of third-country providers.

Commodities

The regulation of markets for commodities and the derivatives based on them was again high up the G20's agenda in 2011. Various bodies, including IOSCO, observed the evolution of these markets and drove forward their regulation. IOSCO presented the G20 heads of state and government with two reports on the evolution of the oil derivatives markets. It revealed that the industry has made noticeable progress on risk management, particularly central clearing. Meanwhile, all leading nations and the EU are preparing laws that will also make central clearing of commodity derivatives mandatory.[8] In addition, IOSCO is monitoring developments relating to the trade repositories for commodity derivatives. These are operated by, among others, the New York-based Depository Trust & Clearing Corporation (DTCC) and EFETnet, which was established by European energy companies.

G20 agreement.

One challenge here stems from the fact that, worldwide, there will be several trade repositories for commodity derivatives, all of which will have to meet international requirements. The background to this is a G20 agreement of 25 September 2009. This stipulates that all OTC derivatives transactions should be reported to trade repositories. These data repositories provide market participants and supervisory institutions worldwide with information on market events and thus contribute to transparency and system stability. Finally, IOSCO completed an updated version of its recommendations on the design of commodity derivatives contracts and the oversight of commodity derivatives markets, which had not been changed since 1997. The new version reflects the lessons learned from the crisis and the far-reaching changes to the technical environment for exchange-traded commodity derivatives. In cooperation with the Organization of the Petroleum Exporting Countries (OPEC) and other international oil industry bodies, IOSCO investigated the role of price reporting agencies (PRAs) in price formation in oil markets. The report confirmed the considerable power over the market exercised by these entities which, in a similar way to credit rating agencies, form a worldwide oligopoly in the provision of price information to oil traders. Taking

[8] See p. 42.

up IOSCO's suggestion, the G20 heads of state and government tasked it with developing international recommendations on the organisation and supervision of PRAs.

Short selling

ESMA develops technical standards on short selling.

In November 2011, the EU adopted the Regulation on Short Selling and Certain Aspects of Credit Default Swaps[9] (CDSs) in response to the different measures adopted by a number of national supervisory authorities since autumn 2008 to monitor and restrict short selling. The regulation provides for ESMA to develop and submit to the European Commission technical standards setting out some provisions in greater detail. Since mid-November 2011, ESMA has therefore been developing more detailed provisions governing the following areas, for example:

- agreements, arrangements and measures that ensure that shares and government bonds are available for settlement (locate rule)
- details with regard to reporting net short positions in shares or government bonds and to their disclosure in the case of shares
- methods of disclosing net short positions in shares
- details of information that national supervisory authorities must submit to ESMA in monitoring short selling
- exemptions from the scope of the regulation for shares whose principal trading venue is outside the EU.

In addition to drafting the standards, the Commission has tasked ESMA with issuing opinions on numerous delegated acts which the Commission may adopt on the basis of the short selling regulation. ESMA had to submit both the technical standards and the opinions requested by the Commission by the end of March 2012.

Sovereign debt crisis

EIOPA FSC: impact of the sovereign debt crisis on insurers.

In 2011, the European Insurance and Occupational Pensions Authority (EIOPA) continuously analysed the impact of the sovereign debt crisis on the insurance sector. In the previous years of the global banking and financial crisis, this had been done by its predecessor, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). The crises in several European countries were a particular focus of EIOPA's analyses. In this context, the EIOPA Financial Stability Committee (FSC) conducted timely ad hoc surveys across the European insurance sector, with the topics in each case being determined by market developments. In particular, these surveys also covered the exposure of undertakings to European government bonds and banks. EIOPA drew up internal reports on the basis of the survey data and made them available at the political level of the EU or to the European Systemic Risk Board (ESRB), so that these

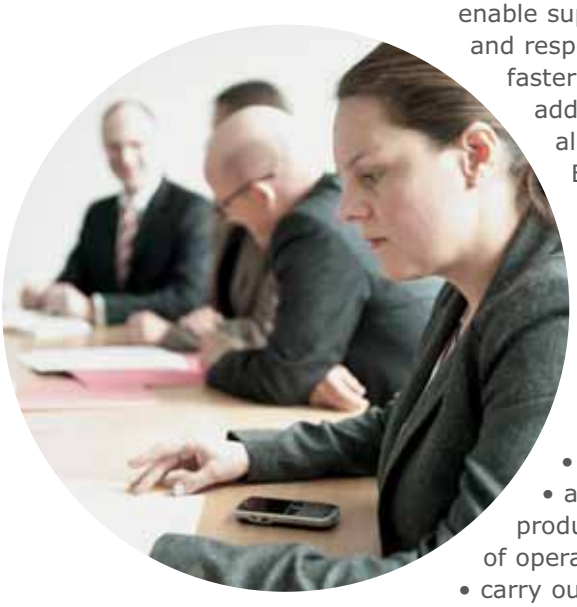
[9] Regulation (EU) No. 236/2012, OJ EU L 86, p. 1 et seq.

institutions always had an up-to-date overview of the European insurance sector's situation. The results of its work were also published in the EIOPA Financial Stability Reports.

Systemically important financial institutions

One of the lessons learned from the recent financial market crisis is to fundamentally reorganise and institutionalise the oversight and regulation of global systemically important financial institutions (G-SIFIs). At its summit in Seoul in November 2010, the G20 tasked the FSB with identifying G-SIFIs and drafting a regulatory framework for those institutions in consultation with international standard-setters, particularly the Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS). The G20's aim was to stabilise the global financial system and protect it against systemic risks via a large number of supervisory and regulatory measures so that taxpayers' money and government guarantees would not be needed if possible to support or rescue G-SIFIs in the event of a crisis.

Development of SIB supervision.



Supervision of systemically important banks (SIBs) must reflect the potential destabilisation risk that those institutions pose to their respective national financial systems and the broader international financial system. The groundwork must be laid to enable supervisory authorities to identify the risks posed by SIBs and respond to them with appropriate supervisory measures much faster than was previously the case, for example by imposing additional regulatory capital requirements such as those already decided. In the FSB Supervisory Intensity and Effectiveness Group (SIE), representatives of BaFin and other national supervisory authorities have drawn up papers[10] that provide for extensive changes to the supervision of SIFIs and above all SIBs. These set out much higher expectations to be met by supervisors and new requirements for large banks.

For example, the FSB expects supervisory authorities to

- increase on-site supervision significantly;
- analyse and assess in greater detail new, highly complex products and product groups, the business model, the result of operations and the risk position;
- carry out more frequent and detailed cross-checks, including at international level;
- carry out intensive and continual monitoring of internal risk models, including regular – and supervisors' own – stress tests (Pillar 2);
- constantly probe the effectiveness of SIBs' risk management from a supervisory perspective;
- focus more on the risk appetite of SIBs;

[10] Report on Intensity and Effectiveness of SIFI Supervision dated 2 November 2010 and Intensity and Effectiveness of SIFI Supervision - Progress Report on Implementing the Recommendations on Enhanced Supervision dated 27 October 2011.

- perform intensive and continual oversight of governance, including constant monitoring of the quality and quantity of the information available to the institutions' management; this also involves continual and extensive dialogue with the management boards and supervisory boards;
- focus more on the infrastructure of SIBs; for example, institutions must aggregate their financial and risk data quickly and accurately, which requires an appropriate IT landscape;
- introduce macroprudential surveillance (in addition to institution-specific supervision); and
- increase international cooperation by supervisors within supervisory colleges.

The task going forward is to implement those international supervisory standards in practice. The FSB sees an effective set of supervisory tools as a basic requirement for more intense and effective supervision of SIFIs and SIBs. It is also demanding that supervisory authorities have sufficiently qualified personnel.

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 currently comprises representatives of 27 countries: representatives of the central banks and supervisory authorities of the member countries. The Basel Committee develops supervisory standards and recommendations for banking supervision, such as the Basel Core Principles for Effective Banking Supervision and the Basel capital adequacy framework. A further aim is to improve cooperation between national supervisory authorities.

BCBS: requirements for systemically important banks.

On behalf of the FSB, the Basel Committee also addressed the issue of global systemically important banks (G-SIBs) in depth in the year under review. In November 2011, the Committee published a paper entitled "Global systemically important banks: Assessment methodology and the additional loss absorbency requirement", which comprises the new requirements for G-SIBs. The G20 heads of state and government had previously given their final approval to the rules text at their summit in Cannes.

Under these rules, the Basel Committee initially selects the 75 largest global banking groups. This process is performed annually – for the first time on the basis of bank data from 2011. National supervisors may report further potential G-SIB candidates at their supervisory discretion. The institutions that are selected and reported are subjected to an indicator-based assessment by the Basel Committee, in which objective figures extracted, among other things, from the institutions' annual financial statements are combined to produce a score that then provides information on a bank's systemic importance. The main indicators – each of which is given a weight of 20% – are an institution's cross-jurisdictional activity, its size, interconnectedness, complexity and substitutability/financial institution infrastructure. These factors are broken down into a number of other individual indicators.

G-SIBs are the banks that reach a particular score. At this point too, national supervisors may add further banks at their supervisory discretion. Depending on the outcome of the assessment, the Basel Committee sorts G-SIBs into five categories of systemic importance (buckets). As the business policy of banks may change and the institutions are reassessed annually, migrations will occur within the buckets and in and out of G-SIB status overall.

In future, G-SIBs will be subject to stricter supervision and regulation, including increased capital requirements. The amount of the capital surcharge for G-SIBs depends on the category of systemic importance to which they are allocated. The additional capital buffer starts in bucket 1 at 1.0% of the risk-weighted assets (RWAs) calculated for the banking group. It increases in increments of 0.5 percentage points up to 2.5% in bucket 4, currently the highest occupied bucket. To stem further growth, the Basel Committee has also established a fifth bucket with a capital surcharge of 3.5%, which is currently empty. So far, the only capital instrument with which this G-SIB capital surcharge can be met is Common Equity Tier 1 (CET 1); no convertible capital instruments are permitted.

FSB publishes list of systemically important banks.

At the time the G20 heads of state and government approved the G-SIB framework in Cannes in November 2011, the FSB published a list of 29 banking groups currently classifiable as G-SIBs, which had been drawn up on the basis of the bank data for 2009. The list was prepared using a methodology almost identical to the methodology approved at the summit in Cannes for identifying G-SIBs. The German institutions on the FSB's current list are Deutsche Bank Group and Commerzbank Group.

Transition periods for implementation of the SIFI framework.

In the coming years, the SIFI framework will have to be transposed into national legislation. However, member states have been given extensive transition periods in which to do so. For example, the capital surcharge for G-SIBs is to be phased in gradually over a period of four years starting on 1 January 2016. It is to amount to 25% of the final capital charge in the first year and to increase by a further 25% of the final capital charge in each of the following years so that the full supervisory capital requirements are implemented on 1 January 2019, at the same time as Basel III is introduced. Until then, a Basel Committee subgroup is to continuously refine the assessment methodology for G-SIBs described above and itself work out the arrangements for the later disclosure by the G-SIBs of institution-specific data.

Under the FSB's plans, domestic SIFIs requiring increased prudential supervision are also to receive special regulatory treatment in future. The Basel Committee is currently working on this problem. An initial progress report was submitted to the G20 finance ministers and central bank governors at their meeting in April 2012.

Founded in 1994, the **International Association of Insurance Supervisors** (IAIS) sets global standards for the supervision of the insurance industry. It also promotes cooperation between national supervisory authorities and provides staff training. The members of the IAIS comprise insurance supervisors from over 140 countries; around 120 further organisations, including a large number of insurance industry associations, have observer status. The principles and standards developed by the IAIS are of considerable importance for national supervisory practices: they are used by international organisations such as the International Monetary Fund as a benchmark for assessing the stability of national and international financial markets. The IAIS's most senior decision-making body is the Executive Committee, of which BaFin is a voting member. Work on content issues is performed in working groups and is supported by the IAIS Secretariat. BaFin is represented in the IAIS working groups.

IAIS: methodology for identifying systemically important insurers.

In light of the G20 decisions on SIFIs and in consultation with the FSB, the IAIS tasked its Financial Stability Committee (FSC) with developing a methodology for identifying potential global systemically important insurers (G-SIIs). One question that must be addressed in the process is whether there are in fact any global systemically important insurers at the present time.

The IAIS is working on the methodology for this and has already developed individual indicators covering the categories interconnectedness, global activity, size, substitutability, and non-traditional and non-insurance activities. In identifying systemically important banks, the Basel Committee looks to similar categories with the exception of the "non-traditional/non-insurance activities" category.

IAIS FSC: paper on the role of insurers in the context of stability.

The IAIS FSC has produced a general paper[11] on the role of the insurance sector in the context of financial stability. This paper was published in November 2011, having already been sent beforehand to the FSB. It describes experiences drawn from the most recent financial crisis and states that the traditional insurance business model has largely proven its worth. Insurers that concentrated on their core business are not a concern from a systemic risk perspective, according to the paper. At the same time, however, it concludes that the crisis has shown that insurance groups and financial conglomerates that engage in non-traditional or non-insurance activities are particularly vulnerable.

AIG systemically important in 2008.

The IAIS is firmly of the opinion that, at the end of 2008, American International Group (AIG) had to be regarded as systemically important and for that reason had to be rescued by the US government and the Federal Reserve using taxpayers' money. It should be noted, however, that AIG's systemic importance and failure were due predominantly to the group's non-traditional activities, particularly its role as a protection seller

[11] Insurance and Financial Stability.

for credit default swaps (CDSs) and its securities lending, as well as a run on an Asian subsidiary.

In developing its methodology for identifying G-SIIs, the IAIS is therefore placing considerable emphasis on insurance groups' non-traditional activities. However, the size of the individual undertaking should not be as relevant for insurers as it is with banks.

Insurers: usually less of a danger than bank failures.

In contrast to banking activities, the nature of traditional insurance activities is such that, if an insurer becomes distressed, there is not the same time pressure as there is in the event of a bank failure. If a traditional insurer threatens to fail, signs usually appear early on, meaning supervisory authorities have more time to introduce appropriate measures. What is more, the impact of a failure is normally less dangerous because insurers play a different role in the economy to banks and do not engage in credit intermediation, for example. This must be reflected in the methodology for identifying G-SIIs and their regulation.

IAIS developing a regulatory regime for G-SIIs.

At the same time as identifying potential G-SIIs, the IAIS is currently working on a regulatory regime for such insurers that would then have to be implemented nationally so that it can be applied to the undertakings concerned.

For this, the FSB stipulates, for example, that supervision must become more intensive and the loss absorption capacity of undertakings increased. In addition, mechanisms must be developed to improve the resolution of G-SIIs. For G-SII regulation too, the IAIS will bear in mind the differences between traditional and non-traditional activities and probably provide for different legal consequences in each case. It is proving difficult to establish criteria for traditional activities. In particular, there appear to be several grey areas such as mortgage insurance and trade credit insurance, for example, that cannot be clearly allocated to traditional or non-traditional activities and that are assessed differently in different countries.

It is also unclear whether a capital surcharge is to be introduced for G-SIIs, as it is for G-SIBs. If so, another question that would have to be addressed is whether this should apply to the entire group or just to a particular insurer's high-risk activities of systemic importance.

Preventing regulatory arbitrage.

It is also important to bear in mind that – unlike for banks – there is currently no globally uniform regulatory capital framework for insurers. The IAIS must therefore ensure that it drafts the rules for G-SIIs in such a way that regulatory arbitrage is not possible – either within the insurance sector or between the banking and insurance sectors.

In mid-2011, the IAIS conducted a data collection exercise among potential G-SIIs via the national supervisory authorities that related to the methodology to be used. In February 2012, it sent the FSB a preliminary report on this. The draft of a paper containing the methodology for identifying G-SIIs and general

proposals for their regulation will be released for consultation in the summer of this year. In autumn 2012, a further data collection exercise will be carried out in order to identify – or not identify – insurance undertakings as G-SIIs. The FSB and the national supervisory authorities are to take final decisions on insurers' G-SIFI status by the beginning of 2013. Until then, the IAIS will also draw up more detailed statements on the regulatory regime, which are likewise to be released for consultation in the course of 2012.

Following the current debate about G-SIIs, the question must be addressed as to whether there are also SIIs at European or national level and how they should be treated by regulators.

Resolution of SIFIs

G20 endorses Key Attributes of Effective Resolution Regimes.

At the beginning of November 2011, the G20 heads of state and government endorsed the "Key Attributes of Effective Resolution Regimes for Systemically Important Financial Institutions", which had been drawn up by the FSB. These state that the objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss as far as possible, while protecting vital economic functions through mechanisms which make it possible for shareholders and creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation.

In particular, a resolution regime of this kind requires that the competent authorities have at their disposal legal instruments that enable them, for example, to replace the senior managers of an institution, appoint an administrator, limit the rights of shareholders or owners, transfer assets to a bridge institution, or – in the insurance sector – undertake a portfolio transfer moving all or part of the insurance business from one insurer to another.

The issue of crisis management has been a focus at global and European level for a number of years. Since as far back as 2008, the FSB and its predecessor, the Financial Stability Forum (FSF), have been working on internationally coordinated approaches that enable a large, internationally active bank to be recovered or – in the extreme case – resolved in an orderly manner without causing significant market disruption and without other banks encountering difficulties.

"Living will".

The term "living will" is frequently used in the international debate on this issue. Considerable headway was made in this area in 2011: in October, the FSB presented its paper listing a total of twelve "Key Attributes of Effective Resolution Regimes for Financial Institutions". Among other things, this document put in place guidance on crisis management for institutions which the FSB has classified as G-SIFIs.

In order to achieve a cooperative solution in resolving an internationally active financial institution, the various national

supervisory and resolution authorities should cooperate more closely in the event of a crisis. Legal impediments to such cooperation must be removed. Above all, foreign creditors may not receive worse treatment than domestic creditors. One important aspect of the FSB guidance on crisis management guidelines is the strengthening of the work of Crisis Management Groups (CMGs), which bring together all the key home and host supervisors, central banks and finance ministries of a G-SIFI so as to enhance preparedness for the institution's possible restructuring or resolution.

Legal basis.

The legal basis for the work of a Crisis Management Group includes an agreement on cross-border cooperation between a G-SIFI's home and host supervisors, setting out the details of cooperation. CMGs are also to conduct regular resolvability assessments. In doing so, they must review the feasibility of an institution's recovery and resolution plans and also assess their impact on the financial system and the overall economy. In addition, jurisdictions are expected to develop an ongoing process for putting in place and reviewing recovery and resolution plans (RRPs), covering at a minimum all national financial institutions that could be systemically significant if they fail. RRPs are intended to ensure that supervisors are able to respond quickly and efficiently in crisis situations and, if necessary, that they can resolve an institution with minimum impact on the stability of financial systems. The aim is also to make supervisory authorities and banks aware of how to handle and reduce systemic risks so as to prevent future crises or at least minimise their negative impact and contagion effects.

FSB: recovery and resolution plans should be in place by the end of 2012.

The FSB lists the key requirements for effective resolution regimes, but allows the individual jurisdictions leeway to implement these requirements within their national systems, particularly their legal systems. The FSB has an ambitious agenda, as the institution-specific RRPs are required to be in place by the end of 2012. Cross-checks of the measures introduced across the member countries are due to take place as early as 2013.

Similar developments can be seen at European level. For example, under the planned EU Crisis Management Directive, the European Banking Authority (EBA) is expected to have new powers, including in relation to setting up crisis management bodies. The EBA Guidelines on the Operational Functioning of Supervisory Colleges already contain a section on crisis management. In a crisis, the EBA will also become involved in crisis management in that it will "facilitate and, where deemed necessary, coordinate any actions undertaken by the relevant national competent supervisory authorities", as stated in the EBA Regulation.

Back in 2005, the Economic and Financial Affairs Council (ECOFIN) signed a memorandum of understanding, extended in 2008, that required Cross-Border Stability Groups (CBSGs) to be established for all large European financial institutions by mid-2011. Like Crisis Management Groups (CMGs), CBSGs aim to strengthen cooperation between supervisory authorities, central banks and finance ministries in the event of a crisis. Their task is also to create a

framework for European cooperation in crisis situations on the basis of a cooperation agreement. For G-SIBs, however, only CMGs must be established; an additional CBSG is not required.

IAIS paper on the resolution of insurance groups.

The issue of resolution was also on insurance supervisors' agenda in the year under review. In mid-2011, the IAIS published an "Issues Paper on Resolution of Cross-Border Insurance Legal Entities and Groups". This is a general paper illustrating the problems related to resolution and outlining initial thoughts on possible solutions. Building on this, the IAIS is currently developing an appropriate regulatory regime for systemically important insurers as part of its work on G-SIIs. This is also to include measures to improve the resolvability of financial institutions. The IAIS's work in this regard is based on the FSB paper on the "Key Attributes of Effective Resolution Regimes for Financial Institutions". The IAIS has tasked its Insurance Groups and Cross-Sectoral Issues Subcommittee (IGSC) with submitting proposals for the application of the FSB paper. The FSB paper is directed primarily at bank supervisors; the IAIS must therefore interpret it for insurers. In doing so, it must also consider instruments such as bail-ins. What is crucial here is to distinguish between traditional activities – and whether these are cross-border activities – and non-traditional and non-insurance activities.

Internationally active insurance groups

ComFrame.

On 1 July 2010, the IAIS had officially begun to develop the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), including binding solvency rules. A year later, the IAIS released the ComFrame concept paper for consultation. The new rules are intended to make global group-wide supervision more effective. ComFrame also aims to establish a comprehensive framework that enables national supervisory authorities to better integrate group-wide activities and risks into their respective supervisory approaches and to improve cooperation with the supervisory authorities of other countries.

During the consultation, the IAIS received a number of comments both from the sector and from supervisory authorities and other interested parties. The response was positive overall. The main component of the consultation were the priority A elements (including the scope of application of ComFrame). Further priority B and C elements will not be explicitly released for consultation until mid-2012 and 2013 respectively. The three-year development phase will be followed by an impact assessment that will be used to calibrate ComFrame.

In 2011, the IAIS's Solvency and Actuarial Issues Subcommittee (SSC) again devoted its attention primarily to developing the modules of the ComFrame international supervisory standard. For example, it laid the groundwork that enabled the first concrete technical specifications to be set down in ComFrame in spring 2012, including a narrow corridor of permissible capital requirements.

Meeting of the Solvency and Actuarial Issues Subcommittee in Bonn

In March 2011, the IAIS SSC met in Bonn at the invitation of BaFin. The focus of the meeting was on developing ComFrame. In all, representatives of 32 member countries were guests of BaFin. Participants developed the ComFrame modules on investments, capital requirements, internal models and risk management. They also discussed the international supervisory standard on valuation for solvency purposes (ICP 14). Impressions based on practical experience were provided in the form of presentations by high-ranking representatives of Münchener Rückversicherungs-Gesellschaft AG and Allianz SE, who reported first-hand on risk management at internationally active groups.

Macroprudential supervision of insurers

Global framework.

In January 2011, the IAIS established the Macroprudential Policy and Surveillance Working Group (MPSWG) in response to the financial crisis. The Group's mandate is mainly to develop a global framework for macroprudential supervision, evaluate tools for identifying systemic risks and tackling their effects, and to update the Global Reinsurance Market Report. It is chaired by Bermuda. In its first year, the Group concentrated on selected core areas of its mandate, such as preparing key indicators for macroprudential supervision.

IAIS adopts core principles.

In recent years, the IAIS has extensively revised its core principles for the supervision of insurance undertakings (Insurance Core Principles – ICPs). The focus here was on introducing a principle on the macroprudential supervision of insurers and insurance groups. The objective was to enable the supervisor to identify and analyse market developments that may affect the insurance sector from both a quantitative and qualitative perspective to a greater extent than was previously the case. The results are to have a direct impact on supervisory practice. The IAIS adopted its amended core principles and supervisory standards on 1 October 2011. They are a response to recommendations from the G20 finance ministers and central bank governors and the FSB. Among other things, the core principles provide the basis for the assessment of national supervisory regimes under the Financial Sector Assessment Program (FSAP) conducted by the International Monetary Fund (IMF) and the World Bank.

Shadow banking system

G20 resolves further steps to address shadow banks.

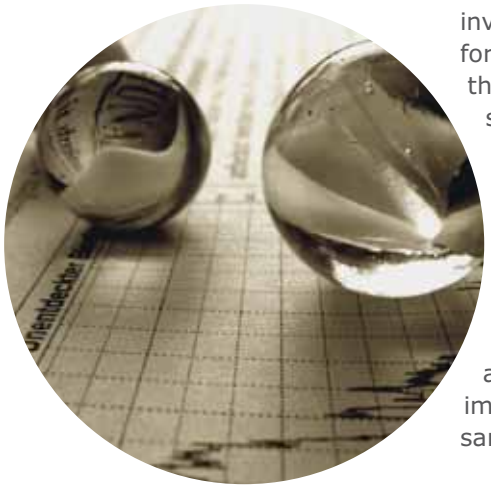
At their summit in Cannes at the beginning of November 2011, the G20 heads of state and government approved the FSB's recommendations on strengthening the oversight and regulation of shadow banks. In submitting those recommendations, the FSB was fulfilling a task assigned by the previous G20 summit, at which the G20 had approved in principle the revised Basel capital adequacy regulations. However, as the adoption of the new supervisory

standards for banks would also give rise to the risk of capital migrating to unregulated or underregulated areas, the FSB was asked to draw up proposals for closing the gaps in cooperation with the standard-setting bodies.

A high-level task force set up under the auspices of the FSB was tasked with first defining the shadow banking system, examining its importance for the financial system and analysing the risks posed by it. The task force was also asked to develop an approach to overseeing the shadow banking system, and to prepare measures designed to help reduce systemic risks and limit the opportunities for regulatory arbitrage.

Defining the shadow banking system.

Although the shadow banking system has been a subject of international debate for some time already, there was no common understanding of the term among regulatory authorities. The discussion process at the FSB was strongly influenced by preliminary work carried out by the Federal Reserve Bank of New York. In a report, the Bank showed that existing alongside the traditional banking sector is a system which, in a division of labour, engages in significant credit intermediation, i.e. in transforming available – short-term, liquid – funds into required – long-term, illiquid – funds. While credit intermediation in the banking sector usually takes place under one roof, multiple entities are normally involved in credit intermediation in the shadow banking system – for example via consumer loan origination, the pooling of loans, the issuance of asset-backed securities, and the pooling and structuring of such securities. In each case, activities are funded in a manner adapted to the purpose in hand, such as by issuing short-term money market securities or through repo transactions. Drawing on these findings, the FSB developed the following definition of the shadow banking system: "[…] the system of credit intermediation that involves entities and activities outside the regular banking system". The definition therefore includes activities and entities directly or indirectly associated with credit intermediation. In addition, the definition implies that prudential regulatory standards are not applied in the same way or to the same extent in the shadow banking system.



However, a purely static definition would not do justice to the constantly changing nature of shadow banks. Therefore, the FSB task force also set out a practical two-step approach to defining the shadow banking system. First, all non-bank credit intermediation should be identified. Second, the focus should be narrowed to those aspects that have the potential to increase systemic risk – including, in particular, liquidity and maturity transformation, imperfect credit risk transfer and leverage – or that could indicate regulatory arbitrage.

Three-step approach to monitoring risks.

Based on this definition, the task force developed a three-step monitoring approach. The first stage involves using "macro mapping" to obtain a rough overview of the extent of activities. The starting point for this are the data from the flow of funds account, a component of the national accounts. For the shadow banking system, the "other financial intermediaries" subsector is

examined, leaving aside certain irrelevant segments. The findings obtained by this method are complemented with further statistical and/or supervisory information. The purpose of the second step in the monitoring process is to more closely examine the individual risk factors derived from non-bank credit intermediation. For example, the competent authorities should use additional information on maturity structures or market liquidity to analyse maturity and liquidation transformation in detail. In addition to assessing systemic risks, they should also follow up indications of regulatory arbitrage. Above all, this requires that the authorities include qualitative as well as quantitative information, for example from supervisory interviews or contact with market participants, so as to identify new, innovative shadow banking activities.

Impact of individual risks.

In the third step in the monitoring process, the potential negative impact of individual risks is assessed, building on the indicators for assessing the systemic importance of financial institution set out in a joint report by the BIS, the FSB and the International Monetary Fund (IMF). Among other things, the focus here is on analysing the links to the banking system, on the size and extent of individual shadow banking entities and activities, and on monitoring earnings indicators. The Standing Committee on the Assessment of Vulnerabilities (SCAV), a high-ranking committee of the FSB, will perform an annual assessment of the scale of and risks posed by the shadow banking system, and will forward the results to the G20.

In addition to developing an approach for monitoring the shadow banking sector, the FSB was also requested to prepare specific measures to strengthen regulation. In July 2011, the FSB Plenary approved the provisional recommendations drawn up by the task force and combined them into five workstreams. The task force and the standard-setting bodies have been asked to submit final recommendations to the FSB Plenary in the course of 2012.

Combination of direct and indirect regulation.

As regards the regulatory framework, the FSB decided to examine options for both direct regulation of shadow banks and indirect regulation, that is regulation of shadow banks' links to the banking sector. This combination makes approaches for regulating shadow banks generally more robust and limits the opportunities for arbitrage. The Basel Committee on Banking Supervision will prepare recommendations on indirect regulation by the summer of 2012. With an eye to the specific features of the shadow banking sector, it will examine consolidation for supervisory purposes, revise the large exposure rules and examine the adequacy of certain risk weights and requirements in relation to reputational risk and implicit support.

The FSB is having recommendations on direct regulation drawn up in several working groups under the task force. It also allocated assignments to the International Organization of Securities Commissions (IOSCO). An IOSCO subgroup will look into possible regulatory measures related to money market funds. The focus is on reducing systemic risks and vulnerability to a run. In 2011, the FSB also asked IOSCO, in coordination with the Basel Committee,

to examine the extent to which retention requirements for securitisations and measures to enhance the transparency and standardisation of securitisation products have been implemented at national level. The basis for the review is the commitment made by the G20 countries at the Pittsburgh summit in September 2009 to introduce appropriate retention requirements for securitisations. Results are scheduled to be available in the second half of 2012.

Other shadow banking entities.

The working groups set up under the task force will deal with the issues of "other shadow banking entities" and "securities lending/repos". One working group is looking at the shadow banking entities that the FSB Shadow Banking Task Force has not yet examined in more detail; these include hedge funds, credit insurers and finance companies. Building on an assessment of the risks posed by these players, the working group will examine the adequacy of existing supervisory rules and, if necessary, draw up proposals for strengthening prudential regulation. The second working group is looking at market practices with regard to repo transactions and securities lending. The focus is, firstly, on the different practices in providing collateral and possible supervisory measures to mitigate procyclicality. The working group will also examine more closely the practices of cash collateral reinvestment and rehypothecation. As part of its further work, the FSB will examine to what extent it makes sense to establish international minimum standards for certain areas and introduce more extensive reporting requirements.

The FSB's Standing Committee on Supervisory and Regulatory Cooperation (SCSRC) will monitor the work's progress and ensure that the measures required to be developed are coordinated.

The work set in train by the FSB is now being taken up and progressed by other global and European supervisory bodies as well. For example, the European Systemic Risk Board (ESRB) and IOSCO are themselves pursuing certain aspects of the shadow banking system.

Collective forms of investment may be part of the shadow banking system.

Certain forms of collective investment such as hedge funds and money market funds also play an important role in the debate over the regulation of shadow banks. This issue has been addressed by European lawmakers. Among other things, the European AIFM Directive[12], which came into force in mid-2011 and must be transposed into national law by July 2013, includes within its wide scope managers of funds that are not already governed by the UCITS Directive[13]. The market participants covered by the Directive are subject to extensive obligations to provide information, including to supervisory authorities. Where necessary for the effective monitoring of systemic risk, the supervisory authority may require additional information on a periodic as well as on an ad hoc basis.

[12] Directive 2011/61/EU, OJ EU L 174, p. 1 et seq.
[13] Directive 2009/65/EC, OJ EU L 302, p. 32 et seq.

The AIFM Directive also contains detailed provisions on cooperation between national supervisory authorities, the European Securities and Markets Authorities (ESMA) and the ESRB, thereby improving the information available for systemic supervision and the basis on which supervisors carry out their duties in this area. In addition, the new rules provide supervisory authorities with specific supervisory tools for enforcement, such as restricting leverage and trading in units, as well as revoking authorisation.

Stress tests

EBA stress test for banks.

In the first half of 2011, the EBA conducted a bank stress test in the European Union member states and Norway in cooperation with the national supervisory authorities, the European Central Bank (ECB) and the ESRB.[14] Ninety-one banks from 21 countries took part. For Germany, 13 institutions participated. All German participants that reported in accordance with the EBA format achieved the minimum capital ratio required by the EBA. For 31 December 2012, the average Core Tier 1 ratio of the German participants that published their results was estimated to be 7.5% in the adverse scenario and therefore well above the required 5.0%.

EIOPA stress tests for insurers.

EIOPA also performed a stress test in 2011 in order to test the resilience of the European insurance sector to potential adverse developments. This was the second European stress test for insurers; the first took place in 2009.

In summer 2011, the national supervisory authorities conducted the survey under the auspices of EIOPA. In the autumn, the actual stress test was supplemented by a satellite stress test comprising interest rate scenarios. The satellite stress test applied to insurers that offer products with interest rate guarantees. In addition to the EU member states, Iceland, Liechtenstein, Norway and Switzerland took part in the stress tests. A total of 58 insurance groups and 71 individual insurance undertakings participated in the main stress test, representing a total of approximately 60% of the European insurance sector as measured by gross premium income. Eighty-two insurers took part in the satellite stress test.

In both stress tests, the solvency capital and the undertakings' assets and liabilities undertakings were calculated based on the provisional status of implementation of the Solvency II framework on the basis of the fifth Quantitative Impact Study (QIS 5). As the Solvency II framework is currently still being revised, the results offer the undertakings that participated and the supervisory authorities important findings for their preparations for the new framework. On the other hand, the stress test results do not allow any direct conclusions to be drawn as to the extent to which the individual undertakings would meet the current own funds requirements were the stress scenarios to occur. Therefore, the

[14] See chapter V 3.2.

results of the EIOPA stress test and the satellite stress tests were only published in aggregated form.

The main stress test comprised a total of three scenarios. In two of the scenarios, the main focus was on the insurance sector's resilience to both underwriting risk and capital market risk, particularly interest rate, equity, real estate and spread risk. There was also an inflation scenario which, in addition to underwriting risk, simulated a rise in capital market rates.

In the satellite stress test, the insurance sector's ability to withstand a prolonged period of low interest rates was examined in two scenarios. As this risk primarily affects insurers that guarantee the amount of future payments to their clients, the sample was adjusted accordingly.

EIOPA published the results of the stress tests in summer and winter 2011. Depending on the scenario in question, approximately 5% to 10% of the participants failed to achieve the Solvency II minimum solvency requirements on the basis of the QIS 5 specifications.

Recapitalisation

The sovereign debt crisis in Europe and its far-reaching consequences for the European financial system prompted EU heads of state and government to resolve fundamental measures to restore confidence in the European banking sector. To this end, ECOFIN decided at a special summit held in Brussels on 26 October 2011 to strengthen the capital position of the large, internationally active European institutions.

The recapitalisation measure focused on building up a temporary capital buffer.[15] The 71 institutions selected by the EBA for its recapitalisation recommendation, including 13 German institutions, have a capital requirement totalling €114.7 billion. Around €13.1 billion of this is accounted for by German institutions. The institutions in need of recapitalisation must reach this capital buffer by 30 June 2012 and must maintain it until further notice. They also had to submit recapitalisation plans to the supervisory authority by mid-January 2012.

Deposit guarantee schemes and investor compensation

Reform of the Directive on Deposit Guarantee Schemes through the informal trialogue process.

Since the second half of 2011, the proposal for the amendment of the European Directive on Deposit Guarantee Schemes has been going through the informal trialogue process.

[15] See chapter V 3.2.

Trialogue process

Trialogue is a process used in EU institutional law. The term refers to the process of negotiation between the three institutions involved in the EU legislative process, namely the European Commission, the Council and the European Parliament. The trialogue process is used if the Council does not approve the European Parliament's amendment proposals from the second reading. A Conciliation Committee is then convened, comprising an equal number of representatives of the Council and the European Parliament. The European Commission plays a mediating role, but has no voting right. In order to avoid this strictly regulated conciliation procedure, an effort is often made to reach agreement in an informal trialogue. This is a meeting of the parties involved in the trialogue that is not bound by any rules and regulations.

In July 2010, the European Commission had originally presented a proposal[16] for the thorough reform of the Directive on Deposit Guarantee Schemes[17], of which BaFin is highly critical in some areas.[18] Among other things, this proposal sets compensation at €100,000. In addition, clients of institutions where deposits are covered by an institutional protection scheme, namely savings banks, Landesbanks, building and loan associations and cooperative banks, are to be granted a legal right to compensation. Clients of these institutions do not currently have an individual legal right to compensation. However, the joint liability or joint guarantee schemes established by the institutions are supposed to ensure that no compensation event can occur among their members in the event of a crisis by taking the appropriate support measures.

Key concerns.

The European Commission no longer wishes to permit higher voluntary cover in excess of €100,000. For Germany, this represents a de facto ban on voluntary deposit guarantee schemes. Other key concerns relate, among other things, to the introduction of a target funding level for the guarantee scheme of 1.5% of eligible deposits within a period of eight years, the reduction of the deadline for payouts from 20 to five days and the mutual obligation for European guarantee schemes to lend to one another.

The Council and the European Parliament did not approve the European Commission's proposal and each submitted their own modified drafts. Both institutions omitted provisions that would prevent voluntary deposit guarantee schemes. The Council is in favour of a lower target funding level of 0.5% of covered deposits. The European Parliament supports a target funding level of 1.5% of covered deposits, 10% of which could also be provided in the form of collateral. Both institutions propose longer periods over which to accumulate the target funding, which are intended to better reflect the capability of the institutions concerned. Both

[16] Proposal for a Directive of the European Parliament and of the Council of 12 July 2010, COM (2010) 371.
[17] Directive 97/9/EC, OJ EC L 84, p. 22 et seq.
[18] See 2010 Annual Report, p. 50 et seq.

proposals enable the continuation of voluntary deposit guarantee schemes at private commercial banks and institutional protection schemes at savings banks, Landesbanks, building and loan associations, and cooperative banks in Germany, and are therefore a considerable improvement on the Commission's proposal. The deadlines for payouts and the target funding level continue to be particularly contentious issues. A compromise is in sight that strengthens deposit guarantee schemes but does not place an excessive financial burden on the member institutions, meaning that the negotiations in 2011 were very successful. A final outcome is likely to be reached in the course of 2012.

Reform of the Investor Compensation Schemes Directive still in dispute.

The draft reform of the Investor Compensation Schemes Directive[19] presented by the European Commission in July 2010 is also still under development. Among other things, the European Commission's original proposal raises the maximum amount of compensation to €50,000 and removes the previous option to require investors to bear 10% of the loss. As expected, this proposal did not obtain a majority in the Council[20]. The member states have spoken out in favour of compensation of between €30,000 and €100,000 and removing the current option to require investors to bear a portion of the loss. In the Council's opinion, a target fund level is unnecessary. The European Parliament, meanwhile, has proposed maximum compensation of €100,000.[21] However, the Parliament sets the target fund level lower than the European Commission, at 0.3% of the value of the funds and financial instruments covered by the compensation scheme. This shows that there are currently no reliable calculations of the target fund level that needs to be saved in order to be able to finance the envisaged compensation. The European Parliament is against mandatory lending, but wishes to permit this on a voluntary basis.

2 Implementation of Basel III – CRD IV and CRR

Commission publishes proposal for CRD IV and CRR.

On 20 July 2011, the European Commission published its proposal for CRD IV in the course of the transposition of Basel III into European law. This represents the third set of fundamental amendments to the Capital Requirements Directive (CRD), which transposed the Basel II rules into European law in 2006. CRD IV differs from the two previous amending directives in two key aspects. Firstly, it does not only amend individual provisions of the Banking Directive[22] and the Capital Adequacy Directive[23], which

[19] Proposal for a Directive of the European Parliament and of the Council amending Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes.
[20] See 2010 Annual Report, p. 51 et seq.
[21] Legislative decision of the European Parliament dated 5 July 2011, EP-PE_TC1-COD (2010) 0199.
[22] Directive 2006/48/EC, OJ EU L 177, p. 1 et seq.
[23] Directive 2006/49/EC, OJ EU L 177, p. 201 et seq.

have so far made up the CRD. Rather, it will completely replace the existing rules. Secondly, significant elements are to be transferred to a directly applicable EU regulation, the Capital Requirements Regulation (CRR).

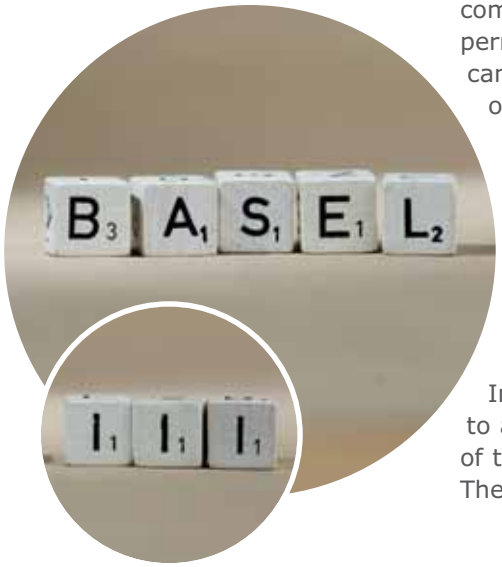
The regulation component primarily governs requirements addressed directly to institutions. For example, it will contain the definition of own funds, the minimum capital requirements, the liquidity requirements and the leverage ratio. The directive component, on the other hand, contains the provisions addressed to the national supervisory authorities or that require these authorities to intervene. In addition to the provisions on supervisory cooperation, these include the provisions governing the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) under Pillar 2, as well as those governing the authorisation procedure, shareholder control and supervisory measures and sanctions.

Like its predecessors, CRD IV is to apply to all deposit-taking credit institutions authorised in the EU. All investment firms within the meaning of Article 4 (22) of the draft CRR will also be subject to CRD IV.

Under the draft published by the European Commission, CRD IV and the CRR will be supplemented by well over 100 binding regulatory and implementing technical standards covering regulation and reporting; these will be developed by the EBA and issued by the European Commission in the form of EU regulations. Through these technical standards, EU lawmakers aim to ensure that the provisions are applied consistently in all European states. Consultations with the banking industry to discuss the new reporting requirements are expected to be held as early as summer 2012.

New definition of own funds under Basel III

Better-quality own funds components.



The aim of the Basel and European proposals regarding the new definition of own funds is to sustainably increase the quality of the components of own funds, more specifically with regard to their permanence, the ability to absorb losses and the opportunity to cancel distributions voluntarily or on the supervisory authority's orders. Significant changes to the current regime involve the clear categorisation of the various classes of capital, their largely principles-based definition and the focus on common equity tier 1 capital. With the capital deductions in particular, the common practice to date of deducting half from Tier 1 capital and half from Tier 2 capital is largely abandoned; in future, deductions will mostly be made directly from common equity Tier 1 capital.

In contrast to Basel III, the European Commission has decided to allocate all components that meet the criteria listed in Article 26 of the draft CRR to an institution's common equity tier I capital. The legal form of the institution is immaterial in this context.

Minimum capital requirements and capital buffers.

The total minimum capital requirement remains unchanged at 8%. In line with the Basel rules, however, the weights of the various capital categories are to change. While it has so far been sufficient to meet half of the minimum capital requirements through Tier 1 capital, the minimum Tier 1 ratio will increase to 6% by the beginning of 2015 and the minimum requirement in relation to common equity tier 1 capital to 4.5%.

In addition, the minimum capital requirements will be supplemented by two capital buffers:

- The capital conservation buffer is a constant surcharge of 2.5% consisting of common equity tier 1 capital. Falling below this percentage leads to restrictions on distributions, among other things.
- The countercyclical buffer, which as an additional component intended to strengthen institutions' own funds, must also be made up of common equity tier 1 capital. The aim is to build up capital buffers in an economic upturn that can shrink to cover losses in the downturn. The capital conservation buffer is a maximum of 2.5% and is set each quarter on the basis of the ratio of credit growth to gross domestic product (GDP) and the recommendations of the ESRB.

The new own funds requirements are to be phased in by 1 January 2019 in line with the Basel rules. In contrast to the Basel text, however, the draft CRR specifically leaves it up to the member states to apply the increased requirements from 1 January 2013 and/or to provide for faster transition.

Table 2
New capital requirements

Year / Requirement (%)	2013	2014	2015	2016	2017	2018	2019
Common equity tier 1 capital	3.5-4.5	4-4.5	4.5	4.5	4.5	4.5	4.5
Total tier I capital	4.5-6	4.5-6	6	6	6	6	6
Total minimum capital	8	8	8	8	8	8	8
Capital conservation buffer	-	-	-	0.625	1.25	1.875	2.5
Minimum capital and capital conservation buffer	8	8	8	8.625	9.25	9.875	10.5
Deductions from common equity tier 1 capital	-	0-100	20-100	40-100	60-100	80-100	100

Source: BaFin

Liquidity requirements.

The Commission draft also follows Basel III when it comes to the new liquidity requirements. More specifically, it provides for the introduction of two new metrics:

- The liquidity coverage requirement (or liquidity cover ratio – LCR) is intended to ensure institutions' short-term resilience to own funding problems in the event of disruptions to market liquidity. The LCR therefore compares the institution's highly liquid assets with net liquidity outflows in a stress scenario over a 30-day horizon.
- The net stable funding ratio (NSFR) compares the available amount of stable funding with the required amount of stable funding over a one-year horizon. The calculation of such a metric has not so far been codified in the draft CRR. This has only happened for the reportable components.

An observation period is provided for both metrics. Only after this period will they be finally established. Based on the data collected, the EBA is required to submit a report to the European Commission by 31 December 2013 for the LCR and by 31 December 2015 for the NSFR. Following its final definition and calibration, the LCR will be introduced between 1 January 2015 and 31 December 2015. The CRR draft does not specify a date from which the NSFR must be observed.

Among other things, a ladder report based on contractual maturities (maturity ladder reporting) is to be introduced as an additional parameter for liquidity monitoring.

If the Council and the European Parliament endorse the Commission's proposal, the principle of home country supervision will also apply to the liquidity supervision of branches in future. This would mark a departure from the existing practice of liquidity supervision by the host country.

Counterparty credit risk.

Building on the European Commission's proposal regarding central counterparties and OTC derivatives as well as the Basel rules, the draft CRR also sets out provisions governing capital requirements for OTC derivatives. Positions that are cleared centrally through a central counterparty are assigned a modest risk weight of around 2%, while OTC derivatives that are not cleared centrally are assigned a higher risk weight. As discussions currently stand, the 2% risk weight may be used in those cases in which the revised CPSS–IOSCO standards, the Principles for Financial Market Infrastructures, are observed.

Leverage ratio intended to act as a brake on debt.

The build-up of excessive on- and off-balance sheet leverage by institutions has been identified as one of the main causes of the banking crisis. In response to this, Basel III provides for a leverage ratio. This ratio is intended to be an easy-to-use tool serving as a corrective to banks' internal risk models, which may underestimate risk. The aim is to better align institutions' leverage and capital resources.

The draft CRR has adopted this concept. As it is a new supervisory tool, the draft CRR, like Basel III, provides for an observation period until 2017. Only after this period will a decision be taken on the basis of an EBA report as to whether and in what form to introduce a binding leverage ratio in 2018, and how high it should

be. Although the observation period will still be running, the draft CRR provides for institutions to publish their leverage ratio starting in 2015.

As well as calculating the leverage ratio, institutions are also to consider the risk of excessive leverage in their internal risk management in future. This is the risk of a destabilising deleveraging process that puts market prices under pressure, causing the carrying amounts of the remaining assets to fall and thus eroding institutions' capital. From 2015, at the same time as publishing the leverage ratio, institutions are also to disclose a description of the processes they use to manage the risk of excessive leverage.

Supervisory sanctions.

The draft CRD IV contains a thoroughly revised and extended section on banking supervisory sanctions. It not only extends the provisions on the minimum powers of intervention which the supervisory authorities within the EU must have. For the first time, the section also contains provisions on harmonising the system of administrative fines. The background to the revision is the considerable extent to which measures and sanctioning regimes within the EU have so far differed. In light of the fact that institutions are increasingly engaged in cross-border activity and that, as accompanying measures, banking supervisory measures and sanctions can ensure the effectiveness of other stabilising and corrective intervention, the European Commission sees the need for at least a minimum degree of harmonisation among supervisory tools in this area, too.

Governance provisions are being revised.

The governance provisions are also being revised. This plan goes back to the European Commission's Green Paper of spring 2011, "The EU corporate governance framework". Here, too, the process is dominated by the lessons learned from the crisis, which laid bare the deficiencies in institutions' internal risk management and the failures of managers and supervisory bodies. One key goal of the new provisions in CRD IV is therefore to strengthen risk oversight by managers and supervisory bodies and the risk management function at undertakings. In addition, the requirements regarding the composition and qualifications of managers and supervisory boards are being extended.

Further harmonisation

Besides implementing Basel III, the European Commission also aims to use CRD IV to further harmonise European banking supervisory law. The intention is to create a single rule book. The leading example of this harmonisation drive is the transfer in particular of the technical Pillar 1 requirements from the existing CRD and its annexes into a directly applicable EU regulation. The previous amendments to the CRD had already gradually reduced national options and discretions; aside from a few narrowly defined exceptions, the regulation no longer contains any. In many cases, the few remaining options and discretions available to the national supervisory authorities are limited by EBA mandates to draft binding regulatory and implementing technical standards.

Timetable and national implementation of CRD IV

As the content is closely linked, the timetable for the implementation and entry into force of CRD IV and the CRR is also based on Basel III. Generally, therefore, the new provisions are to enter into force on 1 January 2013. Bearing in mind the transition and observation periods outlined above, CRD IV and the CRR are to be applied in full from 1 January 2019 at the latest.

The unusual point about national implementation is that, as already described some of the provisions are set out in a directly applicable EU regulation and do not require national implementation. However, existing national law must be amended to remove all competing provisions or provisions incompatible with the EU regulation. As well as the Banking Act (*Kreditwesengesetz* – KWG), this will also affect the Solvency Regulation (*Solvabilitätsverordnung* – SolvV) and the Regulation Governing Large Exposures and Loans of €1.5 Million or More (*Groß- und Millionenkreditverordnung* – GroMiKV) in particular. National implementation is still required for the directive component and in relation to institutions within the meaning of the KWG that do not fall directly within the scope of CRD IV.

Own funds requirements and supervisory standards for central counterparties

Counterparty credit risk and central counterparties.

The Basel Committee on Banking Supervision has tasked the Risk Measurement Group (RMG), in which BaFin also plays an active role, with revising the own funds requirements for central counterparties. The current exemption for exposures to a central counterparty is to be abandoned in favour of a more risk-sensitive approach. To be able to take advantage of the much lower capital requirements compared with bilateral transactions, central counterparties must observe the revised standards for central counterparties issued by the Committee on Payment and Settlement Systems (CPSS) and IOSCO.[24] The RMG's proposal provides for a future risk weight of 2% for trade-related exposures to the central counterparty, as does the current draft of the European Capital Requirements Regulation (CRR).

Risk-sensitive capital requirements have not yet been determined for contributions to default funds. A default fund bears losses resulting from a clearing member's default and mutualises them among the clearing members if the collateral and default fund contributions of the defaulted clearing member are not sufficient (waterfall structure).

The capital requirement for default fund contributions is to correspond to the central counterparty's risk which this counterparty, in turn, passes on to its members via the default fund. Core elements in the calculation are therefore the

[24] Principles for Financial Market Infrastructures, see p. 42 et seq.

hypothetical capital that a central counterparty would itself have to hold as a credit institution in order to cover the counterparty default risk in relation to all its clearing members, and the level of coverage by the default fund. The hypothetical capital requirement is then transferred to the clearing members in proportion to their liability for the central counterparty's losses as a result of their contributions to the default fund or contributions still to be funded.

3 Solvency II

Omnibus II Directive

Adoption of the Omnibus II Directive delayed.

In January 2011, the European Commission presented the draft Omnibus II Directive[25], the aim of which is to amend the Solvency II Framework Directive[26]. The planned amendments mainly relate to the provisions governing delegated acts, regulatory and implementing technical standards, and the role of the European Insurance and Occupational Pensions Authority (EIOPA). In addition, the legal basis is to be established for adopting transitional rules for Solvency II provisions.

In contrast to the original timetable, the "trialogue" – which is designed to reach agreement between the Council, the Commission and the European Parliament – did not start in 2011. The trialogue negotiations will now begin under the Danish Council Presidency. For this reason, the Omnibus II Directive is not expected to be published before the autumn of 2012.

The delays in adopting the Omnibus II Directive impact on the timetable for the entire Solvency II project. The changes that Omnibus II will make to the Framework Directive affect the delegated acts. These cannot be released for public consultation and published until Omnibus II has entered into force. The delegated acts, in turn, have a considerable impact on the guidelines and recommendations produced by EIOPA. They must be published before the guidelines and recommendations can be released for public consultation and finalised. Therefore, the latter may not be completed until some time in the course of 2013.

Delegated acts and technical standards

Draft of the delegated acts being prepared.

In the period to mid-2011, the European Commission discussed the draft of the delegated acts for Solvency II with the member states in several meetings at the level of the Solvency Experts Group. The Commission then revised implementing measures bearing in mind the changes proposed by the member states. It

[25] Proposal for a Directive amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority of 19 January 2011.
[26] Directive 2009/138/EC, OJ EU L 335, p. 1 et seq.

was not possible to prepare a final draft in 2011. A largely final draft version was presented in spring 2012 and will be adopted following the Omnibus II Directive's entry into force.

After EIOPA forwarded the last proposals for the delegated acts to the European Commission in March 2011, the EIOPA working groups in 2011 worked on drafts for various technical standards. These have to be drawn up on certain topics because of amendments expected to the Solvency II Framework Directive as a result of the Omnibus II Directive. For example, there are to be technical standards on reporting requirements, capital add-ons, disclosure requirements, the yield curve, ancillary own funds, the standard formula and numerous aspects of internal models.

EIOPA has also drawn up a number of guidelines and recommendations that are intended to help harmonise the various supervisory authorities' administrative practice. EIOPA is developing many of these papers on its own initiative rather than on the recommendation of the European Commission.

Quantitative requirements

A large number of important topics had to be dealt with in connection with the quantitative requirements of Solvency II. Due to the extent of the issues requiring clarification, EIOPA was not able to complete all guidelines and recommendations in 2011. The quantitative requirements were fine-tuned based on the results of the fifth Quantitative Impact Study (QIS 5).

To support the actuarial function, an EIOPA working group has developed actuarial guidelines that are intended to contribute to uniform calculation of the best estimate.

Own funds played an important role.

Own funds were a key topic in 2011. For example, EIOPA held further discussions with European associations and representatives of credit institutions on the criteria for hybrid capital instruments. The aim was to establish rules that reflect reality and make possible products that will actually be accepted by the capital markets. The eligibility limits for own funds also remained a topic of discussion. The QIS 5 study conducted in 2010 had shown that stricter requirements can be imposed in order to ensure the quality of own funds without endangering insurance undertakings' own funds position. According to the study results, the amount of own funds will tend to increase under Solvency II and own funds will generally be sufficient.

It proved possible to set or keep discussions at European level on a positive course on several quantitative issues of considerable significance to the German insurance industry.

Internal models

EIOPA also focused on drawing up guidelines and recommendations on internal models, as these are seen as essential in the run-up to implementing Solvency II. In particular, this includes guidelines and recommendations on tests and standards, partial internal models and the approval process. The work on guidelines and recommendations on model changes and validation tools also made headway.

Guidelines on the pre-application phase.

EIOPA devoted particular attention to what is termed the pre-application phase. The authority not only developed guidelines and recommendations on this, but also implemented various initiatives decided back in 2010. The aim of these initiatives is to ensure that the practices of the supervisory authorities are sufficiently uniform in the pre-application phase. The intention is also to promote cooperation among the supervisory authorities and further the effectiveness of the work in the supervisory colleges in approving internal group models.

Group supervision

In 2011, EIOPA's work on group supervision focused on developing guidelines and recommendations on intra-group transactions and risk concentration and calculating the solvency capital requirement at group level. Supervisory colleges were also an increasingly important topic in 2011. EIOPA deployed staff from its Oversight Unit, who regularly attend meetings of the colleges and provide critical feedback. In addition, guidelines and recommendations that are intended to harmonise and support the work of the supervisory colleges were prepared. The Supervisory Review Process (SRP) and reporting to the supervisory authority at group level were and remain further topics of discussion. The drafts of the reporting templates were amended and revised in the course of the year and from 7 November 2011 to 20 January 2012 were one of the subjects of the consultation on undertakings' reporting and disclosure obligations.

In addition, EIOPA gave initial thought to guidelines and recommendations on the supervision of third-country branches.

Third-country supervisory systems

Equivalence test.

On the basis of a call for advice from the Commission, EIOPA was asked to assess the equivalence of the supervisory regimes of Switzerland, Bermuda and Japan with Solvency II. It assessed equivalence in relation to Articles 172 (reinsurance), 227 (group solvency) and 260 (group supervision) of the Solvency II Framework Directive in the case of Switzerland and Bermuda and in relation to Article 172 (reinsurance) in the case of Japan.

EIOPA's equivalence findings have an impact on solvency requirements for European primary insurance and reinsurance

undertakings that enter into contracts with reinsurers from the third countries in question, as well as for insurance groups that operate in both the EU and the third countries in question. The findings are therefore of considerable financial significance for the insurance undertakings concerned. The tests were conducted by the EIOPA Equivalence Committee, with BaFin being significantly involved.

More specifically, EIOPA submitted the following advice: Switzerland's supervisory regime is rated "equivalent" to Solvency II overall, albeit with certain, relatively small caveats. Japan was rated as "equivalent, but with certain caveats" in the supervision of reinsurance undertakings. EIOPA rated Bermuda's supervisory regime as "not equivalent" with regard to captives and "equivalent, but with certain caveats" in the supervision of commercial insurers. EIOPA formally resolved the advice regarding the three equivalence tests on 20 October 2011 and then sent it to the European Commission.

EIOPA to examine third-country legal provisions for transitional provisions.

In 2012, EIOPA will examine the legal provisions of those third countries that are potentially eligible to be covered by the transitional provisions for third countries in relation to solvency calculations under Solvency II (equivalence transitional measures). The European Commission has drawn up a list of candidates. In principle, third countries' participation in the exercise is voluntary. However, the Commission can and presumably will also subject third countries that only cooperate to a limited extent to an analysis on the basis of information in the public domain. EIOPA's provisional equivalence decisions are also of considerable relevance for German insurers and insurance groups, as the supervision of insurers from third countries covered by the transitional provisions, including the supervision of the parent undertaking of an insurance group, is recognised as equivalent in the EU and reinsurers from these countries do not have to provide collateral.

Qualitative requirements and reporting obligations

Between 7 November 2011 and 20 January 2012, EIOPA held public consultations on the drafts of two initial papers, which it subsequently revised. These concerned the technical standards, the guidelines and recommendations on undertakings' reporting and disclosure obligations and the related quantitative reporting templates, and guidelines and recommendations on the Own Risk and Solvency Assessment (ORSA). Both issues enjoy a certain exceptional status that has enabled public consultations to be held ahead of the publication of the delegated acts. The ORSA paper is not affected by the delegated acts, as these do not contain any provisions elaborating on the Framework Directive that concern ORSA. As regards the reporting and disclosure obligations, undertakings and supervisory authorities require a certain lead time, as they must put in place an IT infrastructure to ensure reliable and timely reporting. The work on the reporting templates must therefore be completed as quickly as possible. The consultation on the solo and group templates marks the end of a

development phase which had been initiated by EIOPA's predecessor, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), in 2010 and which has involved the close participation of representatives of the European insurance industry. No further public consultations are expected before mid-2012.

BaFin maintains intense dialogue with insurance undertakings

In 2011, BaFin held two conferences on Solvency II with the participation of the Federal Ministry of Finance. These were addressed primarily at insurance undertakings. The theme of the discussion on 7 June was "Solvency II – too complex for small and medium-sized insurers?" and was geared specifically to this target group. The event showed that the undertakings place great hope in the proportionality principle. Undertaking representatives berated the high level of complexity of the quantitative requirements of Solvency II, which they say will lead to an increase in costs and premiums. They are calling for adequate simplifications. As regards the qualitative requirements in the area of business organisation, more flexibility was demanded for small and medium-sized insurance undertakings, which representatives claim would otherwise be overburdened by the organisational requirements. Undertaking representatives also expressed fierce criticism of the planned reporting obligations to the supervisory authority, which are not felt to be proportionate. BaFin explained options and limits associated with the proportionality principle and outlined the current measures and initiatives to simplify the Solvency II Framework Directive, which it has supported and will continue to support.

At the event on 13 October, BaFin provided information on current developments relating to Solvency II. A representative of the European Commission outlined the objectives of Solvency II and described the amendments the European Commission has made to the drafts of the implementing measures. The QIS 5 results have now been taken into account, he explained, reducing the complexity of the provisions in many areas, such as provisions, own funds and the calculation of solvency capital requirements using the standard formula. A representative of the Federal Ministry of Finance explained the project risks associated with any further postponement of the implementation period for Solvency II and provided information on the status of the implementation project at national level. Solvency II came under fire at this event, too. For example, there were calls for the complexity of the framework to be further reduced. Participants also saw a need for action with regard to high volatility in the yield curve, which they say must be avoided. They likewise called for a workable transitional arrangement and a proportionately designed framework so that small and medium-sized insurance undertakings are not overburdened. BaFin endorsed these calls. The main criticism of

the draft implementing act was that consideration of the proportionality principle by the supervisory authority has not been expressly enshrined in the draft act to amend the Insurance Supervision Act. BaFin does not see this as a problem from a legal perspective.

4 European supervisory structure

On 1 January 2011, the three European Supervisory Authorities (ESAs) started work: the European Banking Authority (EBA) based in London, the European Insurance and Occupational Pensions Authority (EIOPA) based in Frankfurt am Main and the European Securities and Markets Authority (ESMA) based in Paris. The three ESAs are the legal successors to the former Level 3 committees, the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR), and have their own legal personality. Alongside the national supervisory authorities, they are responsible for institutional and market supervision, also referred to as microprudential supervision. Macroprudential supervision, i.e. the supervision of the stability of the financial system as a whole, is performed by the European Systemic Risk Board (ESRB) based in Frankfurt am Main. The ESRB is hosted by but independent of the European Central Bank (ECB) and does not have its own legal personality.

Through this European System of Financial Supervision (ESFS), European lawmakers aim to drive forward the harmonisation of financial supervision in Europe and ensure the consistent application of supervisory rules in the single European market.

Powers of the ESAs.

To this end, the three ESAs can issue non-binding guidelines and recommendations; however, national supervisors must give reasons if they do not comply with them. The EBA, EIOPA and ESMA can also draft binding regulatory and implementing technical standards, which are then adopted by the European Commission. The areas in which the ESAs can develop technical standards are set out in the directives for the individual financial sectors. Subject to certain conditions, the three authorities also have powers to take direct action against financial institutions, namely when national supervisors fail to apply EU law or apply it incorrectly, to settle disagreements between national supervisors, or in crisis situations.

However, direct action only becomes possible once a multiphase procedure has been followed: firstly, the ESAs contact the national supervisory authorities to ensure that these take the measures

necessary to respond to developments that pose the risk of a crisis or to remedy a breach of EU law, for example. Only if the national authorities fail to do so can the EBA, EIOPA and ESMA take a decision that is directly applicable to a particular financial institution, subject to strict conditions.

Organisation of the ESAs.

The ESAs are each represented by a Chairperson and managed by an Executive Director, who discharge their duties independently and for a term of office of usually five years. Each of the three ESAs also has a Board of Supervisors and a Management Board. In addition, there is a joint Board of Appeal and a Joint Committee for all three authorities.

Board of Supervisors.

The decision-making body of each ESA is its Board of Supervisors. The voting members of this Board are the heads of the 27 national supervisory authorities. As a rule, the Board of Supervisors takes decisions by simple majority voting according to the principle of one member, one vote.

Exceptions to this rule include decisions on the development of technical standards, the drafting of guidelines and recommendations, and matters related to ESA budgets. These decisions are taken by qualified majority voting. Decisions by which the ESAs settle disputes between national supervisors with binding effect are also subject to separate voting rules. For certain tasks that are assigned to them, the Boards of Supervisors can engage internal committees and bodies.

Management Board.

The Management Boards of the EBA, EIOPA and ESMA each have seven members: the Chairperson of the ESA in question and six other members, who are elected by the voting members of the Board of Supervisors and from among its members. The Management Boards perform administrative tasks and ensure that the European authorities carry out their mandate and perform the tasks assigned to them, for example by proposing an annual work programme.

Board of Appeal.

If Union law is breached, in crisis situations and to settle disagreements between national supervisory authorities in cross-border situations, the ESAs may adopt decisions that are binding on the authorities or institutions concerned, subject to certain conditions. National and legal persons directly and indirectly affected may appeal against these and other decisions taken by the ESAs. For reasons of efficiency and consistency, it was decided to set up one joint Board of Appeal for the three ESAs; however, this is independent of the management and regulatory structures. The decisions of the Board of Appeal can themselves be appealed before the Court of Justice of the European Union.

Joint Committee.

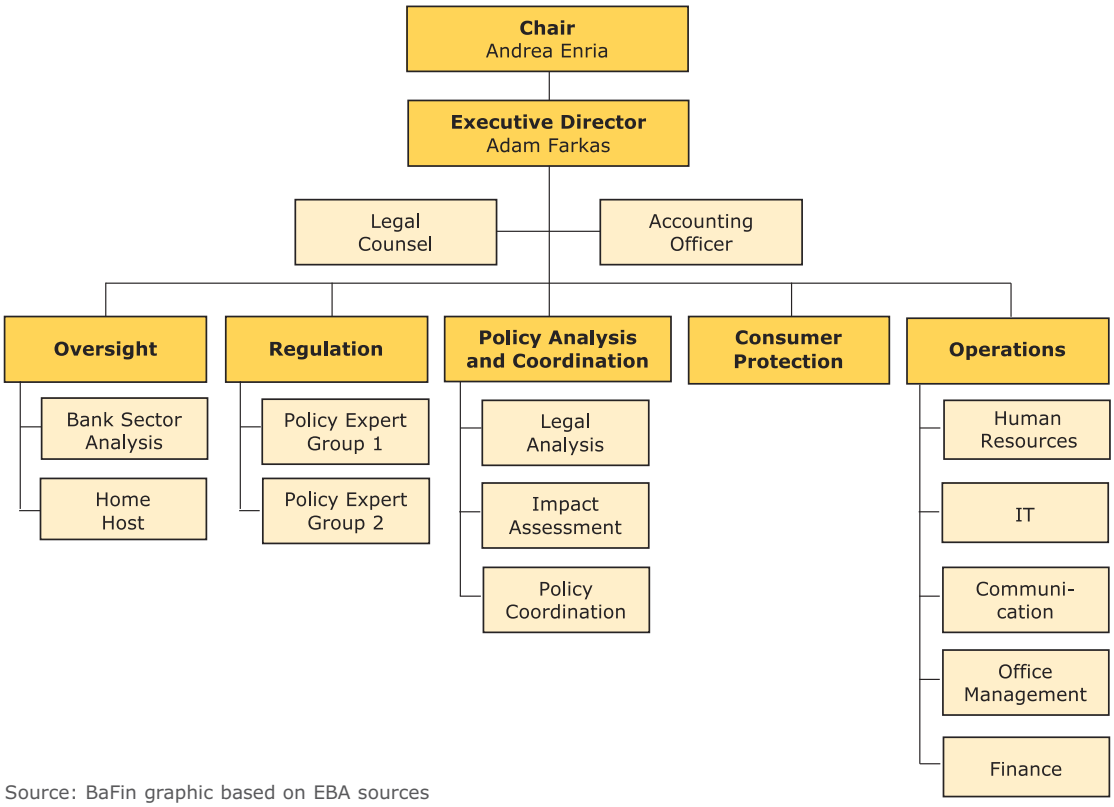
The Joint Committee provides a forum for regular and close cooperation among the three ESAs. Its members are the Chairpersons of the ESAs and the Chairpersons of the Joint Committee’s four subcommittees. At present, the subcommittees are working primarily on the development of measures to improve

the supervision of financial conglomerates, combat money laundering, identify cross-sectoral risks and promote consumer protection. The Joint Committee's prime objective is to ensure that all three ESAs act in a uniform manner.

EBA

The EBA is a banking supervisor. It is chaired by Andrea Enria and managed by its Executive Director, Adam Farkas. The internal organisational structure is as follows:

Figure 14
Structure of the EBA



Source: BaFin graphic based on EBA sources

BaFin is represented on both the EBA's Management Board and its Board of Supervisors by BaFin's Chief Executive Director of Banking Supervision, Raimund Röseler.

The following internal committees have been used to date:

- The Standing Committee on Oversight and Practices (SCOP) advises and supports the EBA in establishing a common supervisory culture, in ensuring that the supervisory colleges function in a coherent manner, in preparing uniform assessments and making decisions, in drafting high-quality technical standards or guidelines and recommendations, and in continually assessing and monitoring risks in the banking sector.

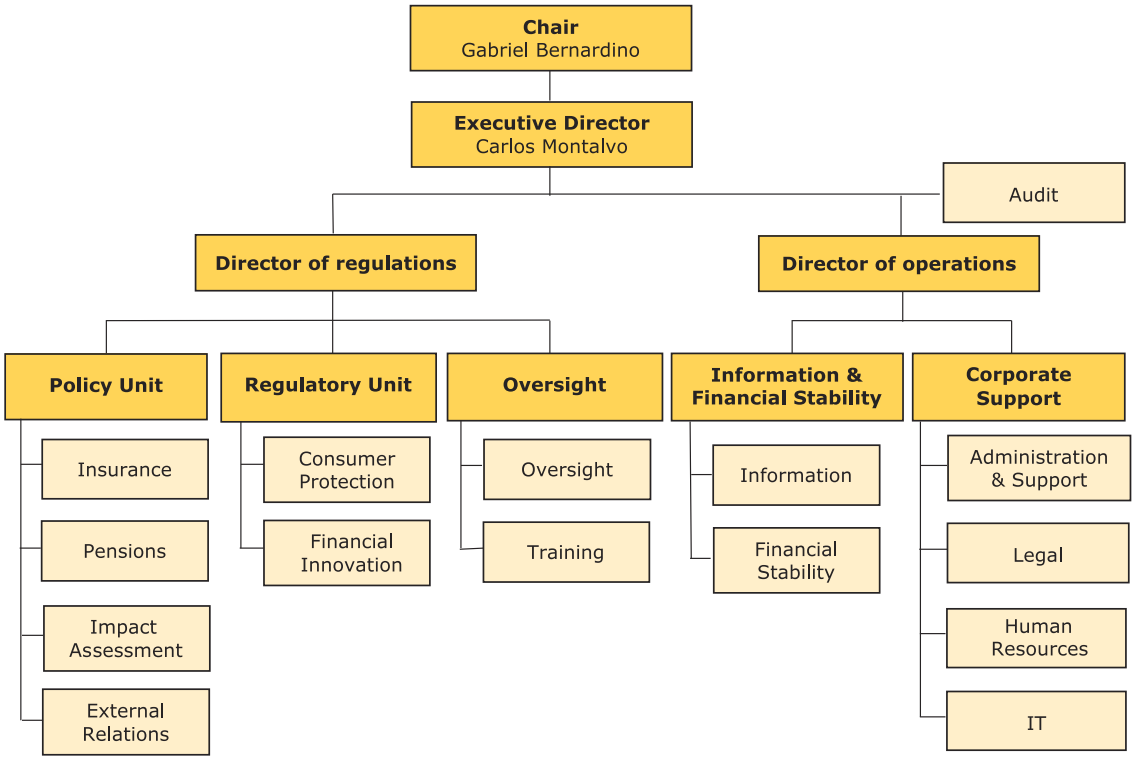
- The task of the Standing Committee on Regulation and Policy (SCREPOL) is to support the EBA in drawing up binding and non-binding rules for banking supervision, for the recovery and resolution of banks, and for payment and e-money transactions.
- As its name indicates, the Standing Committee on Accounting, Reporting and Auditing (SCARA) advises and supports the EBA in the area of accounting, reporting and auditing.
- The main aim of the Standing Committee on Financial Innovation (SCFI) is to advise and support the EBA in monitoring innovative and existing financial activities and in the area of consumer protection in this context.

Since it was established, the EBA has published initial guidelines and recommendations on internal governance and recapitalisation, for example. At present, the EBA is drafting the first binding regulatory and implementing technical standards, which the European Commission must adopt in the course of 2012.

EIOPA

EIOPA is responsible for both insurance and occupational pensions. EIOPA is chaired by Gabriel Bernardino and managed by Carlos Montalvo in his capacity as Executive Director. EIOPA's internal structure is as follows:

Figure 15
Structure of EIOPA



Source: BaFin graphic based on EIOPA sources

The Chief Executive Director of Insurance Supervision, Gabriele Hahn, represents BaFin on EIOPA's Board of Supervisors.

EIOPA currently has ten standing committees, the Review Panel and three task forces. Half of the committees deal with issues related to Solvency II. Other committees focus on occupational pensions, financial stability, consumer protection and financial innovation, issues related to IT and data collection and storage, and EIOPA's internal quality control. The task of the Review Panel is to regularly subject all or some of the activities of the competent national supervisory authorities to a comparative analysis known as a peer review on EIOPA's behalf.

EIOPA addresses consumer protection.

EIOPA has renamed the former CEIOPS Committee on Consumer Protection, adding "and Financial Innovation" to the name, as the EIOPA Regulation covers this, too. This Committee deals not only with conventional areas of consumer protection such as consumer complaints handling or the disclosure of practices in the sale of certain products, but also with financial literacy and education initiatives, for example.

EIOPA sets up stakeholder groups for insurance and occupational pensions.

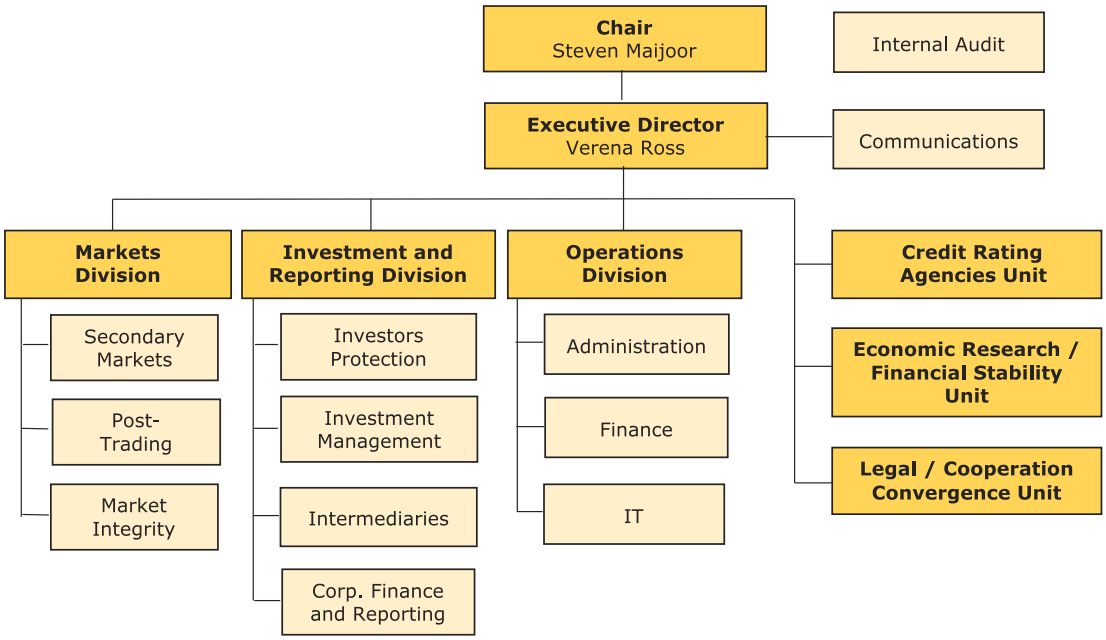
The regulations establishing the three ESAs also provide for stakeholder groups to be set up to facilitate consultation in the areas of relevance to the authorities. Based on its remit, EIOPA has set up two stakeholder groups: one for insurance and reinsurance, and one for occupational pensions.

The stakeholder groups may submit opinions or advice to EIOPA on any issue related to EIOPA's duties. The main focus of this advice is on the binding technical standards drafted by EIOPA, the authority's guidelines and recommendations, and its tasks in relation to the common supervisory culture, peer reviews and the assessment of market developments. Both stakeholder groups were established at the beginning of March 2011. They each have 30 members.

ESMA

ESMA started work in the area of securities supervision under the chairmanship of Steven Maijoor and the management of Executive Director Verena Ross. Karl-Burkhard Caspari, BaFin's Chief Executive Director of Securities Supervision, represents BaFin on the Board of Supervisors. He is also a member of ESMA's Management Board. ESMA's internal structure is as follows:

Figure 16
Structure of ESMA



Source: BaFin graphic based on ESMA sources

ESMA discharges its duties relating to markets and investment/reporting through the following committees in particular:

- The Secondary Markets Standing Committee (SMSC) deals with the structure, transparency and efficiency of secondary markets for financial instruments.
- The ESMA-Pol Standing Committee carries out tasks relating to market supervision, enforcement of mandatory requirements and prohibitions under securities law, and cooperation between national supervisory authorities. It also deals with all issues relating to the regulation of short selling.
- Work on the clearing and settlement of transactions in financial instruments is carried out by the Post-Trading Standing Committee (PTSC).
- The Investor Protection and Intermediaries Standing Committee (IPISC) deals with all issues related to the provision of investment services.
- The Financial Innovation Standing Committee (FISC) is tasked with capturing new consumer trends and financial innovations, with the aim being to promptly identify developments or products of concern and examine whether they pose risks to retail investors or system stability. In doing so, the FISC relies on data provided by national supervisory authorities. The results serve to prepare a broad range of measures from warnings through to product bans. ESMA divides the work associated with these measures with national supervisors to the extent that specific rules and regulations (such as MiFID) empower them to do so.

- The Investment Management Standing Committee (IMSC) deals with issues related to collective investments.
- The Corporate Finance Standing Committee (CFSC) is primarily responsible for issues related to the Prospectus Directive[27], transparency and corporate governance.
- The Corporate Reporting Standing Committee (CRSC) addresses all financial accounting and reporting issues.

ESMA is supported by other bodies in addition to these Standing Committees.

ESMA registers and supervises rating agencies.

Besides the policy work carried out by the Standing Committees, ESMA has been responsible since July 2011 for registering and supervising credit rating agencies (CRAs).[28] ESMA also maintains a central repository in which information regarding credit ratings and the rating agencies' previous rating activities is stored and published. ESMA is supported in this area by the CRA Technical Committee.

ESRB

The ESRB also started work in January 2011. It supplements the new European System of Financial Supervision and monitors the stability of the financial system as a whole by analysing systemic risks, issuing early warnings about them and recommending measures to remedy them. The macro supervision conducted by the ESRB dovetails with the micro supervision for which the EBA, EIOPA and ESMA are responsible. The ESRB therefore makes a significant contribution to the safety and stability of the European financial system.

ESRB completes important work on content and identifies risks.

BaFin is represented at the ESRB by its President, Dr. Elke König, who is not a voting member of the ESRB. BaFin employees are active in various ESRB working groups. The Board has already completed some important work on content. This includes a public recommendation on lending in foreign currencies as well as a number of evaluations and assessments of European and national legislative plans. A further focus was on establishing an institutional framework and a toolkit for macroprudential supervision.

[27] Directive 2003/71/EC, OJ EU L 345, p. 64 et seq., amended by Directive 2010/73/EU, OJ EU L 327, p. 1 et seq.
[28] See p. 82.

5 FSAP assessment

The **Financial Sector Assessment Program (FSAP)** initiated in 1999 is a joint programme of the International Monetary Fund (IMF) and the World Bank. It serves to identify potential vulnerabilities in the financial sectors of IMF member countries and to recommend a course of action. The FSAP scrutinises the legal framework and the resilience to a crisis of the financial sectors in the member country in question. The IMF examines to what extent the supervisory authorities of the G20 member states are observing the international standards of the Basel Committee, the IAIS, IOSCO and the CPSS. In addition, stress tests are performed in the banking and insurance sectors. FSAP assessments are to be carried out roughly once every five years. Germany was first assessed in 2003. The IMF does not have any powers of intervention. However, at their summits in London and Pittsburgh in 2009, the G20 heads of state and government pledged to strengthen the global financial system through suitable measures and reforms.

IMF assesses German financial sector.

At the beginning of 2011, the IMF subjected the German financial sector to an FSAP assessment. In response to the financial crisis, the IMF was particularly interested in banking supervision and the banking sector. The FSAP mainly comprised discussions with BaFin, the Deutsche Bundesbank and the Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF) as well as with undertakings and associations. In addition, BaFin, the Bundesbank and the BMF, which was in overall charge of the assessment, had to complete self-assessments and questionnaires on German financial supervision. The IMF assessment took a good two weeks. During this time, a total of 14 assessors from the IMF and other supervisory authorities were in Germany for discussions and interviews. The IMF published the results of the FSAP in a report on its website.

IMF emphasises importance of the German banking system.

In their report, the IMF assessors emphasised the international importance of the German banking system. They therefore also set a rigorous benchmark. In the final analysis, the FSAP assessment provided important impetus for improving banking supervision in Germany. BaFin has already responded to some of the IMF's criticisms, for example by setting up a section for IT auditing standards in Banking Supervision's Basic issues department. BaFin and the Bundesbank are tackling other criticisms jointly.

In some cases, however, BaFin found the IMF's judgement difficult to understand: based on the small number of supervisory capital add-ons, for example, the IMF has concluded that BaFin is not implementing the applicable capital requirements effectively enough. This kind of analysis focuses purely on the number of supervisory measures instead of gauging supervisory success based on institutions' actual capitalisation.

FSAP assessment of the insurance sector.

In their assessment of insurance supervision, the IMF assessors found that the IAIS Core Principles are observed and implemented to a very high level. This view is all the more important given the high demands the IMF makes of Germany as a result of its pioneer pioneering role and market power. The risk-based supervisory approach and the preparations for the introduction of Solvency II in 2013 were also a topic of discussion, as were BaFin's analysis of the insurance market and its crisis management.

FSAP assessment of securities supervision.

The IMF also found securities supervision to be of a high standard in the FSAP assessment. It assessed both the IOSCO Principles of Securities Regulation and the IOSCO–CPSS Recommendations for Central Counterparties. The central counterparty in Germany is Eurex Clearing AG. The IMF confirmed that the vast majority of the standards relevant to securities supervision are fully implemented in supervisory practice. The IMF also supported the plan for stricter regulation of the "grey" capital market. BaFin likewise received support for its efforts to make supervision more risk-oriented. The IMF recommended increasing the use of on-site inspections at regulated undertakings. It mentioned several opportunities for improvement which are already the subject of regulatory work at European level, one example being the supervision of central counterparties as part of the regulation of OTC derivatives markets.

6 Financial conglomerates

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

Last year saw the introduction of some important changes in the regulation of financial conglomerates at both global and European level.

Joint Forum publishes principles for the supervision of financial conglomerates.

Promptly at the end of the year, the Joint Forum released for consultation the revised and extended principles for the supervision of financial conglomerates after obtaining the approval of its parent organisations, the BCBS, the IAIS and IOSCO. The updated version of the 1999 principles had been adopted at the Joint Forum's meeting in Berlin at the beginning of November 2011 after one and a half years of negotiations. The aim of the amended principles is to establish an effective and consistent global supervisory

framework for financial conglomerates that also captures risks arising from unregulated financial activities and undertakings. The principles provide for a clear legal framework and adequate powers and resources for effective financial conglomerate supervision. They also stress the importance of cooperation among all the supervisory authorities responsible for a financial conglomerate. The Joint Forum has added several principles on corporate governance. It has also drawn up new principles on capital management, internal capital planning processes and liquidity management, and set out requirements for risk management.

The **Joint Committee on Financial Conglomerates** (JCFC) is a subcommittee of the Joint Committee, which was established alongside the three European supervisory authorities, the EBA, EIOPA and ESMA, to ensure cross-sectoral convergence. Among other things, the JCFC's work aims to ensure that the Financial Conglomerates Directive is implemented fully and consistently throughout the individual member states. The JCFC existed as a joint committee of European banking and insurance supervisors even before the European System of Financial Supervision was established.

Directive amending the Financial Conglomerates Directive enters into force.

At European level, the directive amending the Financial Conglomerates Directive[29] entered into force on 9 December 2011. The aim of this amending directive is to close gaps in financial conglomerate supervision and to bring the Financial Conglomerates Directive into line with the new European supervisory structure. The rules governing the supervision of large financial conglomerates have been tightened, while small financial conglomerates have been granted an additional option to obtain exemption from supplementary supervision under the Financial Conglomerates Directive. The amendments are based on the proposals put forward by the Joint Committee on Financial Conglomerates (JCFC) in October 2009 in response to a call for advice from the European Commission. In addition, alternative investment fund managers in accordance with the AIFM Directive have also been included in the scope of the Directive at the request of the European Parliament and member states have been given the opportunity to perform stress tests at financial conglomerate level.

JCFC draws up proposals for the revision of the Financial Conglomerates Directive.

The focus in the year under review was on the work on a further call for advice from the European Commission regarding the Financial Conglomerates Directive. On 20 April 2011, the Commission had asked the JCFC, which is currently being chaired by BaFin, to submit concrete proposals for a further, thorough revision of the Financial Conglomerates Directive by summer 2012. More specifically, this concerns the supervisory requirements for the internal governance of financial conglomerates, effective

[29] Directive 2011/89/EU, OJ EU L 326, p. 113 et seq., Directive 2002/87/EC, OJ EU L 35, p. 1 et seq.

sanctioning options and the scope of the Directive. For example, it is planned to extend the scope by including special purpose vehicles (SPVs), special purpose entities (SPEs) and insurance ancillary services in the supplementary supervision of financial conglomerates.

7 Rating agencies

2011 was dominated by the practical implementation of the amended EU Credit Rating Agencies Regulation (CRA II)[30], which entered into force on 1 June 2011. Under this Regulation, ESMA has been responsible for the supervision of rating agencies since 1 July 2011. However, rating agency applications for registration received by national supervisors before 7 September 2010 were fully dealt with by the colleges of national supervisors set up specifically for this purpose.[31] ESMA had only a coordinating and advisory role in this. The European subsidiaries of the large rating agencies Standard & Poor's Ratings Services, Moody's Investors Service, Fitch Ratings and Dominion Bond Rating Service were registered on 31 October 2011 and have since been under the supervision of ESMA in the EU.

Third-country supervisory systems tested for equivalence.

In addition to registering the agencies, one key task for national supervisors, or later ESMA, was to examine the legal and supervisory systems of third countries. This had to be done in order to ensure that ratings prepared in the countries concerned meet the requirements of the EU Regulation. Only if it is decided that they do may those ratings continue to be used for regulatory purposes within the EU (endorsement).

The third-country ratings used in the EU consist mainly of ratings from the large, globally active rating agencies. Due to the time-consuming process of examining third-country systems, ESMA granted an initial transition period of three months following the registration of those agencies (until 31 January 2012) and extended this period by a further three months until 30 April 2012. During this transition period, third-country ratings could continue to be used for regulatory purposes within the EU even if the examination of the legal and supervisory system in the country concerned had not been completed. After 30 April 2012, these third-country ratings may no longer be used unless ESMA determines that the requirements in the third country are equivalent to those in the EU and the agencies in the country in question are registered and supervised. In addition, ESMA must have entered into a cooperation agreement with the supervisory authority in the third country.

[30] EU 513/2011, OJ EU L 145, p. 30 et seq.
[31] See chapter I.

In the period to 2011, it was only possible to examine the legal and supervisory systems of Japan (2010) and Australia (2011). Ratings from these countries can be endorsed. One of ESMA's main tasks in 2012 is to complete the examination of the legal and supervisory systems of other countries outside the EU. So far, the systems of the USA, Canada, Hong Kong, Singapore, Mexico, Brazil and Argentina have been fully checked. Ratings from these countries can also be endorsed.

Credit Rating Agencies Regulation to be reviewed again.

On 15 November 2011, the Commission presented a proposal for a further amendment of the EU Credit Rating Agencies Regulation (CRA III). This mainly contains amendments or changes in relation to the following:

- reducing the reliance of supervisors and the industry on external ratings;
- restricting opportunities to hold equity interests in rating agencies;
- rotating rating agencies within certain periods;
- the examination of amended or new rating methodologies by ESMA;
- special rules on sovereign ratings;
- the introduction of a European Rating Index; and
- the introduction of civil liability rules.

The Council negotiations on this started at the beginning of 2012 and are due to be completed in summer 2012.

8 Financial accounting and reporting

The **International Accounting Standards Board** (IASB) is the ultimate standard-setter in the field of financial accounting and reporting. It develops and issues accounting principles – International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) – that are applied by a large number of companies across the world and are adopted by the European Union. The IASB's members are accountants, analysts and preparers and users of financial statements.

Write-downs of Greek government bonds

Following negotiations with the Institute of International Finance (IIF), the Greek government presented the banks and other private creditors with its proposals for a haircut on 24 February 2012.[32] As well as a cash payment, this included a provision for the

[32] See chapter VI 5.

holders of Greek government bonds to receive new, long-dated government bonds for the portion not covered by the debt waiver.

The bond exchange programme was an adjusting event that affected the measurement of Greek government bonds in annual financial statements for the year ended 31 December 2011. The write-downs at the end of 2011 of Greek government bonds classified under IFRSs as "loans and receivables" and "held-to-maturity investments", and classified as long-term financial assets under German GAAP, exceeded the agreed 53.5% private participation in the haircut. The higher level of write-downs required – 70% to 80% of the principal amount was expected – resulted from a net present value loss because the new bonds to be issued had a lower interest rate.

IFRS 9 Financial Instruments

Impairment rules still unresolved.

Following the joint presentation in January 2011 by the IASB and the United States Financial Accounting Standards Board (FASB) of a good book/bad book model for determining impairment losses, discussions on the future impairment rules are focussing at present on an approach involving three categories for determining impairment allowances ("three-bucket approach"). Different approaches to measuring impairment allowances are being proposed for each "bucket".

An asset will be allocated to the first bucket if there has been no loss event. However, impairment allowances will be recognised proportionately in this bucket for expected losses in the following twelve months, based on the lifetime expected losses. In the second (portfolio loan) bucket, full remaining lifetime impairment losses will be recognised collectively for all those assets whose losses cannot be measured individually. If a loss event can be attributed to a specific asset (e.g. a loan), it is individually impaired by a single impairment allowance in the third (individual loan) bucket.

The details of this impairment model are currently being debated, and no definitive model has yet been agreed. This is one of the reasons why the IASB has now decided to postpone the effective date of IFRS 9, which will succeed IAS 39, from 1 January 2013 to 1 January 2015.

Hedge accounting will follow risk management.

The underlying approach in the Hedge Accounting Exposure Draft is to align hedge accounting more closely with risk management and thus enhance the link between the two objectives. The IASB is in the final phase of the Hedge Accounting project, although macro hedge accounting has initially been carved out of the project. Because banks mainly use macro hedges to hedge interest rate risk, it is not possible at this point to reach a conclusive assessment of the planned revision of the IFRS 9 hedge accounting rules. However, it is already evident that the IASB has addressed much of the criticism levelled at IAS 39 – which still continues to govern hedge accounting – in the course of its work so far.

Convergence with US GAAP remains unresolved.

The initial exposure drafts issued by the IASB and the FASB showed how difficult it might be to achieve convergence in the field of financial reporting, but the gap between the two standard-setters is now narrowing. The FASB has adopted some of the IFRS 9 recognition and measurement rules. This is also evident from the rules governing the measurement of impairment losses on financial instruments measured at amortised cost, where the two standard-setters are working together on the joint "three-bucket approach".

There are currently two concepts for hedge accounting that differ significantly in a number of areas. It therefore remains to be seen whether it will be possible to achieve full-blown convergence in financial instruments accounting. The following table shows the status of the project as at 11 April 2012:

Table 3
Revision of the accounting rules for financial instruments

<table>
<tr><th></th><th>IASB (IFRS 9)</th><th>FASB</th><th>EU endorsement</th></tr>
<tr><td>Phase I: Recognition and Measurement</td><td>Finalized in 2009, may be revisited</td><td>ED</td><td>No</td></tr>
<tr><td rowspan="2">Phase II: Impairment</td><td>ED</td><td>ED</td><td rowspan="2">No</td></tr>
<tr><td colspan="2">Revised ED announced</td></tr>
<tr><td>Phase III: Hedge-Accounting</td><td>ED for micro hedges (ED for macro hedges announced)</td><td>ED</td><td>No</td></tr>
<tr><td colspan="4">ED = Exposure Draft</td></tr>
</table>

IASB Exposure Draft on Insurance Contracts

Debate about volatility.

Following the end of the comment period on 30 November 2010 for the Insurance Contracts Exposure Draft issued by the IASB, discussions in the course of 2011 concentrated on how to deal with volatility in profit or loss resulting from the way the IASB is proposing to account for technical provisions. The effects of interest rate changes on the measurement of technical provisions over time played a key role here.

At the end of 2011, it emerged that the IASB no longer wants to recognise the effects of changes in interest (discount) rates on the measurement of liabilities in profit or loss, but rather in other comprehensive income (OCI). This would eliminate the existing volatility in profit or loss resulting from the measurement of technical provisions. BaFin will continue to support the IASB in adopting a final insurance standard as quickly as possible.

To avoid an accounting mismatch, especially in the balance sheets of insurance undertakings, the IASB has also proposed a further revision of Phase 1 of IFRS 9, a move that is expressly welcomed by BaFin.

EU: Proposed revision of audit rules

The European Commission's plans for legislation.

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 consultation resulted in two legislative proposals that were published by the European Commission on 30 November 2011: a directive amending the Audit Directive (2006/43/EC) and a new regulation containing specific requirements regarding statutory audit of public-interest entities. Both proposals are part of the financial market reform programme, and the Commission believes that they are necessary in light of the financial crisis.

The main features of the proposed amendment to the Audit Directive are:

- coordination of European supervision of statutory auditors by ESMA
- creation of a single market for statutory audits by introducing a European passport for audit firms
- application of the International Standards on Auditing (ISAs)

In its draft regulation, the Commission is also proposing far-reaching measures for public-interest entities. The main proposals are:

- external rotation of audit firms
- mandatory tendering for auditor selection
- prohibition on the provision by auditors of certain or all non-audit services.

The European Commission believes that its proposed regulation would take account of the global footprint of public-interest entities at the level of the EU and lower the risk of regulatory arbitrage. A regulation has direct legislative force because it takes effect immediately it is adopted.

SEC postpones introduction of IFRSs

Further delay in the use of IFRSs in the USA.

The work programme of the United States Securities and Exchange Commission (SEC) for 2011 included a decision on whether to permit the use of IFRSs for entities that are both listed and domiciled in the USA. At the annual conference of the American Institute of Certified Public Accountants (AICPA) in December on national developments in accounting, the Chief Accountant of the SEC commented that no official statement could be expected from the SEC before 2012. The reasons he gave for this included

insufficient progress made in the convergence efforts of the two standard-setters, the FASB and the IASB, and the fact that the economic impact of a switch to IFRSs had to be taken into account. Although SEC working groups had issued two reports analysing the use of IFRSs in practice in mid-November, he also said that work was progressing on another report that would be crucial for the SEC's decision.

In 2011, the SEC also opened the debate on a "condorsement" approach for adopting IFRSs, which would further prolong the transition process and possibly restrict the adoption of IFRSs by US public companies.

9 Market transparency/integrity and prospectuses

High-frequency trading

IOSCO publishes recommendations on market integrity.

In 2011, computer-assisted high-frequency trading was the subject of what were in some cases critical reports in the business media. It also received substantial attention from the main international and European institutions, namely IOSCO and ESMA. In October 2011, IOSCO adopted a report entitled "Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency". The focus of this report is on high-frequency trading. It concludes with recommendations on safeguarding against potential risks that may arise due to the technological development of trading. Among other things, market operators should have suitable control mechanisms in place to deal with extraordinary market volatility; in addition, any order flow should be subject to pre-trade controls. Regulators are required to continually monitor the situation and, if necessary, to take further action.

At the end of 2011, ESMA published "Guidelines on systems and controls in a highly automated trading environment", which had previously been released for consultation and which also deal primarily with high-frequency trading. These guidelines aim to increase market stability and minimise opportunities for abuse. They set out in greater detail the current provisions in the EU Markets in Financial Instruments Directive (MiFID) governing safeguard mechanisms and risk management for market operators and investment firms in light of the latest technological developments such as high-frequency trading.

Dark pools

IOSCO publishes final report on dark pools.

In the 2010 Annual Report, BaFin had already reported on facilities known as dark pools that are exempt from pre-trade and, in certain cases, also post-trade transparency requirements.[33] In May 2011, IOSCO adopted a report on the issue entitled "Principles for Dark Liquidity". This states that trading on markets should generally be transparent. Departures from this requirement, such as in relation to the pre-trade transparency of certain types of order, for example, should only be possible after careful consideration by supervisors. The latter are required to monitor developments in their markets and intervene where necessary, especially if the extent of dark pools gives them reason to fear an adverse impact on the price discovery mechanism.

Revision of MiFID

European Commission presents draft of a revised MiFID.

One important issue in the context of secondary markets was the start of the work to revise MiFID[34]. In October 2011, following extensive consultation in December 2010 on possible amendments to the MiFID currently in force, the European Commission published its proposals for the revision of MiFID: the draft of MiFID 2 and the draft of the supplementary MiFIR. The proposals for MiFID also concern high-frequency trading and provide for special measures for both investment firms and trading venues that address the risks associated with high-frequency trading. The draft MiFIR contains further fundamental changes with a considerable impact on the existing market infrastructure, such as the introduction of mandatory trade transparency for bonds, structured finance products and derivatives. In addition, MiFID is to create a new category of trading platform, the organised trading facility category, which covers previously unregulated, alternative forms of trading and is thus intended to reduce OTC trading. Council-level negotiations on the drafts of MiFID and MiFIR began in November 2011.

ESMA proposes extensive changes to prospectus law.

In connection with the implementation of the amended Prospectus Directive[35], which governs requirements related to the preparation and publication of securities prospectuses and was published in the Official Journal of the European Union in December 2010, ESMA presented the Commission with extensive proposals for a revision of the Prospectus Regulation[36]. These aim to create more transparency through a summary that contains all key information and allows investors to better compare different offerings. ESMA also wishes to improve investor protection through a much more restrictive base prospectus regime. In future, all key information is to be contained in the base prospectus itself and not, as has been the case so far, in the final terms, and should therefore be checked by supervisory authorities. A base prospectus may be used for a

[33] See 2010 Annual Report, p. 69.
[34] Directive 2004/39/EC, OJ L 145, p. 1 et seq. as last amended by Directive 2006/31/EC, OJ L 114, p. 60 et seq.
[35] Directive 2003/71/EC, OJ EU L 345, p. 64 et seq., amended by Directive 2010/73/EU, OJ EU L 327, p. 1 et seq.
[36] Regulation (EC) No. 809/2004, OJ EU L 149, p. 1 et seq., consolidated version dated 1 January 2009.

number of issues and contains basic information on the issuer and the securities with the exception of issue-specific information such as the issue price, the interest rate, or the underlying. The latter are not set out in the final terms until shortly before the issue and are not checked by BaFin. To reduce bureaucratic hurdles for issuers, ESMA also submitted proposals for reduced prospectus requirements in relation to certain offerings or offerors. In addition to pre-emptive issues, offers by small and medium-sized enterprises and enterprises with low market capitalisation in particular are to be made easier.

AIFM Directive

Supervision of alternative investment fund managers.

The Directive on Alternative Investment Fund Managers (AIFM Directive) was published in the Official Journal of the European Union on 1 July 2011.[37] The member states must transpose it into national law by 22 July 2013. The AIFM Directive establishes requirements governing the authorisation of alternative investment fund managers (AIFMs) and their supervision. An alternative investment fund (AIF) is any collective investment undertaking which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and is not an undertaking for collective investment in transferable securities (UCITS) within the meaning of the UCITS Directive[38]. AIFs include, for example, private equity funds, venture capital funds and real estate funds.

It is immaterial whether the AIF is of the open-ended or the closed-ended type and in what legal form it was established. As the AIFM Directive therefore also covers managers of closed-end funds, the transposition of the AIFM Directive into national law will result in extensive regulation of the "grey" capital market. The AIFM Directive applies only to a limited extent to managers of AIFs where the assets, including assets acquired using leverage (e.g. borrowing, derivatives transactions), do not exceed €100 million in total. A threshold of €500 million applies to AIFs that are not leveraged and do not grant redemption rights within five years of being established. However, AIFMs below this threshold are subject to registration in their home member state and are required to provide certain information to the competent authorities (e.g. information on the principal exposures and most important concentrations of risk). These AIFMs can also choose to opt in under the AIFM Directive.

ESMA: advice on Level 2 measures for the AIFM Directive.

In many areas, the AIFM Directive delegates to the European Commission the power to adopt delegated acts. The European Commission asked ESMA to submit recommendations for these delegated acts by mid-November 2011. Four task forces were formed to draw up those recommendations: the Operating Conditions task force, for example, which was chaired by BaFin, developed proposals for provisions governing the conduct of

[37] Directive 2011/61/EU, OJ EU L 174, p. 1 et seq.
[38] Directive 2009/65/EC, OJ EU L 302, p. 32 et seq.

business, conflicts of interest and organisational requirements as well as on outsourcing, additional own funds and professional indemnity insurance, investment in securitisation positions and valuation. ESMA consulted on the recommendations drawn up by the various task forces in summer 2011. It published the final version of them on 16 November 2011. The Commission will adopt the delegated acts in the course of the year.

10 Occupational retirement provision

Call to EIOPA for advice on the revision of the IORP Directive.

In April 2011, the European Commission issued a call for advice to EIOPA, seeking proposals for possible amendments to the IORP Directive[39]. The call for advice was divided into 23 individual topics and required a response by 15 February 2012.

In its response, the draft of which had previously been released for consultation, EIOPA advises the Commission not to extend the scope of the IORP Directive. It also proposes a tighter definition of the term cross-border activity and supervisory law, based on the activities for which the home member state is responsible under the current Directive.

Other deliberations concern the inclusion of key concepts contained in the quantitative and qualitative rules of the Solvency II Framework Directive in a revised IORP Directive, bearing in mind the specific features of occupational retirement provision. The proposals for the quantitative rules are based on the Commission's aim of achieving Europe-wide harmonisation of supervisory rules governing the calculation of provisions and solvency capital requirements for all types of institutions for occupational retirement provision (IORP). EIOPA stresses that implementing this aim may ultimately require a political decision.

As a possible means of implementing the Commission's aims, EIOPA suggests a holistic balance sheet, which is intended to enable comparison of the IORP's liabilities (provisions and solvency capital) and the resources available to meet pension promises. In addition to the IORP's assets, resources also include the employer's obligation to provide further financial resources where necessary and pension protection schemes. Other specific features, such as the option to reduce benefits, should also be included in the balance sheet.

In many respects, the way in which assets and liabilities in the holistic balance sheet are calculated follows the new European requirements for insurance undertakings (Solvency II). However, in the case of a range of components and the calculation of those

[39] Directive 2003/41/EC, OJ EU L 235, p. 10 et seq.

components, EIOPA's response to the Commission provides for several options. For example, as well as the option of calculating the risk margin in accordance with Solvency II, there is also the option that IORPs do not require such a margin at all. As regards the technical interest rate, the response provides for the option of calculating technical provisions using a higher rate as well as using a risk-free rate.

The response contains the recommendation to undertake a quantitative impact study (QIS) before taking a decision on the form of the future quantitative requirements. The European Commission has now asked EIOPA to undertake such an impact study.

EIOPA's response concludes with the proposal to extend the disclosure obligations, particularly for pure defined contribution obligations.

Developments in cross-border occupational retirement schemes.

In 2011, EIOPA reported on the development of cross-border activities by IORPs within the EU and European Economic Area (EEA). Between June 2010 and July 2011, the number of IORPs engaged in cross-border activity rose by 8% from 78 to 84, according to EIOPA. During this period, 11 new cross-border IORPs were reported, while five others ceased cross-border activity. The reasons for withdrawal vary. The number of home countries rose from seven to nine during this period, and the number of host countries from 22 to 23.

EIOPA report on IORPs' reporting obligations.

In April 2011, EIOPA published a report on the obligations of institutions for occupational retirement provision to report information to supervisory authorities. It provides an overview of reporting obligations in EU member states and EEA signatory states. In the report, EIOPA identifies clear differences within the EU and the EEA. For example, some supervisory authorities receive numerous items of information very frequently, whereas other supervisory authorities mainly obtain information on request. The analysis revealed that the differences within the EU and EEA can be explained in particular by the number of institutions for occupational retirement provision that an authority has to supervise and the number of institutions that have to be supervised per employee. For example, the frequency with which information must be sent to the supervisory authority appears to be higher in states with fewer institutions than in states with thousands of institutions. In addition, it appears to be more common to obtain information on request in countries where a higher number of institutions have to be supervised per employee. By contrast, in states with fewer institutions per employee, information is submitted more frequently, on a monthly and quarterly basis in particular. Annual reporting is especially relevant for states where three to 13 institutions have to be supervised per employee.

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 sets international standards for the supervision of institutions for occupational retirement provision, also has the task of promoting international cooperation and provides a global forum for exchanging information. BaFin is a voting member of the IOPS Technical Committee.

Good practices in the use of alternative investments and derivatives.

The global financial and economic crisis prompted IOPS and the Organisation for Economic Co-operation and Development (OECD) to investigate in greater detail how institutions for occupational retirement provision use alternative investments and derivatives. The different characteristics and risk profiles of these products, and above all their complexity, require the use of sophisticated methods for quantitative and qualitative risk analysis. A paper jointly adopted by IOPS and the OECD in the year under review illustrates how institutions for occupational retirement provision can develop their own principles for the use of alternative investments and derivatives and how an adequate risk management system supports compliance with those principles.

IOPS working paper on efficient information collection.

The question of what information is relevant for supervisors and how they can best obtain that information was an issue even before the financial crisis. IOPS looked into this question – in the context of institutions for occupational retirement provision – and published a working paper on generating an efficient information policy. This paper provides a guide for supervisory authorities, focusing in particular on the specific requirements of risk-based supervision. With it, IOPS is therefore systematically continuing its move to risk-based supervision.

11 Corporate governance

The prime objective of the Paris-based **Organisation for Economic Co-operation and Development** (OECD) established in 1961 is to promote economic growth and employment and raise the standard of living. Its tasks also include strengthening financial market stability and expanding global trade. The OECD sees itself as a forum where the governments of the 34 member countries can swap experiences, identify best practices and develop solutions to problems. Through a series of standards, the OECD attempts, among other things, to establish responsible corporate governance. Its Principles of Corporate Governance represent the main international standard on stock corporation law and company law.

OECD committee continues peer reviews.

Having analysed the weaknesses in corporate governance that came to light in the crisis, the OECD's Committee on Corporate Governance (CCG) is now investigating the implementation of the

OECD's Principles of Corporate Governance in the individual countries (thematic peer reviews). This is intended to better identify the problems that arise in implementing the Principles in the member countries. A further aim is to find best practice. The OECD's recommendations can also help governments to implement unpopular reforms. The results of the peer reviews are to be incorporated in the process of updating the OECD Principles, which is scheduled to take place in 2013. The OECD Principles, which were revised in 2004, are one of the 12 key standards of the FSB.

In 2011, the peer review on the role of institutional investors examined the extent to which institutional investors such as insurers and asset management companies exercise their ownership rights and the barriers to doing so. The background to this is that, in 2009, institutional investors managed a total of US$53 trillion of assets, according to the OECD. It says that, in this respect, the effectiveness and credibility of the entire corporate governance system will to a large extent depend on institutional investors that can make informed use of their shareholder rights and effectively exercise their ownership functions in companies in which they invest. The peer review examining the implementation of the relevant OECD Principles in Germany, among other countries, found that although there have been improvements in Germany in terms of facilitating the exercise of voting rights, this primarily affects domestic investments. By contrast, foreign investors in Germany and German investors abroad only exercise their voting rights to a limited extent. Although this fundamental problem is ultimately due to the portfolio management costs incurred, further efforts are required to facilitate the exercise of voting rights, according to the reviewers. In this context, the CCG also recommended giving investors clearer rules for necessary agreements. It also suggests that clear disclosure and transparency obligations be established and observed. In Germany, this is being achieved through the implementation of the UCITS Directive.

Protection of minority shareholders.

The subject of the second peer review in 2011 was the protection of minority shareholders and related party transactions. The CCG's recommendations aim to protect minority shareholders from abusive actions. This is guaranteed by way of appropriate obligations to disclose conflicts of interest, and by the monitoring of those obligations by the supervisory board. Issues under discussion include the disclosure of related party transactions and the independence of the supervisory board, for example. On the agenda for 2012 are peer reviews on "Board Nomination and Election" and "Enforcement".

Internal governance

EBA adopts guidelines on internal governance.

In September 2011, the EBA adopted a set of guidelines on internal governance. In contrast to corporate governance, internal governance deals only with governance arrangements within an institution. The guidelines do not therefore contain any provisions regarding shareholders, for example.

Firstly, the EBA guidelines deal with the structure and organisation of an institution. In this context, they also introduce the know-your-structure principle, which is intended to prevent corporate structures from becoming opaque. Secondly, they contain provisions regarding an institution's management and its supervisory or administrative board, in particular their appointment, the qualifications of new members and the overall composition of the bodies. In addition, the chapter on risk management takes on board large parts of the "High Level Principles on Risk Management" issued by the EBA's predecessor, the Committee of European Banking Supervisors (CEBS). The chapter on internal control includes sections on the role of the Chief Risk Officer (CRO) and the risk management function. The latter were originally governed by the above-mentioned CEBS principles. Most of the provisions have already been implemented in Germany. The remainder are due to be implemented in 2012.

The deadline for implementing the EBA guidelines is the end of March 2012. These guidelines had already been resolved by CEBS. They bring together several existing sets of guidelines and develop them further and also contain references to other guidelines that deal with certain aspects of internal governance in greater detail, such as outsourcing and remuneration.

12 Bilateral and multilateral cooperation

MoUs and bilaterals

BaFin signs further MoUs.

In 2011, BaFin agreed memoranda of understanding (MoUs) with a number of other supervisory authorities. MoUs put the cooperation between the authorities, and their exchange of information on cross-border credit institutions, investment firms and insurance undertakings, on a formal basis. MoUs are usually signed because undertakings are becoming increasingly active across borders.

In the field of banking supervision, for example, BaFin signed MoUs with the following authorities:

- the Central Bank of Armenia;
- the Superintendencia del Sistema Financiero de El Salvador;
- the Superintendencia de Bancos y de otras Instituciones Financieras (Nicaragua);
- the National Bank of Georgia;
- the Central Bank of the Republic of Kosovo;
- the National Bank of the Republic of Macedonia;
- the National Bank of Serbia; and
- the Banking Regulation and Supervision Agency, Turkey.

In the year under review, BaFin also signed a MoU with the State of Connecticut Insurance Department (CID) on closer cooperation in the field of insurance supervision. The supervisory authorities agreed to exchange information relevant to their respective supervisory and regulatory work. They also agreed on the procedure for on-site inspections.

The year under review also saw BaFin sign an agreement with the Guernsey Financial Services Commission (GFSC) covering all financial sectors under supervision.

Table 4

Memoranda of Understanding (MoUs) in 2011

Banking supervision		Securities supervision		Insurance supervision	
Argentina	2001	Argentina	1998	Australia	2005
Armenia	**2011**	Australia	1998	California (USA)	2007
Australia	2005	Brazil	1999	Canada	2004
Austria	2000	Canada	2003	China	2001
Belgium	1993	China	1998	**Connecticut (USA)**	**2011**
Brazil	2006	Croatia	2008	Croatia	2008
Canada	2004	Cyprus	2003	Czech Republic	2002
China	2004	Czech Republic	1998	Dubai	2006
Croatia	2008	Dubai	2006	Egypt	2010
Czech Republic	2003	France	1996	Estonia	2002
Denmark	1993	**Guernsey**	**2011**	Florida (USA)	2009
Dubai	2006	Hong Kong	1997	**Guernsey**	**2011**
El Salvador	**2011**	Hungary	1998	Hong Kong	2008
Estonia	2002	Italy	1997	Hungary	2002
Finland	1995	Jersey	2001	Korea	2006
France	1992	Korea	2010	Latvia	2001
Georgia	**2011**	Luxembourg	2004	Lithuania	2003
Greece	1993	Monaco	2009	Malta	2004
Guernsey	**2011**	Poland	1999	Maryland (USA)	2009
Hong Kong	2004	Portugal	1998	Minnesota (USA)	2009
Hungary	2000	Qatar	2008	Nebraska (USA)	2007
Ireland	1993	Russia	2001	New Jersey (USA)	2009
Italy (BI)	1993	Russia	2009	New York (USA)	2008
Italy (BI-Unicredit)	2005	Singapore	2000	Qatar	2008
Jersey	2000	Slovakia	2004	Romania	2004
Korea	2006	South Africa	2001	Singapore	2009
Kosovo	**2011**	Spain	1997	Slovakia	2001
Latvia	2000	Switzerland	1998	Thailand	2010
Lithuania	2001	Taiwan	1997	USA (OTS)	2005
Luxembourg	1993	Turkey	2000		
Macedonia	**2011**	United Arab Emirates	2008		
Malta	2004	USA (CFTC)	1997		
Mexico	2010	USA (SEC)	1997		
Netherlands	1993	USA (SEC)	2007		
Nicaragua	**2011**				
Norway	1995				
Philippines	2007				
Poland	2004				
Portugal	1996				
Qatar	2008				
Romania	2003				
Russia	2006				
Serbia	**2011**				
Singapore	2009				
Slovakia	2002				
Slovenia	2001				
South Africa	2004				
Spain	1993				
Sweden	1995				
Turkey	**2011**				
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				

Meetings with other supervisory authorities.

Last year, BaFin also met with representatives of other supervisory authorities at bilaterals, some scheduled and some ad hoc. These bilateral meetings serve to improve mutual cooperation and to exchange information on current developments. BaFin both received high-ranking visitors at bilaterals and organised such meetings at the working level. The meetings are usually about credit institutions or insurance undertakings that operate or have a branch in the countries concerned.

In the year under review, supervisory meetings were held with the Cayman Islands Monetary Authority and the Jersey Financial Services Commission, among others. Meetings also took place with the Austrian Financial Market Authority (FMA) and Luxembourg's Commission de Surveillance du Secteur Financier (CSSF). In addition, BaFin employees met with colleagues from the insurance supervisory authorities in France (Autorité de contrôle prudentiel – ACP) and Italy (Istituto per la Vigilanza sulle Assicurazioni Private e di Interesse Collettivo – ISVAP) at a bilateral where issues related to the direction of EIOPA were particular topics of discussion.

Technical cooperation

Cooperation with Russia.

BaFin has further stepped up its working relationship with the Central Bank of the Russian Federation (CBR). In 2011, the President of BaFin and the CBR representative responsible for banking supervision met three times. Through this in-depth cooperation, BaFin intends to address both the growing importance of the Russian financial market and the strategic partnership between the governments of the two countries. In December 2011, BaFin employees made their first visit to the CBR to provide direct help in implementing international standards and establishing a supervisory system equivalent to those subject to European rules.

Cooperation with China.

Cooperation with supervisory authorities in China continued to strengthen in the year under review. Several seminars and workshops were held in both Germany and China on the basis of a joint declaration signed by the President of BaFin and the Chairman of the China Securities Regulatory Commission (CSRC) in July 2010. Dialogue was also stepped up in the field of banking supervision. Many of these meetings with the China Banking Regulatory Commission (CBRC) and the People's Bank of China (PBC) were initiated or at least supported by the German Agency for International Cooperation (*Deutsche Gesellschaft für Internationale Zusammenarbeit* – GIZ) and the European EU-China Trade Project. One focus of the discussions was the supervision of rating agencies. In 2012, both sides also aim to step up dialogue in the field of insurance supervision.

Cooperation with Korea, Bahrain and India.

In 2011, employees of Korea's Financial Supervisory Service (FSS) again completed multi-week internships in securities and insurance supervision at BaFin. In September, the President of BaFin received

four parliamentarians from Seoul. The main topics of discussion at this meeting were aspects of banking supervision and regulatory challenges.

In the Gulf region, BaFin has a new partner in the form of Bahrain. Meetings were held with colleagues from the Central Bank of Bahrain (CBB), focusing on securities supervision and Islamic financial services.

In the year under review, two delegations from the Securities and Exchange Board of India (SEBI) were guests of BaFin in Frankfurt am Main. The high-ranking delegation was received by the Chief Executive Director of Securities Supervision. The delegates were interested in administrative law at BaFin and in issues related to takeover law. In the year under review, BaFin also continued to collaborate with the officials responsible for insurance supervision at the National Bank of Serbia (NBS), the State Commission for Regulation of Financial Services Markets in Ukraine (SCRFSMU) and the Central Bank of Armenia (CBA).

Contacts with Africa.

At the invitation of the World Bank, two BaFin employees attended the workshop on "The African Approach to the Implementation of International Standards for Banking Supervision and the Basel Capital Framework". The conference was held in the Ugandan capital, Kampala. The main theme was the harmonisation of supervisory standards with the aim of stabilising and strengthening the East African economic area. Through the GIZ, BaFin also kept up contact with the financial services supervisor in Senegal (Direction de la Réglementation et de la Supervision des Systèmes Financiers Décentralisés) in 2011.

European Supervisor Education Initiative

Since 2009, BaFin has been a member of the European Supervisor Education Initiative (ESE). The ESE Initiative aims to offer financial supervisors in Europe high-level training in accordance with uniform standards. With this aim in mind, it combines experiences drawn from supervisory practice with academic findings. Besides BaFin, the founding members of the ESE Initiative were the Bundesbank, the Österreichische Nationalbank (OeNB) and the University of Frankfurt's Goethe Business School. Since then, the central banks of Luxembourg and the Czech Republic have also joined. In 2011, the ESE held a total of 19 seminars, including a seminar on supervisory colleges organised by BaFin. A further 20 seminars are planned for 2012 on topics such as the supervision of rating agencies, the requirements of Basel III and risk models at banks.

As well as seminars, the ESE also holds a biennial conference involving high-ranking representatives of supervisory authorities and central banks as well as experts from academia and industry. The 2011 ESE conference on financial crises and the challenges for supervision was organised by the Banque Centrale du Luxembourg.

Gabriele Hahn,
Chief Executive Director
of Insurance Supervision[40]

IV Supervision of insurance undertakings and pension funds

1 Bases of supervision

1.1 Implementation of Solvency II

The government draft for the Tenth Act Amending the Insurance Supervision Act (*Zehntes Gesetz zur Änderung des Versicherungsaufsichtsgesetzes*) was published on 15 February 2012. This is designed to transpose European Directive 2009/138 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II Framework Directive)[41] into German law. The draft bill currently proposes that the Act will come into effect on 31 October 2012. This is also when the transposition period ends under applicable law (Article 309 of the Solvency II Framework Directive).

BaFin has been providing in-depth support to the Federal Ministry of Finance (BMF) since mid-2010 to prepare for the new Act. BaFin's proposals were initially incorporated into the first draft of the new Insurance Supervision Law, which was discussed in late summer 2011 and subsequently revised, again with support from BaFin.

Transposition of the directive into national law will require substantial amendments to the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG), but will also entail consequential amendments to a range of regulations. What is making the transposition work more difficult is the fact that amendments to the Framework by the Omnibus II Directive[42] are still expected. In addition, the implementing measures that will flesh out the details of the directives have still not been issued.

● Considerable amendments necessary.

Implementation of the directive sticks closely to the requirements set out therein and reflects the common understanding of these developed at the level of the European Insurance and Occupational Pensions Authority (EIOPA). The existing supervisory rules will only be modified to the extent necessary to implement the Solvency II Directive. The content of the recast text – meaning that part of the

[40] Chief Executive Director of Regulatory Services/Human Resources since June 2012.
[41] OJ EU L 335, p. 1 et seq. See chapter III 3 for further information on the Solvency II Framework Directive.
[42] Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority of 19 January 2011. See chapter III 3 for further information on the Omnibus II Directive.

directive that is taken over from earlier directives and has already been transposed into national law – remains almost unchanged.

Future VAG will cover three different supervisory regimes.

The future VAG will cover three different supervisory regimes: firstly, requirements governing insurance undertakings that fall within the Solvency II regime. Secondly, requirements covering undertakings not falling within the scope of Solvency II. On the one hand, these include funeral expenses funds and small insurance undertakings that will continue to be governed by the existing rules (Solvency I) because of their size. On the other (the third supervisory regime), this relates to *Pensionskassen* and pension funds, which – as institutions for occupational retirement provision – are subject to their own directive-based regime. The European Commission intends to publish a proposal for revising the Pension Funds Directive in the third quarter of 2012. Preliminary work on this is already underway.

The new VAG will entail significant changes for undertakings governed by Solvency II. These relate in particular to capital and own funds requirements, the measurement of assets and liabilities, as well as supplementary rules governing business organisation and reporting and disclosure obligations. Additionally, the undertakings can, in future, calculate their solvency capital requirements either using a standard model or a company-specific internal model to be approved by BaFin. Further amendments relate to the investment principles and the prudential regime for groups, which will put the supervision of groups on a new footing.

The existing supervisory regime will continue to apply in large part to the *Pensionskassen* and pension funds not covered by Solvency II, and to small insurance undertakings and funeral expenses funds. This applies in particular with regard to quantitative requirements such as capital requirements, the own funds rules and the technical provisions. The qualitative requirements governing business organisation will be modified slightly to bring them in line with the Solvency II principles. Examples include the requirement for a transparent organisational structure with a clear allocation of responsibilities and an appropriate separation of functions that will be incorporated into the new law, the preparation of written internal policies on various areas and a more detailed breakdown of the requirements to be met by the risk management system. These and other qualitative requirements are already set out in Circular 3/2009 (VA)[43], but will in future be addressed directly in the Act. However, the affected undertakings will not be required to establish an actuarial function, nor will they have to have a compliance function. In terms of reporting obligations, the existing rules will continue to apply to these undertakings, and the new disclosure requirements based on the Solvency II rules will not apply to them.

Further preparations for Solvency II.

The Omnibus II Directive that is currently being negotiated at EU level is designed to further amend the Solvency II Framework

[43] Circular on Minimum Requirements for Risk Management in Insurance Undertakings (*Mindestanforderungen an das Risikomanagement VA* - MaRisk VA).

Directive. Among other things, the period for transposing the directive into national law by the member states will be extended to 31 March 2013 and the application of Solvency II in full by the insurance undertakings will be put back to 1 January 2014. Undertakings will only be able to file certain applications starting in mid-2013, for example regarding internal models, ancillary own funds and the classification of basic own funds that are not contained in the lists drawn up by the Commission. However, negotiations are still in progress. 2013 will therefore be a transitional year of trials and tests in which undertakings will for the first time have to submit some reports in accordance with the Solvency II requirements. The task of the supervisory authorities during this period will be to establish how well-prepared the undertakings are for Solvency II and to urge them to undertake the steps still necessary for implementation by the required deadline.

1.2 New Investment Circular

On 15 April 2011, BaFin published its new Circular 4/2011 (VA) containing guidance on the investment of restricted assets held by insurance undertakings. The new circular replaces Investment Circular 15/2005 (VA), which had to be revised in particular because of the amendments to the Investment Regulation (*Anlageverordnung* – AnlV) in 2007, 2010 and 2011.

New rules for equity interests and funds.

In the circular, BaFin comprehensively revised the sections on equity interests and investment funds in particular. For future investments, for example, it has defined the concept of equity interests in greater detail: investees must now additionally enter into business risks and have a business model. The latter case can be assumed, for example, if the enterprise value – unlike that of e.g. a securities fund – is not composed exclusively of the total of the net asset values held by the company. By contrast, the purchase and sale as well as the management of financial investments within an investee do not constitute a business model that entails business risk. The narrower interpretation of the concept of the equity interest had become necessary because the new limit for investments in accordance with section 2 (1) nos. 9, 12, 13 of the AnlV in the amount of 1% of the restricted assets represented a substantial increase in investment opportunities for most undertakings. This could lead to a risk that investees might be used solely as a shell for investments that are otherwise unsuitable.

Stricter quality standards for funds.

Additionally, the new circular increases the requirements with regard to the fungibility of funds so as not to endanger the insurer's liquidity, which must be ensured at all times. The permanent availability of liquidity is endangered if units of German and foreign funds cannot be redeemed within the following periods; the contractually agreed redemption dates and periods must be taken into account in each case:

- seven months for microfinance funds, infrastructure funds and other funds with predominantly non-liquid assets
- six months for real estate funds
- two months for other funds with predominantly liquid assets
- the periods stipulated in section 116 of the Investment Act (*Investmentgesetz* – InvG), for example 40, 50, or 100 calendar days, for investments in funds with additional risks.
- The above-mentioned periods apply, with the necessary modifications, to special funds whose investment principles are oriented on real estate funds, infrastructure funds and other investment funds.

In some cases, the circular thus lays down stricter quality standards for funds than the Investment Act, whose rules governing investment funds and special funds have been significantly liberalised in recent years. However, the stricter rules are necessary so that the requirements for direct and indirect investments do not differ too strongly.

Largest obligors will be included in diversification percentages.

Under section 4 (1) of the AnlV, the investments by the ten largest issuers (obligors) in a fund must be included in the various diversification percentages. The background to the new rule is as follows: as funds account for a high proportion of investments by insurance undertakings, they must be included in line with the risk that they represent when taking diversification into account. Experience has shown that an insurer often makes the same type of investments both directly and via funds. Equally, this risk cannot be mitigated through diversification over several funds, as these may also invest in the same way. As a result, significant single-obligor concentrations could go unnoticed and endanger the existence of the insurance undertaking in the event of a crisis. Section 4 (1) of the AnlV addresses this situation.

Incorporation of existing pronouncements.

The circular also governs the supervisory treatment of structured products that bear very low or even no coupons compared with standard market yields at the time of acquisition. They may be allocated to the restricted assets if, firstly, their term is 12 years or more and, secondly, a low coupon that erodes the economic substance, or that is even zero, is contractually ruled out. The assessment of when the economic substance is eroded is based on the relevant applicable maximum technical interest rate for life insurance contracts. In practice, this means that, if structured products have a term of less than 12 years, they may not be allocated to the restricted assets. The same applies if – based on the contractual arrangements – they can bear a lower coupon than the relevant applicable maximum technical interest rate for life insurance contracts.

Additionally, the undertakings can invest up to five percent of their restricted assets in promissory note loans that do not fully meet the collateralisation requirements contained in the negative pledge. This is the case, for instance, if the borrower does not meet the minimum rating requirements and/or the unrestricted negative pledge in the case of non-publicly-traded borrowers. The

Investment Circular thus incorporates the notes on investments in corporate loans of 22 March 2010.[44]

Loans to liquidation agencies.

Finally, the "loans" investment category has now been extended: loans to liquidation agencies within the meaning of section 8a (1) of the Financial Market Stabilisation Act (*Finanzmarktstabilisierungsgesetz* – FMStG) are treated as loans within the meaning of section 2 (1) no. 3 e) of the AnlV, provided that the liquidation agency's solvency is guaranteed by the Federal Republic of Germany, its federal states, local authorities, or the institutions mentioned under section 2 (1) no. 3 b) or d). Previously, liquidation agencies as described above did not meet the criteria for the "loans" investment category; as a result, insurance undertakings could only assign them to restricted assets as investments as defined in section 2 (1) no. 10 (ABSs or CLNs) or section 2 (2) of the AnlV (enabling clause).

Requirements for asset-liability management at an insurance undertaking.

Asset-liability management (ALM) is a key condition for developing an undertaking's strategic investment policy. The implementation and proper functioning of the ALM process, which must be anchored in a defined workflow, is particularly important. The process must be suitable for monitoring and managing the asset and liability positions of the undertaking. The goal is to ensure that the assets invested are appropriate to the liabilities and risk profile of the undertaking. When implementing the ALM process, the undertaking must ensure in particular that its ALM goals are consistently derived from the requirements of its risk strategy. Additionally, all material risks that could arise from the undertaking's assets and liabilities, as well as their causes and interactions, must be identified and recorded. The results of the ALM analysis are designed to highlight concrete alternative courses of action and may include recommendations to the responsible management board members.

The revision of the Investment Circular has ensured the overdue harmonisation of the circular with the AnlV. No information obligations for industry, consumers, or administrative authorities were introduced, modified, or removed by the amendment to the Investment Regulation and the revision of the Investment Circular.

New requirements for the "equity interests" and "funds" asset classes will inevitably lead to new administrative practice. This practice must be made sufficiently transparent.

Although ALM had already been mentioned in Investment Circular 15/2005, the new circular gives it much greater prominence. This will inevitably result in an increase in the workload for insurance undertakings for their own organisation, in particular in the areas of documentation and implementation. In view of the wide variety of insurance business activities, the requirements for ALM will vary depending on the volume, structure and type of the insurance

[44] Notes on Circular 15/2005 (VA), Part A. III. no. 3. c) on investments in corporate loans.

business being conducted, as well as on the type and extent of the investments (proportionality principle).

1.3 Updated disclosure requirements

In connection with the publication of the new Investment Circular, BaFin updated its requirements governing the disclosure requirements under section 1 (4) of the AnlV. For example, insurance undertakings are now required, among other things, to provide BaFin by the end of February of each year with both a general description of the intended investment policy and of the planned investment portfolio, as well as with a description of the risk exposure in the investment portfolio. In doing so, the undertakings must present the results of the ALM analysis and explain how they implement them in their investment policy. Additionally, insurance undertakings are now expected to submit their current internal investment guidelines to BaFin.

1.4 Disclosure and reporting obligations for investments

On 21 June 2011, BaFin issued a collective decree setting out requirements for the disclosures and reports to be made by insurance undertakings about their investments.[45]

Updated investment reports.

In this collective decree, BaFin harmonised in particular the quarterly and half-yearly reports by the insurers on the composition of their investments – including carrying amounts and fair values – with the current requirements of the Investment Regulation. In addition, it updated the reporting requirements relating to financial innovations and the structure of the investments. The insurance undertakings were required to submit the modified forms for the first time for the 31 December 2011 reporting date.

As well as the collective decree, the reporting requirements for e.g. real estate and equity investments were updated; for example, the reporting form on the diversification of investments has now been fully aligned with the requirements in the new Investment Regulation.

Reports on commodity risks.

Because of the risks inherent in structured investment products that are linked to commodity risks, BaFin has required the quarterly submission of reports on such investments since January 2012.

[45] Collective decree dated 21 June 2011 setting out the disclosure and reporting obligations of insurance undertakings about their investments (*Anordnung betreffend die Anzeige- und Berichtspflichten der Versicherungsunternehmen über ihre Kapitalanlagen*), (available in German only).

Additionally, since January 2012 several reports are no longer to be filed with BaFin in paper form, but exclusively via BaFin's MVP reporting and publishing platform. Examples of these include the reports on real estate, on the diversification of investments and on the products with commodity risk exposures.

The scope of reporting has remained almost unchanged compared with the previous Circular 11/2005 (VA). However, the amendments to the Investment Regulation mean that there have been changes in emphasis in the reporting.

2 Ongoing supervision

2.1 Authorised insurance undertakings and pension funds

Fewer insurance undertakings supervised by BaFin.

The number of insurance undertakings supervised by BaFin continued to decline. At the end of the year under review, BaFin supervised a total of 600 insurance undertakings (previous year: 603) and 30 pension funds. Out of the total number of insurance undertakings, 580 engaged in business activities, and 20 did not engage in any business activities. The following information also covers ten public-law insurance undertakings supervised by the federal states (nine engaged in business activities and one not engaged in business activities). The breakdown by sector is shown in the following table:

Table 5

Number of supervised insurance undertakings and pension funds*

As at 31 December 2011

	Insurers with business activities			Insurers without business activities		
	BaFin supervision	State supervision	Total	BaFin supervision	State supervision	Total
Life insurers	94	3	97	10	0	10
Pensionskassen	150	0	150	2	0	2
Death benefit funds	39	0	39	1	0	1
Health insurers	48	0	48	0	0	0
Property/casualty insurers	215	6	221	4	1	5
Reinsurers	34	0	34	3	0	3
Total	**580**	**9**	**589**	**20**	**1**	**21**
Pension funds	30	0	30	0	0	0

* These figures do not include the relatively small mutual insurance associations whose activities are mostly regionally based and that are supervised by the federal states (BaFin 2010 statistics – Primary insurers and pension funds, p. 9, table 5[46]).

[46] Only available in German.

Life insurers

Two German life insurers supervised by BaFin ceased operating completely in 2011, while one new life insurer came under supervision by BaFin. Two undertakings from EEA countries (United Kingdom and Ireland) established branch offices (BOs). In addition, six foreign life insurers from the EEA registered for the cross-border provision of services (CBS) in Germany (previous year: seven). A number of service providers expanded their business activities.

Table 6
Registrations by EEA life insurers in 2011
As at 31 December 2011

Country	CBS*	BO**
Belgium	1	0
Greece	1	0
Ireland	0	1
Romania	1	0
United Kingdom	3	1

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

Health insurers

The number of health insurers remained unchanged compared with the previous year, at 48.

Property and casualty insurers

Two property and casualty insurers ceased operating completely in the year under review. Foreign property and casualty insurers from the European Union (EU) established three branch offices: one each from the Netherlands and Luxembourg, and one from the United Kingdom. Thirty-four 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. Twenty-one insurers ceased providing services in Germany in 2011 (previous year: 23).

Table 7

Registrations by EEA property and casualty insurers in 2011

As at 31 December 2011

Country	CBS*	BO**
Belgium	2	0
Bulgaria	2	0
Czech Rebublic	1	0
Denmark	1	0
France	3	0
Greece	1	0
Hungary	2	0
Iceland	1	0
Ireland	1	0
Luxembourg	0	1
Malta	3	0
Netherlands	5	1
Poland	3	0
Romania	4	0
Sweden	1	0
United Kingdom	4	1
of which: Gibraltar	1	0

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

Reinsurers

One reinsurer ceased operating as an independent German reinsurer in 2011. Six branches of EU undertakings operated reinsurance businesses in Germany in the year under review. The branch offices were established by undertakings domiciled in the following EU member states: France, Ireland, Luxembourg and Spain.

Pensionskassen and pension funds

At the 2011 year-end, BaFin supervised a total of 150 *Pensionskassen* and 30 pension funds (previous year: *152 Pensionskassen* and 30 pension funds).

2.2 Interim reporting

2.2.1 Position of the insurance sector

Germany's insurance industry remains stable.

The German insurance industry again remained stable in 2011. However, insurers are still operating in a difficult economic environment marked by low interest rates and high levels of government debt in Europe.

Basically speaking, the insurance industry continues to profit from its long-term business model even under these conditions. However, sustained low interest rates are depressing insurers' income and making it more difficult for them to meet their

contractual guarantees. In addition, the high level of volatility and uncertainty on the capital markets makes both new investments and reinvesting existing investments more difficult. For life insurance policyholders, the low interest rates primarily manifest themselves in the form of declining discretionary bonuses.

Insurers have significant holdings of government bonds.

Insurers have significant holdings of government bonds in their portfolios. These also include bonds issued by EU member states that are being watched particularly closely by the capital markets. However, according to monitoring by BaFin, these government bonds now account for a smaller proportion of portfolios. This was due in particular to write-downs to their fair value. In some cases, however, investors also chose not to reinvest money falling due in such instruments. BaFin estimates that the holdings are not so high as to impact the undertakings' risk-bearing capacity.

The fact that the individual sectors making up the financial market are not fully isolated from each other represents a potential risk. As a result, cross-sectoral and cross-border cooperation is becoming increasingly important for BaFin. The objective is to identify and monitor any potential risk of contagion.

2.2.2 Business trends

Life insurers

New direct life insurance contracts rose by 3.9% year-on-year, from 5.99 million to 6.22 million new policies in 2011. At €255.7 billion, the total value of new policies underwritten was 8.8% higher than in the previous year (€234.9 billion).

The share of the total number of new contracts accounted for by mixed endowment insurance contracts declined slightly year-on-year, from 13.8% to 12.7%. The proportion of term insurance contracts rose slightly from 26.8% to 26.9%. The share of pension and other life insurance contracts increased from 59.4% to 60.4%. The proportion of endowment policies decreased to 6.5% of the total value of new policies underwritten (down from 7.1% in the previous year). The corresponding figure for term insurance declined from 32.2% to 31.3%. The share accounted for by pension and other life insurance contracts increased from 60.8% to 62.2%.

Further decline in early terminations.

Early terminations (surrender, conversion to paid-up policies and other forms of early termination) declined from 3.2 million to 3.0 million contracts. At €106.4 million, the amount insured under contracts terminated early was lower than in previous years (€111.8 million in 2010 and €120.3 million in 2009). Early terminations of endowment policies dropped by 11.2% year-on-year; expressed in terms of the total amount insured, the figure fell by 10.4%.

Direct insurance contracts totalled 89.3 million contracts at the end of 2011 (–1.0%), while the total amount insured was €2,651 billion (+2.7%). The proportion of overall policies accounted for by mixed endowment policies declined from 43.1% to 41.1% and the total amount insured under these policies decreased from 31.6% to 29.4%, continuing the trend seen in previous years. The share of both the number of term insurance contracts (14.1%) and the amount insured under these policies (22.6%) remained almost unchanged as against the previous year. Pension and other insurance contracts continued their positive trend. Their share of overall policies rose from 42.8% to 44.7%, while the amount insured rose from 46.4% to 48.0%.

Gross premiums written in the direct insurance business declined from €86.2 billion to €81.6 billion. The share attributable to endowment policies decreased again, dropping from 32.9% to 32.4%, while the share of pension and other insurance contracts remained more or less constant, at 62.1%.

Health insurers

Gross premiums written in the direct insurance business increased by 4.2% to €34.7 billion in 2011. The number of insured natural persons rose by 2.7% to 36.7 million.

Property and casualty insurers

Property and casualty insurers recorded a slight year-on-year increase in gross premiums written in the direct insurance business in 2011 to €59.3 billion (previous year: €58.0 billion).

Gross expenditures for claims relating to the year under review increased by 1.5% to €21.0 billion (previous year: €20.7 billion). Gross expenditures for claims relating to previous years also rose, to €15.4 billion. Gross provisions recognised for individual claims relating to the year under review amounted to €15.7 billion, compared with €15.4 billion in the previous year, while gross provisions recognised for individual claims relating to prior years amounted to €47.3 billion, compared with €46.6 billion in the previous year.

With gross premiums written amounting to €20.1 billion, motor vehicle insurance was by far the largest insurance class, rising by 5.1% compared with the previous year. Gross expenditures for claims relating to the year under review also rose by 5.0% year-on-year, while gross expenditures for claims relating to previous years rose by 8.8%. Overall, gross provisions recognised for individual claims relating to the year under review declined by 0.7% year-on-year, while outstanding claims relating to the previous year increased by 2.3%.

Property and casualty insurers collected premiums of €7.8 billion (+3.5% in comparison to the previous year) for general liability insurance. As in the previous year, €1 billion was paid out for claims relating to the year under review and €2.4 billion for claims relating to prior years (+5.4% year-on-year). Gross provisions for individual claims, which are particularly important in this insurance class, rose by 1.9% (previous year: 4.5%) to €2.4 billion for outstanding claims relating to the year under review, while gross provisions for outstanding individual claims relating to the previous year rose to €14.1 billion (previous year: +6.5%).

Insurers recorded gross fire insurance premiums written of approximately €1.8 billion (–1.0%). Gross expenditures for claims relating to the year under review rose by 14.8% to €517 million.

Premiums collected for comprehensive household insurance and comprehensive contents insurance contracts amounted to €7.3 billion (+2.6%) in the aggregate. Expenditures for claims relating to the year under review declined by 5.3% year-on-year, while provisions for individual claims rose by 9.7%. Expenditures for claims relating to previous years increased by 5.5%, while provisions for claims relating to previous years rose by 3.6% compared with 2010.

Premiums for general accident insurance contracts rose marginally to €6.4 billion. Gross expenditures for claims relating to the year under review were unchanged year-on-year, at €0.3 billion, while provisions recognised for outstanding claims relating to the year under review rose 1.5% 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 generated by these *Pensionskassen* declined slightly to €3.2 billion (previous year: €3.3 billion).

Pension funds

The number of beneficiaries rose slightly year-on-year to total 777,378 (previous year: 757,388), with 453,886 beneficiaries being members of defined contribution plans and 35,244 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) of the VAG.

2.2.3 Investments

Further increase in investments by German insurers in 2011.

International capital market trends in 2011 were dominated by uncertainty. Although the stock markets started off by stabilising to a large extent, the second half of the year in particular was overshadowed as the financial crisis in the eurozone came to a head. Whereas some countries had to pay hefty risk premiums on their government bonds, Bund yields fell to a historic low at the end of the year.

Aggregate investments by all German insurers supervised by BaFin increased by 2.6% year-on-year to €1,403.2 billion (previous year: €1,368 billion). Health insurers recorded the largest increase among all the sectors, with the carrying amount of their investments increasing by 7.5% or €13.2 billion year-on-year to €189.6 billion. Aggregate investments by all primary insurers in 2011 increased by a total of 2.4% or €27.8 billion to €1,188.1 billion.

Insurers continued to focus their investments on fixed-income securities and promissory note loans. At €263.6 billion, Pfandbriefe, municipal bonds and other debt instruments issued by credit institutions domiciled in member states of the Organisation for Economic Cooperation and Development (OECD) comprised the largest single class of direct investments. Holdings of listed debt instruments rose by 9.3% to €152.6 billion. Significant percentage increases were seen in investments in ABSs and in the private equity area in the period under review. Property investments rose by 8.8% to €29.5 billion.

Indirect investments held by insurance undertakings via investment funds continued to stabilise at the high prior-year level and amounted to €330.6 billion, or 23.6% of all investments. Roughly three-quarters of investments by insurance undertakings in funds are held in bonds.

Table 8
Investments by insurance undertakings

Investments by insurance undertakings	Portfolio as at 31 Dec. 2011		Portfolio as at 31 Dec. 2010		Change in 2011	
	in € million	in %	in € million	in %	in € million	in %
Land, land rights and shares in real estate companies, REITs and closed-end real estate funds	29,454	2.1	27,082	2.0	+ 2,372	+ 8.8
Fund units, shares in investment stock corporations and investment companies	330,626	23.6	320,008	23.4	+ 10,618	+ 3.3
Loans secured by mortgages and other land charges and shareholder loans to real estate companies	55,869	4.0	56,569	4.1	- 700	- 1.2
Securities loans and loans secured by debt securities	1,266	0.1	1,347	0.1	- 81	- 6.0
Loans to EEA/OECD states, their regional governments and local authorities, and international organisations	118,858	8.5	113,436	8.3	+ 5,422	+ 4.8
Corporate loans	11,529	0.8	12,209	0.9	- 680	- 5.6
ABSs/CLNs	4,888	0.3	863	0.1	+ 4,025	+ 466.5
Policy loans	4,626	0.3	4,938	0.4	- 312	- 6.3
Pfandbriefe. municipal bonds and other debt instruments issued by credit institutions	263,626	18.8	265,644	19.4	- 2,018	- 0.8
Listed debt instruments	152,569	10.9	139,612	10.2	+ 12,957	+ 9.3
Other debt instruments	14,802	1.1	14,068	1.0	+ 734	+ 5.2
Subordinated debt assets/profit participation rights	28,656	2.0	30,765	2.3	- 2,109	- 6.9
Book-entry securities and open market instruments	1,723	0.1	1,826	0.1	- 103	- 5.6
Listed equities	6,912	0.5	9,077	0.7	- 2,165	- 23.8
Unlisted equities and interests in companies, excluding private equity holdings	132,804	9.5	128,711	9.4	+ 4,093	+ 3.2
Private equity holdings	9,962	0.7	7,801	0.6	+ 2,161	+ 27.7
Investments at credit institutions	204,815	14.6	200,857	14.7	+ 3,958	+ 2.0
Investments covered by the enabling clause	15,955	1.1	16,485	1.2	- 530	- 3.2
Other investments	14,309	1.0	16,527	1.2	- 2,218	- 13.4
Total investments	**1,403,249**	**100.0**	**1,367,824**	**100.0**	**+ 35,425**	**+ 2.6**
Life insurers	742,747	52.9	734,427	53.7	+ 8,320	+ 1.1
Pensionskassen	115,793	8.3	109,560	8.0	+ 6,233	+ 5.7
Death benefit funds	1,922	0.1	1,879	0.1	+ 43	+ 2.3
Health insurers	189,611	13.5	176,429	12.9	+ 13,182	+ 7.5
Property/casualty insurers	138,018	9.8	138,024	10.1	- 6	- 0.0
Reinsurers	215,158	15.3	207,504	15.2	+ 7,654	+ 3.7
All insurers	**1,403,249**	**100.0**	**1,367,824**	**100.0**	**+ 35,425**	**+ 2.6**
Primary insurers	1,188,091	84.7	1,160,320	84.8	27,771	+ 2.4

The figures are based on the insurance undertakings' quarterly reports and are only preliminary.

Pension funds

Investments for the account and at the risk of pension funds increased from €1,044 million to €1,189 million in 2011, a rise of 14% (previous year: +20%). Pension fund portfolios were dominated by contracts with life insurers, bearer bonds and other fixed-income securities, and fund units. At the balance sheet date, net hidden reserves in the investments made by pension funds amounted to approximately €25 million. All 30 pension funds supervised by BaFin in 2011 were able to cover their technical provisions in full.

Assets administered for the account and at the risk of employees and employers increased only slightly in the year under review, rising from €24 billion to approximately €25 billion. Roughly 85% of these investments consisted of fund units. These investments are measured at their fair value. The technical provisions for the account and at the risk of employees and employers are

recognised retrospectively in line with the assets administered for the account and at the risk of employees and employers. This means that balance-sheet cover for these technical provisions is guaranteed at all times.

Tolerance of Greek government bonds with a "default" rating

In the spring of 2010, a number of rating agencies downgraded Greece's credit rating. Since there was a danger of a downgrade to non-investment grade, insurers had to assess whether they are still permitted to hold Greek government bonds as restricted assets. This is possible, among other things, under the high-yield ratio, which is limited to 5% of restricted assets and to investments that have at least speculative grade ratings (e.g. "B-" from Standard & Poor's and Fitch or "B3" from Moody's). If the ratio had already been utilised by holdings of other high yield bonds, the undertakings would have had to make forced sales.

In order to mitigate procyclical effects, bolster financial market stability and limit losses at the affected insurers, BaFin announced in May 2010 that it would tolerate exceedances of the 5% high yield ratio resulting from the downgrading of Greece's credit rating.

Mid-2011 saw a further deterioration in Greece's creditworthiness, making default more and more likely in the opinion of the rating agencies. In June 2011, BaFin extended its previous announcement to cover investment decisions by insurers resulting from a downgrade of Greece's credit rating to "default". Since then, BaFin also tolerates (Greek) government bonds that are rated as "in default" in insurers' restricted assets for as long as the guarantee issued by the European Stability Mechanism is in force.

In view of the bond swap,[47] the pronouncements on Greek government bonds published in issues 05/10 and 06/11 of the BaFinJournal are no longer applicable.[48]

Effects of the bond swap on the management of Greek bonds in restricted assets

With respect to the management of Greek bonds in restricted assets, a distinction now has to be made between bonds that Greece did not offer to swap and those that it did offer to swap, and within the latter category between swapped and unswapped bonds.

[47] www.greekbonds.gr.
[48] www.bafin.de >> Supervision.

Bonds that Greece did not offer to swap and bonds that the Greek government offered to swap and that were actually swapped by private investors can remain in insurers' restricted assets. BaFin will continue not raising objections to any resulting exceedance of the high yield ratio. The participation in particular of life insurers and health insurers in the voluntary Greek debt swap does not represent an irregularity within the meaning of sections 81c and 81d of the VAG.

In the case of bonds that the Greek government offered to swap but that were not swapped by private investors, their credit rating is now the decisive factor. If bonds do not have an investment grade rating, they can only be held as part of insurers' restricted assets under the provisions governing high yield bonds or the enabling clause ("*Öffnungsklausel*"). The credit quality may be assessed by the insurance undertaking itself and such a procedure may be appropriate to avoid dependencies on rating agencies, provided that the insurance undertaking has the personnel and technical resources necessary to do this, taking into account the nature of the investment.

BaFin draws attention to the fact that the qualitative requirements (MaRisk VA) with respect to the regular review of assets as part of insurance undertakings' internal risk management and control processes remain unaffected by this.

2.3 Composition of the risk asset ratio

For the first time, primary insurers reported their total investments as at 31 December 2011 using the format set out in the collective decree on reporting[49]. The undertakings were required to report their investment types broken down in accordance with the revised schedule of investments in the AnlV, as well as by specific risks.

The following assessments are based on the data for life, health and property/casualty insurers, as well as for *Pensionskassen*. The carrying amount of all investments contained in the restricted assets belonging to these classes amounted to €1,114 billion at that date (previous year: €1,115 billion).

[49] Collective decree dated 21 June 2011 setting out the disclosure and reporting obligations of insurance undertakings about their investments (*Anordnung betreffend die Anzeige- und Berichtspflichten der Versicherungsunternehmen über ihre Kapitalanlagen*), (available in German only).

Table 9

Composition of the risk asset ratio

As at 31 December 2011

Investment type in accordance with section 2 (1) of the AnlV (version dated 11 February 2011)	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*	721,813	100.0	187,000	100.0	120,473	100.0	114,954	100.0	1,144,240	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)	15,513	2.1	4,315	2.3	2,463	2.0	2,113	1.8	24,404	2.1
Listed equities (no. 12)	2,306	0.3	204	0.1	407	0.3	21	0.0	2,938	0.3
Unlisted equities and interests in companies (no. 13)	12,788	1.8	3,117	1.7	3,166	2.6	637	0.6	19,708	1.7
Units in funds (nos. 15-17, incl. hedge funds) that - include equities, profit participation rights, etc.	18,745	2.6	2,306	1.2	5,713	4.7	4,465	3.9	31,229	2.7
- cannot be clearly assigned to other investment types; fund residual value and non-transparent funds	11,004	1.5	1,584	0.8	2,217	1.8	2,156	1.9	16,961	1.5
High-yield bonds and investments in default status	11,239	1.6	2,555	1.4	1,611	1.3	2,044	1.8	17,449	1.5
Increased market risk potential of funds**	3,757	0.5	466	0.2	247	0.2	411	0.4	4,881	0.4
Investments linked to hedge funds (partly already contained in other nos, of the AnlV)	2,011	0.3	398	0.2	228	0.2	679	0.6	3,316	0.3
Investments with commodity risks (partly already contained in other nos. of the AnlV)	0	0.0	52	0.0	0	0.0	0	0.0	52	0.0
Total investments subject to the 35% risk asset ratio	77,363	10.7	14,997	8.0	16,052	13.3	12,526	10.9	120,938	10.6

The figures are based on the insurance undertakings' quarterly reports and are only preliminary.

* 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 of the AnlV.

Source: Sector totals as at 31 December 2011 for life, health and property/casualty insurers, as well as Pensionskassen, from financial statement forms 670 and 673, collective decree dated 21 June 2011.

Insurance undertakings can invest up to 35% of their restricted assets in investments associated with a higher level of risk (cf. section 3 (3) sentence 1 of the AnlV). Specifically, these risk investments include directly and indirectly held investments in equities, profit participation rights and subordinated debt assets, as well as hedge funds and investments linked to commodity risks. They also include the "residual value" of a fund (which is not clearly attributable), the higher potential market risk of funds, and

all non-transparent investments in funds. The risk asset ratio for primary insurers was 10.6% at the reporting date (previous year: 11.6%). This means that insurance undertakings still fall well below the cap on risk assets of 35% of the restricted assets.

Average sector ratio for investments in equities of 3%.

The ratio of quoted investments in equities held by insurance undertakings at the end of 2011 was 3.0% of their restricted assets, down on the previous year. The figure varies from class to class, ranging from 1.3% for health insurers to 5.0% for property/casualty insurers. What is noteworthy is that more than 90% of these investments in equities are held via funds.

Increases in risk investments were recorded for high yield bonds and investments in default status. These are investments in bonds that have not received at least one investment grade rating from a recognised rating agency. As at the reporting date, such investments accounted for 1.5% of investments in restricted assets, 0.3 percentage points higher than in the previous year. The revised ratings issued by the rating agencies for a large number of investments (and in particular for certain government bonds) probably had a corresponding effect here.

Investments in commodities as yet insignificant.

Following the amendment to the Investment Regulation, investments linked to commodities risks can now account for up to 5% of restricted assets (section 3 (2) no. 3 of the AnlV). These investments must also be counted towards the risk asset ratio. At present, such investments are immaterial in relation to the four classes of insurance (see the following table).

Table 10

Share of total investments attributable to selected asset classes

As at 31 December 2011

Investment type	Total assets									
	Life insurance		Health insurance		Property/casualty insurance		*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*	742,747	100.0	189,611	100.0	138,018	100.0	115,794	100.0	1,186,170	100.0
of which attributable to:										
Investments in private equity holdings	6,279	0.8	1,133	0.6	1,560	1.1	357	0.3	9,329	0.8
Directly held asset-backed securities and credit-linked notes	3,062	0.4	376	0.2	291	0.2	181	0.2	3,910	0.3
Asset-backed securities and credit-linked notes held via funds in accordance with Circular 1/2002	3,947	0.5	714	0.4	1,418	1.0	407	0.4	6,486	0.5
Investments in hedge funds and investments linked to hedge funds (held directly and via funds)	2,801	0.4	839	0.4	620	0.4	909	0.8	5,169	0.4
Investments with commodity risks (held directly and via funds)	634	0.1	445	0.2	265	0.2	175	0.2	1,519	0.1

The figures are based on the insurance undertakings' quarterly reports and are only preliminary.

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

Source: Sector totals as at 31 December 2011 for life, health and property/casualty insurers, as well as Pensionskassen, from financial statement forms 670 and 673, collective decree dated 21 June 2011.

The table shows that the proportion of total investments attributable to alternative investments did not change materially compared with the previous year. Only the share of investments in the private equity area rose slightly.

2.4 Solvency

Solvency remains good in all insurance classes.

Preliminary estimates indicate that primary insurers and reinsurers again met the minimum capital requirements in 2011 by a healthy margin.

Life insurers

Life insurers' solvency remained good in 2011. In the projection performed on 31 October 2011, all life insurers demonstrated that they met the solvency requirements as at 31 December 2011. The solvency margin ratio in the year under review amounted to 175%, somewhat below the prior-year figure of 182%.[50]

[50] The 2010 Annual Report mistakenly reported a ratio of 215% instead of 182%.

Health insurers

All health insurers also comply with the solvency requirements according to the forecast contained in the projected scenario as at 31 December 2011. At an estimated 259%, the target solvency margin ratio for this sector is expected to be slightly above the 250% reported in the previous year. The sector continues to have a good level of own funds.

Property and casualty insurers

Solvency margin ratio improves further on previous high level.

The solvency margin ratio for property and casualty insurers increased from 290% in the previous year to 314%. This rise is attributable to two trends: on the one hand, the business volume of these insurers declined slightly while a smaller proportion of claims expenditures was covered by reinsurers. These offsetting effects led to the solvency margin remaining almost unchanged overall. On the other hand, the undertakings' own funds increased as a result of capital contributions by shareholders, earnings retention and extraordinary factors. This strengthened the sector's own funds, which remain 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[51] in 2010. The supervisory solvency requirements of €6.4 billion were more than exceeded by the reinsurers' own funds of €68.7 billion. The solvency margin ratio for reinsurers declined slightly from 1,145% in the previous year to 1,080%.

One of the reasons 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 companies produced an average solvency margin ratio of 295% in 2010 for reinsurers supervised in Germany (previous year: 302%), well above the target supervisory ratio of 100%.

[51] No information for 2011 was available for reinsurers at the time of going to press, since the deadline for preparing the annual financial statements in accordance with section 341a (5) of the HGB is six months later than for primary insurers.

Pensionskassen

The forecast solvency margin ratio for the *Pensionskassen* is an average of 131%, up slightly on the figure for the previous year (126%). According to the estimates, three *Pensionskassen* were unable to meet the solvency margin ratio in full as at 31 December 2011. 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 solvency margin required for supervisory purposes equalled the minimum guarantee funds of €3 million (for limited companies) or €2.25 million (for mutual pension funds) at the vast majority of the total of 30 pension funds. The individual solvency margin for these pension funds is below the minimum guarantee funds. This is due either to the relatively low volume of business engaged in or the type of business concerned. According to the results of the projection, all pension funds supervised again had sufficient available uncommitted assets in 2011.

2.5 Stress test

BaFin conducted a stress test in 2011 as at the 31 December 2010 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 EURO STOXX 50 share price index.

The index level at the reference date resulted in a 20% mark-down for the stand-alone equities scenario, and a 14% mark-down for the combined scenarios (equities/bonds and equities/real estate). The mark-downs for both the bond and the real estate components were unchanged, at 5% for bonds and 10% for real estate. The stand-alone bond scenario was also unchanged, with a 10% mark-down.

Once again, all life insurers ...

Ninety-two 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; one of these insurers voluntarily submitted the stress test. All 92 life insurers reported positive results for the stress test overall in the four scenarios.

... and all health insurers reported positive results.

BaFin included 42 health insurers in its analysis of the sector; seven companies were exempted from the duty to submit a stress 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.

Five property/casualty insurers …

BaFin asked 174 of the 216 property/casualty insurers supervised by it to submit their stress test results. 42 undertakings were exempted from this requirement. Of the total figure, 169 property/casualty insurers reported positive stress test results in all four scenarios. Negative results were recorded for all four scenarios at three undertakings. One insurer produced negative results in three scenarios, while another failed two of the four scenarios. The key reason for the negative results was the fact that the stress test model required the adjustment of the provision for claims outstanding; this was largely based on extraordinary factors at the individual undertakings and led to increased target levels of cover for the technical liabilities. When the individual situation of the five property/casualty insurers that failed the stress test in whole or in part is taken into account, it can be assumed at present that these undertakings also have sufficient risk-bearing capacity.

… and four Pensionskassen reported negative stress test results.

BaFin exempted 20 of the 152 *Pensionskassen* it supervised at the end of 2010 from their obligation to submit stress tests because of the low-risk nature of their investments. Of the 132 *Pensionskassen* subject to the stress test, 128 reported positive results in all four stress test scenarios. The four *Pensionskassen* with negative results generally reported minor shortfalls. These companies instituted measures to improve their risk-bearing capacity in the course of the year under review.

2.6 Risk-based supervision

Schedule for application procedure for internal models.

The new Solvency II insurance supervision regime allows insurance undertakings to calculate their solvency capital requirements using an internal model approved (certified) by the supervisor. BaFin offers undertakings the opportunity to take part in a pre-application phase before submitting their application for approval. The objective is to enable participants to assess how ready their model is for approval. However, such assessments are still difficult in some areas, since the legal bases for the new Solvency II supervisory regime have not yet been finally approved and/or are still in the consultation phase.

Furthermore, it is not clear as to when undertakings can submit applications for their internal models to be approved. It is important to lay down a uniform date for this throughout Europe, since this is the only way to ensure that the application of Solvency II gets off to a smooth start. Although the Omnibus II Directive is expected to specify a time frame for the successive commencement of Solvency II along with a corresponding reference date, it is not expected to come into force before the fourth quarter of 2012. The Board of Supervisors that meets regularly under the auspices of EIOPA has therefore resolved a schedule for the transitional period according to which undertakings can submit applications for the approval of internal models to the relevant authorities as from 1 January 2013.

Internal Models Working Group.

The Internal Models Working Group (*Arbeitskreis Interne Modelle* – AKIM) met twice in the course of 2011. It is chaired by BaFin and serves to facilitate the exchange of information between the supervisory authority, the insurance undertakings and the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e.V.* – GDV). The animated discussions and talks following the presentations again showed how important this forum is for everyone involved.

Current issues addressed by the AKIM.

The first meeting in June focused among other things on questions arising in relation to partial internal models. Also addressed were ideas on how to handle major changes to internal models. These have to be approved by the supervisory body, since they represent material changes to the original internal model. The question of whether undertakings may start using the revised internal model before it has been approved is still open. In BaFin's opinion, this is only possible once preliminary approval of the changes to the model has been granted. However, not all European legal systems permit preliminary approval to be granted on the basis of a merely summary examination.

At the second meeting of the AKIM in December, discussions by the attendees focused in particular on assessing operational risk in the context of internal models. Representatives of two undertakings used practical examples to demonstrate potential approaches. After this, BaFin representatives addressed recent developments in the approvals process and presented problems relating to the requirement for consistency between the assessment and the risk model laid down in the Solvency II Directive. The particular focus here was on underwriting risk in the life insurance area.

Discussions with 24 undertakings on the preliminary review of internal models.

A number of insurance undertakings and groups took advantage of BaFin's voluntary offer to perform a preliminary review of internal models (pre-application phase). BaFin held in-depth discussions with 24 insurers on this topic in the year under review. Reviews of internal models were performed at six undertakings in the period up to and including 2011, and reviews are planned for 2012 at a further seven. German subsidiaries of foreign parent undertakings are also preparing to conduct pre-application phases in 2012. This shows that constant dialogue and information exchanges between the supervisory body and undertakings is vital for preparing for Solvency II.

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 and quality. The market relevance of life insurers, *Pensionskassen* and funeral expenses funds, and pension funds is measured on the basis of their total investments. The relevant 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 the following factors:

- net assets, financial position and results of operations
- growth
- quality of management.

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 2011 reference date:

Table 11
Risk classification results for 2011

Undertakings in %		Quality of the undertaking				
		A	B	C	D	Total*
Market relevance	high	0.8	6.1	3.0	0.0	9.9
	medium	4.4	9.9	5.4	0.2	19.9
	low	11.3	38.1	19.8	1.0	70.2
	Total*	16.5	54.1	28.2	1.2	100.0

* Figure includes six insurance undertakings (0.1%) that were not classified.

Good-quality insurers predominate.

In the course of the risk classification, BaFin rated 70.7% of the insurers as "A" or "B". This means that the proportion of insurance undertakings in the upper quality ratings decreased slightly compared with the previous year. The proportion of undertakings with "C" ratings increased moderately year-on-year, while the proportion of undertakings with "D" ratings declined. As in the previous years, BaFin did not rate any insurers with high market relevance as having a low quality.

Modest rise in the number of medium-quality insurers.

In the case of life insurers, funeral expenses funds, *Pensionskassen* and reinsurers, the proportion of undertakings rated "A" and "B" declined overall, whereas the proportion of undertakings with a "C" rating rose by between 12% and 21%, depending on the class.

By contrast, ratings improved at the health insurers. The proportion of undertakings with an "A" rating rose by approximately 10%, while the proportion of undertakings with a "B" rating declined by approximately 3%.

Pension fund ratings also improved. For example, the number of undertakings rated "A" rose by approximately 7.5%.

There were no significant shifts for property/casualty insurers.

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 in 2011. 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 further 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 65 on-site inspections, roughly on a level with the previous year. 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 12
Breakdown of on-site inspections by risk class in 2011

On-site inspections		Quality of the undertaking					
		A	B	C	D	Total	Under-takings in %
Market relevance	high	2	19	9	0	30	50.0
	medium	3	1	4	0	8	13.3
	low	5	10	7	0	22	36.7
	Total*	10	30	20	0	60	100.0
	Under-takings in %	16.7	50.0	33.3	0.0	100.0	

* There were five on-site inspections at unclassified undertakings in the year under review, bringing the total to 65 on-site inspections.

2.7 Intermediaries

In 2011, BaFin conducted several examinations for cause and one scheduled examination in its supervision of the sales channels used by the insurance undertakings. The examinations for cause were conducted at health insurers, among others, who had drawn attention to themselves because they paid high brokerage fees.

Examinations for cause focused on the structure of the sales organisation.

In the course of an examination for cause conducted simultaneously at the holding company and various insurance undertakings in an insurance group, the organisational and operational structure of the sales channels was examined and various incidents that had been reported in the media were clarified. Among other things, attention focused on an incentive trip for insurance intermediaries at one company that had been organised in such a way as to damage the reputation of the entire insurance group. Another issue to be clarified was the extent to which the undertakings in the group satisfied their advisory and documentation obligations under the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG) in the course of marketing and selling insurance contracts.

At another insurer, BaFin objected to the structures in the sales network (sales organisation structure) in the course of an examination for cause. Based on an initial assessment, organisational defects were among the factors that had hampered the detection of fraudulent activities and other conduct damaging to the undertaking.

Compliance with prudential requirements tested during scheduled examination.

The main focus of the scheduled examination was on whether the insurance undertaking being examined satisfied the supervisory requirements under sections 80 and 80a of the VAG and Circular 9/2007 (VA). The results of the examination indicated that the legislative and supervisory requirements governing insurance mediation are generally firmly anchored in the undertaking's risk management system. This also applies to the reports of the tied intermediaries to the register of intermediaries that the undertaking is required to make.

Ban on passing on commissions in life insurance.

One insurance intermediary advertised on its website its intention to share the brokerage fees it received from the insurance undertakings with its own end-customers.

BaFin called on the intermediary to stop passing on commissions, citing the ban on passing on commissions. It also notified the intermediary of the possibility of initiating an administrative offence procedure. The intermediary then brought a declaratory judgment action before the Administrative Court in Frankfurt am Main in order to clarify the legality of its business model. The court sided with the plaintiff, arguing that the Regulation Governing the Ban on the Passing on of Commissions in Life Assurance (*Verordnung zum Provisionsabgabeverbot in der Lebensversicherung*) dating back to 1934 was insufficiently precise and thus did not satisfy the requirements of the Basic Law (*Grundgesetz* – the German constitution).[52]

BaFin initially appealed against this judgment at the Federal Administrative Court. Following a further, detailed examination, it withdrew its appeal because the specific case in question was not suitable overall for obtaining supreme court clarification on the legality of the ban on passing on commissions. The decision by the Administrative Court in Frankfurt am Main became final and unappealable following withdrawal of the appeal. BaFin was prompted by the judgment of the administrative court to review the general principles underlying the ban. In this context, BaFin launched a consultation procedure in April regarding the ban on passing on commissions and on incentives in health, life and property/casualty insurance. The consultation procedure is designed to allow interested associations, undertakings and individuals to participate in the debate on the future of these legislative prohibitions.

2.8 Developments in the individual insurance classes[53]

Life insurers

Lower interest rates are leading to higher valuation reserves.

The life insurers supervised by BaFin generated gross premiums of approximately €81.6 billion (previous year: €86.2 billion) in their

[52] Administrative Court in Frankfurt, case ref. 9 K 105/11.F (V).
[53] The 2011 figures are only preliminary. They are based on the interim reporting as at 31 December 2011.

direct insurance business in 2011. This represents a year-on-year decline of approximately 5.3%. Aggregate investments increased slightly by approximately 0.7% to around €739 billion (previous year: €734 billion). The life insurers' financial position in the year under review was stable. Because of the low interest rates, the sector continues to report high valuation reserves in interest-bearing securities, with developments on the equity markets having only a marginal influence on these reserves. Based on preliminary figures, the sector had net hidden reserves of approximately €42.6 billion at year-end (previous year: €30.6 billion), corresponding to roughly 5.7% of the aggregate investments, following 4.2% in the previous year.

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. 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 16% 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 4.09%.

Preliminary figures put the average net investment return at 4.09% in 2011, on a level with the prior-year figure of 4.15%.

Low interest rate environment.

The continued low interest rates and their long-term effects on the earnings position of the undertakings were again a core issue for BaFin in 2011. Already in 2010, the Federal Ministry of Finance, the German Insurance Association and BaFin had discussed measures to help the undertakings build or maintain the necessary medium- and long-term risk-bearing capacity. BaFin continued its efforts to implement these measures in the year under review.

Additional projection on interest guarantees in life insurance

Can the life insurers meet their return commitments in the long term even given the constraints of a phase of low interest rates? In 2011, BaFin again conducted an industry-wide survey on this question. As in 2009[54], it asked the life insurers to calculate a low interest rate scenario that allows conclusions about the performance of the sector to be drawn. The current study concentrated on issues that reflect the change in conditions since 2009. For example, one of the factors that BaFin analysed was the effect of the "*Zinszusatzreserve*" (an additional provision to the premium reserve introduced in response to the lower interest rate environment) required to be established starting in financial year 2011 by section 5 of the Regulation on the Principles Underlying the Calculation of the Premium Reserve (*Deckungsrückstellungs-verordnung* – DeckRV).

[54] See 2009 Annual Report, p. 101.

As in the case of the 2009 survey, it was clear from the study that investment income in the sector would be sufficient to pay the guaranteed return for a total of 15 years in the defined low interest rate scenario. However, the simultaneous growth in the "*Zinszusatzreserve*" for the period thereafter and the participation of the policyholders in the valuation reserves will lead to considerable additional burdens for the life insurers. BaFin will incorporate these findings in the development of its future supervisory requirements.

Life insurers reduce discretionary bonuses.

In light of the low interest rates obtainable for new investments, many life insurers cut their discretionary bonuses for 2012. 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 contracts is an average of 3.80% for the sector. This figure was 3.95% in 2011 and 4.13% in 2010.

Also in 2011, substantial distributions were made to enable the policyholders to participate in the valuation reserves, although these did not quite reach the same level as in the previous year. The distributions are linked to the level of the valuation reserves, which remain very high because of the prolonged low interest rates.

Investments by life insurers in the PIIGS countries

Together with the projection as at 31 October 2011, BaFin surveyed life insurers to establish the extent to which they expected to be invested in Portugal, Ireland, Italy, Greece and Spain (the "PIIGS" countries) at the year-end.

The survey revealed that the insurers had invested 2.9% of their total investment assets measured at fair value in the PIIGS countries. Investments in the individual PIIGS countries were in single-digit percentages for all insurers. Compared with previous surveys, it was evident that the insurers are actively managing the country risks and only hold a limited amount of these country exposures.

Private health insurance

Buoyant revival in new business with premium growth estimated at over 4%.

The 48 private health insurers supervised by BaFin generated premium income of approximately €34.7 billion in 2011 (previous year: €33.3 billion), representing year-on-year growth of more than 4%. The market for private health insurance remained difficult. The perpetual debate on modifications to the German healthcare system probably prompts potential customers to await further developments rather than take out private health insurance.

Nevertheless, BaFin still expects there to have been a buoyant revival in new business in 2011. The Act on the Financing of Statutory Health Insurance (*GKV-Finanzierungsgesetz* – GKV-FinG) abolished the "three-year limit" as at the end of 2010/beginning of 2011. As a result, salaried employees can again opt to switch from the statutory health insurance system to private health insurance 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. This saw lawmakers abandoning the rule, only introduced in 2007, under which 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 in three consecutive calendar years.

Improved reserve situation thanks to low interest rates, although the earnings position is weaker.

The health insurers increased their investment portfolio by 7.5% in the year under review to approximately €189 billion (previous year: €176 billion). The effects of the financial market crisis continued to be felt in 2011. The banking crisis was followed by the debt crisis in several eurozone countries. The EURO STOXX 50 and the DAX were in significantly negative territory at the end of the year. It is therefore likely that the volume of write-downs of investments has increased and earnings weakened compared with 2010. The continued drop in interest rates significantly improved the sector's reserve position. Net hidden reserves contained in the investments rose from €7 billion in the previous year to €10.7 billion in the year under review, corresponding to growth of around 50%.

All health insurers withstand projection.

As at 30 June 2011, BaFin asked 37 health insurance undertakings to prepare a projection and report the results. Twelve 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 operated similar to property insurance.

The projections are an additional, risk-based supervisory tool along with BaFin's stress tests. They simulate the impact of adverse capital market developments on the insurer's performance. BaFin's 2011 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. All of the health insurers withstood the assumed scenarios financially.

Net investment return of less than 4% expected for 2011.

Because of the weak capital market performance and the debt crisis in a number of eurozone countries, the projections indicate that net investment income will be lower. BaFin therefore believes that the sector will generate a net investment return of slightly less than 4%.

All health insurers were 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 provision for increasing age. However, the undertakings are able to generate sufficient surpluses from other sources (e.g. safety loading) to guarantee the necessary addition to the provision for increasing age.

Property and casualty insurers

Premium growth accompanied by a modest increase in claims expenditures.

Business performance by property and casualty insurers was positive overall in 2011. Gross premiums written rose, and motor vehicle insurance – the largest class in property and casualty insurance – also recorded significant premium increases.

Based on figures currently available, gross premiums written in the direct insurance business increased by 2.4% year-on-year to €59.3 billion. In addition to the significant increase in premiums in the traditionally important motor vehicle business, the other major classes also recorded an increase in premium income. Only fire insurance premium income declined.

Claims expenditures rose in parallel with the growth in premium income in almost all insurance classes, and thus also overall. Compared with the increase in gross premiums, however, claims expenditures increased at a slower pace, with a resulting slight decrease in the claims ratio. The declining expenditures for natural disasters in Europe reinforced this trend.

Overall, the expense ratio was reduced slightly year-on-year. The combined ratio for the direct insurance business therefore decreased significantly year-on-year, thus reversing the negative trend of the previous years. The underwriting profit increased correspondingly compared with the previous year.

Pensionskassen

Slight overall decline in premium income.

Based on the projections as at 31 October 2011, premium income at the *Pensionskassen* competing on the open market (*Wettbewerbspensionskassen*) that have been established since 2002 was on a level with previous years, 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 suggest that the premium income of these *Pensionskassen* declined slightly.

The aggregate investment portfolio of the 152 *Pensionskassen* supervised by BaFin increased by around 5.6% in 2011 to approximately €115.8 billion.

Additional projection on interest guarantees for *Pensionskassen*

The prolonged period of low interest rates and its impact on earnings are a core issue for the *Pensionskassen*, which mainly have portfolios of contracts with long-term interest guarantees. Because of this, they need to have sufficiently high-yielding investments that will allow them to meet their benefit obligations on a sustainable basis. At present, the average technical interest rate for *Pensionskassen* is 3.47%, and it is only declining at a slow pace.

BaFin conducted a survey of the impact of low interest rates at *Pensionskassen* in 2011 that was based on the same basic concept as at the life insurers: the development of returns on investments in defined pessimistic scenarios. The survey was adapted to the specific conditions prevailing at *Pensionskassen*. These result in particular from statutory requirements governing occupational pensions and, especially at the regulated *Pensionskassen*, from supervisory and insurance contract law requirements.

The analysis of the data provided indicated that the *Pensionskassen* will probably be in a position to pay the benefits they have promised to the beneficiaries even if the phase of low interest rates persists in line with the defined low interest rate scenario. Many *Pensionskassen* have already responded to the declining interest rates on the capital markets and have initiated countermeasures, or are in the process of doing so. For example, they cut the technical interest rate for new and existing insurance contracts. These measures are closely coordinated with BaFin because most of the *Pensionskassen* calculate their premiums and the premium reserve they have to recognise on the their balance sheet on the basis of business plans that have been approved by BaFin.

Higher premium reserves will result in higher expenditures.

In addition to the investment risks reflected in the BaFin 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 actuarial assumptions and to top up their premium reserves in the coming years. This is not easy in the current period of persistently low interest rates because it is increasingly difficult to generate sufficient surpluses.

Projection indicates stable financial position overall for the Pensionskassen.

BaFin asked the *Pensionskassen* to prepare projections as at 30 June and 31 October 2011 in which they projected their profit for the financial year in four equity and interest rate scenarios. The number of *Pensionskassen* asked to prepare projections was 135, of which 17 were exempted from this requirement due to the low-risk nature of their investments. The projections revealed that the solvency margin ratio rose slightly overall compared with the previous year. The short-term risk-bearing capacity of the sector therefore continues to be assured. It also became clear that the difference between the return on investments and the average

technical interest rate for the premium reserve is narrowing. This will make it more difficult to finance increases in reserves because of the need to reinforce the biometric actuarial assumptions.

Pension funds

At €2,154 million, pension funds recorded an overall decrease in gross premium income in the reporting period compared with the previous year (€5,967 million). 87% of the higher total sector income in the previous year was attributable to single premiums at one newly established pension fund. Benefit payouts increased from €1,199 million to €1,458 million. The number of beneficiaries increased to 777,378 persons at year-end (previous year: 757,388), of whom 491,855 were vested employees and 285,523 were pensioners.

Projections indicated stable economic position.

As in every year, BaFin asked the pension funds to submit their annual projection in accordance with section 55b of the VAG as at 30 June 2011. The scenarios surveyed at year-end 2011 were the capital market situation at the reference date and an equity scenario. In addition, scenarios were used that combined the above-mentioned scenarios with an increase in the yield curve. All of the pension funds forecasted that they would be able to withstand the four assumed scenarios financially at the reference date.

V Supervision of banks, financial services institutions and payment institutions

Raimund Röseler,
Chief Executive Director
of Banking Supervision

1 Bases of supervision

1.1 Implementation of CRD III

In 2010, European lawmakers amended the EU Banking Directive and Capital Adequacy Directive by issuing an amending directive referred to as the Capital Requirements Directive III (CRD III).[55] The various elements of CRD III, which are required to be applied as at 31 December 2011, were transposed into German law by the Second Regulation on the Further Implementation of the Amended Banking Directive and the Amended Capital Adequacy Directive of 26 October 2011, the CRD III Amendment Regulation (*Zweite Verordnung zur weiteren Umsetzung der geänderten Bankenrichtlinie und der geänderten Kapitaladäquanz-richtlinie* – CRD-III-ÄnderungsVO).[56]

Higher own funds requirements.

The changes that have been made are largely the result of the tighter regime published by the Basel Committee on Banking Supervision in summer 2009 in response to the financial market crisis (Basel 2.5). These provide in particular for increased and more risk-sensitive capital requirements in the trading book and for re-securitisations as well as stricter disclosure requirements.

The increase in own funds requirements in the trading book focuses mainly on those institutions – small in number but constituting an important group in terms of market relevance – which use their own (market) risk models to calculate own funds requirements or which have allocated a significant volume of securitisation positions to the trading book.

Re-securitisation exposures are included in capital requirements at higher risk weights. This applies under both the Credit Risk Standardised Approach (CRSA) and the Internal Ratings Based Approach (IRBA), regardless of whether the re-securitisation positions have an external rating or not. The increase in the risk weights enables the risk from re-securitisations to be captured more appropriately than under the previous rules.

Use of external ratings based on an institution's own guarantees not permitted.

An institution may not use a credit rating from a recognised rating agency for a securitisation position if that credit rating is based on (non-cash) support granted by the same institution for the securitisation position concerned. The lack of a credit rating may

[55] Directive 2010/76/EU, OJ EU L 329, p. 3 et seq.
[56] Federal Law Gazette (BGBl.) I 2011, p. 2103.

lead to a capital deduction. To prevent this from resulting in inappropriately harsh capital requirements for asset-backed commercial paper (ABCP) programmes, the institution has the option of using the same risk weight for the commercial paper as for a securitisation liquidity facility provided for the same ABCP programme if that risk weight was calculated using an internal assessment approach that has been granted supervisory approval. An institution may make use of this exemption provided, in particular, that the commercial paper does not entail a higher risk than a securitisation liquidity facility provided by the institution for the same ABCP programme.

The new rules address the situation observed during the financial market crisis where sponsors in particular had taken on commercial papers in order to ensure that the ABCP programmes they were supporting were financed.

Stricter disclosure requirements.

In addition to the increase in minimum own funds requirements, the provisions governing the disclosure requirements for institutions have also been tightened up. For market risk, this means an enhancement of both the quantitative and the qualitative requirements. For example, there are now separate disclosure obligations in relation to own funds requirements for the special price risk relating to net interest positions in securitisations and to the internal approaches introduced under Basel 2.5. The enhanced disclosure requirements for securitisations include additional disclosures on securitisation positions in the trading book, the sponsoring of special purpose entities, the design of the internal assessment approach, securitisation liquidity facilities, re-securitisations and assets awaiting securitisation. The changes address the realisation that, under the previous rules, capital market participants were inadequately informed about the volume of and risk associated with the securitisation transactions executed by institutions and the securitisation positions held by them.

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

Institutional investors were not the only people to suffer as a result of the financial crisis – clients who used the investment advisory services of investment services enterprises also did. In day-to-day supervisory practice, this was reflected especially in the large number of complaints in which clients accused enterprises of wrongly advising them. The root of these complaints was often disputes about the information provided on risk or on charges. By amending the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG) by way of the Act to Increase Investor Protection and Improve the Functioning of the Capital Markets (*Anlegerschutz- und Funktionsverbesserungsgesetz* – AnsFuG), lawmakers addressed the continuing stream of complaints and adapted the prudential rules applicable to the provision of investment advice. Legislative efforts focused on the sale of financial instruments via investment advisory services and resulted in the introduction of the

new requirement contained in section 34d of the WpHG. Essentially, the new statutory provisions now require that certain employees working in sales have minimum qualifications and that groups of employees be registered in an internal database at BaFin known as the employee register.

Sales and compliance also a focus of supervision.

In future, investment services enterprises wishing to engage certain employees in their sales operations will have to verify beforehand whether those individuals possess the necessary expertise and reliability. Besides investment advisers, who make up the most numerous group, sales representatives and compliance officers must also have minimum qualifications. As well as the employees entrusted with actually providing investment advice, BaFin is therefore focusing its attention on these functions too, which are usually invisible to clients. Here, experience gained from ongoing supervision has shown that sales targets can sometimes have a considerable impact on advisory practice. Details of the requirements for expertise and reliability are contained in the WpHG Employee Notification Regulation (*WpHG-Mitarbeiteranzeigeverordnung* – WpHGMaAnzV).[57] BaFin published the Regulation on 30 December 2011, more than ten months before the entry into force of the new rules, enabling affected enterprises and individuals to prepare to meet the future requirements and take appropriate action in good time.

Employee register reveals frequency of complaints.

The employee register becomes particularly important in light of the additional obligation to report information not only on specific individuals but also on, for example, the complaints received by an investment services enterprise regarding the provision of investment advice by them. This will enable BaFin to identify any irregularities. In future, it will be able to spot a large number of complaints made against a single investment adviser or against various investment advisers of a single sales officer. Equally, it will be possible to spot clusters of complaints in individual regions or areas.

BaFin has been given far-reaching powers to implement the new rules. For example, it may prohibit an institution from engaging an employee in the reported activity, as long as that employee does not satisfy the statutory requirements. It may also caution the employee or the institution or prohibit the institution from engaging the employee for a period of up to two years. If orders become non-appealable, they may be published without specifying the name of the employee concerned, unless doing so is likely to damage the legitimate interests of the enterprise.

New supervisory regime increases investor protection.

By granting these powers, lawmakers are demonstrating the importance of future supervision in the area of investor protection. The aim is for BaFin to use the database, in which not only the investment advisers but also all compliance officers and sales representatives will be registered, as a new source of information and to carry out its supervisory activities in a risk-based manner.

[57] Federal Law Gazette (BGBl.) I 2011, p. 3116.

Furthermore, BaFin should not limit itself to formal checks of existing instructions and controls by institutions' internal organisational units (compliance, internal audit), but use its own personnel to perform its own research directly and immediately.[58] BaFin therefore expects a significant proportion of its supervisory activities in the investment advisory area to be carried out on the ground in future. In 2011, it restructured and recruited additional staff to the department entrusted with supervising investment services enterprises so as to be able to meet these amended requirements. It also set up highly specialised units to deal solely with the sale of financial instruments via investment advisory services.

1.3 Amendment of Legislation Governing Investment Intermediaries and Capital Investments

Changes relating to the sale of investments.

In the year under review, the Bundestag (the lower house of the German Parliament) adopted the Act to Amend the Law Governing Investment Intermediaries and Capital Investments (*Gesetz zur Novellierung des Finanzanlagenvermittler- und Vermögensanlagenrechts*).[59] Most of its provisions will enter into force on 1 June 2012. As a result of this amending legislation, investments will qualify as financial instruments within the meaning of the Banking Act (*Kreditwesengesetz* – KWG) from that date onwards, which means that, in future the organisational requirements and conduct of business obligations laid down in the WpHG will apply when investment services enterprises supervised by BaFin provide investment advice and engage in investment broking.

Greater regulation of the grey capital market.

The amending legislation will also increase investor protection in what is referred to as the grey capital market. Many investors see the investment offerings in this market as an alternative to investment classes such as equities and certificates even though they often have a long term to maturity and cannot be sold early, and hence entail high risks. Since they qualify as financial instruments within the meaning of the KWG, capital investments generally fall within the scope of the banking business and financial services activities defined in section 1 (1) and (1a) of the KWG. Due to an exemption, however, the placement of these investments and the services related to their management will still not require authorisation. Shares in cooperatives within the meaning of section 1 of the Cooperative Societies Act (*Genossenschaftsgesetz*) are specifically exempted in all cases; they also fall outside the scope of the Capital Investment Act (*Vermögensanlagengesetz* – VermAnlG).

[58] Report of the Finance Committee, Bundestag publication 17/4739, p. 13.
[59] Federal Law Gazette (BGBl.) I 2011, p. 2481.

Equally, due to a statutory exemption, BaFin will continue not to supervise independent intermediaries of pure investments within the meaning of section 1 (2) of the VermAnlG who merely forward client orders and are unable to obtain ownership and possession of client money or assets. The same applies to independent intermediaries of open-ended funds. Supervision of these investment intermediaries remains the responsibility of the local trade supervisory authorities in accordance with sections 34f and 34g of the Industrial Code (*Gewerbeordnung*), although its content has been improved. Independent investment intermediaries must now demonstrate greater expertise and are subject *mutatis mutandis* to the main investor protection obligations under the WpHG. Details of these obligations are to be governed by a regulation.

Section 64n of the KWG creates a transitional provision for institutions that are required to obtain authorisation as a financial services institution due to the expanded definition of financial instruments. If these institutions submit a full application for authorisation by 31 December 2012, authorisation will be deemed to have been granted provisionally as at 1 June 2012 until BaFin reaches a decision. This provision addresses the interest of the enterprises concerned in continuing to operate.

1.4 Circular on Tier 1 Capital Instruments

Through 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 Kapitaladäquanzrichtlinie* – CRD-II-Umsetzungsgesetz)[60], lawmakers made extensive changes to the requirements for institutions' Tier 1 capital. BaFin published Circular 5/2011 (BA) on 5 May 2011 in order to explain the resulting changes to the requirements contained in section 10 of the KWG regarding the recognition of Tier 1 capital instruments in greater detail. The Circular implements at national level the guidelines[61] of the former Committee of European Banking Supervisors (CEBS) on hybrid capital instruments and the other components of Tier 1 capital within the meaning of Article 57a of the Amended Banking Directive.[62] The Circular does not apply to Tier 2 or Tier 3 capital.

Fundamental principles governing eligibility as Tier 1 capital.

In amending the legislation, lawmakers introduced the terms "other capital" and "miscellaneous capital". The BaFin Circular sets out in detail the features other capital and miscellaneous capital (referred to as hybrid capital) must have in order to be recognised as Tier 1 capital. The fundamental principles for eligibility as Tier 1 capital are:

[60] Federal Law Gazette (BGBl.) I 2010, p. 1592.
[61] Implementation Guidelines regarding Instruments referred to in Article 57 (a) of the Directive 2006/48/EC recast.
[62] Directive 2009/111/EC, OJ EU L 302, p. 97 et seq.

- the permanence of the cash inflows;
- the flexibility of payments; and
- the ability to absorb losses.

The rules on the ability to absorb losses are the focus of the explanations in Circular 5/2011 (BA). Other capital, which is eligible as Tier 1 capital without restriction, must meet stricter requirements than miscellaneous capital, which is subject to limits of 15%, 35%, or 50%. However, miscellaneous capital also offers institutions greater flexibility, as they can agree moderate incentives to redeem, issuer call options, dividend pushers and stoppers, and alternative coupon satisfaction mechanisms. Provided institutions observe the Circular's requirements, they may also issue miscellaneous capital via a special purpose vehicle.

Early repayment requires approval.

As a general rule, institutions must obtain BaFin's approval before any early repurchase or early repayment of Tier 1 capital instruments. The Circular sets out the details of the application procedure as well as exemptions from the requirement for approval. It also provides simplifications for the termination of membership of a cooperative bank.

1.5 Implementation of CEBS guidelines on large exposures

Circular explains formation of risk units in greater detail.

As a result of the CRD II Implementation Act, BaFin has also published rules aimed at standardising administrative practice in relation to large exposures. Circular 8/2011 (BA) of 15 July 2011 introduced the CEBS guidelines of 11 December 2009 on the implementation of the revised large exposures regime into national administrative practice. In particular, the Circular sets out in greater detail the new statutory provisions governing the formation of risk units and how to determine the borrower in the case of investments in "schemes with underlying assets" within the meaning of the Regulation Governing Large Exposures and Loans of €1.5 million or More (*Groß- und Millionenkreditverordnung*). The aim is to capture concentration risk in a more risk-sensitive manner than was the case previously.[63]

In the case of risk units, unilateral dependencies in particular should also lead to borrowers being aggregated if they might prove to be an existential risk. In the case of schemes with underlying assets, such as investment funds, BaFin also requires a look-through to the underlying assets as a basic principle. This is because such a look-through enables a full picture to be obtained of the risk concentration: if applicable, an institution should add positions held indirectly through the scheme to positions with the same counterparty that already exist as a result of other credit relationships.

[63] See 2010 Annual Report, p. 119.

1.6 Circular on interest rate risks in the banking book

Interest rate shock specified by BaFin is increased.

In contrast to interest rate risk in the trading book, interest rate risk in the banking book is not subject to a general own funds requirement under Pillar I. Nevertheless, the Banking Directive[64] requires BaFin to monitor this risk and to take measures if interest rate risk in the banking book is high.

In order to identify institutions with increased interest rate risk in the banking book, institutions must calculate the effects of an interest rate shock. BaFin's Circular 11/2011 (BA) defines this as +/–200 basis points, bringing the interest rate shock into line with that used in European Union (EU) partner countries. The measures available to BaFin range from examining the institution's overall risk position in accordance with supervisory standards, including the interest rate risk in the banking book, through to ordering increased own funds requirements under section 10 (1b) no. 1 of the KWG.

1.7 Minimum Requirements for Compliance

In June 2011, BaFin published a new version of its Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 et seq. of the WpHG for Investment Services Enterprises (*Mindestanforderungen an die Compliance-Funktion und die weiteren Verhaltens-, Organisations- und Transparenzpflichten nach §§ 31 ff. WpHG für Wertpapierdienstleistungsunternehmen* – MaComp). The first version of this circular, which serves as a compendium of all BaFin's interpretations of the conduct of business, organisational and transparency requirements under the WpHG for investment services enterprises, dates back to June 2010.

New module on requirements for investment advice minutes.

As BaFin announced when it published the Circular last year, it reviews and updates MaComp at regular intervals. Where individual provisions of sections 31 et seq. of the WpHG require further clarification, it continually supplements the Circular by adding new modules. The new version published in 2011 contains changes in the following areas: the newly included module BT 6 sets out the requirements for investment advice minutes in greater detail. It explains the scope of section 34 (2a) of the WpHG and the content requirements. The background to this is the statutory requirement introduced as at 1 January 2010 for investment services enterprises to prepare investment advice minutes when providing such advice to retail clients. BaFin's initial review of this new rule showed that many enterprises are still unclear about the content requirements and that not all the minutes used to date satisfied the statutory provisions. The findings of the review were incorporated into the module. For example, the new version of MaComp clarifies that investment advice minutes need to be

[64] Directive 2006/48/EC, OJ EU L 177, p. 1 et seq.

prepared even if a consultation with a client does not result in a transaction being concluded. BaFin also explains that, even though a certain amount of standardisation is permitted, the minutes must also provide free text fields for various points.

In addition, the new version refers to Circular 5/2010 on the Minimum Requirements for Risk Management in Investment Companies (*Mindestanforderungen an das Risikomanagement für Investmentgesellschaften* – InvMaRisk), which entered into force after the original MaComp was published. MaComp has thus been extended to asset management companies and clarifies the scope of the rules on financial analysis.

In the new version, BaFin has also removed the general exemption for bonds issued by member states of the European Free Trade Association (EFTA) from the monitoring of personal account dealings conducted by employees. European sovereign bonds are now treated in the same way as other financial instruments for the purposes of this monitoring. Lastly, the new Circular sets out in greater detail the requirements with regard to representing the performance of financial instruments in information and marketing communications to clients. It explains how the impact of commissions, fees and other charges can be reflected in presentations of performance in accordance with section 4 (4) to (6) of the Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises (*Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung* – WpDVerOV). In particular, the new version clarifies that investment services enterprises must disclose any custody charges in an additional note and must not include these charges in the specimen calculation.

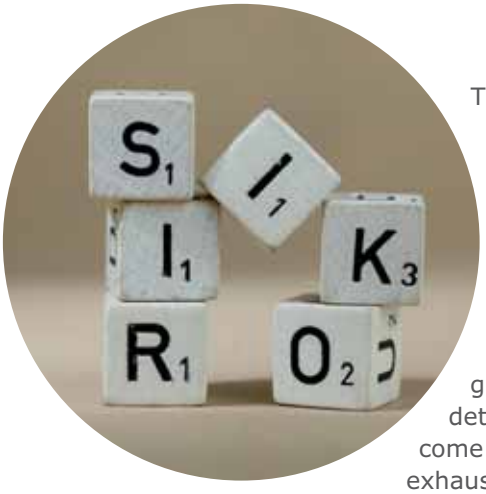
2 Preventive supervision

2.1 Risk-bearing capacity

Guidance notice on the assessment of risk-bearing capacity concepts.

In December 2011, BaFin published a guidance notice on the supervisory assessment of banks' internal risk-bearing capacity concepts, in which it outlines the main assessment criteria. By doing so, BaFin met the banking industry's frequent requests for the assessment criteria to be made generally transparent.

Section 25a (1) of the KWG requires credit institutions to put in place appropriate and effective procedures to gauge and continuously safeguard risk-bearing capacity. The term "risk-bearing capacity" is defined in greater detail in the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk). These require credit institutions to ensure on the basis of the overall risk profile that material risks, including risk concentrations, are covered by risk-taking potential on an ongoing basis.



The freedom available to credit institutions in selecting the methods by which they calculate risk-bearing capacity has led to numerous different approaches in practice due to the heterogeneity of the German banking sector. In assessing the methods as part of the supervisory review process, BaFin is guided by the basic principles of the completeness with which risks are reflected, the consistency of the procedures and the prudence principle, while at the same time bearing in mind the proportionality principle. The guidance notice sets out these basic principles in greater detail and outlines the assessment criteria that have repeatedly come to light in supervisory practice. In other words, there is no exhaustive list of all the potentially relevant considerations and BaFin and the Deutsche Bundesbank factor further considerations into their assessment on a case-by-case basis.

Risk-taking potential: going concern and liquidation approaches.

Among the methods encountered at institutions, the guidance notice distinguishes between going concern and liquidation approaches. Going concern approaches are those methods of managing risk-bearing capacity in which the institution concerned could continue as a going concern while meeting prudential minimum capital requirements, even if all risk cover items reported were eroded by emerging risks. If, however, the risk-taking potential reported as risk cover includes items required in order to meet minimum capital requirements under the Solvency Regulation (*Solvabilitätsverordnung* – SolvV) and without which the institution could not fundamentally continue as a going concern, the method involved is a liquidity approach.

Only those approaches based on the risk-bearing capacity resulting from a credit institution's own assets are considered to be appropriate when examining risk-bearing capacity. Payments an institution hopes to receive from third parties which are to be used to cover emerging risks in the event that the institution is unable to do so itself may not therefore be reported as risk-taking potential.

Income statement-/balance sheet- and value-based methods of calculating risk-taking potential.

The guidance notice also distinguishes between value-based and income statement- or balance sheet-based methods of calculating risk-taking potential. Most German credit institutions apply income statement-/balance sheet-based methods that draw on items in the external financial statements, whereas value-based approaches are encountered more rarely. With income statement-/balance sheet-based methods, BaFin expects that not all balance sheet items will be taken over unfiltered in calculating risk-taking potential; more specifically, this applies to deferred tax assets, goodwill, non-controlling interests and any effects on the institution's own credit standing resulting from the fair value measurement of liabilities. To this extent, stricter standards must sometimes be applied to the adjustment of reported equity under liquidation approaches in the interests of consistency.

Elimination of hidden liabilities ...

BaFin also expects hidden liabilities relating to securities treated as fixed assets to be fully eliminated in a coordinated management approach if they are substantial in amount. This can be done by

deducting them from risk-taking potential or recognising them as a value at risk. Hidden liabilities can also result from a credit institution's pension obligations. In the case of liquidation approaches at least, these must be taken into account when calculating risk-taking potential.

... and a nuanced view of hidden reserves.

Whether and under what conditions hidden reserves are suitable as risk-taking potential depends in particular on the nature of the reserves. For example, it is generally acceptable from a supervisory perspective to recognise non-committed contingency reserves pursuant to section 340f of the Commercial Code (*Handelsgesetzbuch* – HGB) as risk-taking potential in a coordinated management approach based on the financial statements prepared in accordance with the HGB. The contingency reserves could be realised in the next annual financial statements through a simple measurement and used to offset losses in a tax-neutral manner. However, a different view is taken of hidden reserves that could only be realised through transactions in which a tax liability might have to be taken into account. In addition, the realisation of reserves taking the form of less fungible assets in particular entails considerable uncertainty. BaFin therefore takes a very cautious view of stating these hidden reserves as risk-taking potential and attaches strict rules to doing so.

Many credit institutions manage risk-bearing capacity primarily using a going concern approach, taking into account the budgeted profit for the current and following year as the key measure of risk-taking potential. Although these amounts do not yet exist, but are expected only in the future, BaFin generally accepts this provided certain conditions are met. In particular, budgeted results must be calculated conservatively and adjusted promptly in the event of any negative deviations from forecasts.

Inclusion of specific risk types such as credit spread risk.

MaRisk already basically lists the types of risk required to be taken into account in managing risk-bearing capacity. Expanding on this, the guidance notice contains information on the inclusion of certain specific risk types. The course taken by the financial crisis since 2007 has shown that credit spread risk can become extremely significant. BaFin therefore assumes that, for interest-bearing transactions in a bank's proprietary securities account, credit spread risk should also be calculated and included when managing risk-bearing capacity. Depending on how the positions are allocated to specific categories in the financial statements, however, this may not be necessary when applying going concern approaches.

Inclusion of expected and unexpected losses.

When quantifying risks, both expected and unexpected losses must be adequately reflected. If only the expected loss is stated, the figure will be too low. The expected amount is not a risk, but the actual basis for planning. Conversely, only the threat of a less favourable performance than the expected amount can be described as a risk.

Criteria for risk quantification factors.

BaFin does not stipulate which risk measures must be used to quantify the risk types included in managing risk-bearing capacity. However, it reserves the right to review the adequacy of the risk

measures laid down by a credit institution itself. Taking the risk measurement methods commonly used in practice as its starting point, the guidance notice lists several criteria for various risk quantification factors. For example, risk quantification must be based on a uniform, forward-looking period of time. Appropriate methods must be applied to ensure that this is the case even if, for trading portfolios for example, a value at risk is calculated assuming that the positions will be held for a shorter period. Strict requirements are therefore attached to such a method. Further supervisory criteria relate to the observation period for which data are captured in order to calculate values at risk as well as to other risk quantification parameters generally. The guidance notice also emphasises the importance of stress tests in assessing banks' internal risk-bearing capacity concepts.

2.2 Reporting system

Revised supervisory reporting system.

BaFin and the Deutsche Bundesbank have drawn up a joint concept paper on reporting. This provides for reporting of financial data (Module A) and loans of €1.5 million or more (Module B) to be restructured so as to significantly improve the available information base and thus strengthen micro- and macroprudential banking supervision. Following a public consultation at the beginning of 2011, the concept paper was discussed with the industry at a technical committee meeting in June 2011 and subsequently adapted by BaFin and the Bundesbank.

Changes to financial data reports.

The content and frequency of interim financial data reporting are to be improved and adapted in some areas to reflect European requirements under the Revised Guidelines on Financial Reporting (FINREP). BaFin has plans for a nuanced reporting module based on the format of annual and consolidated financial statements in accordance with the HGB and International Financial Reporting Standards (IFRSs). A basic HGB-based reporting system is to be introduced based on existing monthly reports. Publicly traded parents that prepare IFRS consolidated financial statements are supposed to meet both the requirements under FINREP and more extensive reporting requirements. In future, FINREP will form part of an implementing technical standard which is currently open for consultation at the European Banking Authority (EBA) and which, once adopted, will be directly applicable in the member states. The changes relating to financial data will provide BaFin with substantially improved opportunities for analysis and a more extensive overview of institutions' financial position.

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

In order to gain a deeper insight into the nature, scope and quality of lending, BaFin is also to extend the reporting system for loans of €1.5 million or more under section 14 of the KWG. For this, the definition of a loan is to be extended and the reporting threshold probably lowered to €1 million. In addition, institutions are to submit reports fully electronically and more frequently so that the quality and topicality of the data on such loans can be improved.

As the development of FINREP is still ongoing, BaFin and the Bundesbank published the adapted Module B in February 2012 and then Module A in April 2012 separately. The Common Reporting (COREP) module originally contained in the concept paper on the modernisation of the prudential supervisory reporting system and intended to reflect the standardisation of solvency reporting requirements at European level was omitted. The same goes for the module for submissions under the Internal Capital Adequacy Assessment Process (ICAAP).

3 Institutional supervision

3.1 Authorised banks

The number of authorised banks in Germany declined again in 2011. A total of 1,883 institutions were under supervision, down 40 year-on-year (1,923). The fall is much smaller than in previous years, however. 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 group of other institutions includes 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.

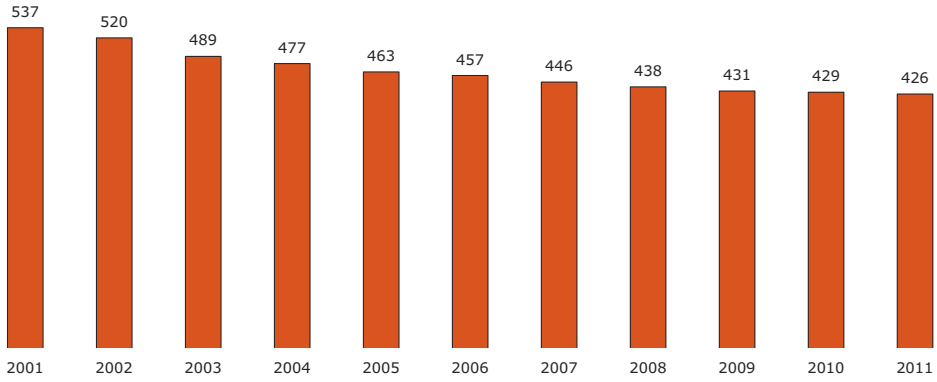
Table 13
Number of banks by group of institutions

Group of institutions	2011	2010
Commercial banks	185	189
Institutions belonging to the savings bank sector	436	439
Institutions belonging to the cooperative sector	1.125	1.145
Other institutions	137	150
Total	**1.883**	**1.923**

Pace of mergers in the savings bank sector almost unchanged ...

In the savings bank sector, 426 savings banks, nine Landesbanks and DekaBank, the central provider of fund services for the Sparkassen-Finanzgruppe, were under supervision at the end of 2011. The pace of mergers remained largely unchanged. The number of savings banks declined by three (previous year: 429). This means that the number of supervised savings banks decreased by 0.7% year-on-year.

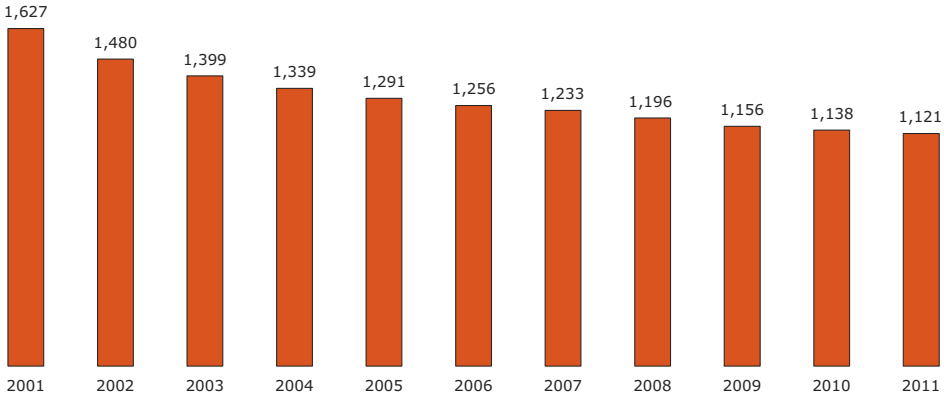
Figure 17
Number of savings banks



... and comparable with that in the cooperative sector.

In BaFin's cooperative sector, a total of 1,121 primary institutions, two central institutions, ten related institutions providing specialist services and 49 housing cooperatives with a savings scheme (which also belong to the cooperative segment) were under supervision at the end of 2011. The number of primary institutions therefore dropped by 17 or 1.5%; the pace of mergers among cooperative credit institutions remained at a low level.

Figure 18
Number of cooperative primary institutions



Number of Pfandbrief banks continues to increase.

Despite the overall decline in the number of credit institutions, new licences are granted on a regular basis. Often, these are required for a special business model. The trend for institutions to acquire a Pfandbrief licence is also continuing more or less undiminished.

The number of Pfandbrief issuers continued to increase in 2011 and now stands at 70 institutions (previous year: 69). Interest in acquiring a licence to issue Pfandbriefe therefore remained high even in what was generally a difficult year for the institutions. The focus here was clearly on mortgage Pfandbriefe, which have proven to be a comparatively cheap funding instrument even in the difficult environment. In addition to the savings bank sector, where

several institutions have also become Pfandbrief banks in recent years, foreign providers showed an increased interest in acquiring an existing Pfandbrief bank or establishing a new one in the year under review. This interest is also likely to be due to the fact that mortgage Pfandbriefe have proven very robust compared with rival foreign covered bonds. In some cases, the latter could only be placed in the market at significant risk premiums. Overall, therefore, mortgage Pfandbriefe are expected to remain a preferred funding instrument going forward.

Number of building and loan associations unchanged at 23.

The number of supervised building and loan associations did not change in 2011. As in the previous year, BaFin supervised 13 private and ten public-sector building and loan associations.

Table 14

Foreign banks in the Federal Republic of Germany*

As at 31 December 2011

Country	Subsidiaries	Branches	EU-branch offices*	Representative offices
Australia	1	1	2	-
Austria	2	-	10	4
Azerbaijan	-	-	-	1
Bahrain	-	-	1	-
Belarus	-	-	-	1
Belgium	2	-	1	1
Brazil	-	1	-	2
Canada	1	-	-	1
China	-	4	-	1
Czech Republic	-	-	-	1
Denmark	1	-	3	2
Egypt	1	-	-	-
Finland	-	-	1	-
France	9	-	20	11
Greece	1	-	1	-
Hungary	-	-	2	-
India	-	1	1	-
Iran	1	3	-	-
Ireland	-	-	1	1
Israel	-	-	-	4
Italy	7	-	7	1
Japan	4	3	-	2
Jordan	-	-	1	-
Latvia	-	-	1	1
Lebanon	-	-	1	-
Luxembourg	2	-	-	-
Mongolia	-	-	-	1
Morocco	-	-	1	-
Netherlands	6	-	12	-
Norway	-	-	1	-
Pakistan	-	1	-	-
Philippines	-	-	-	2
Portugal	-	-	-	5
Qatar	-	-	-	1
Russia	1	-	1	3
Slovenia	1	-	-	-
South Korea/Rep. Korea	2	-	-	2
Spain	1	-	2	7
Sweden	1	-	3	-
Switzerland	11	-	2	-
Tajikistan	-	-	-	1
Turkey	4	-	3	4
United Kingdom	8	-	7	-
USA	17	4	8	3
Vietnam	-	1	-	1
Total as at 31 December 2011	**84**	**19**	**93****	**64**
Previous year	92	18	152	71

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

** The list only contains entities with banking licences. This means that, in contrast to the prior-year report, it does not include financial services institutions, for example. Based on the prior-year criteria for inclusion, the number of EU branches amounts to 157.

3.2 Economic development

2011 EBA stress test

Positive stress test results for German banks.

In the first half of 2011, the European Banking Authority (EBA) conducted the bank stress test in the EU member states and Norway, working closely together with the national supervisory authorities, the European Central Bank (ECB) and the European Systemic Risk Board (ESRB). The sample covered 91 banks from 21 countries, representing at least 50% of the total assets of each national banking sector and 65% of the total assets of the entire European banking sector. For Germany, 13 institutions participated in the stress test.

Stress tests subject institutions to hypothetical ("what if") analyses of highly adverse but unlikely developments. They help to assess whether the institutions' capitalisation is adequate. As such, they 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.

Baseline and stress scenario.

The 2011 stress test was based on two scenarios.[65] While the baseline scenario described expected economic developments, the stress scenario assumed a significant deterioration in economic conditions. The assumptions for this adverse scenario were much tougher in 2011 than in the previous year. It was assumed that GDP growth in Germany would fall by 4.5 percentage points compared with the baseline scenario over 2011 and 2012. The adverse scenario also assumed a rise in unemployment: by 0.7 percentage points compared with the baseline scenario in Germany and by an average of 1.9 percentage points across the EU member states.

In addition to this deterioration in macroeconomic indicators, the 2011 EU stress test primarily assumed a fall in asset prices and a continuing debt crisis in peripheral EU countries. In modelling country risk, the bank stress test made distinctions based not only on the nationality of the debtor, but also on the remaining terms to maturity of the positions held. The stress assumptions originally formulated in March 2011 were adapted in line with current developments in June in those cases in which the actual decline in value or increase in yields was higher than initially assumed.

Apart from the tougher assumptions for the adverse scenario, the 2011 stress test also involved extended disclosure requirements for participating institutions compared with the previous year.

[65] Detailed information on the methodology and parameters used in the 2011 EU stress test can be found at www.eba.europa.eu.

Furthermore, a 5% Core Tier 1 capital ratio developed by the EBA specifically for the stress test established a much tougher criterion for passing the stress test than in 2010 (Tier 1 capital ratio of 6%).

EBA definition of Core Tier 1 capital

The Core Tier 1 defined by the EBA for the 2011 stress test consists of regulatory Tier 1 capital excluding hybrid components. At the banks participating in the stress test, this is mainly just share capital and reserves – after deduction in full of the items specified by the Capital Requirements Directive (CRD)[66] as amended by CRD II[67]. Under existing law, half of these items would, with a few exceptions, have to be deducted from Tier 1 capital and half from Tier 2 capital. In this respect, their deduction in full from Core Tier 1 capital (Tier 1 capital excluding hybrid elements) anticipates the future requirements under Basel III and CRD IV. However, this extends only to the question of where deductions must be made from, and not to the additional group of deductions under Basel III and CRD IV.

In addition, the EBA tried to improve the comparability of the results by specifying certain parameters. This was also behind the requirement to use the portfolios as at 31 December 2010 for the stress period: institutions were not permitted to assume that exposures would be reduced during the stress period in order to bolster their capital base. The only exceptions were legally binding restructuring measures that had been mandated by the European Commission as a result of state aid proceedings, for example. The static balance sheet assumption even meant that items intended to cushion losses, such as the dynamic provisions of Spanish banks or non-committed contingency reserves pursuant to section 340f of the HGB, were not allowed to be used to cover losses in the stress scenario, as this would have required a management decision.

All German participants achieved the minimum ratio required by the EBA.

All 12 German participants that reported in accordance with the EBA format achieved the minimum ratio required by the EBA. As at 31 December 2012, the average Core Tier 1 capital ratio of the German participants was 7.5% in the adverse scenario and therefore well above the required 5.0%.

Landesbank Hessen-Thüringen did not consent to the results being published in accordance with EBA requirements after a conversion from "miscellaneous" capital to "other Tier 1 capital" on which binding agreement had been reached with the owners and which increased the Core Tier 1 ratio significantly was not recognised by the EBA for the purposes of the stress test.

[66] Directive 2006/48/EC, OJ EU L 177, p. 1 et seq.
[67] Directive 2009/111/EC, OJ EU L 302, p. 97 et seq.

Table 15
Results of German banks in the 2011 EU stress test

Bank	Core Tier 1 ratio			
	Actual	Baseline scenario	Adverse scenario	
	End of 2010	(incl. capital measures before 30 April 2011*)	(incl. capital measures before 30 April 2011*)	(incl. additional counter-measures**)
Bayerische Landesbank	9.3%	9.0%	7.1%	8.3%
Commerzbank AG	10.0%	8.9%	6.4%	6.4%
DekaBank Deutsche Girozentrale	13.0%	12.3%	9.2%	9.2%
Deutsche Bank AG	8.8%	8.5%	6.5%	6.5%
DZ Bank AG	8.2%	9.5%	6.9%	6.9%
HRE Holding AG	28.4%	14.8%	10.0%	10.0%
HSH Nordbank AG	10.7%	10.5%	5.5%	9.1%
Landesbank Baden-Württemberg	8.2%	9.1%	7.1%	7.5%
Landesbank Berlin AG	14.6%	13.9%	10.4%	10.4%
Norddeutsche Landesbank	4.6%	6.8%	5.6%	5.6%
WestLB AG	8.7%	8.8%	6.1%	6.1%
WGZ Bank AG	10.8%	11.9%	8.7%	8.7%
Arithmetic mean	**11.3%**	**10.3%**	**7.5%**	**7.9%**

* Including capital raisings, government support measures and mandatory restructuring plans publicly announced and fully committed between 31 December 2010 and 30 April 2011.
** Supervisory recognised capital ratio calculated on the basis of additional mitigating measures (including the use of valuation allowances and/or other provisions, future planned issues of common equity and other disposals as well as restructuring measures not yet approved by the European Commission).

2011 EBA recapitalisation survey

The sovereign debt crisis in Europe and its far-reaching consequences for the European financial system prompted EU heads of state and government to resolve fundamental measures to restore confidence in the European banking sector. At a special summit of ECOFIN, the council of EU finance ministers, held in Brussels on 26 October 2011, they decided to strengthen the capital position of the large, internationally active European institutions.

Capital buffer: Core Tier 1 ratio of 9%.

The recapitalisation exercise focuses on building up a capital buffer made up of two components: firstly, institutions must achieve a Core Tier 1 ratio of 9% of their risk-weighted assets (RWAs). Secondly, they must also establish a sovereign capital buffer in the amount of the hidden liabilities from receivables due from member states of the European Economic Area (difference between carrying amounts and fair values) as at 30 September 2011. The amount of the sovereign capital buffer is fixed on that date and cannot be reduced by selling sovereign bonds.

EU-wide capital requirement of €114.7 billion.

The 71 institutions selected by the EBA for the recapitalisation survey, including 13 German institutions, have a total capital requirement of €114.7 billion. Around €13.1 billion of this is accounted for by German institutions: Commerzbank requires

€5.3 billion, Deutsche Bank €3.2 billion, Landesbank Hessen-Thüringen €1.5 billion, Norddeutsche Landesbank €2.5 billion, WestLB €224 million and DZ Bank €353 million.

The institutions in need of recapitalisation must reach this capital buffer by 30 June 2012 and maintain it until further notice; WestLB is an exception due to the current restructuring process. The other institutions in need of recapitalisation had to submit their recapitalisation plans to BaFin by mid-January 2012, explaining the measures to be taken to build up the capital buffer. In examining these plans, BaFin ensured that building up the capital buffer does not endanger the supply of credit to the real economy, as stipulated by the ECOFIN special summit.

Table 16
Results of the EBA recapitalisation survey

Bank	Core Tier 1 ratio as at 30 Sept. 2011	Capital requirement in € million*
Bayerische Landesbank	10.0%	-
Commerzbank AG	8.8%	5,305
DekaBank Deutsche Girozentrale	9.6%	-
Deutsche Bank AG	8.3%	3,239
DZ Bank AG	9.2%	353
HSH Nordbank AG	9.6%	-
HRE Holding AG	27.9%	-
Landesbank Baden-Württemberg	9.1%	-
Landesbank Berlin AG	13.8%	-
Landesbank Hessen-Thüringen	6.3%	1,497
Norddeutsche Landesbank	6.0%	2,489
WestLB AG	8.5%	224
WGZ Bank AG	10.2%	-
Total		**13,107**

* Capital requirement necessary to achieve the minimum capital ratio of 9% (including the sovereign capital buffer).

Situation at the major private commercial banks

Escalating euro crisis impacts results.

Financial year 2011 was a year of two halves: in the first half, the relative stabilisation seen in the previous year continued, helped by the still-healthy state of the economy. Influenced by what was a mainly strong and positive first quarter by comparison with the prior year, particularly in trading, earnings in the first half of 2011 were better than in the same period of 2010. With the euro crisis escalating sharply, a number of negative factors arose from July onwards, not only internationally, but for large German banks too. As a result, the second half of the year brought significantly lower operating results – and even losses for some large banks in the third quarter. Above all, large banks' earnings were negatively impacted by write-downs of Greek bonds, which also hit many banks with exposures in this area at international level. In addition, net trading income in the second half of the year was

significantly lower than in the first half; net fee and commission income from securities business also declined due to market-related factors. Allowances for losses on loans and advances were mostly stable or declined slightly but, together with the reduction in administrative expenses resulting from efficiency gains, were not enough to fully offset the negative trends described.

External growth aside, the major earnings components of net interest and net fee and commission income – which are generally regarded as being relatively stable – again largely failed to increase in 2011. The sustainability of earnings remains uncertain due to the market uncertainty caused by the euro crisis and, in some cases, increased payments arising from realised legal risks. This is likely to be reflected in generally lower earnings in 2012 as well. Alongside the EBA recapitalisation exercise with its short-term horizon, supervisory activity is therefore focusing increasingly on analysing the sustainability of business models.

Situation at the Pfandbrief banks

Issues in the Pfandbrief market.

2011 saw a further decline in the number of issues relative to the already comparatively weak previous year, with Pfandbriefe worth a total of €71.67 billion being sold. New issues had amounted to €87 billion in the previous year and significantly more than €100 billion in each of the years before (see table 17). Despite this trend, the market was again much more receptive to Pfandbrief issues than other funding instruments in 2011.

A sharp decline in public-sector Pfandbriefe ...

As in the two previous years, sales of mortgage Pfandbriefe (2011: €41.14 billion) again exceeded public-sector Pfandbriefe; the figures for all periods include ship Pfandbriefe. Public-sector Pfandbriefe recorded total issues of just €30.53 billion following a further sharp decline last year. New issues of public-sector Pfandbriefe have been declining sharply for years; in 2007, public-sector Pfandbriefe worth some €108 billion were issued. The sharp decline is due partly but not entirely to a reassessment of the risks associated with bonds, which are permitted as cover for public-sector Pfandbriefe. Institutions are currently shunning investments in countries particularly affected by the sovereign debt crisis. In addition, the abolition/modification of the institutional liability (*Anstaltslast*) and guarantor liability (*Gewährträgerhaftung*) for public credit institutions is still having an effect, which is why for many years less material that is eligible for cover has been available to institutions. This is leading to a gradual reduction in volumes, with the result that the requirement for public-sector Pfandbriefe as a means of funding is naturally declining. In addition, government lending is traditionally considered to be a relatively low-margin business. In recent years, a number of issuers have therefore largely discontinued these operations and merely funded existing positions by issuing public-sector Pfandbriefe as and when necessary.

... and a positive outlook for mortgage Pfandbriefe.

By contrast, the importance of mortgage Pfandbriefe has increased sharply in recent years. Despite declines in sales over the past two years, the prospects for mortgage Pfandbriefe are regarded as positive.

Table 17
Gross Pfandbrief sales

Year	Mortgage Pfandbriefe (€ billion)	Public-sector Pfandbriefe (€ billion)	Total sales (€ billion)
2007	27.46	107.91	135.37
2008	63.40	89.52	152.92
2009	58.14	52.25	110.39
2010	45.40	41.57	86.97
2011	**41.14**	**30.53**	**71.67**

Further decrease in outstanding Pfandbriefe in 2011.

The total volume of outstanding Pfandbriefe continued to fall in 2011, as new issues were again more than offset by maturing ones; it now stands at around €586 billion. The following table shows the changes in volumes of outstanding Pfandbriefe in recent years. It reveals that the volume of outstanding public-sector Pfandbriefe has almost halved since 2007, while the volume of outstanding mortgage Pfandbriefe has remained roughly unchanged.

Table 18
Volumes of outstanding Pfandbriefe

Year	Mortgage Pfandbriefe (€ billion)	Public-sector Pfandbriefe (€ billion)	Total outstanding (€ billion)
2007	217.11	699.40	916.51
2008	217.94	620.62	838.56
2009	231.93	524.88	756.81
2010	231.31	444.37	675.68
2011	**230.32**	**355.67**	**585.99**

Situation at the private commercial, regional and specialist banks

Economic conditions often supportive.

As in the previous year, the situation at the private commercial, regional and specialist banks was again impacted by the effects of the financial market crisis in the year under review. Several institutions continue to find themselves in a difficult financial situation and therefore require close prudential supervision. Most institutions benefited from the economic recovery in Germany, however.

Number of holder control proceedings in accordance with section 2c of the KWG remains at a high level.

Year-on-year, private commercial banks faced an almost unchanged number of shareholder changes in 2011 leading to holder control proceedings in accordance with section 2c of the KWG. BaFin's main focus in these proceedings is on examining the personal reliability and financial soundness of prospective

purchasers. In the year under review, individual prospective purchasers again proved to be personally unreliable or lacked the necessary financial soundness, as a result of which they were not permitted to complete the planned acquisitions.

Microfinance made in Germany

Microfinance has experienced a rapid upturn in recent years. The microfinance model was first introduced by Grameen Bank, a Bangladesh bank founded by economics professor Muhammad Yunus in 1983. His idea was to help the poor by providing microloans, enabling them to take their fate into their own hands and build a livelihood. The concept was so successful that Yunus was awarded the Nobel Peace Prize for it in 2006.

Microfinancing, which can be described as retail banking in developing countries, consists of microloans, savings deposits, payment transactions and microinsurance. Microloans are extended on different terms from the loans typically granted by commercial banks in Germany, and usually have the following features:

- the loan is for a small amount
- the maturities are short
- interest payments and capital repayments are made in many small instalments
- mechanisms such as group loans with joint and several liability compensate for the lack of collateral
- extremely close to the client – the bank comes to the client
- women in particular are targeted

In Germany, the state-owned KfW Entwicklungsbank has been involved in microfinance for a number of decades. The Frankfurt-based ProCredit Holding is another microlender. The ProCredit banks' lending business focuses on small and medium-sized enterprises, whereas their deposit business primarily serves clients in the middle and lower income brackets. KfW Entwicklungsbank is one of the largest shareholders. The ProCredit Group currently comprises 22 banks and operates in Latin America, Africa, Eastern Europe and Asia. On 20 December 2011, BaFin awarded the German ProCredit AG a licence to conduct banking business in Germany. Since then, the ProCredit financial holding group has also been under the consolidated supervision of BaFin.

Situation at the Landesbanks

Financial crisis continues to depress earnings.

Earnings at the Landesbanks in 2011 continued to be negatively impacted by the effects of the international financial market crisis. Overall, the earnings performance of the Landesbanks varied. In some cases, for example, the Landesbanks shortened their balance sheets significantly.

On 16 November 2011, the rating agency Moody's published the results of its latest review of the Landesbanks' ratings. With the exception of Landesbank Berlin, Landesbanks were downgraded by one to three notches. Moody's said this reflected a decreasing willingness to provide support for banks as well as restrictions imposed by the European Commission on future support measures.

EU state aid proceedings involving HSH Nordbank, WestLB and BayernLB.

In 2011, the capital aid that HSH Nordbank received in spring 2009 from its main shareholders, the federal states of Hamburg and Schleswig-Holstein, was given final approval by the European Commission subject to conditions. HSH Nordbank must fulfil those conditions by the end of 2014. They include shrinking the bank's balance sheet and reducing ship financing operations as well as discontinuing several business lines (aircraft financing and international real estate business) and equity interests.

In the year under review, the European Commission also gave its approval under the EU state aid rules to the break-up of WestLB AG, which will lead to the sale and eventual resolution of its banking business. Under the restructuring plan presented by Germany with the approval of the shareholders, the activities serving regional savings banks will be spun off and combined within a "Verbundbank". On 30 June 2012, all assets and liabilities that have not been spun off to the Verbundbank or sold will be transferred to Erste Abwicklungsanstalt (EAA). After 30 June 2012, WestLB will not engage in new banking business and will be transformed into a servicing platform with a resolution vehicle holding the remaining positions transferred to or hedged by EAA. The number of employees will also be reduced, with the remaining members of staff being employed by the asset management and servicing company.

The European Commission has not yet reached a final decision on the EU state aid proceedings involving Bayerische Landesbank.

Situation at the savings banks

Increased risk provisioning impacts earnings and risk position.

The earnings and risk position of the savings banks deteriorated slightly again year-on-year. This was due, among other things, to the sharp increase in risk provisioning expenses in the securities business. Allowances for losses on loans and advances also increased year-on-year. In terms of interest income, the savings banks continue to profit from the comparatively steep yield curve, i.e. the substantial spread between short- and long-term capital market rates. However, many institutions seem to be less interested in offsetting falling net interest margins with increased income from maturity transformation. Overall, net interest income declined slightly compared with 2010. The improvement in pre-tax income for 2011 that occurred nevertheless was achieved at the expense of the amounts allocated to the contingency reserves, which are positive but significantly lower than in the previous year.

Savings banks become the sole owner of DekaBank.

Since June 2011, the savings banks have been the sole owner of DekaBank. The German Savings Banks Association (*Deutscher Sparkassen- und Giroverband* – DSGV) sees the acquisition of all Deka shares as a key strategic step. It said that, for a number of years, it had been the savings banks' aim to underline their cooperation with DekaBank, the central fund company of the Sparkassen-Finanzgruppe, by increasing their involvement at the company law level as well. The savings banks are pursuing a similar aim at Landesbank Berlin Holding AG (LBB), which has been hard hit by the sovereign debt crisis, even though write-downs of the equity interest in the Landesbank in the amount of €850 million weighed heavily on the savings banks' balance sheets in 2011. As write-downs in the amount of €430 million had already been required in the previous year, the total write-downs on the equity interest in LBB now amount to 23% of the original purchase price. The savings banks currently hold 98.7% of the shares and have initiated a squeeze-out procedure in order to obtain all the shares.

Effects of Basel III on Core Tier 1 capital.

In 2011, BaFin conducted an investigation to enable it to assess the possible effects of the Basel III rules on institutions' Core Tier 1 capital. This investigation showed that, as at 30 June 2011, the savings banks' average Core Tier 1 capital ratio was 11.2% of their risk-weighted assets. Of the 429 savings banks included in the investigation, 24 institutions had a Core Tier 1 capital ratio of less than 7%. If contingency reserves had also been taken into account, the Core Tier 1 capital ratio would have been below the 7% threshold at just six savings banks.

Situation at the building and loan associations

Building and loan associations confirm their positive trend.

The year under review saw a continuation of the previous year's trend, shaped by sustained low market interest rates: once again, building and loan associations were able to sign more new contracts than in the previous year. Home savings volumes also continued to rise in the year under review.

Sales of home savings loans continued to be sluggish, however, as many clients shunned home savings loans in favour of loans extended by other providers of real estate finance on even more attractive terms. Overall, therefore, home savings loans continued to decline as a percentage of the building and loan associations' total lending volume.

Situation at the credit cooperatives

Upbeat earnings situation continues.

In 2011, credit cooperatives maintained the very favourable earnings situation seen in previous years. This was mainly because primary credit cooperatives benefited from an attractive yield curve; maturity transformation accounted for a significant share of the earnings growth in their interest business. The positive economic situation had a flanking effect. However, the challenge for the cooperative banking sector remains to bolster the low net

interest margins in their operating profit. This was boosted by clear successes on the cost management front. Overall, the credit cooperatives were again able to recognise adequate provisions in the year under review. These achievements were also recognised by the rating agencies FitchRatings and Standard & Poor's, which awarded the cooperative banking sector long-term ratings of AA- and A+ respectively.

Regulations set to impact credit cooperatives.

However, regulations are set to impact the cooperative banking sector and its institutions. A significant burden will come from a series of German and European regulations affecting equity, among other things. The add-on for the extended liability of cooperative members will no longer be regarded as regulatory capital, for example. Credit cooperatives face the threat of a further negative effect on their own funds due to the amendment of section 19 of the KWG, under which they must deduct equity interests in their central institutions (WGZ Bank and DZ Bank) from their liable capital. However, this will restrict the long-term financing of the top-level institutions by the primary credit cooperatives. Furthermore, as a result of Basel III, it is unclear whether hidden reserves (section 340f of the KWG), a significant item at credit cooperatives, can be recognised as liable capital. The liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) under Basel III also present a challenge for credit cooperatives. The LCR, for example, threatens to have a significant adverse effect on the cash pool.

The subject of maturity transformation should not go unmentioned. BaFin is considering regularly imposing a tangible capital add-on when the Basel II ratios, the calculation criteria for which were significantly tightened by Circular 11/2011 (BA), are exceeded. In addition, the EU is giving thought to clients also being entitled to repay mortgages early. The fixed-rate loans typical in Germany consequently came under threat.

Situation at securities trading banks, exchange brokers and energy derivatives traders

Unsettled business environment for securities trading banks and exchange brokers.

The business environment for securities trading banks and exchange brokers was difficult and marked by considerable uncertainties last year. Besides the introduction of the new specialist model at the Frankfurt Stock Exchange and Deutsche Börse's planned merger with the New York Stock Exchange, the uncertainties were also attributable to the lack of clarity in some areas surrounding the future course of financial market regulation. In addition, competitive pressures are mounting from one year to the next due to advances in exchange trading, the entry into the market of more high frequency and algorithmic traders, and new trading platforms. This is forcing institutions to combine to form larger entities or to structure their service offering as a niche offering to meet specialist client needs. As in previous years, therefore, business development at the individual institutions depended heavily on their strategic focus. The environment for corporate finance remained weak, especially in the small and medium-sized enterprise segment.

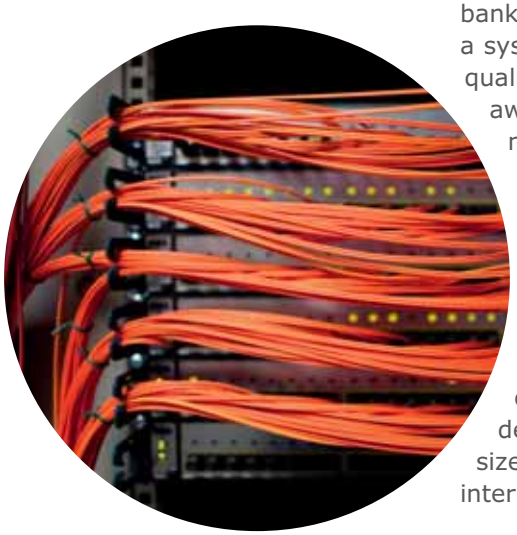
In 2011, BaFin again identified organisational weaknesses at a number of institutions, particularly in risk management and control, in the risk-bearing capacity concepts applied and in the documentation of transactions. As a result, the management of several institutions had to be told to remedy those deficiencies.

Energy derivatives traders miss turnover target.

The turnover generated by energy derivatives traders authorised by BaFin again fell short of the institutions' original expectations in 2011. The trading volumes recorded by the European Energy Exchange in Leipzig varied in the course of 2011. They also account for only a proportion of the transactions executed. Interest in financial products remains relatively weak, however. European trading in CO_2 certificates fell sharply as a result of the decline in industrial production in Europe. In light of the existing crisis of confidence, however, clients still seem interested in clearing OTC transactions through a central counterparty.

3.3 Risk classification

Two dimensions of risk classification.



In the course of its risk classification activities, BaFin consolidates the findings and assessments it has gathered regarding individual banks into two dimensions: a quality rating from "A" to "D" and a systemic importance rating ranging from "low" to "high". The quality grading using a letter bears no relation to the ratings awarded by an external rating agency: a D-rated institution has not necessarily "defaulted" in the banking supervision sense.

The second rating, systemic importance, reflects the institution's supervisory significance. In this case, BaFin is assessing the impact on the financial sector if the bank were to experience distress. The Deutsche Bundesbank and BaFin also 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 between the authorities. The criteria include size, the intensity of interbank relationships and the extent of international connections.

BaFin has performed a risk classification of credit institutions and securities trading banks since 2004. In the past six years, there have barely been any changes 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 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.

Risk classification affects supervisory activities.

As part of the ongoing institutional oversight assigned to it, the Bundesbank prepares a proposal for classifying institutions on the basis of a risk profile. The latter reflects a bank's risk situation and capital resources, its risk management system and the quality of its organisation and management. The final decision on an

institution's classification is taken by BaFin. The Bundesbank and BaFin then base the intensity of their supervisory activities on the classification. BaFin significantly steps up its oversight of institutions with high systemic importance. 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 for quality and systemic importance.

Table 19
Risk classification results for 2011

Institutions in %		Quality of the institution*				
		A	B	C	D	Total
Systemic importance	High	0.2	0.7	0.9	0.2	2.0
	Medium	3.6	3.6	1.8	1.0	9.9
	Low	43.6	34.1	8.5	1.8	88.1
	Total	47.4	38.3	11.3	2.9	100**

* Including the 17 financial services institutions that are authorised to obtain ownership or possession of customer funds and securities of or that perform proprietary business or trading.
** Deviations in the total figures are due to rounding differences.

Classification during the financial crisis.

The German banking sector as a whole continued to hold up well five years after the beginning of the financial crisis. The savings banks and cooperative banks in particular continue to show stable results, including for BaFin's assessments. As a result, the banking sector's overall quality rating is encouragingly stable. For banks with medium and high systemic importance, the classifications even improved slightly compared with 2010.

3.4 Supervisory activities

Three types of special audit.

With respect to special audits, BaFin distinguishes between 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 case 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 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), market risk models, 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.

270 special audits in 2011.

In 2011, BaFin again had to perform extensive audit activities. Of the total of 270 special audits (previous year: 258), 194 were initiated by BaFin, compared with 189 in the previous year. In addition, there were 62 requested audits (previous year: 53) and 14 statutory cover audits (previous year: 16).

Among the audits initiated by BaFin, the number of valuation audits increased slightly year-on-year, from 22 to 25. 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 held in institutions' trading books. As in the previous year, the special audits initiated by BaFin focused on the implementation of the institutions' organisational and risk management obligations (section 25a of the KWG) that were defined by BaFin in the Minimum Requirements for Risk Management (MaRisk).

Table 20
Number of special audits

	2011	2010
Impairment-related special audits	25	22
Section 25a (1) of the KWG (MaRisk)	169	166
Other	0	1
Cover audit in accordance with PfandBG	14	16
Market risk models	10	9
IRBA (credit risk measurement)	47	35
AMA (operational risk measurement)	3	7
Liquidity risk measurement	2	1
Other risk measurement	0	1
Total	**270**	**258**

The following table shows a breakdown of the audits by groups of institutions. The significantly higher overall percentage of audits at commercial banks and institutions in the savings bank sector compared with the cooperative sector reflects the greater systemic importance of these institutions in accordance with the risk matrix.

Moreover, the figures for these groups of institutions again comprise requested IRBA and AMA audits as well as statutory audits. As in the past, both types of audit were rarely conducted in the cooperative sector in 2011.

Table 21

Breakdown of special audits in 2011 by groups of institutions

	Commercial banks	Savings bank sector	Cooperative sector	Other institutions
Impairment-related special special audits	1	6	18	0
Section 25a (1) of the KWG (MaRisk)	29	49	82	9
Other	0	0	0	0
Cover audits in accordance with PfandBG	3	6	0	5
Market risk models	5	5	0	0
IRBA (credit risk measurement)	25	11	4	7
AMA (operational risk measurement)	2	1	0	0
Liquidity risk measurement	1	0	1	0
Total	**66**	**78**	**105**	**21**
in %*	**17.8%**	**14.0%**	**8.9%**	**10.2%**

* Percentages do not include the audits conducted at an institution's request and 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 customer funds and securities or to perform proprietary business or trading.

Combining the audit figures with the risk classification matrix reveals how risk-based the special audits were. Table 22 below contains only those audits initiated by BaFin. Only in the case of these audits is there a link to the risk classification of the supervised institutions.

Audit focus on 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. Accordingly, almost one in four problematic D-rated institutions was the subject of an audit initiated by BaFin. The proportion of audits at banks with high systemic importance was 57.9%.

In 2011, BaFin again examined institutions rated as good based on random sampling. A special audit was conducted at only one in 17 of A-rated institutions, however.

Table 22
Breakdown of special audits initiated by BaFin in 2011 by risk class

Special audits		Quality of the institution*					
		A	B	C	D	Total	Institutions in %**
Systemic importance	High	2	4	12	4	22	57.9
	Medium	6	14	9	5	34	18.4
	Low	44	67	23	4	138	8.4
	Total	52	85	44	13	194**	11.0
	Institutions in %	5.9	11.9	20.8	23.6	10.4	

* Including the 17 financial services institutions that are authorised to obtain ownership or possession of customer funds and securities or to perform proprietary business or trading.
** Percentage of the total number of institutions in the respective quality/importance category accounted for by the institutions audited.

Use of IRBAs.

At the end of 2011, 49 (previous year: 47) institutions and groups of institutions reported their capital requirements for counterparty risk based on internal securitisation rating systems and assessment approaches (IRBAs), including two credit cooperatives and one savings bank. Of the 49 IRBA institutions, 41 used the advanced IRBA on a group or individual basis (previous year: 42).

Since the entry into force of the Solvency Regulation (SolvV), BaFin has conducted approvals processes to confirm the suitability of a total of around 550 internal rating systems and IRBAs. At the end of 2011, 1,830 institutions and groups of institutions exclusively used the Credit Risk Standardised Approach (previous year: 1,846), of which 165 were commercial banks (previous year: 164), 1,120 credit cooperatives (previous year: 1,141) and 426 savings banks (previous year: 428).

Use of AMAs.

As in 2010, 16 institutions and groups of institutions used a total of 17 Advanced Measurement Approaches (AMAs) in the year under review. BaFin was responsible for the approvals 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; one belongs to the group of "Other institutions". Two institutions are from the savings banks

sector and one from the credit cooperative sector. At least one further AMA institution is due to be included in 2012.

Fifty-one institutions and groups of institutions used a standardised approach in the year under review (previous year: 71), with one institution having been approved to apply an alternative indicator in the standardised approach. Rather than being a surprising development, the change as against the previous year is attributable to a change in the method of counting. The other institutions use the Basic Indicator Approach.

The follow-up audits and audits of model revisions conducted at several AMA institutions in 2011 revealed a number of improvements to procedures and models. There continues to be scope for improvement, however, particularly in the area of validation. In addition, business environment and internal control factors, and the allocation procedure are often not fully developed.

Authorisation of internal risk models at credit institutions.

At the end of 2011, BaFin had confirmed to a total of 12 credit institutions that their internal market risk models meet the supervisory requirements for determining capital adequacy (previous year: 14). In 2011, two institutions returned their supervisory approval to use an internal market risk model in full and have since calculated the own funds requirement using standardised approaches. A further institution returned its supervisory approval for the special price risk relating to net interest positions.

At 39, the number of backtesting exceptions was significantly higher than in the previous year (22). This rise is primarily attributable to greater market volatility – particularly in the area of interest rate risk. This is mainly due to heightened uncertainty regarding a potential default on sovereign bonds issued by eurozone member states and hence on indirectly related bonds issued by credit institutions and, to a lesser extent, insurance undertakings.

CRD III introduces new requirements.

CRD III established or tightened numerous regulatory requirements in order to increase capital requirements for market risk and make them more risk-sensitive. Required to be transposed into national law by 30 December 2011, the new rules were implemented by way of the Second Regulation on the Further Implementation of the Amended Banking Directive and the Amended Capital Adequacy Directive of 26 October 2011 (CRD-III-ÄnderungsVO).[68] One significant new requirement is the calculation of stressed VaR, which is obligatory for all institutions using a market risk model that has been granted supervisory approval. Institutions that also use their internal risk model to determine the special price risk relating to net interest positions must calculate an incremental risk charge (IRC) as well as appropriately capturing the default and migration risk relating to net interest positions. Furthermore, securitisations in the trading

[68] Federal Law Gazette (BGBl.) I 2011, p. 2103.

book are excluded from capture by internal market risk models relating to own funds. Henceforth, the capital requirement for these securitisations must be calculated exclusively using the standardised approach. The only possible exception are positions in the correlation trading book if the institution concerned calculates a comprehensive risk measure (CRM) for this that captures all price risks.

Audit of market risk models.

In addition to the regular follow-up audits of the internal market risk model conducted on an ad hoc basis, the Bundesbank was required to carry out a total of nine audits of compliance with the new statutory provisions in relation to the IRC and CRM and to perform at least one fact-finding exercise per institution in relation to stressed VaR. In the process, 12 decisions were taken on stressed VaR, six on the IRC, two on the CRM and three closely related to the new statutory requirements. All decisions were positive (although in some cases capital charges were required) and communicated to the institutions in good time by 30 December 2011.

The decisions are of considerable significance for the regulatory own funds requirements of the institutions concerned: stressed VaR alone is likely to increase own funds requirements for market risk covered by the market risk model by more than 120%. Overall, there has been an up to sevenfold increase compared with the previous own funds requirements as a result of the new regulatory provisions governing the own fund requirements for market risk effective as at 31 December 2011.

Without prompt supervisory decisions regarding compliance with the new requirements for the use of internal market risk models, many credit institutions would not be able to ensure the regulatory own fund requirements for the market risks they have entered into in accordance with the standardised approach.

Table 23
Risk models and factor ranges

Year	New applications	Applications withdrawn	Rejections	Number of model banks	Minimum add. factor*	Maximum add. factor*	Median
2001	2	0	0	13	0	1.5	0.30
2002	1	0	0	14	0	1.0	0.25
2003	0	0	0	15	0	1.8	0.20
2004	1	1	0	15	0	1.0	0.30
2005	2	1	0	16	0	1.0	0.25
2006	0	1	0	15	0	1.0	0.2
2007	0	0	0	15	0	1.0	0.2
2008	1	1	0	15	0	1.0	0.2
2009	0	0	0	14	0	2.5	0.3
2010	0	0	0	14	0	2.5	0.4
2011	**1**	**1**	**0**	**12**	**0**	**2.5**	**0.5**

* 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 1.0).

Supervisory law objections and sanctions imposed.

In 2011, the results of special audits and supervisory inquiries in particular resulted in 98 supervisory law objections and sanctions (previous year: 187). The following table shows a breakdown of the sanctions and objections by groups of institution:

Table 24

Supervisory law objections and sanctions in 2011

Type of sanction			Groups of institutions: Commercial banks	Savings bank sector	Credit cooperative sector	Other institutions	Total
Serious violations			33	26	28	0	87
Sanctions against managers	Dismissal requests	Formal	0	0	0	0	0
		Informal	0	0	0	0	0
		By third party	0	0	0	0	0
	Cautions		2	1	1	0	4
Sanctions against supervisory/ administrative board members	Dismissal requests	Formal	1	0	1	0	2
		Informal	0	0	0	0	0
		By third party	0	0	0	0	0
	Cautions		0	0	0	0	0
Administrative fines			2	0	0	0	2
Sanctions in the case of danger (i.a.w. section 46 KWG)			2	0	1	0	3
Total			**40**	**27**	**31**	**0**	**98**

Supervision of foreign institutions

Supervisory measures designed to remedy deficiencies.

The market share of foreign banks in Germany continued to stabilise year-on-year in 2011. Organisational deficiencies relating, among other things, to risk-bearing capacity, market conformity checks, liquidity management and intra-group lending business were identified at a number of foreign banks in the year under review. The supervisory measures taken by BaFin help to ensure that these deficiencies are quickly removed. An increasingly critical view is also taken of domestic banks that are existentially dependent on the solvency and liquidity of the group company in question. It is essential, therefore, that risk management at domestic entities is strengthened so as to enable them to at least wind up their own business operations in an orderly manner if the group becomes insolvent. Supervisory activity in this context typically focuses on group-specific risk concentrations and outsourcing arrangements as well as contingency planning. BaFin continued to establish, structure and improve the quality of information exchanges with other countries' supervisory authorities, which is essential for the oversight of international groups.

Iran sanctions

On 23 May 2011, the Council Implementing Regulation (EU) No. 503/2011 implementing Regulation (EU) No. 961/2010 on restrictive measures against Iran added Europäisch-Iranische Handelsbank AG to the EU's sanctions list. As a result, all funds and economic resources under the ownership of, in the possession of, or held or controlled by Europäisch-Iranische Handelsbank AG were frozen. Europäisch-Iranische Handelsbank AG is still authorised to make payments to settle liabilities that arose before the effective date of the sanctions. Before the EU Regulation was adopted, BaFin had taken banking supervisory measures with the aim of obtaining the bank's assets.

By "listing" Europäisch-Iranische Handelsbank AG, the European Commission imposed sanctions on the last bank in Germany with Iranian shareholders following the freezing of the assets of Bank Sepah Iran (2007), Bank Melli Iran (2008) and Bank Saderat Iran (2010).

3.5 Securitisations

Further decline in the securitisation volume of large German banks.

Due to Deutsche Bank's takeover of Postbank, the number of large German institutions included in the securitisations survey fell to 16 in the year under review. The total book value of the securitisation positions held by those banks amounted to around €142 billion at the end of 2011, a significant decline compared with the prior-year figure (€164 billion). The reduction in the securitisation positions was due mainly to the maturity and repayment of some of the securities held and partly to value adjustments on them. Conversely, exchange rate changes in the reporting period and the netting of long and short positions increased the total book value slightly. It is important to bear in mind that this figure represents the positions before hedging. After deducting hedging positions, the banks' net exposure is therefore lower.

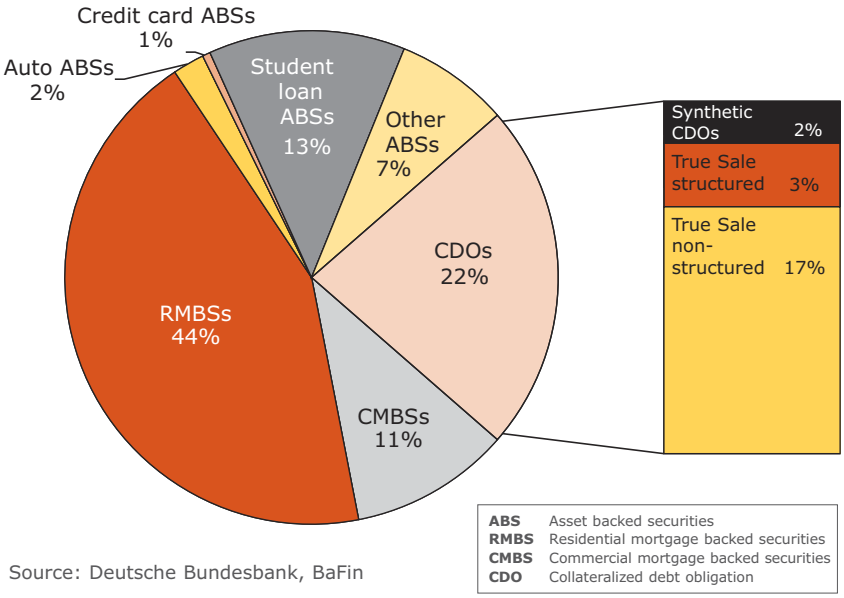
Over half of the securitisation positions held by German banks (55%) comprised residential mortgage-backed securities (RMBSs) and commercial mortgage-backed securities (CMBSs). RMBSs accounted for around four-fifths of the mortgage-backed securities, a similar proportion to the previous year; the remaining 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 2011, around 61% of the mortgage-backed securities were rated AAA or AA. The proportion of tranches rated sub-investment grade increased and there was therefore a further deterioration in the rating structure.

Collateralised debt obligations (CDOs) also had a significant weighting, accounting for just over a fifth (22%) of the total securitisation portfolio of German banks. Most of these were true sale transactions. At €16.3 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 €18.2 billion. By contrast, other forms of investment, such as auto loan and credit card asset-backed securities, played a minor role.

Figure 19

Securitisation positions by type of collateral

As at 31 December 2011

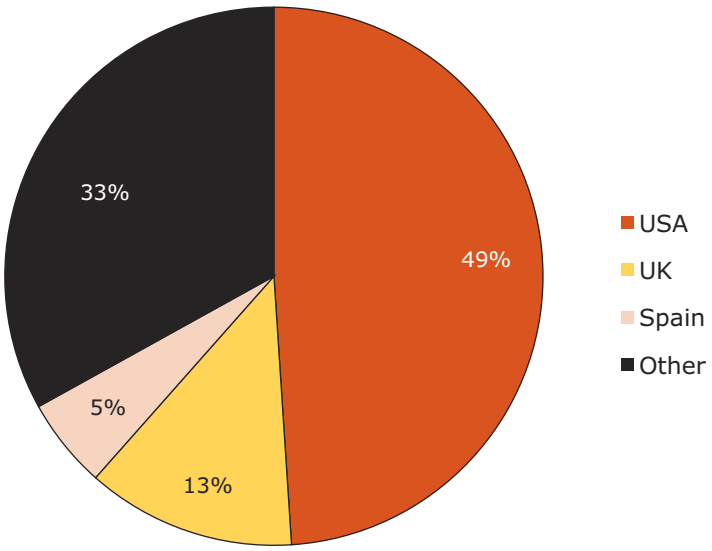


Source: Deutsche Bundesbank, BaFin

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 2011 (49%). However, the regional breakdown varies considerably from bank to bank depending on their 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 20
Regional breakdown of underlyings
As at 31 December 2011



Source: Deutsche Bundesbank, BaFin

3.6 Financial services institutions

680 financial services institutions provided investment services.

At the end of 2011, 680 financial services institutions (previous year: 717) and 72 German branches of foreign institutions (previous year: 71) were under BaFin's supervision. 163 of the financial services institutions under supervision were engaged only in investment and contract broking and the provision of investment advice (previous year: 177). A total of 517 institutions were authorised to conduct portfolio management (previous year: 521). As in previous years, two financial services providers were authorised to obtain ownership or possession of client money or securities.

In 2011, 42 enterprises applied for authorisation to provide financial services (previous year: 58); 17 institutions applied to have the scope of their authorisation extended (previous year: 10).

Tied agents

Audit focus at tied agents.

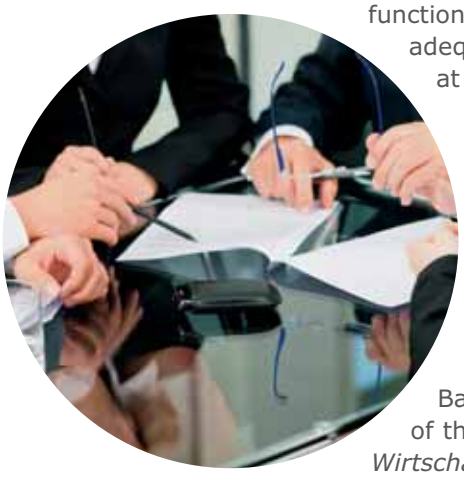
At the end of 2011, there were around 40,400 tied agents registered with BaFin (previous year: 39,700). The number of liable companies was on a par with the previous year at approximately 190. Most tied agents operate on behalf of credit institutions. Their number is likely to continue to increase sharply due to the amendment of the legislation governing investment intermediaries and capital investments. In the course of the legislative process, the total number of independent investment intermediaries was estimated to be around 80,000.

If intermediaries of investment funds, closed-end equity investments and trust models, for example, do not meet the stricter trade law requirements, their only option is to place themselves under the liability umbrella of an institution accepting liability. Against this background, in spring 2011 BaFin continued its in-depth risk-based audit of the liability umbrellas that it had begun back in 2010. For this, auditors scrutinised ten credit institutions with approximately 39,000 intermediaries and 23 financial services institutions with around 1,500 intermediaries in accordance with BaFin's detailed specifications. The audit reports are still being evaluated.

Supervisory law objections.

BaFin observed that financial services institutions that function as liability umbrellas often fail to adequately define the activities and processes outsourced to intermediaries. Frequently, there are also shortcomings in the selection of intermediaries, particularly with regard to their personal reliability and professional qualifications, the activities of intermediaries are insufficiently integrated into the institution at an organisational level, and there is a lack of adequate precautions in compliance and internal auditing. In addition, the agency arrangement is often not disclosed clearly and unambiguously on the Internet and when business is conducted electronically, for example. Finally, intermediaries are sometimes improperly included in institutions' portfolio management activities by way of advisory agreements or memberships of investment committees, for instance. BaFin also criticised institutions or asset management companies over the unauthorised provision by intermediaries of independent investment advice, the unauthorised provision by intermediaries of advice on a fee basis at their own risk and for their own account, and the provision by intermediaries of investment services for their own account while formally using the authorisation granted to the institution.

Business models that are based on liable companies (liability umbrellas) enabling independent intermediaries to provide investment services for their own account without their own authorisation in return for a fee of 10% to 25% of their intermediation income circumvent the authorisation requirement under section 32 of the KWG. This applies in particular when intermediaries are not integrated into the institution's organisational structure, compliance function and internal auditing function to the necessary degree and are not subject to adequate and effective local supervision. BaFin reiterated this at the beginning of 2011.



In 2012, BaFin will continue its efforts to adequately monitor this segment of the German financial market – which is particularly relevant for consumers in terms of risk – and to take action against abuses.

Cooperation

BaFin's annual consultation with the WpHG working group of the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer in Deutschland e.V.* – IDW) was again

concerned mainly with the results of the current audits of the investment services business at credit institutions and financial services institutions. Discussions focused on the question of whether institutions had already implemented the extended Minimum Requirements for the Compliance Function (MaComp). The investment advice minutes required to be prepared by investment advisers were another core topic at the annual consultation. BaFin expects auditors to satisfy themselves that the provision of investment advice is fully documented and that appropriate samples are taken during the audit.

Annual consultation and joint workshop with the IDW.

As in the previous year, BaFin held a workshop with the IDW with the aim of exchanging information on specialist topics and increasing cooperation. Issues discussed included various aspects of investment services business audits in accordance with section 36 of the WpHG. For example, BaFin explained the information it expects to be included in the audit reports on compliance. In particular, the reports should outline the preventive tasks and monitoring activities performed by the compliance function. Furthermore, BaFin considers it essential for auditors to perform audits at branches and tied agents so that they can satisfy themselves of the effectiveness of the compliance function's monitoring activities locally.

Workshop with auditing associations.

In December 2011, BaFin held a workshop with auditors from the auditing bodies of the savings bank and giro associations and the cooperative auditing associations. On the agenda were the results of the annual audit under section 36 of the WpHG and the notification requirements on the appointment and removal of compliance officers in accordance with MaComp. BaFin also held discussions with the auditing associations regarding a key issues paper on the planned amendment of the Investment Services Examination Regulation (*Wertpapierdienstleistungs-Prüfungsverordnung* – WpDPV) and on complaints under the WpHG.

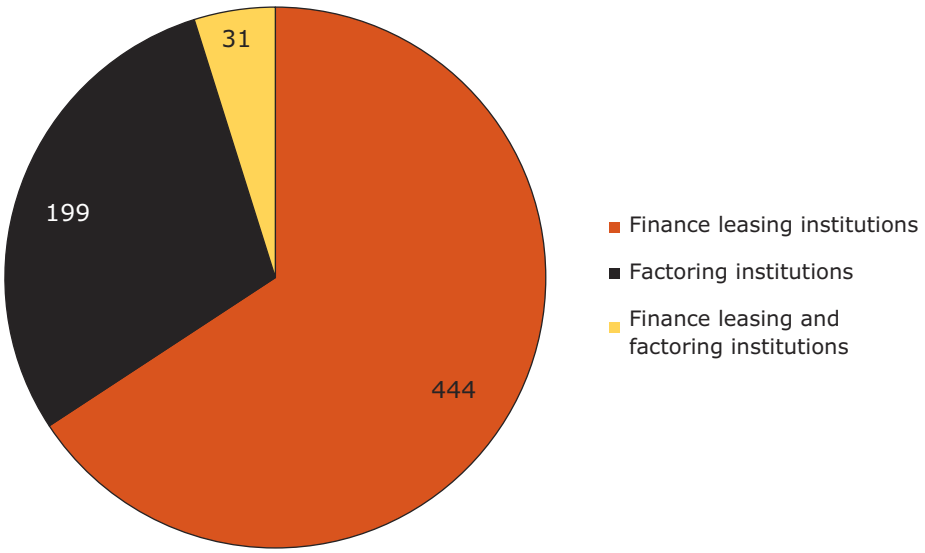
Supervision of factoring and leasing institutions

Further consolidation in the leasing and factoring market despite upward trend.

The finance leasing and factoring sector continued to feel the effects of the financial crisis in 2011. Although the funding options available to these "Group V institutions" were much better than in the previous year and both demand for capital goods in the leasing sector and the volume of purchased receivables in the factoring sector rebounded significantly, the crisis resulted in several insolvencies. The trend towards market consolidation also continued, albeit at a weaker pace. In 2011, authorisation holders again gave up existing authorisations to engage in finance leasing and factoring; at the same time, various institutions merged.

As at 31 December 2011, 444 finance leasing institutions (previous year: 499), 199 factoring institutions (previous year: 204) and 31 institutions engaged in both finance leasing and factoring (previous year: 40) were authorisation holders under the ongoing supervision of BaFin.

Figure 21
Breakdown of Group V institutions
As at 31 December 2011



33 new authorisations issued.

The finance leasing and factoring sector remains in flux. In 2011, decisions were taken on 33 applications for new authorisations under section 32 of the KWG, which involve considerable work for applicants and BaFin. A further 31 applications for new authorisations are still being processed. In 2011, 57 Group V institutions were the subject of holder control proceedings in accordance with section 2c of the KWG in conjunction with the Holder Control Regulation (*Inhaberkontrollverordnung* – InhKontrollV) – some of them on several occasions. In these proceedings, which have to be completed by a certain deadline, BaFin is required, among other things, to build up a comprehensive picture of the integrity of the potential purchaser of a qualifying holding and to check the existence and origin of the funds used to make the purchase.

Implementation of MaRisk and anti-money laundering requirements.

In 2011, the Group V institutions for the first time consistently prepared their annual financial statements for 2010 in accordance with the special provisions for institutions. The external auditors of the annual financial statements examined how the institutions had implemented the accounting requirements as well as the provisions of the KWG and the Money Laundering Act (*Geldwäschegesetz* – GwG). In addressing deficiencies, particular consideration was given to the new regulatory regime. In the process, BaFin bore in mind that enterprises had been given until the end of 2010 to implement the Minimum Requirements for Risk Management (MaRisk). In the year under review, BaFin also acted in line with the principle that MaRisk should be applied proportionately by issuing the sector with various guidance documents so as to illustrate its objective to smaller finance leasing and factoring

institutions in particular and prevent inefficient efforts at implementation. It plans to set out this guidance in greater detail in 2012.

At the same time, BaFin sanctioned institutions for massive and systematic failures under supervisory law, using a variety of supervisory measures up to and including the use of coercive measures and the revocation of authorisations. In addition, increased deficiencies were identified in the prevention of money laundering, terrorist financing and other criminal offences. BaFin will therefore increase its focus on raising institutions' awareness of these areas of preventive action and press for their implementation.

Prosecution of dubious business models.

In 2011, BaFin devoted particular attention to a significant number of finance leasing and factoring institutions that were operating dubious business models for a specific purpose. For example, various practices were uncovered, often in cooperation with criminal prosecution authorities conducting parallel investigations, in which institutions created contractual snares in the form of obligations to pay commission and make special payments, deliberately relieved investors and shareholders of the assets they contributed, or systematically added non-existent receivables to factoring portfolios. In several cases, BaFin responded to the irregularities identified by revoking the institutions' authorisations.

In 2012, BaFin will again take vigorous action against institutions of this kind as a matter of priority, using all the supervisory tools at its disposal.

Risk-based supervision

The risk classification exercise performed by BaFin in 2011 covered 680 financial services institutions. Due to their business activities, financial services institutions are not generally regarded as systemically important, as they do not pose risks to the stability of the financial system comparable to those presented by credit institutions. Financial services institutions are not authorised to obtain ownership or possession of client money or securities in providing financial services or to trade financial instruments for their own account. Therefore, none are classified as of "high" systemic importance. Increased risks in their area of business, as a result of a particularly large number of clients or a large client volume under management or brokerage for example, result in institutions being placed in the medium category. The sale of specific high-risk products, such as financial instruments that are particularly difficult for clients to understand due to their opaque structure, or the assumption of liability for a large number of tied agents and a strong international orientation also result in a medium risk classification. In the course of 2011, BaFin amended its criteria for classification as of medium systemic importance. As a result, the number of institutions in this group increased to 24.5% (previous year: 13.0%).

Table 25
Risk classification results for 2011

Institutions in %		Quality of the institution				
		A	B	C	D	Total
Systemic importance	High					
	Medium	9.0	12.3	3.1	0.1	24.5
	Low	24.5	44.1	6.0	0.9	75.5
	Total	33.5	56.4	9.1	1.0	100.0

Audits and measures

Further increase in on-site presence at audits.

In 2011, BaFin continued its efforts to increase its direct involvement in audits. It participated in 89 audits at financial services institutions (previous year: 76) and conducted 107 supervisory interviews with senior managers or management board members (previous year: 112).

56 authorisations ended.

In the year under review, 56 authorisations held by financial services institutions ended (previous year: 44), in most cases because they were returned.

BaFin revoked the authorisation of one financial services institution due to the unreliability of the managers of a qualifying holding, who were also the latter's owners, and due to serious organisational deficiencies. In the previous year, it had carried out a special audit at two tied agents of the financial services institution. This 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. The special audit confirmed the suspicion that the tied agents were making cold calls, that is, contacting clients by telephone without their prior consent. Substantial deficiencies were also identified in the organisational integration of the tied agents and their monitoring for compliance purposes by the liable institution. Internal procedures, training and checks on the qualifications of the tied agents' employees were not fully documented. Furthermore, the financial services institution was not carrying out its own monitoring measures in order to implement contractually agreed rights to perform checks and prevent

violations of the ban on cold calling. As a result, BaFin issued a notice of revocation.

BaFin held a consultation with another financial services institution regarding the revocation of its authorisation after the appointed manager left and the institution was unable to appoint another manager who met the requirements for reliability, adequate professional qualifications and management experience. In this case, the institution returned its authorisation voluntarily. In a further case, BaFin asked an institution to submit product information documents for the products it was selling mostly through tied agents that were also the subject of investment advice, threatening to prohibit the sale of the products if the institution did not do so. The institution announced a change in its business plan and in 2011 de-registered all its tied agents.

Tied agents often not sufficiently monitored.

The special audit at one cross-border institution revealed serious deficiencies relating to its liquidity and accounting and confirmed doubts about the result of the audit of the annual financial statements. The audit also revealed that the institution's tied agents were not integrated into ongoing monitoring and that they were harming investors in the course of their business activities by brokering them worthless shares. BaFin held a consultation with the institution regarding the revocation of its authorisation and filed a criminal complaint against one of the tied agents.

A client of a financial services institution authorised to engage in investment and contract broking filed a criminal complaint with the relevant public prosecutor's office. The complaint concerned the off-exchange sale of worthless shares, the sellers of which were companies domiciled in the United Kingdom. The purchase price was paid to their account at a bank in Latvia. The transactions were brokered by a tied agent of the institution. When criminal investigators and BaFin employees searched the agent's business premises, it emerged that the agent had had clients sign blank order slips, which it copied and used to place orders for which there were no client instructions. The agent faxed the manipulated order slips to the broker maintaining the account for execution through the institution. BaFin was unable to find these blank order slips and other client documents during the audit of the tied agent conducted a short time later under section 36 of the WpHG. Following the consultation with BaFin regarding the prohibition of its use of tied agents, the financial services institution gave notice of termination to all agents. Shortly afterwards, the broker gave notice of the termination of its cooperation with the financial services institution. The institution renounced its authorisation and is in liquidation.

Investment limits breached.

Client complaints alerted BaFin to the fact that a financial services institution authorised to engage in portfolio management had possibly breached the investment objectives and limits agreed with the clients. The complaints mainly concerned purchases of illiquid second-line stocks of foreign companies that were listed on the Frankfurt Stock Exchange's Open Market. BaFin reviewed the transactions that had been carried out and the agreements that

had been entered into with the clients. In doing so, it examined all the transactions that the institution had carried out in the illiquid second-line stocks. It found that the investment limits agreed with several clients had been breached. As a result, the institution reorganised itself, closed the branch office via which the transactions had been performed and relocated portfolio management to its head office so that it could be better monitored. In addition, the responsible management board member left the institution.

BaFin cautioned the senior manager of a financial services institution operated in the legal form of a German stock corporation (*Aktiengesellschaft*) because the institution had engaged in unauthorised proprietary trading in its own preferred shares. BaFin had ascertained this from the annual financial statements that had been submitted. The institution was instructed to keep an orderly share register. The reversal of the proprietary trading was overseen and has now been completed.

BaFin also held a consultation with a financial services institution regarding the planned revocation of its authorisation because it had continuously fallen below the required minimum capital of €50,000. As a result, the institution increased its own funds and thus avoided having its authorisation revoked. In addition, BaFin cautioned the senior manager of another financial services institution as, for a relatively long period of time and despite repeated reminders, this manager had failed to fulfil the notification and reporting requirements designed to ensure the monitoring of net assets and financial position.

3.7 Payment and e-money institutions

30 authorisations issued since the ZAG entered into force.

The Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG) has been in place for more than two years now. Since it entered into force, BaFin has authorised 30 institutions to provide payment services, while 17 applications for authorisation have been rejected or withdrawn. Some of the enterprises were already under the supervision of BaFin as remittance service providers. The transitional period granted to these enterprises under the ZAG to obtain authorisation expired on 30 April 2011.

Ongoing supervision of payment institutions.

In the year under review, ongoing supervision by BaFin and the Bundesbank began for the payment institutions already licensed. The points of reference used in this process include the monthly returns and annual financial statements required to be submitted by the institutions on a regular basis and the audit reports of the auditors engaged by the institutions. The notifications the institutions are obliged to submit in specific cases also provide BaFin with important insights. An institution is obliged to provide notification, for example, if it appoints a new manager or if the owner changes. BaFin imposed an administrative fine on one of the regulated payment institutions because it had failed to submit the

current annual financial statements or the monthly returns in good time and, in some cases, the documents submitted contained errors.

In 2011, BaFin carried out an on-site inspection at one payment institution. The audit, which lasted several days, focused on the safeguarding requirements that the institution has to meet in order to protect client money. For example, the payment institution must pay client money into a trust account. The institution can also take out insurance or a bank guarantee in favour of clients. The on-site inspections are to be extended in 2012.

Provision of cross-border services in Europe.

An authorised payment institution may also provide payment services in other European Economic Area (EEA) countries. It can do so through a branch, or agents, or by providing cross-border services. Supervision of branches and agents in another EEA country is the task of the home supervisor of the institution in question. Cross-border services, agents and branches must merely be notified to the host country's supervisory authority. BaFin has so far been notified of around 2,800 agents of foreign payment institutions operating in Germany. In the case of branches and agents of institutions from other EEA countries, BaFin remains responsible for monitoring the prevention of money laundering.

Supervision of e-money institutions.

In 2011, three enterprises applied to BaFin for authorisation to operate as an e-money institution in accordance with the new law in effect since 30 April 2011.[69] Moreover, foreign e-money institutions providing cross-border services in Europe now also conduct e-money business in Germany in accordance with the new law. The "e-money agents" they use for sales are now obligated parties under the GwG.

Supervision of agents and e-money agents.

Since May 2011, BaFin has carried out anti-money laundering supervision of agents and e-money agents under the new legal basis in the GwG. The agents and e-money agents mostly operate on behalf of payment and e-money institutions domiciled in other EU countries. BaFin ordered 82 on-site inspections of agents of payment institutions domiciled outside Germany.

BaFin completed 43 of these inspections successfully; 39 inspections could not be carried out. In 26 cases, it emerged that the foreign payment institution registers in which agents operating in the Federal Republic of Germany must be entered in order to be allowed to operate as an agent were incorrect. Agents entered in those registers had never started to operate or had already ceased to operate for the foreign payment institution in question without BaFin becoming aware of this. In the other 13 cases, it was not possible to carry out the inspection as planned for other reasons, such as the absence of the person concerned.

[69] See chapter VII 3.1.

Agents exhibit major deficiencies.

BaFin criticised the activities of agents in all the cases it investigated. It found that a large number of agents were in breach of their obligations under the GwG, probably out of ignorance. In all cases, it is examining whether it is necessary to initiate administrative fine proceedings. In three cases, BaFin reported suspicions of money laundering.

Occasionally, BaFin also found that both agents and their employees were processing payment orders for third parties through the payment institution's electronic transfer systems under their own name, instead of doing so in the name of the payment institution. They were therefore engaging in unauthorised remittance business. One reason for this conduct was to conceal the identity of the real client. BaFin prohibited these agents from operating as a result of their providing unauthorised payment services.

3.8 Market supervision of credit and financial services institutions

Information documents for financial instruments

Requirements for information documents.

Since 1 July 2011, investment services enterprises supplying investment advice to their retail clients have to provide them with a short, easy-to-understand information document for each financial instrument they recommend in good time before any transaction is executed. The general requirements for this document contained in the WpHG are set out in greater detail in the Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises (*Wertpapier-dienstleistungs-Verhaltens- und Organisationsverordnung* – WpDVerOV). The information document may not exceed two pages of A4-sized paper in the case of simple financial instruments and three pages in the case of complex financial instruments. It must be clear and comprehensible and describe the key features of the product. It must enable the client to understand the nature of the financial instrument and how it works, assess the associated risks, the prospects for repayment of the amount invested and the returns in different market conditions, and the costs associated with the investment, and to best compare the features with those of other financial instruments. The information document may refer to only one financial instrument and may not contain any promotional statements.

BaFin examined comparability of information documents.

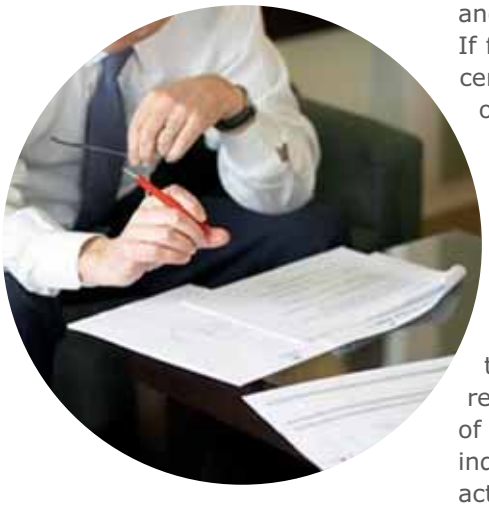
In the second half of 2011, BaFin examined the comparability of around 130 product information documents regarding shares, bonds and a certificate with a broad stock market index as the underlying on a random sampling basis. For this, it sent requests for information and documentation to 180 credit and financial services institutions. BaFin found that the length specified for an information document by lawmakers was largely adhered to. In addition, the majority of the information documents examined

were structured in accordance with the standard developed by the German Banking Industry Committee (*Die Deutsche Kreditwirtschaft*). However, the way in which the template was filled with content varied.

Many information documents did not yet fulfil their intended function of enabling the client to gain an adequate understanding of the different financial instruments and, above all, to compare products. Furthermore, many of the documents used by the institutions were only comparable to a limited extent.

For example, a number of investment services enterprises provided only abstract information on the costs associated with purchasing the recommended financial instrument in the information documents. Some information documents gave only maximum or average amounts while using wording such as "up to", "usually", or "possibly"; others referred to the price schedule of the institution providing investment advice or the information provided by the investment adviser. However, the purchase costs associated with an investment decision are a key factor in an investment's performance.

In addition, the description of the risks often did not relate to the recommended product; instead, all the conceivable risks associated with financial instruments were frequently listed. In several cases, information documents referred to foreign currency risk even though the financial instrument described did not actually entail such risk. In other cases, important risk information, such as information on the risk of total loss, was missing. Issuer risk, price or interest rate risk and dividend risk are generally important and must be included in the information document if they exist. If further risks exist, these should also be listed. In the case of certificates where the return is dependent on reaching, exceeding, or falling below certain thresholds, trigger thresholds must be stated in a clear, explicit and comprehensible manner. It is sufficient for the product description to make an abstract reference to the problems associated with the thresholds if the thresholds and the events that trigger them are specified in the information describing the risk.



BaFin also found that the description of the products and how they work was often too abstract and superficial. However, it requires that a minimum level of detail be provided – in the case of shares and corporate bonds, for example, by stating the industry of the issuing enterprise and the main focal points of its activities. Furthermore, some of the wording was difficult for the average investor to understand. In the information documents, investment services enterprises used unexplained technical terms, multi-word constructions, long and complicated sentences, and unfamiliar abbreviations.

Information was also often missing completely. Some information documents lacked descriptions of possible performance scenarios or details of the financial instrument's term to maturity, for instance. In some cases, it was also unclear whether the document

was up-to-date, as the preparation date was missing. In addition, some information documents contained ratings (only good or very good) or impermissible statements on the responsibility of the author. As ratings do not exist for all financial instruments recommended by investment advisers – no information document contained a Pfandbrief rating, for example – ratings must be regarded as promotional in this context. Therefore, they may not be used in the information document. Neither may an investment services enterprise limit its responsibility for the document using a standard disclaimer; the WpHG stipulates that information documents may not be false or misleading.

Initial changes to the information documents.

At the end of 2011, BaFin criticised particularly severe breaches at the institutions in those cases in which the associations involved had not promised a change in practice on behalf of their members. In December 2011, many investment services enterprises announced changes to the information documents – some even presented revised information documents before the month was out. BaFin will continue to track implementation of its requirements as a result of the investigation.

Credit institutions

Special audit of fixed-price transactions.

As part of its market supervision activities, BaFin conducted a special audit at a credit institution and investigated whether this institution had entered into fixed-price transactions with retail clients at prices in line with the market. A credit institution is obliged to do so if it does not forward clients' securities orders to an exchange or other trading venue for execution but instead concludes the transactions itself. If, on the other hand, the institution forwards a securities order to a trading venue, it bills the client for the commission stated in the schedule of prices and services separately. This is not the case with a fixed-price transaction. Rather, the credit institution concludes the transaction at a price above the current market price in the case of a client buy order and below the current market price in the case of a sell order. The institution does not show the resulting margin separately in the contract note.

BaFin found that, for around one-fifth of the fixed-price transactions investigated, the institution's branch employees had stated a margin that exceeded the maximum amount stipulated in an internal directive. This was due to organisational deficiencies. The IT systems used to record orders allowed an excessively high margin to be stated. In addition, the credit institution did not use downstream controls to check whether the maximum amounts stipulated in the directive were being observed.

BaFin also found that the maximum margins stipulated were not transparent. For example, the maximum margin stipulated for certain fixed-price transactions was four times as high as the commission for execution via an exchange.

The institution revised its directive and brought the maximum margins closer into line with the commission for executions via an exchange. It also promised to modify its IT systems and introduce IT-based checks. Until this measure has been fully implemented, all fixed-price transactions will be subject to downstream monitoring and the bills for transactions with excessive margin will be adjusted.

A further special audit in accordance with section 35 of the WpHG.

In a further special audit, BaFin investigated suspicions of cold calling by the tied agent of a securities trading bank. It emerged that employees of the tied agent continued to call clients known to them from previous jobs without first obtaining their consent. The liable institution had not monitored the tied agent sufficiently. The audit results were forwarded to BaFin, which in such a case can initiate sanctions in accordance with the KWG.

The annual audit in accordance with section 36 of the WpHG and individual complaints alerted BaFin to the fact that another institution was continuously in violation of the rules and regulations governing the provision of investment advice. Although formally permitted to engage in the provision of investment advice, its business model did not provide for this kind of advisory offering. It was presumed that employees of the institution repeatedly disregarded this and failed to fulfil the downstream obligations associated with the provision of investment advice. In another special audit, BaFin identified deficiencies including the inadequate integration of the tied agents into the enterprise's organisational structure. It emerged that the activity of the tied agents was aimed at capital markets business, while the institution was essentially engaged only in execution and had taken no further measures to properly integrate the tied agents and their business into the organisational structure.

Specific selling instructions must be critically examined.

BaFin investigated one case in which an e-mail from a bank's sales officer had been printed out and anonymously forwarded to it. In the e-mail, the sales officer gave specific instructions to sell individual products. He instructed the advisers assigned to him to sell clients high-margin products, including securities. BaFin consequently conducted a supervisory interview with the bank's management board and the sales officer concerned, making it clear that a selling instruction that gives priority to the profit-making interests of the institution is not compatible with the interests of clients. BaFin also pointed out that such deficiencies cannot be avoided through system checks, but very probably only through on-site checks by compliance function employees or external auditors. In order to uncover such incidents, BaFin therefore requires that on-site checks be carried out by both the compliance function and external auditors. Conspicuous advisers and sales officers can be identified through interviews at branches, for example.

In the year under review, BaFin focused its supervisory activities on determining whether investment services enterprises had implemented MaComp in good time. In particular, some investment services enterprises had paid insufficient heed to the provision

stating that the compliance function may not be embedded within the legal department. BaFin therefore put pressure on the enterprises concerned to change their organisational structure. The requirement to separate the compliance and legal functions is the result of an inherent conflict of interest between these two departments. While the activity of the legal department is geared primarily to serving the enterprise's interests, the activity of the compliance function is also based on client interests.

Audit exemptions

68 institutions exempted from annual audit.

BaFin exempted 68 credit and financial services institutions from the requirement to perform an annual audit under section 36 of the WpHG (previous year: 95). Thirty-two exemptions were granted to credit institutions, including 20 cooperative banks and five savings banks, and 36 to financial services institutions. In addition, BaFin exempted 22 credit institutions (previous year: 50) from a securities custody business audit.

Administrative fines

In 2011, BaFin instituted 30 new proceedings for the imposition of administrative fines against banks and financial services institutions (previous year: 11). Fifteen proceedings were still pending from previous years (previous year: 11). BaFin imposed two administrative fines of up to €7,000 for violations of the ban on cold calling and two administrative fines of up to €8,500 for late notification of an auditor. Administrative fines totalling €24,000 were levied on a credit institution and the responsible management board member for a breach of the duty of supervision relating to violations of the ban on making recommendations. In addition, BaFin imposed two administrative fines of up to €11,000 for violations of obligations to make and keep records. In one case, violations of the obligation to submit the annual financial statements, the management report and the audit report led to a total administrative fine of €10,000. BaFin suspended one proceeding for discretionary reasons. Thirty-six cases were still pending at the end of 2011.

VI Supervision of securities trading and the investment business

Karl-Burkhard Caspari,
Chief Executive Director
of Securities Supervision

1 Bases of supervision

1.1 Act Implementing the UCITS IV Directive

The Act Implementing Directive 2009/65/EC (*OGAW-IV-Umsetzungsgesetz*) entered into force on 1 July 2011. Among other things, it allows the cross-border management of harmonised investment funds and the cross-border creation of master-feeder structures. Furthermore, the new legislation harmonises the requirements on domestic and cross-border mergers and simplifies the notification procedure for the cross-border marketing of funds. The new key investor information document now replaces the simplified prospectus.

Key investor information.

The key investor information document (KIID) summarises the main features of the fund in a condensed and easy-to-understand form. The purpose of this standardised information document, which must be used consistently throughout Europe, is to enable investors to understand the nature and risks of the product and thus make a sound investment decision. The KIID therefore makes an important contribution to improving transparency and thus increasing investor protection.

On two pages of A4-sized paper[70], the investment company has to provide information on the identity of the fund, the risk and earnings profile, costs and fees, and the fund's performance to date. In addition, it has to provide a brief description of the investment objectives and investment policy and give investors certain practical information, such as the name of the custodian bank, the information agent and tax information. Regulation (EU) No 583/2010 contains detailed requirements for the content, format and structure of the KIID. Standardising the information contained in this document guarantees that the marketed investment funds are comparable throughout Europe.

In contrast with the simplified prospectus, these requirements apply not only to UCITS funds. Rather, after the transitional period expires at the end of 2012, they will also

[70] Three pages of A4-sized paper for structured UCITS in accordance with Article 37 of Regulation (EU) No 583/2010.

apply to non-UCITS funds, such as open-ended real estate funds, infrastructure funds, and funds of funds and hedge funds.

Amendments to fund rules.

In the absence of a legal transitional period, the fund rules of UCITS funds were adapted to the new legal requirements of the Act Implementing the UCITS IV Directive as from 1 July 2011. There was no statutory provision for tran- sitional periods. Because of the short time between the date when the Act Implementing the UCITS IV Directive was promulgated (25 June 2011) and the date when it entered into force (1 July 2011), approval of the amended fund rules posed a particular challenge for BaFin.

To prepare carefully for the impending approval procedures, BaFin adapted the model fund rules in cooperation with BVI Bundesverband Investment und Asset Management e.V. The amendments related primarily to the changed requirements for the use of derivatives and the newly added option of merging funds across borders. In addition, the models created by BaFin were used as the basis for the approval notices issued before 1 July 2011. What is more, BaFin produced a timetable that specified exactly when the companies had to submit notifications of change, when BaFin had to create and deliver the approval notices, and finally when the amendments to the fund rules had to be published in the Federal Gazette. Since the timetable was strictly adhered to, BaFin was able to deliver approval notices for a total of 1,266 UCITS as early as one working day after the Act was promulgated.

For non-UCITS funds, there is a transitional period until 31 December 2012 for adapting the fund rules to the Act Implementing the UCITS IV Directive.

Regulations in conjunction with the Act Implementing the UCITS IV Directive

In addition to the Act Implementing the UCITS IV Directive, four regulations entered into force on 1 July 2011.

Investment Conduct and Organisation Regulation.

Among other things, the Regulation Governing Rules of Conduct and Organisational Rules under the Investment Act (*Investment-Verhaltens- und Organisationsverordnung* – InvVerOV) contains organisational rules, rules for conflicts of interest and codes of conduct that asset management companies have to comply with in collective investment management. They are mostly based on the rules to be observed by investment services enterprises. In addition, they take into account the specific aspects of collective investment management.

First Regulation Amending the Derivatives Regulation.

The purpose of the amendments to the Derivatives Regulation (*Derivateverordnung* – DerivateV) is primarily to implement Directive 2010/43/EU implementing the UCITS IV Directive as well as the related CESR Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS dated 28 July 2010.

The exhaustive list of derivatives eligible for the use of the simplified approach previously included in the Derivatives Regulation has been withdrawn. As a result, this approach can also be used for investment funds invested to a minor extent in more complex derivatives. In turn, the requirements for the recognition of hedging transactions have been tightened. In addition, another method for determining the market risk limit has been introduced as part of the qualified approach. Previously, it was mandatory to construct a derivative-free benchmark fund against which the value at risk of the investment fund was measured. It is now also possible to limit the absolute amount of the potential exposure of the investment fund. Moreover, adjustments have been made to the way that counterparty credit risk is calculated.

Investment Arbitration Board Regulation.

In accordance with section 143c (3) of the Investment Act (*Investmentgesetz* – InvG), BaFin has set up an arbitration board; consumers can bring any disputes in connection with the provisions of the Act before this board. It is responsible for cases not dealt with by the ombudsman service for investment funds of the BVI.

The aim of the Investment Arbitration Board Regulation (*Investment-Schlichtungsstellenverordnung* – InvSchlichtV) is to give consumers an easily accessible, efficient channel for settling disputes under the Investment Act cost-effectively and comparatively quickly in collaboration with an independent, objective body without involving the courts.

Regulation on the Electronic Notification Procedure.

The Regulation on the Electronic Notification Procedure under the Investment Act for German Investment Funds Complying with Directive 2009/65/EC (*Verordnung zum elektronischen Anzeigeverfahren für richtlinienkonforme inländische Investmentvermögen nach dem InvG* – EAInvV) defines the notification requirements for marketing German-issued harmonised funds in the EU/EEA. An asset management company or EU management company has to notify BaFin if it intends to market units of a German UCITS in another EU/EEA country. This is governed by the EAInvV, which contains provisions relating to the permitted transmission method, formats and names of the files to be transmitted.

1.2 Regulating the grey capital market

The Act Amending the Law on Investment Intermediaries and Investment Products (*Gesetz zur Novellierung des Finanzanlagenvermittler- und Vermögensanlagenrechts*)[71] marks an important step towards improving investor protection. Its intention is to strengthen the position of consumers, especially with regard to the marketing of grey capital market products. The grey capital market comprises investments not backed by securities, for example units in closed-end funds and profit participation rights. Previously, these products did not constitute financial instruments under the Banking Act (*Kreditwesengesetz* – KWG) and the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG), and – apart from examining the prospectus for completeness – their distribution was not subject to supervision by BaFin. The regulation that has now been introduced is the response of the lawmakers to the considerable losses on investments that investors in this market segment suffered in the past.

Stricter requirements for non-securities investment prospectuses.

The core element of the Act Reforming the Laws on Intermediaries for Financial Investments and on Investment Products is the new Capital Investment Act (*Vermögensanlagengesetz*), which will replace the Prospectus Act (*Verkaufsprospektgesetz*) and impose stricter requirements on non-securities investment prospectuses. Starting 1 June 2012, BaFin will examine these prospectuses for completeness, comprehensibility and consistency. The level of examination will thus be aligned with that for securities prospectuses. In addition, the act requires additional content for prospectuses. For example, providers will in future have to present their reliability, disclose existing conflicts of interest and provide more transparent cost information. They are also obliged to give customers a key investor information document, which on no more than three pages of A4-sized paper provides short and easy-to-understand information on the investment being offered, especially its opportunities, risks and costs. Finally, the Act also extends the deadlines for making prospectus liability claims and thus makes them more investor-friendly.

1.3 Regulating short selling

In 2011, BaFin continued to deal with the legal ban, resolved in 2010, on certain naked short sales and credit derivatives and the obligation to keep short selling transparent. In addition to practical supervision of the bans, BaFin developed two defining regulations in this context.

[71] Federal Law Gazette (BGBl.) I 2011, p. 2481.

Short-Selling Notification Regulation.

There are exemptions from the ban on naked short selling under section 30h of the WpHG and the ban on entering into certain credit derivatives under section 30j of the WpHG for market makers as well as persons and companies performing similar liquidity-providing functions on the financial markets. To qualify for the exemption, this activity must be notified to BaFin. Content and transmission details of the notifications are governed by the Short-Selling Notification Regulation[72], which entered into force on 16 April 2011.

Regulation on Net Short Positions.

The notification and publication requirement under section 30i of the WpHG, which had already been resolved in 2010, entered into force on 26 March 2012 for all shares admitted to trading on the regulated market of a German stock exchange. Details are governed by the Regulation on Net Short Positions (*Netto-Leerverkaufspositionsverordnung* – NLPosV)[73], which also entered into force on 26 March 2012. The Regulation governs the calculation of net short positions, the notification and publication procedure, and the identification of the person or entity subject to the notification and publication requirements. In principle, the Regulation provides for an electronic procedure; only the authorisation for the persons or entities subject to the notification and publication requirements to use the electronic system is applied for and granted in writing. The requirements for the content of the notification to BaFin are largely the same as the requirements for publication in the electronic Federal Gazette.

1.4 Implementation of the revised Prospectus Directive

On 30 November 2011, the Federal Government submitted a draft bill to transpose the Directive Amending the EU Prospectus Directive[74] into national law. The bill has four main objectives: summaries in securities prospectuses are to become more succinct and a prescribed structure is to make them more comparable. Certain public offerings of securities that were previously exempt from the requirement to publish a prospectus will in future be required to do so, because the minimum selling price and the minimum denomination per unit have been increased from €50,000 to €100,000. However, no prospectus will in future be required for shares issued under employee share schemes of European companies. In addition, it is proposed that investors should be granted the right to withdraw their

[72] Federal Law Gazette (BGBl.) I 2011, p. 636.
[73] Federal Law Gazette I (BGBl.) 2012, p. 454.
[74] Directive 2010/73/EU, OJ EU L 327, p. 1.

acceptance of the purchase of securities in more cases than previously if the issuer has to correct the prospectus by publishing a supplement. The amendments will enter into force on 1 July 2012.

2 Monitoring of market transparency and integrity

2.1 Short selling

Regulating short selling through bans and transparency.

Two complementary approaches are used to regulate short selling in Germany. Firstly there are bans on naked short sales of certain shares, government debt securities and naked credit default swaps (CDSs), and secondly there are transparency requirements for holders of net short positions.

Bans on short selling

Naked short sales prohibited.

Since July 2010, naked short sales of shares and of debt securities issued by EU member states in the eurozone and admitted to trading on the regulated market of a German stock exchange have been prohibited by law (section 30h of the WpHG). Shares issued by companies domiciled abroad are only covered by this ban if these shares are exclusively admitted on the regulated market of a German stock exchange. There is also a ban on entering into credit derivatives on debt instruments of EU member states in the eurozone if the transaction is not entered into for the protection buyer's own hedging purposes and is therefore naked (section 30j of the WpHG). This covers both CDSs and structures where CDSs are embedded in other instruments, e.g. credit-linked notes or total return swaps. The ban relates exclusively to transactions entered into in Germany.

Notifications received from 85 market makers and other liquidity providers.

Market makers as well as persons and entities performing similar liquidity-providing functions on the financial markets (lead brokers, specialists, designated sponsors, etc.) are exempt from the ban. They must notify BaFin of their activities and the financial instruments concerned. A total of 85 market makers and liquidity providers submitted such notifications to BaFin in 2011 (previous year: 83); 45 of them are domiciled in Germany (previous year: 47) and 40 abroad (previous year: 36). Most notifications contain information on more than one type of financial instrument; they are submitted simultaneously for shares and debt securities, for example. As at 31 December

2011, the notifications submitted by companies related to shares in 78 cases (previous year: 74), to government debt securities in 47 cases (previous year: 35) and to CDSs in 14 cases (previous year: 14). There was a decline in the number of lead broker notifications relating to shares from the third quarter 2011 onwards because the Xetra specialist model has replaced lead-broker-based activities on the Frankfurt Stock Exchange. The switch prompted some lead brokers to discontinue their activities.

Table 26
Notifications by market makers and other liquidity providers
As at 31 December 2011

	Lead brokers		Others		Total	
	2011	2010	**2011**	2010	**2011**	2010
Shares						
Q1 (reporting date 31 March)	**17**	—*	**60**	—*	**77**	—*
Q2 (reporting date 30 June) or reporting date 27 July 2010**	**17**	21	**64**	68	**81**	89
Q3 (reporting date 30 September)	**13**	22	**63**	53	**76**	75
Q4 (reporting date 31 December)	**13**	21	**65**	53	**78**	74
Debt securities						
Q1 (reporting date 31 March)	**9**	—*	**33**	—*	**42**	—*
Q2 (reporting date 30 June) or reporting date 27 July 2010**	**11**	7	**37**	32	**48**	39
Q3 (reporting date 30 September)	**10**	8	**38**	28	**48**	36
Q4 (reporting date 31 December)	**10**	8	**37**	27	**47**	35
CDSs						
Q1 (reporting date 31 March)	**1**	—*	**14**	—*	**15**	—*
Q2 (reporting date 30 June) or reporting date 27 July 2010**	**/**	2	**14**	14	**14**	16
Q3 (reporting date 30 September)	**/**	1	**15**	11	**15**	12
Q4 (reporting date 31 December)	**/**	2	**14**	12	**14**	14

* There is currently no obligation to notify activities.
** Regulation came into force on 27 July 2010.

68 investigations relating to shares, debt securities and CDSs.

In 2011, BaFin investigated a total of 68 new cases of naked short selling (previous year: 18). It became aware of these cases as a result of its own suspicions, complaints, tip-offs and by analysing notified net short positions. Thirteen investigations were still pending from the previous year. BaFin discontinued 40 proceedings, for example because the violations were minor or the short sales were covered by securities lending (previous year: four). Thirty-eight investigations were still pending at the end of 2011. In three cases, BaFin continued to proceed by imposing administrative fines (previous year: one). In two cases, BaFin provided administrative assistance to foreign supervisory authorities for investigations of naked short sales.

Sources of information: own suspicions, …

BaFin's investigations were prompted by its own suspicions in 22 cases (previous year: 16). They were triggered by events such as notified net short positions, significant price falls, or (unsuccessful) capital increases. Prompted by such a capitalisation measure, BaFin probed naked short sales made in 2011 by a German institution. In the process, it uncovered over 200 violations relating to shares in 21 different companies with a total value of several million euros. BaFin is pursuing this and another case launched in response to its own suspicions by initiating administrative fine proceedings in 2012. BaFin discontinued 16 proceedings (previous year: 4). Investigations continue in 17 cases.

… suspicious transaction reports and voluntary self-reporting …

Firstly, BaFin receives suspicious transaction reports relating to possible naked short sales by customers of investment services enterprises, credit institutions, asset management companies and other operators of OTC markets where financial instruments are traded. Secondly, institutions, funds and private individuals also voluntarily report their own naked short sales. In 2011, BaFin received a total of 14 suspicious transaction reports (previous year: 2). In an investigation launched in response, BaFin found evidence of naked short sales by a foreign fund relating to shares in ten different companies with a total value of several million euros; it is pursuing this case as an administrative offence. It discontinued the investigations in five of the six cases of voluntary self-reports received. BaFin is investigating one report with a view to imposing an administrative fine, because it uncovered other naked short sales that had not been reported. The other suspicious transaction reports are still being investigated.

… and reported settlement delays.

Settlement delays may also indicate a violation of the ban on short selling. For this reason, Clearstream Banking AG, Frankfurt am Main, BaFin's settlement institution, reports an average of 40 unusual securities transactions a week that remain unsettled at S+10 (agreed settlement date plus ten further trading days). BaFin has so far discontinued half of the investigations launched in response to these reports because it did not find any evidence of naked short sales. Delivery delays occurred because of technical problems, for example, but there were no naked short selling positions. The other investigations are continuing.
BaFin was able to discontinue the investigations into CDS transactions involving Portuguese and Irish sovereign bonds launched at the end of 2010. BaFin examined whether the German companies involved in the transactions had actually entered into the CDS positions for legitimate hedging purposes. Evidence of these purposes had been found in seven of the eight cases investigated. One transaction had been entered into by a market maker eligible for the legal exemption from the ban.

Three administrative fine proceedings initiated.

In three of the completed investigations, BaFin continues to pursue the case as an administrative offence (previous year: one). In one case, BaFin imposed an administrative fine of €12,000 on a private individual for the naked short sale of 50,000 shares in Infineon AG. This individual had made the short sales acting as the authorised agent of a company. Three cases were still pending at the end of 2011.

Transparency requirements for net short positions

240 notifications, 38 of them published.

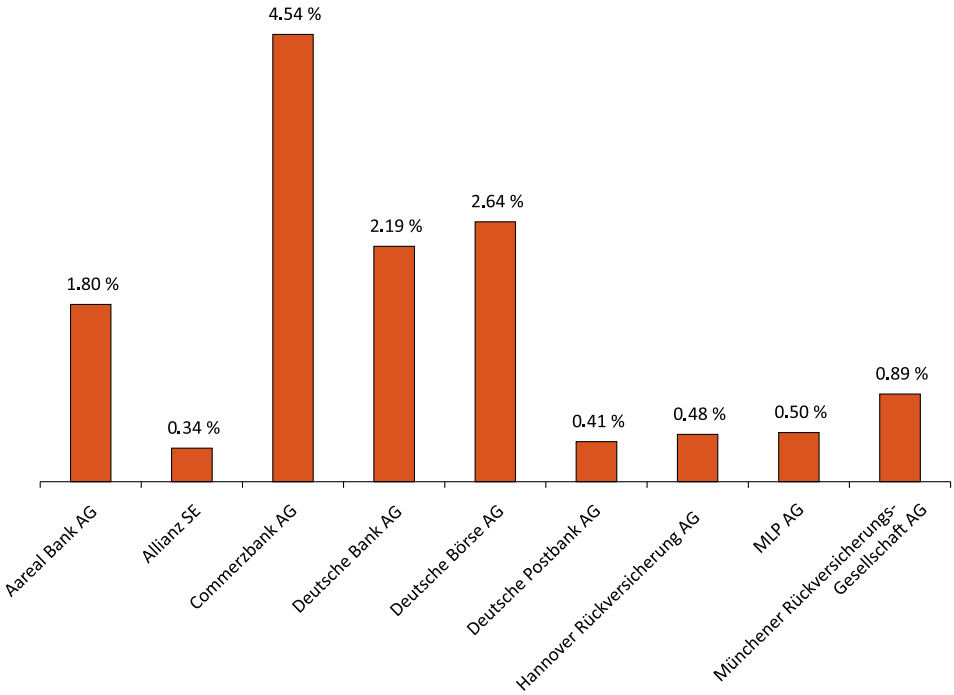
Pursuant to a general decree that has since been extended, market participants have since March 2010 been obliged to report to BaFin net short positions in the financial stocks of Aareal Bank AG, Allianz SE, Generali Deutschland Holding AG, Commerzbank AG, Deutsche Bank AG, Deutsche Börse AG, Deutsche Postbank AG, Hannover Rückversicherung AG, MLP AG and Münchener Rückversicherungs-Gesellschaft AG, if they reach, exceed, or fall below 0.2%. For 0.5% or more, BaFin additionally publishes anonymised information on the net short positions on its website.

In 2011, BaFin was notified of 240 net short positions (previous year: 203 notifications since the general decree entered into force on 4 March 2010). This corresponds to an average of one notification per trading day. The notifications related to all financial stocks with the exception of Generali Deutschland Holding AG. A total of 47 companies notified BaFin of their own net short positions. For each company, there were net short positions in shares of up to four companies subject to notification requirements.

Thirty-eight notifications were subject to publication requirements (previous year: 56). Most of them related to Commerzbank AG and dated from spring 2011. However, they did not reflect the net short positions of up to 16% alleged in the media in connection with the institution's two-stage capital increase. They reached a maximum of 7.56% on 12 May 2011 (aggregate net short positions reported). After this temporary increase, the net short positions in shares of Commerzbank AG were reduced again; at the end of 2011 the total position stood at 4.54%. The aggregate positions for the other nine financial stocks varied between 0.12% and 4.36% in 2011.

The following figure shows the aggregate net short positions reported at the end of 2011 in relation to the total number of shares in issue.

Figure 22
Net short positions in certain financial stocks
As at 31 December 2011



On 26 March 2012, the legal provisions of section 30i of the WpHG replaced the notification and publication requirement that had previously applied on the basis of the general decree. Since then, the transparency requirements have applied to all shares admitted to trading on the regulated market. Details of the reporting and disclosure obligations are set out in the Regulation on Net Short Positions (*Netto-Leerverkaufspositionsverordnung* – NLPosV).

The EU Regulation on Short Selling and Certain Aspects of CDSs will enter into force on 1 November 2012. At the end of 2011, the member states of the European Union already began to develop interpretative regulations for this event. To this end, the ESMA Task Force on Short Selling was established, which counts various representatives of national supervisory authorities, including BaFin, among its members. This Task Force had to develop draft implementing and regulatory technical standards and present them to the European Commission by 31 March 2012. In addition, the Commission has to prepare delegated acts.

2.2 Market analysis

Analyses and expert reports.

BaFin analysed 259 cases of possible market abuse in the year under review. The automatic analysis of ad hoc disclosures, which had led to 1,197 analyses in the previous year, was suspended in 2011 in favour of a full conceptual revision. The corresponding comparable prior-year figure for 2010 is 305 analyses.

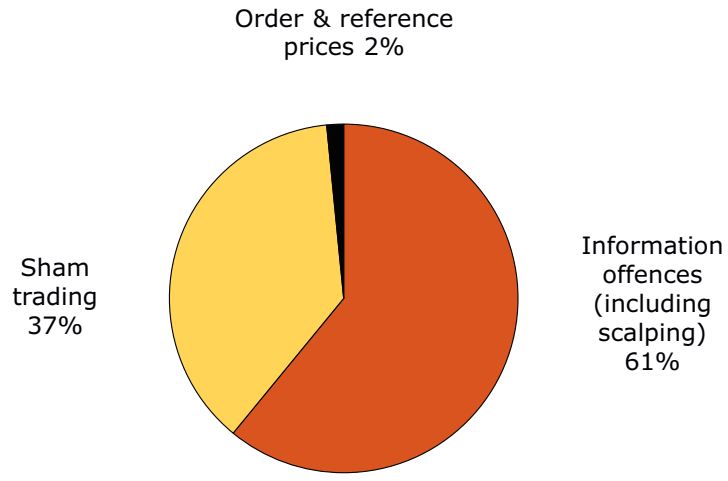
The number of positive analyses where BaFin found initial indications of possible market abuse and launched further investigations rose to 91 in 2011 (previous year: 64). BaFin continued to focus heavily on analysing market manipulation. The number of cases of manipulation pursued further rose again sharply (64, previous year: 30). Because of suspected insider trading, the analysis was followed up with an investigation in 27 cases (previous year: 34). In addition to analyses, BaFin created a total of 21 detailed expert reports in 2011 (previous year: 6), most of them for public prosecutors. In these reports, it often expressed an opinion on whether the market price of a financial instrument had been influenced by market manipulation. Market manipulation that results in actually influencing the market price is a criminal offence; if there is no influence, it only constitutes an administrative offence.

Focus of analysis: market manipulation.

Among the market manipulation analyses, the focus shifted in 2011 towards information crimes, with 39 cases analysed (previous year: 11). These crimes may relate to incorrect, misleading, or withheld information, but also to scalping. Sham activities, which include e.g. collusive transactions, were the subject of analysis in 24 cases (previous year: 17). Manipulation relating to the order situation and reference prices only played a minor role in 2011, accounting for just one case (previous year: 2).

Figure 23

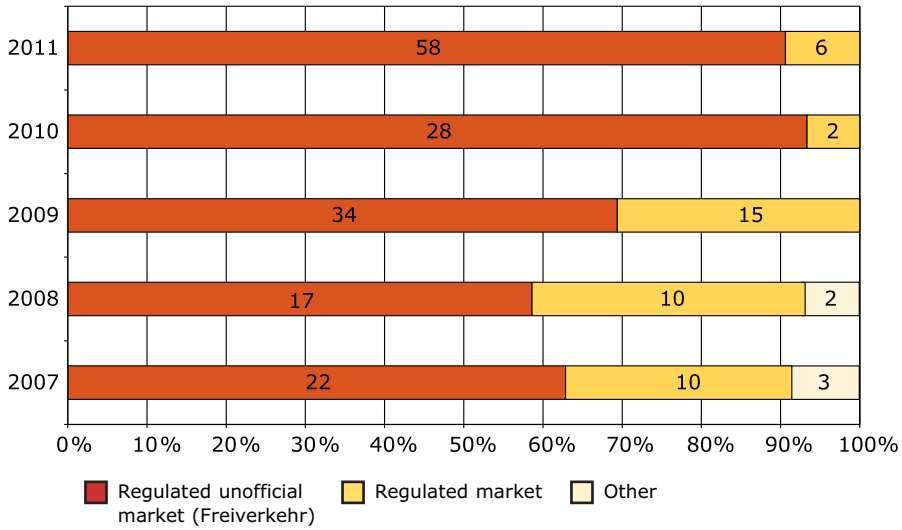
Positive manipulation analyses by issue



Market manipulation concentrates on the regulated unofficial market.

A breakdown of the incidents of market manipulation by segment shows that the significance of the regulated unofficial market, which has been on the rise in the past few years, has stabilised at a high level. The number of positive analyses increased to six on the regulated market (previous year: 2) and to 58 on the regulated unofficial market (previous year: 28). The regulated unofficial market is not an EU-regulated market; compared with the regulated market, it has significantly fewer (and in some cases no) admission requirements or post-admission obligations for issuers.

Figure 24
Positive manipulation analyses by segment



Listing and delisting shares on the regulated unofficial market

In addition to the regulated market, Deutsche Börse AG operates a regulated unofficial market called the Open Market. Although the trading rules are largely the same as those on the regulated market, this segment is not an exchange, but a special form of multilateral trading facility. The Open Market is organised into the Entry Standard and the First and Second Quotation Boards. Compared with the regulated market, the Open Market has significantly fewer (transparency) requirements and post-admission requirements. These requirements are the least stringent for the First Quotation Board. The segment includes shares that have not yet been admitted at any other trading venue recognised by Deutsche Börse AG.

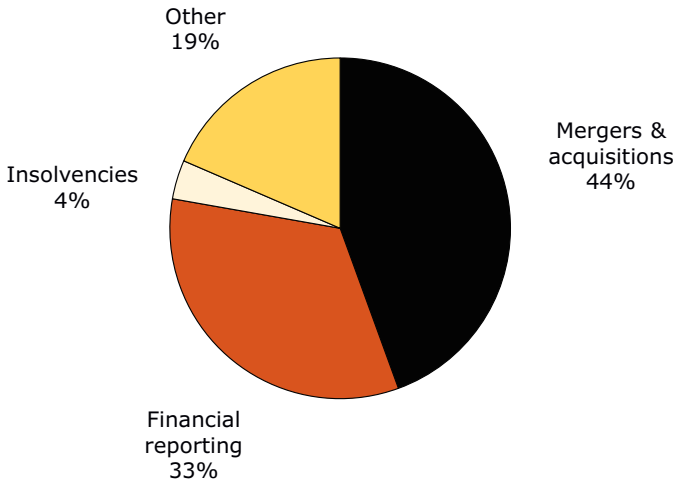
Admission to the First Quotation Board is granted on application by an entity authorised for trading on the Open Market, normally a securities trading bank. The issuer is not required to be involved in this process. For admission, it is sufficient if an auditor has confirmed that the entity has equity of at least €500,000 and each share has a par value of at least €0.10. These requirements do not apply if a securities prospectus approved by a supervisory authority is presented, although this option is rarely used. After admission, these entities are not subject to any exchange-specific publication requirements.

Deutsche Börse AG has successively been tightening the admission requirements in the past few years. At the beginning of 2011, it threatened to delist those entities that did not meet the new requirements. In November 2011, Deutsche Börse AG acted on its threat, initially by suspending trading in the shares of 174 entities on the First Quotation Board. Prompted by new incidents of suspected market manipulation, it decided in December 2011 not to admit any new entities to the First Quotation Board and to investigate further action in cooperation with the Hesse stock exchange supervisory authority and BaFin. In February 2012, Deutsche Börse AG finally announced that the First Quotation Board would be closed and trading would cease in the third quarter of 2012.

Little change in distribution of insider analyses.

The breakdown of positive insider analyses by issue shows only minor changes compared with the previous year. Most of the analyses related to mergers and acquisitions (44%, previous year: 41%) and companies' earnings figures (33%, previous year: 24%). Insolvencies (4%, previous year: 12%) and capitalisation measures (7%, previous year: 21%), which are included in other issues, accounted for a smaller proportion. The number of positive insider analyses related to the regulated unofficial market fell to five (previous year: 14). At 22, the majority of insider analyses related to financial instruments on the regulated market (previous year: 20).

Figure 25
Positive insider analyses by issue



Almost 1.5 billion transactions reported.

In 2011, BaFin received over 910 million transaction data records via the German reporting system (previous year: 1.31 billion) and an additional 550 million data records via the Europe-wide TREM platform. In total, this corresponds to 5.6 million data records per trading day.

BaFin also receives transaction data records from investment services enterprises transacting on foreign multilateral trading facilities (MTFs) or foreign exchanges. As in the previous year, BaFin supervised two exchange-operated MTFs in 2011. In addition, four foreign market operators were granted approval to permit German trading participants to perform exchange trading as remote members (previous year: four). Foreign exchanges from non-EU countries require approval from BaFin to set up trading screens in Germany if they provide German market participants with direct market access via an electronic system.

Large number of reports of suspected spam campaigns.

In addition, BaFin received 473 suspicious transaction reports relating to market manipulation and insider trading (previous year: 241). Of these reports, 302 related to 42 stocks; one report each was received in relation to a further 133 stocks. In particular, many institutions submitted reports in connection with spam campaigns, for example 78 reports alone on Adera AG and 30 on BAS Logistics plc. A total of 38 suspicious transaction reports related to other instruments, such as warrants, certificates and funds.

The institutions also reported a large number of cases of unauthorised order placement by telephone. Many of these attempts failed, because the credit institutions prevented the orders from being executed. Moreover, BaFin consistently issues warnings to the public as soon as any relevant information about a security is available.

2.3 Insider trading

Insider trading complaints filed against 52 people.

BaFin initiated 29 new investigations into suspected insider trading in 2011 (previous year: 34). Of these, 27 were prompted by BaFin's own analyses and two by information provided by the prosecuting authorities and trading surveillance units. BaFin referred 20 cases to the public prosecutor's office (previous year: 10), filing complaints against 52 people in this process (previous year: 33). It found no evidence of insider trading in 14 of the cases it had investigated (previous year: 17). The number of investigations that had not been completed at the end of 2011 was 29 (previous year: 34), some of which related to previous years.

Table 27
Insider trading investigations

Period	New investigations	Results			Pending
		Discontinued	Referred to public prosecutors		
	Insiders	Insiders	Cases	Individuals	Total
2009	30	37	28	78	27
2010	34	17	10	33	34
2011	**29**	**14**	**20**	**52**	**29**

Only two people were convicted of insider trading in 2011 (previous year: 11), one of them in summary proceedings and therefore without going to court (previous year: 2). The public prosecutors discontinued proceedings in 24 cases (previous year: 32 cases), of which four cases (previous year: 26 cases) were part of out-of-court settlements.

Table 28
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
2009	53	28	14	1	7	3	0
2010	69	32	26	0	2	9	0
2011	**31**	**24**	**4**	**0**	**1**	**1**	**1**

BaFin received 24 enquiries related to insider trading proceedings from abroad (previous year: 28), with the largest number coming from France and Austria. BaFin itself contacted foreign authorities, and particularly those in Switzerland as well as in the United Kingdom, Austria and Luxembourg, 51 times (previous year: 19).

Examples of selected completed cases are given in the following.

Schmack Biogas AG

On 26 July 2007, Schmack Biogas AG announced that it expected to report a significant loss of €6 million for 2007. As a result, the share price fell by 38.67%.

Two governing body members had already sold 31,326 shares[75] at the end of May and 417,616 shares in June and July, thus avoiding losses and generating a special advantage of at least €1.5 million over the value they would have obtained if the sale had been made after the inside information had been made public.

In July 2011, the Local Court in Regensburg sentenced them following summary proceedings to a total fine of 90 daily rates of €100 each, i.e. a total of €9,000. At the same time, the Court ordered that €1.5 million be forfeited as compensation.

Schering AG

Merck Vierte allgemeine Beteiligungsgesellschaft mbH, a subsidiary of Merck KGaA, issued an ad hoc disclosure on 12 March 2006 announcing the acquisition of Schering AG. It announced the takeover price of €77 per share on 13 March 2006.

Prior to that, in the period between 13 February and 13 March 2006, an employee in the finance department of Merck KGaA had traded in call warrants on Schering shares, invested €72,157 and generated proceeds of approximately €760,000 by selling the warrants. However, he denied having acted on the basis of inside information.

In accordance with section 153a of the Code of Criminal Procedure (*Strafprozessordnung* – StPO), the public prosecutor's office at the Regional Court in Frankfurt am Main discontinued the proceedings in October 2010 in return for a payment of €150,000 as part of an out-of-court settlement. The payment corresponded to 60% of approximately €248,000, the amount of the special advantage that had remained in the hands of the defendant after payment of taxes.

[75] 2010 Annual Report, p. 192.

Escada AG

On 29 June 2006, Escada AG published its half-yearly results for 2005/2006. They revealed that consolidated profit had fallen by €8 million year-on-year to €6.5 million. The Board of Management believed it would be necessary to adjust some carrying amounts recognised in the balance sheet. Internally, Escada AG had already started the relevant examinations on 16 February 2006. As a result, the Escada share price closed down almost 4% compared with the previous day.

Already in April 2006, a governing body member had exercised share options it held and bought 40,000 Escada shares for a total of €580,000. In the period from 3 to 15 May 2006, the governing body member sold a total of 13,040 shares in 25 transactions, generating a profit of €337,641 and avoiding a loss totalling €78,145.

In accordance with section 153a of the StPO, the public prosecutor's office at the Local Court in Munich discontinued the proceedings in February 2009 in return for a payment of €50,000 as part of an out-of-court settlement.

Conergy AG

Conergy AG announced on 25 October 2007 that the preliminary figures for the first nine months of 2007 were significantly below expectations and, as a result, the revenue and profit forecast for the 2007 financial year would have to be cut.

In the period from 2 to 8 October 2007, a governing body member, who had left the company at the end of February 2007 but continued to keep close contact with the company, bought 344,000 put warrants on Conergy shares. He sold all of them on 26 October 2007, generating a profit of €374,100.

In accordance with section 153a of the StPO, the public prosecutor's office at the Regional Court in Hamburg discontinued the preliminary investigations in March 2011 in return for a payment of €120,000 as part of an out-of-court settlement.

Hugo Boss AG

The quarterly figures of Hugo Boss AG published on 2 November 2009 revealed that, in the first nine months, the company's revenue had declined by 9%, EBIT by 25%, EBITDA by 12% and consolidated profit by 22% year-on-year. As a result, the price of Hugo Boss AG shares ended this day 10.6% down on the opening price.

An employee of Hugo Boss AG, who because of his job had prior knowledge of some of the revenue figures, had bought a total of 10,000 turbo knock-out put warrants for €4,400 on 27 October 2009. He sold them at the beginning of 2010 without making a profit.

In accordance with section 153a of the StPO, the public prosecutor's office at the Regional Court in Stuttgart discontinued the preliminary investigations in March 2011 in return for a payment of €15,000 as part of an out-of-court settlement.

Further selected proceedings that the public prosecutors discontinued in accordance with section 170 (2) of the StPO are presented below.

Leifheit AG

On 11 February 2009, Leifheit AG published an ad hoc disclosure with its preliminary results for 2008. According to these figures, the group had generated a 1.3% increase in revenue to €280 million, its first such increase since 2001. The company was expecting EBIT of €4 million for the financial year, significantly more than the €2.4 generated in the prior-year period.

One of the company's managers had passed on this inside information to his wife before it was published. Subsequently, on 9 February 2009, she spent about €6,000 on buying 1,000 Leifheit shares.

Another manager had passed the inside information on to his daughter, who then bought a total of 3,900 Leifheit shares for about €24,780 on 9 and 10 February 2009.

After the public prosecutor's office in Koblenz questioned the managers and their related parties, it discontinued the proceedings in May 2011 in accordance with section 170 (2) of the StPO. The premises of the suspects had not been searched. The public prosecutors believed that the fact that the suspects had not realised any profit indicated that there had not been any insider trading, a claim also denied by the suspects. The investigations had not produced sufficient grounds for taking legal action.

Advanced Medical Optics Inc.

On 12 January 2009, the pharmaceutical group Abbott Laboratories announced its intention to acquire Advanced Medical Optics Inc., offering shareholders US$22 per share.

On 21 November 2008, an employee of Advanced Medical Optics Germany GmbH had bought a total of 1,000 shares in Advanced at a price of €3.80 each. He sold these shares on 13 January 2009 for €15.60 per share, thus making a profit of about €11,800 on an investment of about €3,800.

The public prosecutor's office in Essen discontinued the proceedings against the suspect in February 2011 in accordance with section 170 (2) of the StPO, because it believed that it was impossible to prove how the employee had obtained the inside information. No search had been conducted in this case either.

2.4 Market manipulation

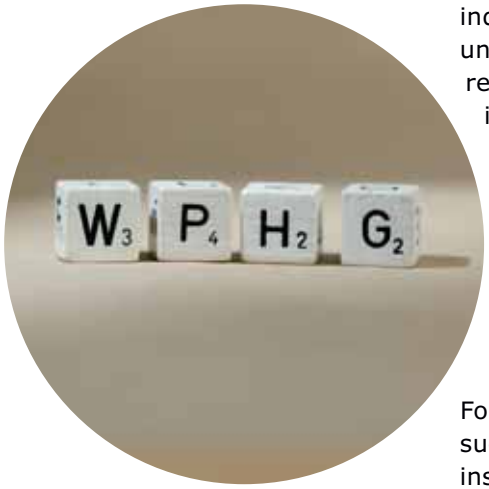
Number of market manipulation investigations launched by BaFin up almost 50%.

BaFin investigated 166 new cases of market manipulation, almost 50% more than in the previous year (116). The increase was due above all to a significant rise in the number of enquiries made and information provided by criminal prosecution authorities (26%), primarily related to scalping. They led to 43 investigations (previous year: 11). Another focal point, accounting for 70 investigations (42%), was information provided by the trading surveillance offices (previous year: 72). Internal analyses resulted in 28 investigations, in some cases in combination with suspicious transaction reports from institutions or investors (17%). BaFin made enquires to foreign supervisory authorities about 81 cases of market manipulation (previous year: 151). In turn, they contacted BaFin in 23 cases (previous year: 22).

BaFin sets its sights on spam fax campaigns.

Several large-scale fax campaigns intended to influence stock market prices flooded the market in 2011. Some of these campaigns involved sending hand-written faxes to a large number of recipients. They contained share recommendations supposedly based on inside knowledge, for example on an imminent takeover. They were intended to create the impression on the recipient that they had been misdirected. For example, they were addressed to a specific first name and also signed with a first name. Other campaigns involved sending documents claiming to be market newsletters.

In many cases, the buy recommendations issued were based on astronomical target prices. The companies being advertised often operated in trend sectors such as the precious metal or extractive



industry. Frequently, the shares were only tradable on regulated unofficial markets of German exchanges. In some cases, BaFin received up to 100 alerts or suspicious transaction reports from institutions that had received these spam faxes. In particularly serious cases, BaFin posted timely warnings of these recommendations and the incorrect information they contained on its website – nine times alone in the fourth quarter of 2011. BaFin encouraged investors to obtain comprehensive information before making an investment decision. In some cases, the exchanges suspended trading in the shares of the companies affected.

For investors there is another compelling reason to be cautious in such cases. If buy recommendations present information as inside knowledge, investors who buy these shares are liable to prosecution for attempted insider trading.

Table 29
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		
2009	150	115	60	120	4	6	64	71
2010	116	29	62	109	6	9	68	90
2011	**166**	**30**	**104**	**211**	**7**	**13**	**111**	**115**

Evidence of market manipulation was found in 104 of the cases investigated (previous year: 62). BaFin filed complaints against 211 suspects with the relevant public prosecutor's office, almost twice as many as in the previous year (109). In another seven cases involving 13 individuals, there was evidence of an administrative offence (previous year: 6). These cases are receiving further attention in the internal administrative fines section. BaFin discontinued 30 investigations (previous year: 29). The number of investigations still pending at the end of 2011 was 115 (previous year: 90).

Eleven convictions for market manipulation.

The German courts convicted eleven market manipulators in 2011, more than ever before (previous year: 7). Eight of these rulings were made following summary proceedings (previous year: 6). The public prosecutors discontinued investigative proceedings due to market manipulation in 69 cases (previous year: 43 cases), in 13 cases (previous year: 16 cases) as part of out-of-court settlements.

BaFin initiated a total of 13 new administrative fine proceedings due to suspected violations of the ban on market manipulation (previous year: 10). A total of 14 proceedings were still pending from previous years. BaFin imposed administrative fines of up to €30,000 in two cases and discontinued eight cases in line with the principle of discretion, with the parties concerned being informed of their legal position and duties in two cases. Seventeen cases were still pending at the end of 2011.

Table 30

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
2009	46	18	9	0	5	9	0	2	3
2010	73	43	16	0	6	1	1	4	2
2011	**90**	**56**	**13**	**0**	**8**	**3**	**0**	**8**	**2**

Information on selected completed cases is given in the following.

RussOil Inc. and others

In the period from September 2005 to May 2007, through his e-mail hotline with almost 20,000 subscribers, a market newsletter, as well as in television programmes and seminars, a well-known publisher of market newsletters recommended shares held in securities accounts of a company in Mauritius at the time the recommendations were made. The publisher of the market newsletter had an equity interest in this company's parent. He had not drawn attention to this fact.

On 14 April 2011, the Regional Court in Berlin sentenced the defendant to a suspended jail term totalling one year and nine months for 36 cases of market manipulation in the form of scalping. The court reasoned that the personal financial interests of the convicted individual gave rise to a conflict of interest. Through the positive performance of the securities accounts of the company in Mauritius, he had attempted to increase the value of his equity interest in the parent company. The fact that he was not himself a financial beneficiary of the securities accounts but only had an indirect interest in the performance

of the accounts was immaterial. In addition, the court found an undisclosed personal financial interest in the fact that the managing director of a limited liability company (GmbH) – who held the shares in trust for the convicted individual – had acquired further shares on behalf of the convicted individual using the GmbH's funds. The convicted individual pleaded that he had not been aware that an indirect interest also entailed a disclosure requirement. The court regarded this as an avoidable and therefore irrelevant mistake of law. As a businessman, he should have been familiar with the legal requirements.

In addition, the court ordered that an amount of €420,400 be forfeited by the accused and an amount of more than €42.2 million by the company in Mauritius, thus declaring the entire sale proceeds forfeited. The reason for this given by the court was that the purchase of shares for the purpose of selling them again quickly was connected with the act of deceit in such a way that it represented an inseparable part of the manipulation itself. It seemed unrealistic within this coherent process to distinguish between a share purchase that was not subject to complaint and a sale that was. In any event, if the perpetrator entered into the positions that led to the conflict of interest in one timely, coherent act for the sole reason of drawing financial gain from his recommendation, it conformed to the intent and purpose of the ban to regard the sale proceeds as having been generated in their entirety. In accordance with the gross principle, no fees were deducted either. The judgement is final.

Case law on scalping

In a decision dated 4 March 2011, the Higher Regional Court in Munich issued a statement on important legal issues of scalping, confirming the view held by BaFin. An example of scalping is if a trading participant buys a certain stock and then recommends it for purchase without adequately and effectively disclosing their conflict of interest at the same time as making the buy recommendation. The conflict of interest relates to the fact that they also own the recommended shares themselves and may want to sell them. Irrespective of whether or not the recommendation was correct, such conduct amounts to market manipulation in accordance with section 20a (1) sentence 1 no. 3 of the WpHG in conjunction with section 4 (3) no. 2 of the Market Manipulation Definition Regulation (*Marktmanipulations-Konkretisierungsverordnung* – MaKonV). The recommendation always entails the implicit declaration that it is being made without ulterior motives, especially the motive of influencing the price in one's own interest. Even an objectively justified buy recommendation may therefore amount to market manipulation, if existing conflicts of interest are not adequately and effectively disclosed.

In this regard, the Higher Regional Court in Munich does not consider it sufficient to provide a general disclaimer that the recommending party "may" hold the securities referred to at the time of publication. To point out the mere possibility in this way only served to highlight the fact that, as a matter of course, editors of financial publications or related third parties were not prohibited in general from entering into securities transactions for their own account. For this reason, any specific conflict of interest had to be disclosed clearly and unambiguously in the media statement. Therefore, if a conflict of interest existed at the time of publication, attention had to be drawn explicitly to the position held in the security concerned. The Higher Regional Court in Munich clarified that an error by the recommending party about the specific obligation to disclose a conflict of interest did not invalidate the allegation.

The Higher Regional Court in Munich additionally found that scalping can also be committed collaboratively. If, on the basis of a joint plan, one person holds the shares and another person subsequently recommends them for purchase without disclosing the existing conflict of interest, both could be committing market manipulation in complicity.

IKB Deutsche Industriebank AG

On 20 July 2007, IKB AG published a press release about its financial situation, in which it made clear that it was virtually untouched by the US real estate crisis and was not expecting any significant impact on the forecast financials. However, contrary to this announcement, IKB AG and the special purpose vehicle Rhineland Funding Capital Corporation that it had established had invested to a considerable extent in asset-backed securities and collateralised debt obligations based on loans that banks in the USA had granted to subprime borrowers for the purchase of homes (subprime mortgages). In total, IKB AG faced losses of US$1.4 billion from imminent downgrades by rating agencies. The company should have announced this already on 30 July 2007.

On 13 July 2009, the Regional Court in Düsseldorf therefore sentenced the governing body member of IKB AG who was responsible for the misleading press release at the time to a jail term of ten months for market manipulation. The sentence was suspended.

On 20 July 2011, the Federal Court of Justice (*Bundesgerichtshof* – BGH) rejected as unfounded the defendant's appeal against this sentence. The review of the judgement had not revealed any errors in law to the defendant's disadvantage. In particular, it

confirmed that the Regional Court in Düsseldorf had correctly interpreted the press release as misleading. The judgement is therefore final.

Cobracrest AG & Co. KGaA

Before the start of stock exchange trading on 20 January 2006, Cobracrest AG & Co. KGaA announced that it was to be acquired by Carlyle International Inc. According to the announcement, Carlyle International Inc. already held 93% of the shares in Cobracrest and was making the remaining shareholders a cash offer of €5.23 per share.

This announcement contained incorrect and misleading information that was relevant to the market valuation and had the potential of having a positive impact on the share price of Cobracrest AG & Co. KGaA. In particular, it created the incorrect impression that the takeover offer had come from the Carlyle Group, one of the largest private equity firms in the USA. As a result of this information, Cobracrest shares opened at €3.82 on 20 July 2006, up significantly from the previous day's close of €2.48, and rose to an intraday high of €4.51. The increase in the share price was also accompanied by unusually high turnover.

On 28 November 2011, the Regional Court in Berlin sentenced three people, including two former executive body members of Cobracrest AG & Co. KGaA, to jail terms of between six months and one year and six months. The court suspended each of the sentences. Two of the convicted individuals additionally have to pay fines of €10,000 each. The judgements are final. The court discontinued the proceedings against another defendant in return for a payment, also of €10,000.

Ceramic Fuel Cells Ltd.

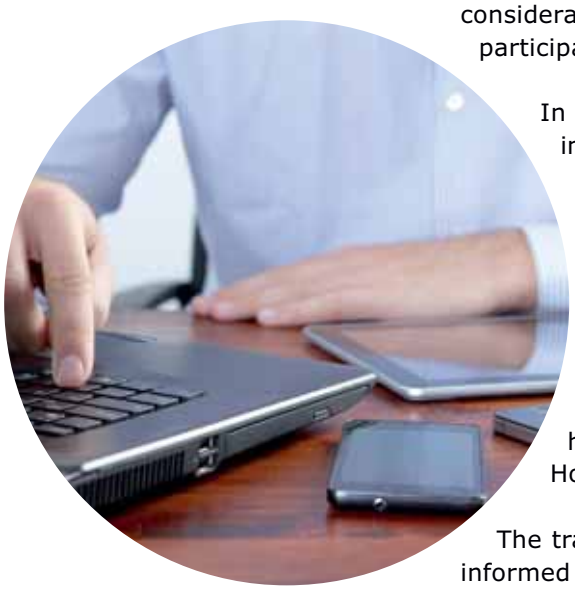
In February 2010, a private investor traded shares in the Australian company Ceramic Fuel Cells Ltd. on the Frankfurt Stock Exchange and simultaneously on the Tradegate Exchange electronic trading platform in Berlin.

During this process, on 17 February 2010, he placed a buy order for a large number of shares in the company on the Frankfurt Stock Exchange and increased its limit several times. In this way, he artificially increased the spread for trading on Tradegate, which emulates the spread on the Frankfurt Stock Exchange, for brief periods. The investor took advantage of this manipulated fixing to sell shares in Ceramic Fuel Cells Ltd. on the trading platform in Berlin at a price that could not have been obtained without his manipulation.

The trading surveillance office of the Frankfurt Stock Exchange informed BaFin of the unusual transactions and cancelled the suspicious orders retrospectively. BaFin filed charges with the public prosecutors in Chemnitz. On 23 August 2011, the Local Court in Chemnitz sentenced the defendant following summary proceedings to a fine of €2,700. The decision is final.

Intershop Communications AG

On 20 March 2008 and on 9 July 2008, a private investor placed offsetting orders for shares in Intershop Communications AG for the Xetra opening auction. Initially, on 20 March 2008, he placed a large-volume sell order, whose limit was significantly below the best sell limit set by the other trading participants up to that point. At that point, the Xetra trading system was in the opening auction call period. Immediately afterwards, through a second securities account, he entered an unlimited large-volume buy order in the Xetra order book. As a result, an executable low-limit sell order was matched by an executable unlimited buy order of the same private investor. Only a short time later, the private investor accessed his sell order, which already had a low limit, and reduced its limit again in two steps, so that it was now considerably below the best sell limit of the other trading participants. However, no price was fixed.



In the second offence on 9 July 2008, the private investor initially entered a large-scale unlimited sell order in the order book during the pre-trading phase of the Xetra opening auction. Immediately afterwards, he placed an offsetting buy order for the same quantity through a second securities account. He put a limit on this buy order that was significantly above the best buy limit set by the other trading participants up to that point. As a result, in the Xetra order book, an executable unlimited sell order was now matched by an executable high-limit buy order of the same private investor. However, no price was fixed in this case either.

The trading surveillance office of the Frankfurt Stock Exchange informed BaFin of the unusual orders. Since the private investor's manipulation activities had not affected the share price, BaFin pursued them as an administrative offence and imposed a fine of €6,500 on 13 October 2011.

2.5 Ad hoc disclosures and directors' dealings

Ad hoc disclosures

Approximately 2,000 ad hoc disclosures published.

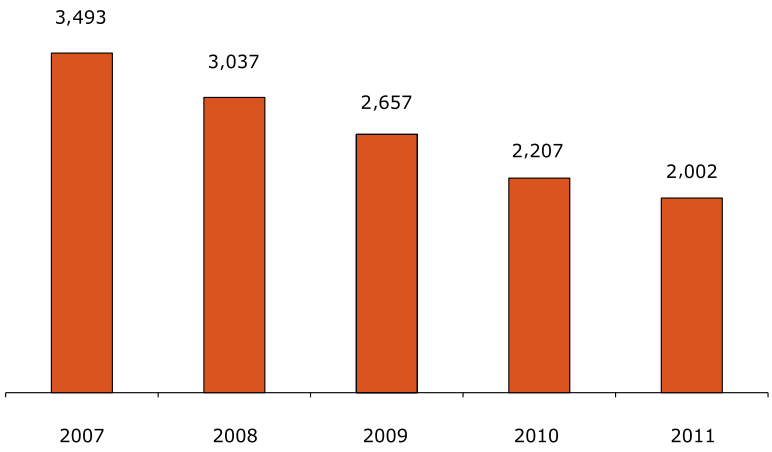
The number of ad hoc disclosures published by listed companies declined again in 2011, from 2,207 in the previous year to 2,002 in the year under review. Some issuers seemed uncertain how to deal with the publication requirements for financial results.

Publication requirements for financial results

If a company has not issued any forecast of its interim financial results, these results usually have the potential to have a significant impact on the price and must therefore be published on an ad hoc basis if they differ significantly from the corresponding prior-year values or from market expectations, or if they represent a break from the business performance up to that point. However, if the issuer has published a forecast of its interim financial results and the figures are in line with expectations, there is no publication requirement. If the issuer has only published a full-year forecast and finds during the preparation of interim financial results (for example in the form of a quarterly report) that they differ from market expectations, these results may be subject to ad hoc publication requirements, even if the original full-year forecast is retained. If the year-end or interim financial results constitute inside information, they have to be published in the form of an ad hoc disclosure immediately, i.e. independently of any publication dates, press or analyst conferences arranged in advance, and of stock exchange trading hours.

The number of exemptions started to rise again, reaching 212 in the year under review (previous year: 177). Companies use exemptions particularly frequently in the case of multi-stage decision processes, for example if an executive management decision still requires supervisory board approval. To prevent an ad hoc disclosure from pre-empting the supervisory board's decision, issuers may consider an exemption. Premature publication of the decision made by the executive board would weaken the supervisory board's position in its discussions with the executive management body and thus detract from its function under company law. As a matter of principle, it is not in the interest of investors and good corporate governance to weaken the supervisory board's position in this way. Especially given that the supervisory board's position has been strengthened in recent years, this body will invariably subject the executive board's decision to a thorough review in those types of cases that have considerable potential to influence prices. Indications of cases where exemptions had not been sought were found in particular in connection with mergers and acquisitions.

Figure 26
Number of ad hoc disclosures



Four administrative fines imposed.

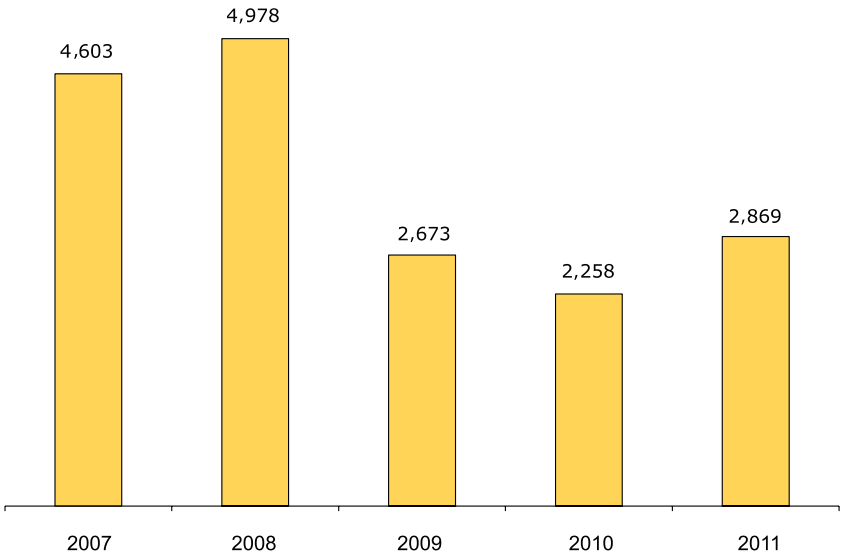
BaFin sent 133 requests for information to issuers (previous year: 162). It sends requests for information in all cases where it has found initial indications of a violation of ad hoc publication requirements. As in the previous year, BaFin followed these up by launching administrative fine proceedings in 23 cases; 45 cases were still pending from the previous year. In four cases, it imposed administrative fines of up to €95,000 for failing to disclose or publish inside information in good time, correctly, or completely, or for failing to do so at all (previous year: 9). Seven proceedings were discontinued in line with the principle of discretion (previous year: 10), with the parties concerned being informed of their legal position and duties in two cases. The number of cases still pending at the end of 2011 was 57.

Directors' dealings

2,869 reports.

The members of executive and supervisory boards and their related parties have to notify the issuer and BaFin of their own transactions in shares or related financial instruments (directors' dealings) within five working days. This obligation is intended to make the capital market more transparent and also to prevent insider trading and market manipulation. In 2011, executive managers and their related parties reported a total of 2,869 securities transactions for their own account (previous year: 2,258). The number of reported transactions, which had almost halved between 2008 and 2009, rose again slightly in 2011.

Figure 27
Number of directors' dealings



Two new administrative fine proceedings initiated.

BaFin initiated two administrative fine proceedings due to suspected violations of the directors' dealings provisions contained in section 15a of the WpHG (previous year: 3). Ten proceedings were still pending from previous years. BaFin imposed administrative fines of up to €12,000 in four cases (previous year: 1). It discontinued four cases in line with the principle of discretion, with the parties concerned being informed of their legal position and duties. Four proceedings were still pending at the end of 2011.

2.6 Voting rights and duties to provide information to security holders

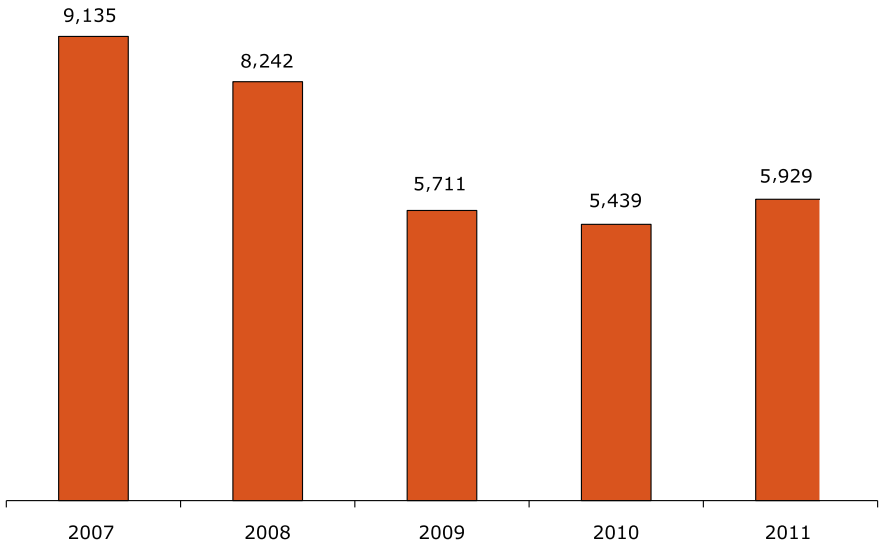
Voting rights

5,929 changes in voting rights reported.

In 2011, BaFin received 5,929 voting rights notifications, reflecting an increase in the number of changes in the shareholder structure of listed companies compared with the previous year (5,439). Notifications related to financial instruments amounted to 135 (previous year: 57). Following declines in the past, the number of voting rights notifications thus began to rise again. The extension of notification requirements for financial instruments, which entered into force in February 2012, to include, for example, retransfer claims under securities lending transactions and cash-settled financial instruments will accelerate this trend further. At 389, the number of notifications published by issuers on changes in their voting

share capital was also slightly higher than the 345 notifications of the previous year. With 859 companies admitted for trading on a regulated market, the number of issuers continued its decline (previous year: 908).

Figure 28
Reports on voting rights



209 new administrative fine proceedings due to violations of reporting obligations.

BaFin initiated 209 administrative fine proceedings (previous year: 196) because companies did not report changes in voting rights in good time, correctly, or completely, or because they failed to report them at all. Another 500 proceedings were still pending from previous years. BaFin imposed administrative fines of up to €60,000 in 25 cases (previous year: 85 cases). It suspended 181 cases, 160 for discretionary reasons. BaFin informed the parties concerned of their legal position and duties in 60 cases. The number of cases still pending at the end of 2011 was 503.

Duties to provide information to security holders

Issuers of securities admitted to exchange trading informed BaFin in a total of 355 cases in the year under review that they intended to amend their articles of association or other governing legal basis. This is approximately 25% more than the number of notifications filed in the previous year (284).

Issuers notified BaFin of changes in rights associated with securities admitted to trading, bond issuance and the publication of material information in third countries in 2,983 cases, an increase of almost 40% compared with the previous year (2,149).

In addition, issuers of admitted shares have to publish certain details in accordance with section 30b (1) and (2) of the WpHG. When convening the annual general meeting, these include the attendance rights, the agenda and the total number of shares and voting rights. The same applies to the place, time, agenda and attendance rights when convening the meeting of debt securities holders. Moreover, a large number of resolutions and events are subject to publication requirements. These include the issue of new shares or the distribution of dividends by the issuer. There is no obligation to notify BaFin in such cases.

41 new administrative fine proceedings due to violations of duty to provide information.

BaFin initiated a total of 41 new administrative fine proceedings due to suspected violations of the duty to provide information (previous year: 42). A total of 51 proceedings were still pending from previous years. In nine cases BaFin imposed administrative fines of up to €16,000 (previous year: 4). It suspended twelve proceedings (previous year: 8), six for discretionary reasons. Two affected parties were informed of their legal positions and duties. The number of cases still pending at the end of 2011 was 71.

2.7 Rules of conduct for financial instruments analysis

Credit institutions and financial services institutions

289 credit institutions and financial services institutions offered investment research.

In 2011, BaFin supervised a total of 289 credit and financial services institutions that either produced their own research or acquired third-party reports for their clients or for public dissemination (previous year: 293). The number declined slightly because some institutions discontinued the production of financial research. Instead, they now offer their clients general economic information and pure-play price data for financial instruments.

In one case in 2011, BaFin identified serious deficiencies in meeting the WpHG's organisational and transparency requirements in relation to investment research. The institution has since discontinued the production of equity research and now sources these reports from a third-party provider.

Independent analysts

Reachability of market newsletter producers.

In 2011, 149 independent natural or legal persons who had notified BaFin of their activities in accordance with section 34c of the WpHG were subject to supervision by BaFin (previous year: 138). Financial analysts domiciled abroad are also required to notify BaFin of their activities if their publications relate to financial instruments that are traded on an exchange in Germany or are admitted for trading on a regulated market in another EU/EEA state. Producers of market newsletters disseminated online often fail to meet this requirement. If BaFin has information about this, it first attempts to contact these companies. However, in 2011 there were many cases where market newsletter producers were not reachable at the addresses that they had specified or that BaFin had identified using its resources as an administrative authority. Some companies had not supplied an address in the legal section of their website. In such cases, BaFin cannot conclusively determine whether the information published by these companies is investment research as defined in section 34b (1) sentence 1 of the WpHG and the applicable competence, organisational and transparency obligations are met. To inform investors about this and allow them to draw their own conclusions about unreachable producers of market newsletters, BaFin has published their names on its website since mid-2011.

Investment services enterprises, asset management companies, investment stock corporations and the analysts they employ are not required to notify BaFin. The same applies to journalists if they are subject to comparable self-regulation.

Interpretation enquiries.

BaFin responded to 35 written interpretation enquiries (previous year: 26). Often, these involved categorising business models from a supervisory perspective. For example, former employees of credit institutions asked BaFin whether they need to register even for the temporary production and publication of investment research until they start a new job. The notification requirement does not relate to a specific duration. The producers of investment research have to notify BaFin even if they only engage in this activity on a short-term basis. However, if they subsequently obtain a separate licence as an investment services enterprise, they are not subject to the notification requirement under section 34c of the WpHG.

BaFin discontinued the two administrative fine proceedings from the previous year for discretionary reasons. It did not initiate any new proceedings in 2011.

3 Prospectuses

3.1 Securities prospectuses

Increase in the number of approval procedures.

BaFin approved 3,039 securities prospectuses, registration documents and supplements in 2011, after examining them for completeness, comprehensibility and consistency (previous year: 2,102). It refused to grant approval in four cases (previous year: 2). In 80 cases, proceedings already started were withdrawn by the applicants concerned.

Table 31
Number of approvals in 2011 and 2010

	2011	2010
Equities/IPOs/capital increases	69	65
Derivatives	140	166
Bonds	214	219
Registration documents	31	32
Supplements	2,585	1,620
Total	**3,039**	**2,102**

The main cause of the 45% increase in approvals is the jump in the number of approved supplements to 2,585 (previous year: 1,620). Because of the economic situation, supplements are needed more frequently in periods in which material new circumstances arise relatively frequently at issuers and in the overall market environment.

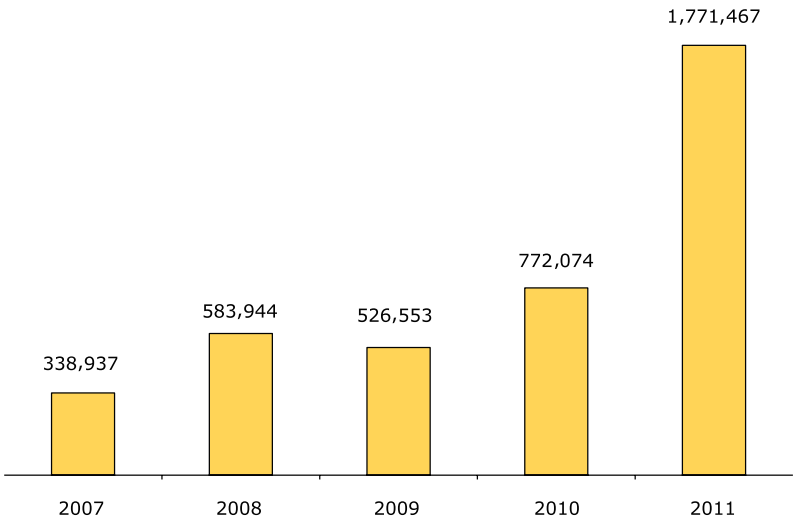
The number of prospectuses approved for initial public offerings, admissions to the regulated market and capital increases was stable at 69, virtually unchanged from the previous year (66). This figure does not take into account the 46 applications for approval that were withdrawn (previous year: 9).

By contrast, a slight decline was recorded in the number of prospectuses for derivative products and debt securities. In total, BaFin approved 354 prospectuses (previous year: 385). Issuers took the opportunity to include the information about the respective issuer required for a base prospectus in a separate registration document in 31 cases (previous year: 32).

Another record for total issuance.

At 1,771,467 prospectuses, final terms and supplements based on the old legislation, total issuance reached another record high in 2011. It was up 127% on the prior-year figure (772,074), thus continuing the trend of previous years.

Figure 29
Trend in total issuance



The number of supplements governed by the old Sales Prospectus Act (*Verkaufsprospektgesetz* – VerkProspG) declined to eight, thus continuing the rapid fall, as was to be expected (previous year: 8,162). By contrast, the number of final terms rose sharply to 1,771,315 (previous year: 763,763). The reason is that issuers publish more final terms for each base prospectus.

Many issuers also used the European Passport in 2011. BaFin issued notifications for EU countries other than Germany for 2,658 prospectuses and supplements (previous year: 2,581). Conversely, issuers from EU member states obtained notifications for the German market for 1,747 prospectuses (previous year: 1,105). However, at 4,602, the number of outgoing notifications was significantly higher than the number of prospectus and supplement notifications received. This is because notifications for prospectuses are often issued for several member states at the same time. A separate procedure is required for each member state. For incoming notifications, by contrast, Germany can be notified of the document approved by a foreign authority in a single procedure only.

Table 32
Outgoing and incoming notifications in 2011

	Notifications issued	Notifications received
Austria	2,182	59
Belgium	84	5
Denmark	20	
Finland	68	
France	146	83
Ireland	21	51
Italy	196	
Liechtenstein	169	26
Luxembourg	1,131	796
Netherlands	108	355
Norway	80	
Spain	110	
Sweden	107	
United Kingdom	135	363
Other	45	9
Total	**4,602**	**1,747**

Change in securities prospectus fees.

To allow the administrative effort involved in chargeable official acts to be accurately determined, the structure of BaFin's cost and management accounting was expanded as from 1 January 2009. Since then, the time spent on each chargeable event has been recorded so that the costs can be analysed accurately. An assessment made on this basis of the schedule of fees of the Securities Prospectus Fees Regulation (*Wertpapierprospektgebührenverordnung* – WpPGebV) led to the fees being modified as from 1 January 2011. This has improved the accuracy of the distribution of fees and thus achieved greater fairness in the structure of the Fees Regulation.

Administrative fines.

BaFin initiated five new administrative fine proceedings in relation to actual evidence of violations of the Securities Prospectus Act (*Wertpapierprospektgesetz* – WpPG) in the year under review (previous year: 7). A total of 16 proceedings were still pending from previous years. BaFin imposed administrative fines of up to €16,000 in two cases (previous year: 1). It discontinued three proceedings in line with the principle of discretion. Sixteen cases were still pending at the end of 2011.

3.2 Non-securities investment prospectuses

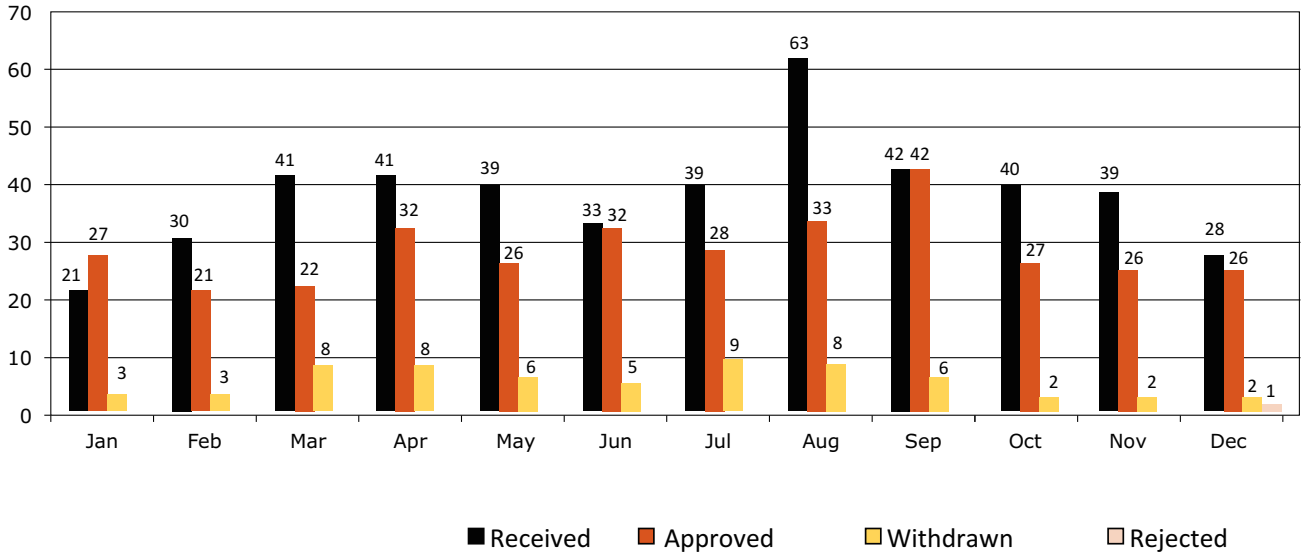
Slight decline in non-securities investments.

In 2011, BaFin examined a total of 456 sales prospectuses (previous year: 535). It approved publication of 400 (previous year: 442) and rejected two offerings (previous year: 4). Issuers withdrew their applications in 66 cases (previous year: 92). The number of prospectuses submitted and approved for publication was therefore lower than in the previous year. This trend shows that – following a moderate recovery in the previous year – the non-securities investment market weakened again in 2011 in the

wake of the financial crisis. The funds offered were designed to attract around €7.7 billion of equity, slightly more than the previous year's €7.4 billion.

Figure 30

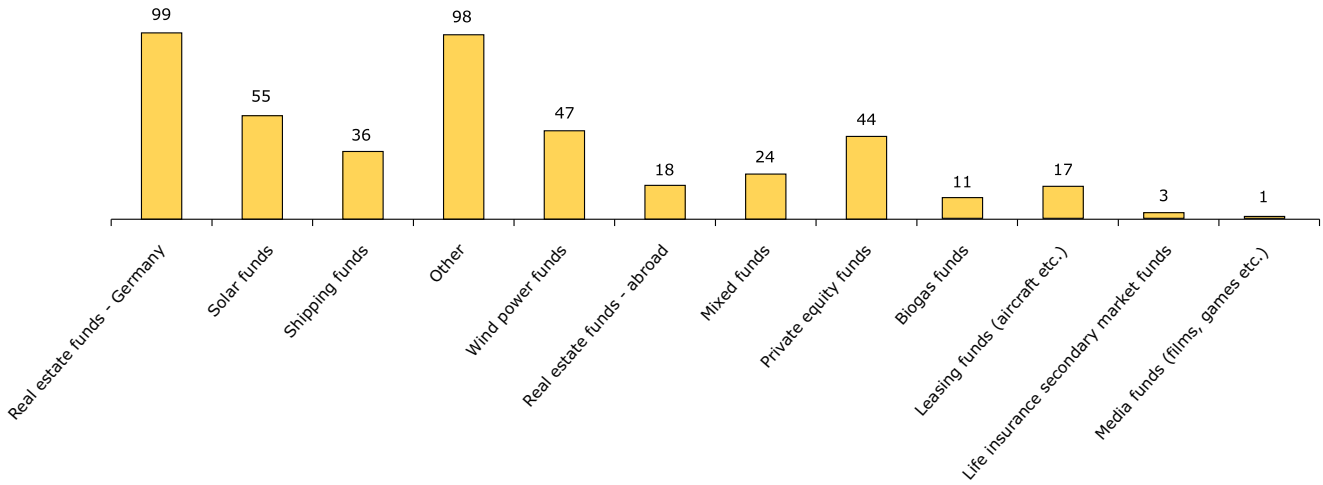
Prospectuses received, approved, withdrawn and rejected



Real estate and renewable energies remain popular.

At 26%, real estate funds were again the largest target investment segment (previous year: 32%). 22% of the funds invested in domestic properties (previous year: 25%) and 4% in foreign properties (previous year: 7%). Renewable energy funds were in second place, at around 24% (previous year: 27%); these can be broken down into solar power plants (12%, previous year: 15%), wind power (10%, previous year: 8%) and biogas plants (2%, previous year: 4%). The proportion accounted for by ship funds declined to 8% (previous year: 13%). Conversely, private equity funds were on the rise, accounting for a share of 10% (previous year: 6%).

Figure 31
Prospectuses by target investment



Decline in supplements continues.

Unlike securities prospectus supplements, the number of supplements to non-securities investment prospectuses declined further, to 362 (previous year: 425). This can be interpreted as a sign of a slight recovery of the non-securities investment market. The speed of placing out issues is increasing again and fewer new details arise that the issuer is required to present to the investor as a supplement during the offering.

Consistency checks extended to non-securities investment prospectuses from June 2012 onwards.

The new Capital Investment Act will enter into force on 1 June 2012. It introduces coherence checks for non-securities investment prospectuses as well. BaFin already examines securities prospectuses for coherence. The approval of non-securities investment prospectuses and supplements will also be aligned with the examination practice applied to securities prospectuses. Moreover, the new key investor information document is intended to make investments more transparent and comparable for investors. In addition, the Investment Products Act introduces new financial reporting requirements for issuers and provides new rules for prospectus liability in cases where sales prospectuses contain errors or have not been produced at all.

Workshop on the new Capital Investment Act.

To facilitate a seamless transition to the new legislation, BaFin presented a workshop in November 2011 to almost 300 market participants, particularly issuers, offerors, associations, lawyers and auditors, to introduce the new requirements of the Capital Investment Act and of the Capital Investment Regulation. It

presented the new examination procedure in detail and explained when providers are only required to submit a supplement to a prospectus that has already approved and in what cases they are obliged to submit a new prospectus.

Internet surf week 2011.

During its annual Internet surf week, BaFin again trawled the Internet in 2011 looking for public offerings for which no prospectus had been prepared. It found a total of 26 suspicious instances, primarily in the area of renewable energy (solar, wind and biogas). There was also an increased number of investment offerings in the form of profit participation rights. BaFin finally identified 16 unauthorised offerings and contacted the offerors, who discontinued their unauthorised public offerings immediately and changed their websites.

Administrative fines.

In 2011, BaFin initiated new administrative fine proceedings in one case due to suspected violations of the Sales Prospectus Act (previous year: 2). Eight proceedings were pending at the beginning of the year. BaFin suspended four proceedings (previous year: 2), three for discretionary reasons. In one case, the administrative fine proceedings were suspended in favour of criminal prosecution, after BaFin had handed the matter over to the responsible public prosecutor's office. Four proceedings were still pending at the end of 2011.

4 Corporate takeovers

Slight increase in number of offer procedures.

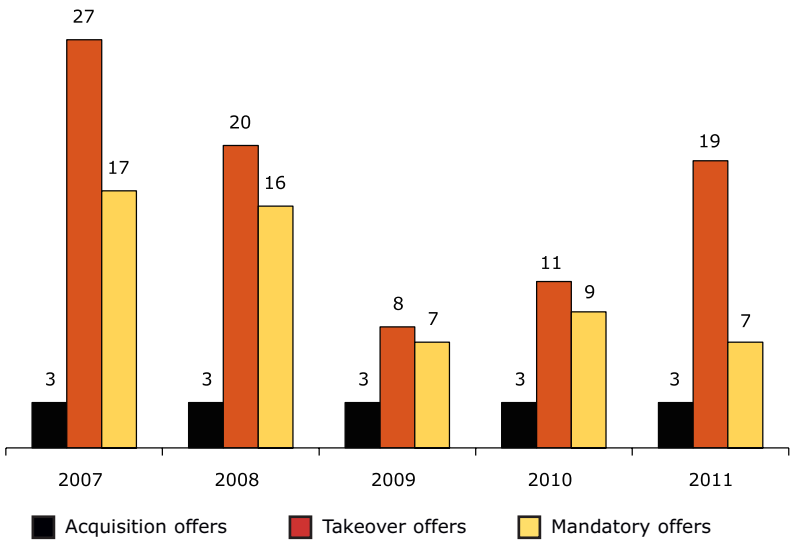
In 2011, BaFin examined and approved a total of 29 offers (previous year: 23), of which 21 were in the first six months (previous year: 11) and eight in the second half of the year (previous year: 12). By historical standards, the number of approved offers remained below the average of recent years despite the slight upward trend. Especially the second half of the year was impacted by the negative developments on the financial markets and the resulting difficulties in financing mergers and acquisitions. There was no case where BaFin had to prohibit an offer.

4.1 Offer procedures

Out of the 29 offer procedures, seven 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 19 procedures related to takeover offers that were aimed at acquiring 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 32
Number of offer procedures



Increase in transaction volumes.

Transaction volumes[76] increased, unlike in the previous year. The transaction volume of approximately half of the offers in 2011 was above €100 million, while for most offers in the previous year it had been significantly below €100 million. At approximately €12.6 billion, Alpha Beta Netherlands N.V.'s takeover offer to Deutsche Börse AG's shareholders was the procedure with the highest transaction volume, followed by NECKARPRI GmbH's offer to EnBW Energie Baden-Württemberg AG's shareholders (approximately €10.3 billion) and the mandatory offer made by Volkswagen AG to MAN SE's shareholders (approximately €9.7 billion). The mandatory offer made by Florian Behnk to RWL Verwaltungs- und Beteiligungs-AG's shareholders had the lowest transaction volume (approximately €950,000).

Acquisition procedures in the public spotlight.

In particular, Alpha Beta Netherlands N.V.'s takeover offer to the shareholders of Deutsche Börse AG attracted great public interest in 2011. This offer was carried out as an exchange offer and formed part of an overall plan to combine Deutsche Börse AG and NYSE Euronext under a joint holding company. After the European Commission prohibited the merger on 1 February 2012, the exchange offer expired and the planned merger failed.

[76] The transaction volume is calculated by multiplying the number of shares to be acquired by bidders by the amount of cash the bidder is obliged to pay per share as determined in the offer procedure. Incidental transaction costs are added to the result.

Likewise, the US-based Terex Group's takeover offer to the shareholders of Demag Cranes AG, which was being rejected by the target company's governing bodies for a long time, was the focus of media attention for several weeks.

In addition, the practical application of acquisition law was enhanced in other procedures. For example, in the case of Clariant Verwaltungsgesellschaft mbH's mandatory offer to the shareholders of Süd-Chemie AG and Lenovo Germany Holding GmbH's takeover offer to the shareholders of Medion AG, BaFin had to deal with questions such as how and at what dates listed shares are to be measured that the bidder grants as pre-acquisition consideration, consideration parallel to acquisition and post-acquisition consideration.

The takeover offer made by Engine Holding GmbH, a joint subsidiary of Daimler AG and the Rolls-Royce Group plc in the UK, to the shareholders of Tognum AG, was the first offer in accordance with the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz* – WpÜG) in which BaFin allowed the inclusion of a compliance condition.

Takeover offer (exchange offer) by Alpha Beta Netherlands Holding N.V. to Deutsche Börse AG's shareholders

On 15 February 2011, Alpha Beta Netherlands Holding N.V. (Alpha Beta) announced its intention to submit a takeover offer in the form of an exchange offer to the shareholders of Deutsche Börse AG (Deutsche Börse).

Offer subject to complex terms.

The exchange offer was part of an overall plan to combine Deutsche Börse and NYSE Euronext under a Dutch holding company, Alpha Beta. In relation to NYSE Euronext, this was to be achieved not on the basis of an exchange offer, but by merging NYSE Euronext with a US subsidiary of Alpha Beta. The following exchange ratios were relevant for the offer: each Deutsche Börse share was to be exchanged for one Alpha Beta share; each NYSE Euronext share was to be exchanged for 0.47 Alpha Beta shares. Alpha Beta already published these exchange ratios in its announcement of 15 February 2011. The exchange offer and the merger were linked by reciprocal conditions in such a way that the failure of one component measure would lead to the failure of the entire project. The exchange offer was thus subject to the (satisfied) condition that the shareholders of NYSE Euronext approve the merger. In turn, the merger was to be implemented only if the exchange offer was also consummated.

After publishing its decision to make a takeover offer, Alpha Beta should normally have submitted an offer document to BaFin within four weeks. However, at Alpha Beta's request, BaFin

extended this period by four weeks until 12 April 2011. BaFin can extend the time limit only in exceptional circumstances, for example in the case of cross-border offers.

Extension of time limit for cross-border offer (section 14 (1) sentence 3 of the WpÜG)

BaFin can extend the submission time limit for a cross-border offer if there is an unavoidable conflict of laws between the applicable legal frameworks and this conflict makes it impossible for the bidder to meet the regular time limit for submitting the offer document. Accordingly, it is not sufficient if the offer also has to comply with the provisions of a foreign legal framework. Rather, BaFin examines in each individual case whether it is impossible for the bidder to meet the time limit for submitting the offer document because of the conflict of rules – even if all personnel, financial and legal resources are used.

Alpha Beta was able to demonstrate credibly that it could not submit the offer document to BaFin within a time limit of four weeks because of the conflict of laws between the WpÜG and provisions of the US Securities Act of 1933 and the Securities Exchange Act of 1934 that were also applicable. Without a registration document declared effective by the US Securities and Exchange Commission (SEC), the offer of shares in Alpha Beta as consideration would have been unlawful under US law. Unlike the German WpÜG, however, the applicable provisions in the law of the United States of America do not specify any firm time limits for examining the approval document. Because of the time limit rule of the WpÜG, Alpha Beta faced the risk of having to publish the offer document after expiry of the time limit set under German law at a time when the SEC had not yet declared the registration document effective. Since the extension of the time limit was granted and the SEC was prepared to speed up the examination process as far as possible, Alpha Beta was able to meet the requirements under both legal frameworks during an extended submission period.

On 1 April 2011, NASDAQ OMX Group Inc. (Nasdaq) and Intercontinental Exchange Inc. (ICE) announced that they would make a cash offer to the shareholders of NYSE Euronext. However, in view of the expected resistance from the competition authorities, Nasdaq and ICE abandoned their plans in May 2011. For this reason, the bidding war the public had expected following the announcement by Nasdaq and ICE failed to materialise.

The exchange offer and the contracts entered into as a result of accepting the exchange offer were subject to a large number of conditions being met. In spite of the complexity, caused in particular by the large number of approvals that had to be obtained from the authorities, the description of the conditions was not allowed to contain vague terms such as "material" or "reasonably".

Clear offer conditions

In accordance with the transparency requirement of section 3 (2) of the WpÜG, for which further details are set out in section 11 of the WpÜG, holders of securities of the target company must have sufficient time and adequate information to be able to make an informed decision about the offer. The offer document must be drawn up in a form which facilitates its comprehensibility and evaluation (section 11 (2) sentence 4 of the WpÜG). Conditions on which the effectiveness of the offer is to depend must therefore be sufficiently determined or determinable. For example, the bidder must not require the shareholder of the target company to examine whether a matter is "material" or can "reasonably" be expected. This also applies to complex situations where the bidder has an understandable interest in using vague terms. Even in complex situations, the bidder is in a better position to define the vague terms than the shareholders of the target company, who cannot normally judge when a matter is material for the bidder.

BaFin approved the publication of the offer document on 2 May 2011.

On 7 June 2011, Deutsche Börse and NYSE Euronext published their intention to recommend to Alpha Beta's Board of Directors the distribution of a special dividend of €2.00 per share from Alpha Beta's capital reserves shortly after consummation of the combination. The total dividend payment was expected to amount to €620 million/US$904 million, providing 100% of Deutsche Börse shareholders accepted the offer. Since this special dividend would not have been paid in exchange for shares of Deutsche Börse and would have benefited all future shareholders of Alpha Beta, it would not have constituted consideration as defined in the WpÜG and would therefore not have been subject to the provisions of section 31 of the WpÜG.

By the end of a further acceptance period on 1 August 2011, the exchange offer had been accepted for a total of 186,060,779 Deutsche Börse shares, corresponding to 95.4158% of the share capital and of the voting rights. By the end of the period for asserting pre-emptive rights on 4 November 2011, the offer had been accepted for a further 3,169,942 shares, corresponding to 1.63% of the share capital and of the voting rights. In total,

189,230,721 shares were tendered under the exchange offer. This corresponds to an acceptance ratio of 97.04%.

Prohibition of the business combination by the European Commission.

After the European Commission had prohibited the merger on 1 February 2012, a material condition of the exchange offer was not met. This made the exchange offer ineffective. The shares already tendered for exchange were rebooked to the original securities number.

Takeover offer by Terex Industrial Holding AG to Demag Cranes AG's shareholders

On 2 May 2011, Terex Industrial Holding AG (TIH) published its decision to make a takeover offer to the shareholders of Demag Cranes AG (Demag Cranes) at a price of €41.75 per share. TIH is a subsidiary of the listed Terex Corporation (Terex) based in Westport Connecticut, USA. Terex had been making initial contact attempts since April 2010. In summer 2010, more intensive discussions were held between Terex and Demag Cranes; they resulted in an expression of interest by Terex with a planned offer price of between €32 and €35. However, Demag Cranes eventually terminated the discussions in September 2010, stating that a takeover by Terex was not in the interest of Demag Cranes. In February and March 2011, Terex made fresh attempts to start negotiations with Demag Cranes, but they were again rejected.

In a statement in accordance with section 27 of the WpÜG released on 31 May 2011, the Management Board and the Supervisory Board of Demag Cranes rejected the offer published on 18 May 2011. They recommended to the shareholders not to accept the offer. The reasons given were that, in the opinion of the governing bodies of Demag Cranes, consideration of €41.75 was not adequate and that a takeover would lead to disadvantages for Demag Cranes' own strategy. After the statement, Terex made various attempts to contact Demag Cranes, which finally resulted in exploratory discussions on 14 and 15 June 2011. The negotiations resulted in an agreement to combine the two companies (business combination agreement) being entered into on 16 June 2011, which also provided for a higher offer price.

On the same day, TIH formally increased the offer price to €45.50. In a further statement in accordance with section 27 of the WpÜG, the Management Board and the Supervisory Board of Demag Cranes described this increased offer price as adequate and welcomed the takeover and business combination. After that, the takeover offer was successfully completed; at the end of an additional acceptance period, TIH held approximately 81.83% of the shares and voting rights in Demag Cranes.

Mandatory offer by Clariant Verwaltungsgesellschaft mbH to Süd-Chemie AG's shareholders

On 18 April 2011, Clariant Verwaltungsgesellschaft mbH (Clariant) achieved control, as defined in takeover law, of Süd-Chemie AG (Süd-Chemie) and published this fact on 19 April 2011 in accordance with the provisions of the WpÜG. On 17 May 2011, Clariant published the mandatory offer document approved by BaFin on 16 May 2011 for the acquisition of the shares in Süd-Chemie against payment of cash consideration or €126.38 per Süd-Chemie share. In determining the minimum consideration, Clariant also had to take into account previous acquisitions.

Determination of minimum consideration on the basis of share purchases made before, in parallel to and after the acquisition

The bidder in a takeover or mandatory offer is not free to determine the consideration, but has to comply with certain minimum thresholds. For example, section 4 of the WpÜG Offer Regulation (*WpÜG-Angebotsverordnung*) specifies that the consideration for the shares of a target company must be equivalent to at least the highest value paid or agreed by the bidder, persons acting in concert with it, or subsidiaries of the latter to acquire shares in the target company in the last six months preceding publication of the achievement of control or of the intention to make a takeover offer. Agreements as a result of which the transfer of ownership of shares may be demanded are afforded equal status with a purchase.

The WpÜG contains similar rules for purchases parallel to the acquisition made in the period between the publication of the offer document and the end of the acceptance period (section 31 (4) of the WpÜG), and post-acquisition purchases made off-exchange within one year of publication of the acceptance ratio (section 31 (5) of the WpÜG).

On the basis of several block purchase agreements dated 16 February 2011, Clariant had acquired a total of 5,415,113 Süd-Chemie shares on 18 April 2011 and thus attained control. As consideration for part of the Süd-Chemie shares, Clariant granted listed shares of Clariant AG, which is domiciled in Switzerland. To be able to quantify the pre-acquisition consideration, Clariant therefore had to determine the value of the shares of Clariant AG. Clariant did so by applying the highest price at which shares of Clariant AG were traded on the Swiss Stock Exchange on the relevant dates. To base the consideration on the average price of the shares granted as pre-acquisition consideration in accordance with sections 5, 6 and 7 of the WpÜG Offer Regulation would not have been consistent with the

principle of equal treatment resulting from section 4 of the WpÜG Offer Regulation. The addressees of the offer must receive the same financial treatment as an individual shareholder who receives a block premium during the period prior to a takeover offer.[77] This can only be achieved if the value of the pre-acquisition consideration is determined from the recipient's perspective. In cases where listed shares are granted as pre-acquisition consideration, this value will, as a rule, be based on the current market price of the shares granted as pre-acquisition consideration, because the recipient of the pre-acquisition consideration could sell the acquired shares at this price.

The relevant date for determining the value is the pre-acquisition event in each case. In accordance with section 4 of the WpÜG Offer Regulation in conjunction with section 31 (6) of the WpÜG, both the agreement of the pre-acquisition consideration and its granting constitute a pre-acquisition event. For this reason, Clariant had to determine the value of the shares of Clariant AG, both at the time the pre-acquisition agreements were entered into and subsequently when they were consummated, and disclose the value in its offer document.

By the end of the acceptance period on 14 June 2011, the offer had been accepted for 295,356 Süd-Chemie shares. This corresponds to 2.49% of the share capital and of the voting rights of Süd-Chemie. The total number of Süd-Chemie shares for which the offer had been accepted by the end of the acceptance period, plus the Süd-Chemie shares held by or attributable to Clariant and Clariant AG at the reference date, was 11,679,449 Süd-Chemie shares. This corresponds to 98.64% of the share capital and of the voting rights of Süd-Chemie.

Takeover offer by Lenovo Germany Holding GmbH to Medion AG's shareholders

On 1 June 2011, Lenovo Germany Holding GmbH (Lenovo) published its intention to make a takeover offer to the shareholders of Medion AG (Medion). BaFin approved the offer document on 27 June 2011 and Lenovo published it on 28 June 2011. In determining the minimum consideration, Lenovo had to take into account pre-acquisition purchases. Part of the pre-acquisition consideration consisted of the transfer of listed shares of Lenovo's parent company (Lenovo Hong Kong). However, because of the chosen contractual arrangements, Lenovo did not have to measure the pre-acquisition consideration on multiple occasions (at the time of entering into the agreement and at the time of granting the pre-acquisition consideration), although the contract was consummated on 29 July 2011, i.e.

[77] Government draft explanatory note, Bundestag publication 17/7034, p 80.

during the parallel acquisition period of section 31 (4) of the WpÜG. In accordance with the agreement between the parties, the pre-acquisition consideration was to consist of a cash and an exchange component, although the parties had defined the total pre-acquisition consideration to be paid as a fixed amount. Lenovo had to compensate for fluctuations in the value of the Lenovo Hong Kong shares between entering into the pre-acquisition agreement and consummating it by adjusting the cash component. This ensured that the total value of pre-acquisition consideration in the period between entering into the pre-acquisition agreement and consummating it remained constant, even if the stock exchange price of the Lenovo Hong Kong shares fluctuated.

Lenovo's offer was accepted for a total of 4,564,927 Medion shares. This corresponds to approximately 9.43% of the share capital and of the voting rights of Medion. At the end of the additional acceptance period, Lenovo held 29,280,494 Medion shares in total, including the 4,157,211 Medion shares already tendered during the original acceptance period. This corresponds to approximately 60.47% of the share capital and of the voting rights of Medion AG.

Takeover offer by Engine Holding GmbH to Tognum AG's shareholders

On 9 March 2011, Engine Holding GmbH, a joint subsidiary of Daimler AG and Rolls-Royce Group plc, published its decision to make a takeover offer to the shareholders of Tognum AG. The offer document was published on 6 April 2011. The takeover offer was subject to a large number of conditions, especially relating to merger control approval of the acquisition in a large number of jurisdictions. It was the first time that a so-called compliance condition was included and approved by BaFin. Compliance means adherence to rules of conduct, laws and guidelines. In terms of content, the specific condition comprised violations of the law such as corruption and granting an undue advantage as well as – in the form of a blanket clause – ethical requirements under the legal system concerned. BaFin only permits the inclusion of blanket clauses very restrictively, since under the transparency requirement of the offer procedure, it has to be clear to the shareholder of the target company whether or not a condition has been met. In this offer procedure, BaFin considered comprehensive reference to all applicable rules permissible, because responsibility for clarifying whether a condition was met had been assigned to an independent expert. From BaFin's point of view, this structure ensured sufficient transparency.

4.2 Exemption procedures

56 applications for exemption.

BaFin received 56 applications for exemption or non-consideration (previous year: 78). In 17 cases, holders of voting rights requested that voting rights should not be considered in accordance with section 36 of the WpÜG (previous year: 11), while 39 applications for exemption were made in accordance with section 37 of the WpÜG (previous year: 63). BaFin approved 42 applications (previous year: 50) and rejected three. Five were withdrawn by the applicants and five were still being processed at the end of the year under review.

Several grounds for exemption apply simultaneously.

On 20 April 2011, BaFin exempted NCR GmbH and its US parent NCR Corporation in accordance with section 37 of the WpÜG from submitting a mandatory offer for Turbon AG.
This decision stood out because it was based on three special grounds for exemption at the same time. The special grounds for exemption are laid down in section 9 of the WpÜG Offer Regulation. They provide details of individual exemption options of section 37 of the WpÜG, which defines them in broad terms like a blanket clause.

Turbon AG intended to retire treasury shares. Because of the resulting reduction in the company's share capital, it was to be expected that, even though the number of shares would not change, the percentage represented by the block of shares held by NCR GmbH would rise above 30%. Where control is attained passively in this way, BaFin can grant an exemption because control is attained without the shareholder's active involvement and lawmakers regard it as inappropriate to require a mandatory offer in such cases. In addition, two other special grounds for exemption were met in relation to "the actual possibility of exercising control" (section 37 of the WpÜG): firstly, another shareholder, HBT Holdings GmbH, held a larger share of the voting rights than the two applicants. Secondly, in light of the attendance at annual general meetings in the previous three years, it was not to be expected that NCR GmbH would in future have a majority at the annual general meeting of Turbon AG.

All three grounds for exemption lead to a discretionary decision by BaFin, in which ancillary provisions are invariably used to protect the bases of the decision. If control is attained passively, BaFin normally prohibits the active acquisition of additional shares. However, because there were several grounds for exemption in the case of Turbon AG, the ancillary provisions had to be coordinated in such a way that NCR GmbH was allowed to acquire additional shares of Turbon AG, providing its share of the voting rights remained lower than that of HBT Holdings GmbH and no majority was achieved at the annual general meeting.

4.3 Administrative fines

Purchase offer in the electronic Federal Gazette.

In 2011, BaFin initiated a total of 14 new administrative fine proceedings due to suspected violations of takeover law provisions (previous year: 16). A total of 41 proceedings were still pending from previous years. BaFin imposed administrative fines of up to €15,000 on three occasions (previous year: 5). It discontinued 16 proceedings, most of them in line with the principle of discretion (previous year: 26). It informed the parties concerned of their legal position and duties in five cases. Thirty-six cases were still pending at the end of 2011.

5 Financial reporting enforcement

5.1 Monitoring of financial reporting

873 companies subject to financial reporting enforcement.

The financial statements of German and foreign companies whose securities are admitted to trading on the regulated market in Germany are subject to financial reporting enforcement. As at 1 July 2011, a total of 873 companies from 22 countries (previous year: 915 companies from 19 countries) were subject to the two-tier enforcement procedure performed by BaFin and the Financial Reporting Enforcement Panel (FREP): 728 from Germany, 113 from other European countries (76 from EU member states) and 32 from six non-European countries. When examining a foreign company, BaFin liaises with the supervisory authorities in the company's home country.

Table 33
Breakdown by country of companies subject to financial reporting enforcement
As at 1 July 2011

Germany	728
Jersey, Channel Islands	25
Netherlands	24
USA	22
Austria	16
Luxembourg	11
Switzerland	9
United Kingdom	8
Ireland	7
Israel	4
France	3
Japan	3
Finland	2
Italy	2
Spain	2
Cayman Islands	1
Guernsey, Channel Islands	1
Iceland	1
Isle of Man	1
Canada	1
Netherlands Antilles	1
Sweden	1
Total	**873**

The FREP completed 110 examinations in the year under review (previous year: 118), of which 90 were sampling examinations, six were examinations for cause and 14 were performed at BaFin's request.[78]

BaFin completed 32 financial reporting enforcement procedures (previous year: 30), with an error publication order being issued in 30 cases. The FREP had previously identified errors in consultation with the relevant companies in 25 of the 32 cases. The remaining seven cases were based on error identification procedures performed by BaFin, five of which concluded with errors being identified. BaFin performs its own error identification procedures, for example if a company does not accept the errors

[78] Source: FREP.

identified by the FREP or refuses to cooperate with the FREP. The companies concerned did not accept the errors identified by the FREP in five of the seven error identification procedures performed by BaFin. BaFin identified errors at the end of four of these procedures, while one case was completed with no errors being found. BaFin closed one of the two other procedures with errors being identified where the companies concerned had refused to cooperate with the FREP. The error identification procedure at BaFin related to a wide variety of accounting errors, with management reporting being one of the focus areas. BaFin ordered the errors identified in completed procedures to be published in all cases.

Fourteen cases were still pending at BaFin at the end of 2011. The following table gives an overview of the completed error identification and publication procedures.

Table 34
BaFin enforcement procedures from July 2005 to December 2011

	Error findings: yes	Error findings: no	Error publication: yes	Error publication: no
1) Company accepts FREP's findings	131		128	3
2) Company does not accept FREP's findings	27	6	25	2
3) Company refuses to cooperate with FREP	2	6	2	0
4) BaFin has considerable doubts as to the accuracy of the examination findings or the FREP procedure	3	0	2	1
55) BaFin takes over the examination (banks and insurance undertakings)	0	0	0	0
Total	**163**	**12**	**157**	**6**

European coordination of financial reporting enforcement by ESMA.

The European Securities and Markets Authority (ESMA), which was created at the beginning of 2011, plays an increasingly important role in monitoring financial reporting. Its tasks range from assessing specific accounting issues to harmonising the European enforcement systems. Through the European Enforcers' Coordination Sessions (EECS), for example, ESMA coordinates the Europe-wide activities for monitoring company financial statements. This is designed to ensure that the International Financial Reporting Standards (IFRSs) are applied as consistently as possible to strengthen investor protection and boost confidence in the European capital markets. The EECS has 38 members from 29 EU/EEA countries, including BaFin. The committee has no decision-making powers; ultimate responsibility lies with the competent national supervisory authority.

ESMA initiative on the accounting treatment for Greek sovereign bonds

Together with the national supervisory authorities, ESMA pursued an approach that was coordinated throughout Europe in 2011, for example in the accounting treatment for Greek sovereign bonds. To this end, the accounting practice used in the half-yearly financial statements as at 30 June 2011 of 53 selected European banks and insurance undertakings was analysed. The main issue was whether the institutions had improperly failed to recognise the write-downs on Greek sovereign bonds required as at that reporting date. ESMA wanted to establish in this way whether the companies' financial statements comply with the rules across Europe. It published the results of the study in November 2011.

The accounting practice differed in that some institutions had written Greek sovereign bonds down to their fair value as at 30 June 2011, while others had not. In addition, there were differences in the percentage of the write-downs recognised in relation to the carrying amounts of the bonds. However, different amounts of write-downs are not necessarily an indication of an incorrect accounting treatment, but may have a variety of reasons. Firstly, the relevant International Financial Reporting Standard itself provides for **several measurement categories**, only some of which require fair value to be used as a relevant benchmark for subsequent measurement (for example in the case of sovereign bonds held for trading). The other measurement categories, however, also permit lower write-downs (for example if a sovereign bond is to be held to maturity).

When **sovereign bonds** are **measured at fair value**, differences in write-down percentages in relation to the carrying amount are not surprising, because there were significant differences in the fair values of Greek sovereign bonds as at 30 June 2011 – depending on the remaining maturities. Sovereign bonds with very short maturities had relatively high fair values, but the opposite applied to long-dated bonds. As a consequence, the amount of write-downs required could differ from financial institution to financial institution, depending on the remaining maturity of the bond portfolio held. In some cases, another cause of differences in write-down percentages was that companies had already acquired Greek bonds at low fair values shortly before 30 June 2011 (for example as part of a business combination) so that the write-down required was relatively small.

For the **other measurement categories** in the relevant International Financial Reporting Standard, companies have to measure bonds they hold at amortised cost. A decisive criterion in determining the impairment of Greek sovereign bonds held in this measurement category was in particular the proportion of bonds that mature before 2020 (and are therefore included in the

Private Sector Involvement plan of July 2011) or have longer maturities. In the case of bonds maturing after 2020, the amount of any write-down required critically depended on how the institution preparing the financial statements judged the prospects for success of the bailout package for Greece. This meant that the proportion of bonds maturing before and after 2020 included in a portfolio could also have an impact on the level of the write-down percentage.

ESMA's study also included the half-yearly financial statements of twelve German banks and insurers. For these institutions, there were no specific indications of violations of any financial reporting standards that led to a financial reporting enforcement procedure being instituted for cause.

ESMA revises CESR standards.

To further harmonise European enforcement, ESMA is revising CESR Standards No. 1 and No. 2 on Financial Information. The predecessor organisation, CESR (Committee of European Securities Regulators), published these financial reporting enforcement rules in 2003 and 2004. CESR Standard No. 1 (Enforcement of Standards on Financial Information in Europe) recommended that member states should adopt a basic structure of financial reporting enforcement that is harmonised throughout the EU. CESR Standard No. 2 (Coordination of Enforcement Activities) additionally suggested a system under which national enforcement activities are coordinated throughout Europe. The CESR Standards form a consistent framework for monitoring financial reporting in Europe. They were also taken into account when the German Financial Reporting Enforcement Act (*Bilanzkontrollgesetz* – BilKoG) was adopted in 2005.

The standards are being modified in two phases. In the first phase, which was completed in 2011, ESMA collected data across all enforcement systems in Europe (fact-finding). In the second phase, CESR Standards No. 1 and No. 2 are being revised and debated. This process is expected to be completed by the end of 2012. BaFin represents Germany's interests during the revision of the standards. The issue of what binding effect the standards will have in future has not yet been resolved.

5.2 Publication of financial reports

Publicly traded companies have to make all their financial reports available online and publish information in advance about where and from what date these reports can be accessed, normally on the company's own website (publication notice). These include annual and half-yearly financial reports as well as interim management statements.

After the amendments to the financial reporting requirements had entered into force with the Transparency Directive Implementation Act (*Transparenzrichtlinie-Umsetzungsgesetz* – TUG) in 2007, BaFin focused on the large number of issuers that had consistently failed to meet their financial reporting obligations. A positive trend has now emerged in this area, due in part to the administrative procedures pursued to enforce these requirements. For this reason, BaFin now concentrates on monitoring whether the companies publish their financial reports in a timely manner.

Continued focus on Internet publication.

In 2011, BaFin examined in approximately 2,400 cases whether the financial reports were actually published on time on the Internet (previous year: 1,150). This means that, on average, each issuer was the centre of BaFin's attention several times a year. In 53 cases, BaFin did not find any financial report on the company's website at the time of examination (previous year: 47 cases). Moreover, in individual cases no website with any financial information could be traced at all.

Coercive fines of up to €114,000 threatened.

BaFin opened six administrative procedures (previous year: 34) relating to the subsequent rectification of about 60 cases of failure to issue publications or communications (previous year: 200). A total of 20 administrative procedures were still pending from the previous year. BaFin closed 14 administrative procedures (previous year: 45) after the issuers subsequently met their obligations. In more than half of these cases, BaFin had to threaten coercive fines of up to €27,500 that were ultimately imposed in five cases. In three cases, the issuers paid the imposed coercive fines, but without subsequently meeting their obligations. BaFin therefore threatened further coercive fines of up to €35,000. In one of these cases, the issuer then met its financial reporting requirements. In two cases, BaFin imposed a second coercive fine of up to €35,000. In both cases, it had to threaten a third coercive fine of up to €66,000. In response to that, one issuer met its financial reporting requirements. It was, however, necessary to threaten the other issuer with a fourth coercive fine of €114,000 before it finally met its obligations.

Twelve administrative procedures involving around 220 rectification requirements were pending at the end of 2011. BaFin has to date threatened coercive fines of up to €17,000 in six cases and imposed such fines in five cases. In one case, it had to impose a second coercive fine of €28,000.

18 administrative fines imposed.

BaFin initiated 44 administrative fine proceedings relating to suspected violations of financial reporting requirements (previous year: 95). A total of 96 proceedings were still pending from previous years. BaFin imposed administrative fines of up to €19,000 on 18 occasions (previous year: 14). It suspended

19 proceedings (previous year: 5), 18 for discretionary reasons. The parties concerned were informed of their legal position and duties in two of these cases. The number of cases pending at the end of 2011 was 103.

6 Supervision of the investment business

The German fund sector was struggling with the fallout from the financial crisis. Although there were sporadic examples of positive trends, the market did not stage a broad-based recovery.

In addition to dealing with the crisis, BaFin's and the fund sector's main focus in 2011 was on transposing the UCITS IV Directive (Directive 2009/65/EC) into German law. BaFin was actively involved in creating the legal framework and, by approving the amended fund rules of UCITS in good time, successfully completed the transposition as at 1 July 2011. In addition, BaFin held several workshops and seminars to provide information about the new requirements at both national and European level.

It performed 48 supervisory visits and annual interviews on site. It additionally discussed acute problems in 40 ad hoc meetings, concentrating on open-ended real estate funds, as in the previous year.

6.1 Asset management companies

In 2011, BaFin granted five German asset management companies their first licences to manage assets in accordance with the Investment Act (*Investmentgesetz* – InvG). One asset management company was merged with another asset management company. This meant that, at the end of the year, 77 asset management companies were licensed in accordance with the InvG (previous year: 73). As in the previous year, five asset management companies applied for the scope of their licences to be extended to include the "other funds" category.

2,147 mutual funds and 3,745 special funds.

At the end of 2011, asset management companies managed a total of 5,892 funds (previous year: 5,997) comprising assets worth €1,139 billion (previous year: €1,137 billion). Of this figure, 2,147 (previous year: 2,210) were mutual funds with assets of €314.9 billion (previous year: €339.6 billion) and 3,745 (previous year: 3,787) were special funds with assets of €823.8 billion (previous year: €797.4 billion). Of the mutual funds, 260

were organised as funds of funds or funds of hedge funds (previous year: 265); among the special funds, there were 70 funds of funds and funds of hedge funds (previous year: 72).

A total of 14 mutual funds were merged in 2011, while the management rights for 45 mutual funds were transferred to other asset management companies. A total of 65 mutual funds were liquidated.

Aggregate (net) cash inflows into mutual funds and special funds – i.e. all cash inflows from the sale of fund units less all cash outflows from the redemption of fund units – amounted to €45.2 billion at the end of the year. (Gross) cash inflows totalled €231.3 billion, of which €101.4 billion was attributable to mutual funds and €129.9 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 101 subpools of assets (*Teilgesellschafts-vermögen*). Total assets under management at these investment stock corporations and subpools of assets amounted to approximately €15 billion.

Decline in new approvals continues.

The number of new approvals decreased considerably compared with 2010: only 88 new special funds were approved (previous year: 153). Compared with the development of the past few years, this figure represents a new low (2009: 147, 2008: 278). One reason for this is the financial crisis, which continues to have a negative impact on the fund market. The next year will show whether the decline has bottomed out and the low number is also a sign of consolidation on the fund market.

Risk-based supervision

Risk-based planning and management of the intensity of supervision.

In 2011, BaFin performed its third comprehensive review of risk structures at asset management companies. It uses the insights gained in this process to weight 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 35
Risk classification results for 2011

Investment companies		Quality of investment companies				
		A	B	C	D	Total
Impact	High	30	3	2	0	35
	Medium	12	1	1	0	14
	Low	16	5	0	0	21
	Total	58	9	3	0	70*

* No classification has yet been performed for the five asset management companies that received licences in 2011 to perform asset management in accordance with the InvG. A final classification is still pending for another two companies.

6.2 Investment funds

Financial and liquidity risks due to the crisis.

BaFin's work focused on examining financial and liquidity risks at German special funds. In particular, BaFin asked for regular reports on investments in bonds issued by some eurozone countries. 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 three funds of funds in 2011. The asset management companies have meanwhile terminated the management of two of these funds of funds. After the end of the notice period, the funds must be liquidated. BaFin continued to request daily information on the portfolio structure and liquidity of funds of funds holding units in real estate funds as target funds.

Apart from these three funds of funds and the open-ended real estate funds that suspended the redemption of units in 2011 due to the crisis, no other investment funds had to be closed. The two special funds that were still closed at the end of 2010 remained closed in 2011.

Large variations persist in results of operations in spite of the upward trend.

The audit reports analysed by BaFin showed that, in spite of the tangible impact of the financial crisis, the fee and commission income and thus the results of operations of most asset management companies had improved significantly compared with the previous year. Fifty-four asset management companies

reported higher fee and commission income than in the previous year; at six of them, the year-on-year increase exceeded 50%, in some cases substantially so. Sixteen companies had to accept a decline in fee and commission income; in three cases the losses exceeded 20% in some areas.

Number of complaints down significantly.

The number of complaints received in relation to the investment sector declined significantly in 2011 compared with previous years. This permits the conclusion that some calm has returned to the market. Compared with 242 complaints submitted to BaFin in 2010, the number fell to 130 in 2011. The majority again related to the performance of specific funds during the financial crisis.

Investment arbitration board.

To settle consumer law disputes out of court in accordance with the InvG, BaFin established an independent arbitration board as from 1 July 2011. It offers consumers involved in investment law disputes the option to ask a mediator rather than a court to resolve the matter in dispute between themselves and their contracting partners. However, use of the arbitration board is not intended to replace court proceedings, but to offer consumers an additional option for settling disputes.

6.3 Real estate funds

Suspension of fund unit redemption and liquidation.

2011 saw another rise in the number of open-ended mutual real estate funds that first temporarily suspended the redemption of fund units and are now being liquidated, following notice of termination by the asset management company managing the funds. Of the total of 48 open-ended real estate funds, another four funds managed by three asset management companies were unable to reopen the funds permanently within the statutory period of two years.[79] In the previous year, this had been the case at three funds. The asset management companies therefore terminated their management of the mutual real estate funds, giving notice periods of up to three years, so as to be able to liquidate the funds in question. The asset management companies of the funds being liquidated aim to sell all of the funds' properties during the notice

[79] TMW Immobilien Weltfonds (notice of termination effective as from the end of 31 May 2014), DEGI GLOBAL BUSINESS (notice of termination effective as from the end of 30 June 2014), AXA Immoselect (notice of termination effective as from the end of 20 October 2014), DEGI INTERNATIONAL (notice of termination effective as from the end of 15 October 2014).

period.[80] In the case of one mutual real estate fund, all properties have already been sold.[81] From the sale proceeds, the asset management companies distribute half-yearly interim payments to investors, to the extent that the proceeds are not needed to ensure proper ongoing management of the remaining real estate or to settle liabilities. The fund assets left at the end of the notice period will be transferred to the custodian bank, which liquidates the fund and distributes the proceeds to the investors.

2012 a critical year.

For another six mutual real estate funds that suspended the redemption of units in 2010, the decision about whether the funds can be reopened permanently is due to be taken in the course of 2012. In the case of four funds, the two-year period will end in May 2012, and in the case of two funds it runs out in October and November 2012 respectively.[82] Another mutual real estate fund suspended the redemption of units for an initial period of three months in 2011.[83] This means that 14 out of a total of 48 open-ended real estate funds have now suspended unit redemptions or are being liquidated. As a result, over 25% of the money invested in open-ended real estate funds cannot be accessed by unit holders. At supervisory interviews, BaFin asks for regular updates about the latest situation of the funds under suspension or liquidation. In addition, it receives regular written progress reports from the asset management companies dealing with the current sales efforts relating to the real estate funds concerned.

Catastrophe in Japan.

Another asset management company suspended unit redemptions in 2011 as a result of exceptional circumstances (section 37 (2) of the InvG).[84] The reason was that the fund's properties located in Japan – approximately 20% of the fund's value at the time – could not be measured because of the consequences of the earthquake and the proximity of the properties, all of which are located in the greater Tokyo area, to the damaged nuclear reactors in Fukushima. The suspension of unit redemptions was ended after three months, when the real estate experts came to the conclusion that the value of the properties could be measured again.

[80] 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), TMW Immobilien Weltfonds (notice of termination effective as from the end of 31 May 2014), DEGI GLOBAL BUSINESS (notice of termination effective as from the end of 30 June 2014), AXA Immoselect (notice of termination effective as from the end of 20 October 2014), DEGI INTERNATIONAL (notice of termination effective as from the end of 15 October 2014).
[81] KanAm US-grundinvest Fonds.
[82] KanAm grundinvest Fonds, SEB ImmoInvest, CS EUROREAL, AXA Immosolutions (May 2012), UBS (D) 3 Sector Real Estate Europe (October 2012), DEGI GERMAN BUSINESS (November 2012).
[83] SEB Global Property Fund (March 2012).
[84] UniImmo: Global (suspension effective from 16 March 2011 until 16 June 2011).

Large number of complaints.

As a result of the continuing suspension of unit redemptions or the liquidation at 14 open-ended real estate funds, there were again numerous complaints and enquiries in the year under review (91, previous year: 106).

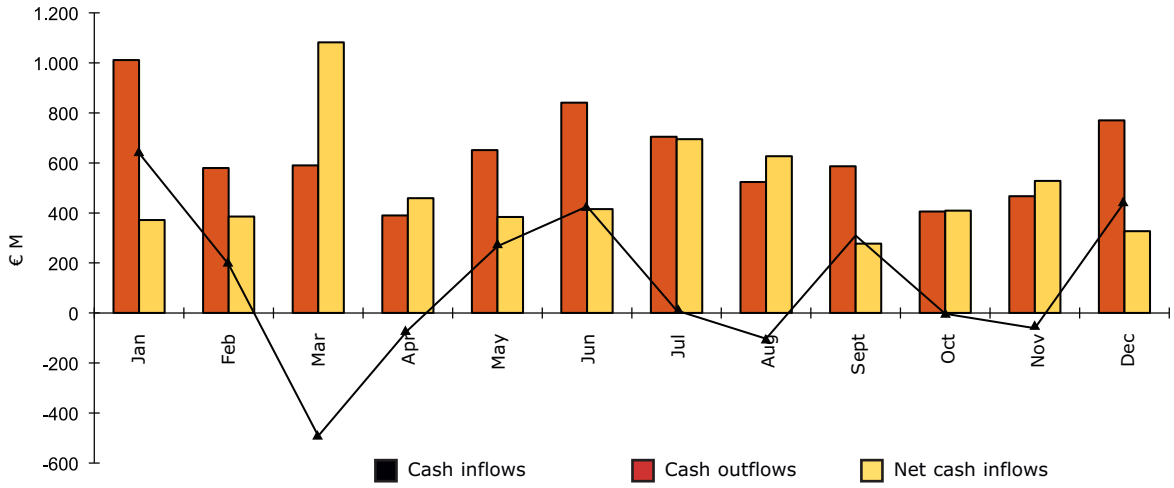
General trends in open-ended real estate funds

At the end of 2011, 21 German asset management companies managed 48 (previous year: 48) mutual real estate funds with an aggregate volume of €86 billion (previous year: €86.6 billion) and 176 (previous year: 153) special real estate funds with aggregate net asset values of €32.8 billion (previous year: €29.6 billion).

Overall, the 48 mutual real estate funds recorded a slight decline in net cash inflows to just under €1.6 billion in 2011 (previous year: €1.9 billion). The fund flows of mutual real estate funds again varied widely across individual months in the year under review.

As in the previous year, BaFin received five applications for permission to carry on the real estate fund business. The companies want to concentrate primarily on business with institutional investors. The trend observed for the past few years of establishing new asset management companies with a strategic business focus on institutional investors thus continued in 2011.

Figure 33
Fund flows of mutual real estate funds in 2011



6.4 Hedge funds

Since the outbreak of the financial crisis, stricter supervision of hedge funds has been an important topic, both nationally and internationally. Their role is currently being examined, in particular in connection with shadow banking.

Impact of the AIFM Directive on German hedge funds.

The Alternative Investment Fund Managers Directive (AIFM Directive) and the transposition proposals published by ESMA on 16 November 2011 will also lead to new regulations for hedge funds when transposed into German law. The Investment Act already includes comprehensive provisions for regulating not only the fund managers, but also the hedge funds. The measures include strict conditions for authorisation and in-depth ongoing supervision by BaFin. However, the supervisory possibilities of detecting systemic risks that may emanate from hedge funds (for example through leverage) are to be improved by subjecting fund managers to additional reporting and information requirements.

Decline in the number of German hedge funds.

At the end of 2011, there were a total of 28 authorised German single hedge funds (including one special fund) plus eight German funds of hedge funds (also including one special fund). While the number of single hedge funds licensed under German law fell compared with the previous year (34), the number of funds of hedge funds remained unchanged. Nine single hedge funds were liquidated, while only three new funds were approved (previous year: 13).

In 2011, BaFin's supervisory activities also included nine supervisory visits and annual on-site interviews at hedge fund asset management companies, including companies with newly launched hedge funds. In addition, BaFin is in constant contact with the supervised companies – with greater intensity in times of crisis.

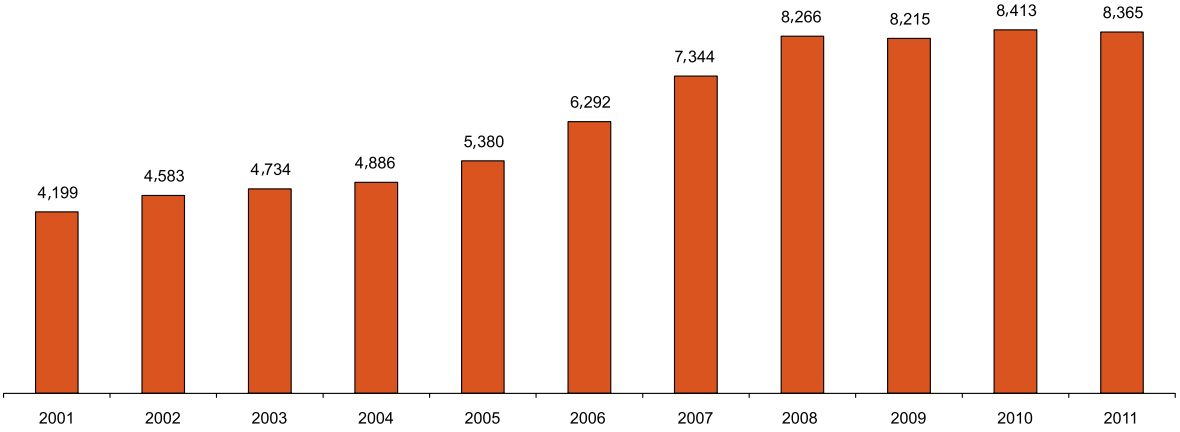
6.5 Foreign investment funds

UCITS funds

Decline in number of distribution notices.

In 2011, BaFin received 752 new distribution notices for UCITS funds. Although a simplified Europe-wide notification procedure between the respective supervisory authorities has been in force since 1 July 2011, the number of new distribution notices fell sharply year-on-year as a result of the financial crisis (previous year: 1,049). The funds authorised for distribution originated above all in Luxembourg, Ireland, France, Austria and Liechtenstein. The total number of foreign UCITS funds authorised for distribution decreased slightly to total 8,365 at the end of 2011 (previous year: 8,413).

Figure 34
UCITS funds

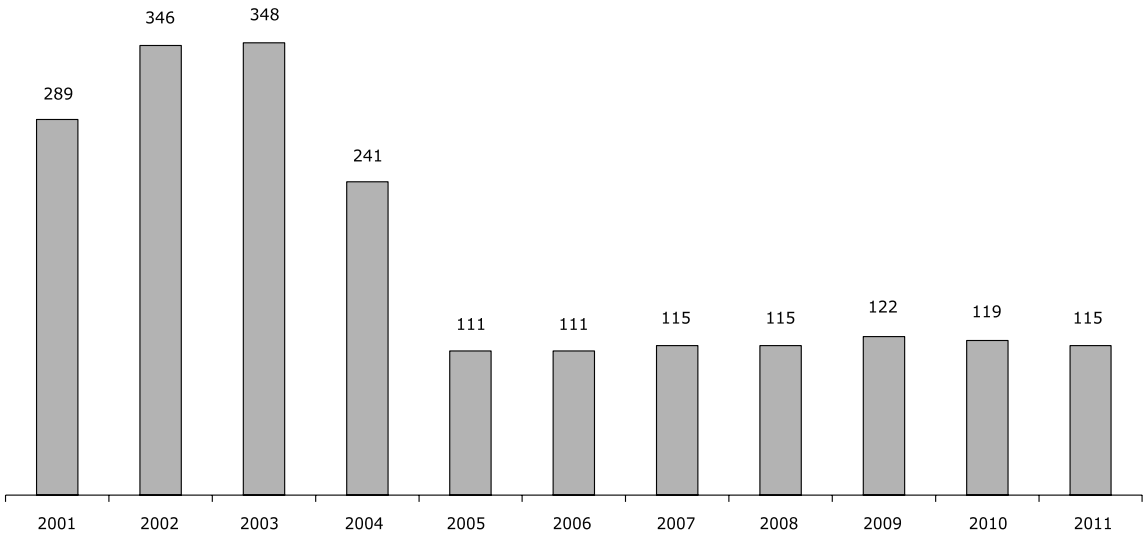


Foreign non-UCITS funds

At the end of 2011, 115 foreign funds were authorised for public distribution in Germany, including three funds of hedge funds. The number of non-UCITS funds authorised for distribution was thus slightly lower than in the previous year (120). A large majority of the funds are domiciled in Luxembourg, although funds from Switzerland, the United States and Austria are also included. Six new funds notified BaFin in 2011 of their wish to distribute foreign investment units in the Federal Republic of Germany (previous year: 5). Three investment funds were authorised to commence public distribution in Germany in 2011 (previous year: 11). Seven investment funds discontinued public distribution (previous year: 13). In one case, BaFin prohibited ongoing public distribution, since the fund was already distributing its units to the public during the notification procedure without authorisation having been obtained. BaFin prohibited seven other non-UCITS funds that had not filed notification from ongoing public distribution because public distribution had not been authorised.

In July 2011, BaFin published an updated version of the guidance notice for notifications by foreign funds under section 139 of the InvG. For example, from the beginning of 2013 onwards, non-UCITS funds will also have to prepare a key investor information document.

Figure 35
Foreign non-UCITS funds



* From 2006 onwards, the statistics also contain foreign funds of hedge funds that have been authorised for distribution.

VII Cross-sectoral issues

1 Deposit protection, investor compensation and guarantee schemes

Michael Sell,
Chief Executive Director of Regulatory Services/Human Resources[85]

BaFin supervises the statutory compensation schemes and bank guarantee schemes governing banks and securities trading companies, as well as the statutory guarantee schemes for life and substitutive health insurance.

Supervision of the Compensatory Fund of Securities Trading Companies

In 2011, BaFin again focused on the Phoenix Kapitaldienst GmbH compensation event. The Federal Court of Justice (*Bundesgerichtshof* – BGH) has now ruled on further legal issues. This puts the Compensatory Fund of Securities Trading Companies (*Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW) in a position to decide on all reported compensation claims; it is planning to do so by April 2012.

BGH rulings relating to Phoenix

Civil Panel XI of the BGH ruled on 20 September 2011 in three parallel proceedings[86] that all compensation claims have now become due. In addition, Civil Panel XI ruled on 25 October 2011 that the EdW had to take trading losses into account. The EdW had done so up to that point. At the same time, the BGH decided that administration charges and trail commissions must not be deducted.[87] As a result, the EdW also has to pay compensation for the trail commissions paid to Phoenix. The BGH argued that – in accordance with the legal concept of section 654 of the German Civil Code (*Bürgerliches Gesetzbuch* – BGB) (activity in breach of contract) – the claim to commission assigned to the EdW had been forfeited. As a result, the EdW did not have any offsetting claim against the party to be compensated. The EdW will therefore have to change its compensation practice accordingly and make additional payments for any trail commissions already deducted. The EdW will take out another federal loan to cover the additional financing requirement.

Civil Panel IX of the BGH had already clarified in 2010 that there are no rights of separation of the assets secured by the insolvency administrator.

[85] Michael Sell joined the Federal Ministry of Finance in May 2012.
[86] Case ref.: IX ZR 434/10, 435/10 and 436/10.
[87] Case ref.: XI ZR 67/11.

By 10 February 2012, the EdW had approved approximately 58,500 decisions amounting to a total of approximately €238 million. Of these, 16,780 are second-round decisions that became necessary because, in the first round of determining the compensation claims, the EdW had applied a deduction for possible rights of separation of assets.

Supervision of the Compensation Scheme of German Banks

Contributions will be levied with greater focus on risk.

Starting in 2012, the Compensation Scheme of German Banks (*Entschädigungseinrichtung deutscher Banken GmbH* – EdB) will levy its contributions with a greater focus on risk. The Regulation on Contributions to the Compensation Scheme of German Banks (*Beitragsverordnung der gesetzlichen Entschädigungseinrichtung deutscher Banken* – EdBBeitrV) was reformed in 2011.[88] It will be applied for the first time in the 2011/2012 settlement year. The calculation of the annual and special contributions to be made by the institutions will in future also take into account their risk of triggering a compensation event. Before the amendment, the Contribution Regulation of the EdB had based contributions only on the "liabilities to customers" balance sheet item and thus on the potential extent of compensation claims. Although this reference variable measures the possible compensation volume, it is not indicative of the institutions' actual credit risk because it does not take into account specific risk factors, such as the business model or the risk position and profit or loss. Institutions with a higher credit risk will now have to pay higher contributions than institutions whose risk is lower. The contributions will not change for institutions exposed to average default risk. The total amount of contributions collected by the EdB will remain approximately the same.

BaFin, together with the EdB, the Auditing Association of German Banks (*Prüfungsverband deutscher Banken e.V.*) and GBB-Rating Gesellschaft für Bonitätsbeurteilung mbH, started to develop a model for the new system of levying contributions in 2010. A new component is a credit rating factor, half of which is based on key indicators – for example the Tier 1 ratio, own funds ratio, return on equity – and the other half on ratings of the institutions. This factor is 0.75 for institutions with a very low risk profile, 1.0 for those exposed to average risk and 2.0 for institutions with very high risk levels. The annual contribution amount is calculated by multiplying the existing contribution rate of 0.016% of the amounts due to customers by the credit rating factor. The system is based on the voluntary Deposit Protection Fund of the Association of German Banks (*Bundesverband deutscher Banken* – BdB), which has already proved itself in practice.

[88] Federal Law Gazette (BGBl.) I 2011, p. 2684.

2 Authorisation requirements and pursuit of unauthorised business activities

2.1 Authorisation requirements

BaFin examines whether investment and retirement savings offerings require authorisation and pursues companies operating without the necessary authorisation. Providers have the opportunity to ask BaFin to examine whether authorisation is required for a planned business venture. This allows them to make sure that they comply with legal requirements. If a business requires authorisation, it may only be carried on once BaFin has granted written authorisation. BaFin may prohibit providers operating without such authorisation from carrying on the business and force it to be unwound. In addition, such conduct is punishable by law.

716 enquiries about authorisation requirements.

In 2011, BaFin examined 716 requests to examine whether an authorisation was required for planned business ventures (previous year: 937). Of the requests, 576 related to the Banking Act (*Kreditwesengesetz* – KWG), 21 to the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) and 119 to the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG).

Guidance notices on payment services, financial instruments and investment clubs.

To help market participants ascertain as early as possible whether their business venture requires authorisation, BaFin published additional guidance notices in 2011.

One comprehensive guidance notice explains the new payment services under the ZAG. Among other things, it deals with the e-money business, which has been removed from the list of banking business transactions in the KWG and is now covered by the ZAG in modified form. The guidance notice explains what activities are authorised and what transactions are prohibited. For example, the lending business is allowed, even though it is subject to very strict conditions; there is, however, a general prohibition on the acceptance of repayable funds.

Another guidance notice deals with selected financial instruments. It explains how securities, money market instruments, foreign exchange and units of account are defined.

Lastly, BaFin revised the guidance notice on the authorisation requirement for investment clubs and their managing directors. Investment clubs taking the legal form of a civil law partnership (*Gesellschaft bürgerlichen Rechts* - GbR) are associations of natural persons who have joined together to invest their assets collectively in securities and other financial instruments, under the

management of one or more managing partners. Key requirements for exemption from the authorisation requirement include, for example, a membership ceiling of 50 people and a limit on funds paid in of €500,000. The guidance notice replaces the previous guidance, in particular in relation to recently updated legal precedents set by administrative courts on principal broking services.

For 2012, BaFin is planning a guidance notice on derivatives, among others. This document will explain what transactions are covered by the definition of derivatives in section 1 (11) of the KWG, for example forward transactions. Another guidance notice will deal with business prohibited under section 3 of the KWG, with particular attention to the prohibition on employee savings banks (*Werksparkassen*) and special purpose savings enterprises (*Zwecksparunternehmen*).

2.2 Exemptions

279 institutions exempted.

BaFin exempted seven companies from supervision for the first time. As a result, a total of 279 institutions were exempted at the end of 2011. BaFin may exempt a company from the authorisation requirement if the nature of its business makes supervision unnecessary. This normally relates to low-level auxiliary or ancillary transactions conducted in association with (principal) business activities that do not otherwise need authorisation.

Providers from third countries outside the EU can also apply to BaFin for exemption if they want to commence cross-border activities in Germany. However, they must be subject to comparable supervision in their home country. Last year, BaFin exempted one foreign company.

2.3 Illegal investment schemes

The fight against illegal investment schemes is essential for safeguarding Germany's integrity as a financial centre and for protecting investors. For this reason, BaFin rigorously pursues banking, insurance and financial services businesses operated without the authorisation required under the KWG, VAG, or ZAG. In cooperation with the Deutsche Bundesbank, it determines the precise transaction processes. BaFin takes action against providers of unauthorised business – irrespective of any criminal proceedings. It coordinates its action with the police and the public prosecutors.

Higher sentences threatened for perpetrators.

Since 30 April 2011, providers of unauthorised business have to expect higher sentences. In cases of intent, the maximum jail term is now five instead of the previous three years. For offences committed negligently, the maximum term has been increased from one to three years. In addition, public prosecutors are obliged

to give BaFin an opportunity to comment if they intend to discontinue preliminary investigations. In the interest of customer protection, the intention is to give violations of the authorisation requirement a comparable weight in criminal prosecutions as financial crimes under the German Penal Code, such as breach of fiduciary duty and fraud.

BaFin's sanctions enforceable immediately.

Since the end of June 2011, threats and impositions of sanctions (especially coercive fines) that BaFin uses to enforce its measures against unauthorised transactions have been immediately legally enforceable. This means that objections and legal challenges by those affected do not have a suspensive effect on such action.

Court rulings on the purchase of second-hand life insurance contracts

In pilot proceedings, the Administrative Court in Frankfurt am Main confirmed the prohibition imposed by BaFin on the purchase of life insurance contracts and financial investments.[89] The business model involved a provider – acting as the authorised agent of customers – cancelling the life insurance contracts and financial investments of those customers and having the capitalised surrender value paid out to it. The provider paid part of this value to customers only if they specifically requested this. However, the provider retained the remaining amount for a contractually specified period of up to ten years. In return, it promised to pay the customers a total amount of money that was up to twice as high as the surrender value actually obtained as a result of cancelling the life insurance policy or financial investment. In BaFin's opinion, this constituted deposit business that required authorisation; it prohibited the business and ordered the transactions to be reversed. The provider resisted BaFin's decision.

The court confirmed BaFin's decision. In an overall assessment, which took into account general banking practice, the court ruled that the use of certain contractual arrangements or a specific type of contract was not material to classifying a transaction as deposit business. The contract terms and conditions had been agreed with the objective that the provider would cancel the life insurance policy or financial investment, have the surrender value to which the customer was entitled paid out to it and retain this amount. The provider has lodged an appeal against the judgement. To date, no ruling has been made on it; the judgement is therefore not yet final.

BaFin conducted further proceedings in 2011 because of unauthorised deposit business being carried on in connection with the purchase of second-hand life insurance contracts or other financial investments. It will continue to pursue such proceedings in 2012 and seek binding clarification of individual cases by an administrative court.

[89] Judgement dated 11 July 2011, case ref.: 9 K 646/11.F.

Lawyer's duty of confidentiality not incompatible with requests for information and the submission of documents.

In December 2011, the Federal Administrative Court (*Bundesverwaltungsgericht*) ruled that BaFin could also issue a request for information and the submission of documents to a lawyer. The court clarified that, under the German Federal Lawyers Code (*Bundesrechtsanwaltsordnung*), a lawyer's duty of confidentiality was not an absolute requirement, but applied only within the limits of existing laws, in this case therefore the KWG. Accordingly, BaFin could also approach a lawyer if its attempts to obtain the necessary information from the client about his or her business activities were not successful. In the case on which the judgement was based, the lawyer had accepted significant amounts of money into his private account on behalf of his client. The purpose specified for each transfer pointed to a financial investment and gave grounds for suspecting that it concerned deposit business that required authorisation.

Supervisory and investigative measures

689 new investigations.

In 2011, BaFin launched a total of 689 new investigations (previous year: 627). Only 38 concerned the unauthorised operation of insurance business (previous year: 21). Payment services under the ZAG led to investigation proceedings in 67 cases (previous year: nine). At 584, most supervisory measures related to unauthorised banking and financial services transactions, as in the previous year (597). BaFin issued formal requests for information and the submission of documents to suspicious companies in 55 cases (previous year: 46) und and imposed coercive fines in 22 cases (previous year: eight). It performed eight searches of premises (previous year: seven).

Twelve prohibition orders and 19 wind-up orders.

BaFin issued 12 prohibition orders (previous year: 40) and 19 wind-up orders in 2011 (previous year: 18). A liquidator was appointed in two cases. BaFin takes formal measures in all cases where a provider does not discontinue its unauthorised business operations voluntarily. It can also formally instruct individuals and companies that are – knowingly or not – involved in the initiation, signature and settlement of unauthorised business transactions by third parties, for example Internet or other telecommunication services providers. BaFin used these powers in 12 cases in 2011 (previous year: 10).

Legal remedies against BaFin measures.

In 2011, individuals or companies against which BaFin had taken formal measures filed objections in 33 cases (previous year: 36 cases). BaFin completed 24 objection procedures (previous year: 198), eleven of them on the basis of objection notices (previous year: 91).

Some affected parties took legal action against supervisory measures. The courts handed down rulings in a total of 16 cases in 2011 (previous year: 33), of which 14 were in favour of BaFin (previous year: 31) and two in favour of the affected parties (previous year: two).

3 Money laundering prevention

3.1 International anti-money laundering activities and national implementation measures

BaFin was actively involved in the drafting of new international standards and national laws in 2011.

Revised FATF Standards approved.

In February 2012, the Financial Action Task Force (FATF) approved its revised recommendations. The objectives of the FATF are to set international standards for combating money laundering, terrorist financing and proliferation financing. The Recommendations of the FATF were restructured in February 2012 and contain interpretation notes that have been expanded to provide additional information. The revised Standards follow a risk-based approach more closely than was previously the case. The requirements that apply to the identification and verification of the identity of beneficial owners that are legal persons or legal structures and to preventive measures against corruption have been expanded. Each FATF member state is called upon to conduct a national risk analysis for all sectors of the economy and to base its countermeasures on this analysis.

Act to Implement the Second E–Money Directive.

The Act to Implement the Second E–Money Directive (*Gesetz zur Umsetzung der Zweiten E-Geld-Richtlinie*), which was promulgated on 8 March 2011, provides new rules for solvency supervision of issuers of e-money (e-money institutions). Since the activities of e-money institutions and payment institutions are often closely interlinked, the provisions for e-money institutions have been integrated into the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG). The group of parties subject to the requirements of the Money Laundering Act (*Geldwäschegesetz* – GwG) has been expanded in this context to include the agents of institutions.

The Act also makes changes relevant to money-laundering law in the KWG and the VAG. For example, the institution's or insurance undertaking's obligation to investigate doubtful or unusual circumstances has been expanded, and additional requirements have been included for situations of low or increased risk exposure. The amendments made to the Audit Report Regulation (*Prüfungsberichtsverordnung* – PrüfbV) for institutions are intended to lead to higher-quality audit reports and thus improve the standard of risk classification of the institutions as part of effective risk-based supervision.

Impact of the Act to Combat Tax Evasion and Money Laundering (*Schwarzgeldbekämpfungsgesetz*).

Since the beginning of May 2011, insider trading and market manipulation have been part of the predicate offences of a money laundering offence in accordance with section 261 of the German Penal Code (*Strafgesetzbuch* – StGB). This results in particular in parties subject to the requirements of the GwG having to report

instances where assets are suspected of originating from a predicate offence under section 261 of the StGB. BaFin is also subject to a reporting requirement vis-à-vis the investigating authorities and the Financial Intelligence Unit if it receives information about insider trading and market manipulation as part of its activities.

Act on Optimising the Prevention of Money Laundering.

The Act on Optimising the Prevention of Money Laundering (*Gesetz zur Optimierung der Geldwäscheprävention*) contains amended and, in some cases, stricter rules applicable to all parties subject to its requirements. Measures relevant to the financial sector include amendments in relation to general, simplified and enhanced due diligence requirements as well as to internal safeguards against money laundering, and changes to the requirement to report suspicious transactions. In addition, the definition of beneficial owner has been described in greater detail.

Working group publishes guidance on administrative practice.

The Anti-Money Laundering Working Group (*Gemeinsame Arbeitsgruppe zur Geldwäscheprävention* – GwAG) of the Federal Ministry of Finance (BMF), BaFin and the German Banking Industry Committee (*Die Deutsche Kreditwirtschaft*) developed a large number of interpretation and application guidelines for the prevention of money laundering in 2011. They relate for example to substantive and organisational requirements on the prevention of other punishable offences that may compromise the institution's assets, such as actions with fraudulent intent, misappropriation of property and violations or circumventions of regulations relevant under criminal law. Since March 2011, all institutions have had to establish a central office, which must be headed by the anti-money laundering officer. The intention is to improve and coordinate more closely the relevant safeguards the institutions implement to combat money laundering, terrorist financing and other punishable offences. BaFin published the requirements for the other parties subject to the requirements under the KWG in its Circular 7/2011 (GW).

In addition, the GwAG resolved more detailed guidance on the position of the anti-money laundering officer, which was published in February 2012.

3.2 Anti-money laundering activities at banks, insurers, financial services institutions, payment institutions and agents

32 special audits.

As part of its anti-money laundering supervision, BaFin conducted 32 special audits at credit institutions. By the end of 2011, most institutions had not yet fully implemented the regulations, which have been in force since March 2011. Although safeguarding mechanisms have been put in place in various areas, especially against punishable offences that may compromise the institution's assets, there is often room for improvement in relation to the necessary systematic capture and assessment, as well as

coordination by an independent unit. BaFin and the German Banking Industry Committee agreed, in consultation with the BMF, initially not to object to any shortcomings identified in this regard until the end of March 2012. Many banks only addressed this issue towards the end of the year and established a central office.

Politically exposed persons.

Special anti-money laundering requirements, for example the clarification of the origin of funds transferred or stricter monitoring of business relations, apply to foreign politically exposed persons. BaFin examined in 2011 how major banks deal with persons who come from countries with dictatorial regimes. It found that the institutions questioned met the stricter requirements the Act imposes for this group of persons. However, because of the shortcomings in the prevention of money laundering and the local administrative conditions in many of these countries, the banks are in many cases unable to determine the origin of funds.

Prevention of money laundering at insurers.

BaFin's own audit teams conducted special audits at eight life insurers to examine the status of money laundering prevention and the measures taken against terrorist financing. One of the problems they identified was how the relief granted by section 80f (1) of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) is applied, under which the requirement to identify a policyholder is deemed to have been met if the premium is collected by direct debit from an account of the policyholder. De facto, however, this legal fiction of identification is ineffective, because in preparation for the future Single European Payment Area (SEPA), banks are no longer required to check whether an account belongs to the specified account holder. A policyholder can therefore specify any account, and no check is carried out as to whether it is in fact the policyholder's account from which the premiums originate.

In addition, BaFin identified shortcomings in the treatment of beneficiaries: in particular in cases where the beneficiary and the policyholder are not the same person, the beneficiary's identity was often not checked. Moreover, where the person paying the premiums, who is usually also the beneficiary of the life insurance, is not the same person as the policyholder, his or her identity was often not sufficiently determined.

4 Account information access procedure

Account information access procedure used extensively.

According to police crime statistics, financial and computer crime, and in particular fraud, experienced rapid growth in 2010. For this reason, the renewed increase in the number of requests for account information in 2011 was due in particular to requests for information from authorities conducting investigations in this area. For BaFin too, however, requests for account information continue

to be an important way to acquire facts. The table below shows the growth in enquiries and their breakdown by the different account information recipients.

Table 36
Account information recipients

Account information	2011		2010	
recipients	absolute	in %	absolute	in %
BaFin	757	0.6	1,371	1.3
Tax authorities*	13,122	11.2	13,673	12.9
Police authorities	69,330	59.3	58,477	55.4
Public prosecutors	25,997	22.2	23,765	22.5
Customs authorities*	7,316	6.3	8,054	7.6
Other	386	0.3	275	0.3
Total	**116,908**	**100**	**105,615**	**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.

Quality defects in account information access files.

The success of the account information access procedure – an elementary tool in the pursuit of money laundering, other criminal offences and unauthorised business transactions – depends crucially on the accuracy of the data stored. It is particularly important for the names of account holders and other authorised users to be on the one hand as complete as possible, but on the other free from additions that are not part of the name, such as "RA" (lawyer) or "trustee".

Joint working group comprising BaFin, BMF and banking associations.

In one particularly serious case, where first names had not been stored in full for 80% of the accounts examined, BaFin imposed an administrative fine of €25,000 in 2011.

BaFin performed on-site inspections at eight banks. During these inspections, it sampled the data relating to account holders and other authorised users the banks had collected during identification and authentication checks and stored in the account information access file. Although the procedure is often sufficiently regulated on the basis of work instructions and backed by the appropriate technical support, there was evidence in many cases that the institutions had not transferred the data correctly to the access file. Meanwhile, the audited banks have developed and, in some cases, implemented processes such as technical checks, to improve data quality. BaFin will conduct follow-up investigations to determine whether the institutions have taken appropriate measures to improve the quality of account information access files.

5 Consumer complaints and enquiries

The number of clients of insurers, credit institutions and financial services institutions who contacted BaFin with complaints, enquiries, or information in 2011 was 21,547 (previous year: 20,941). Complaints often provide important information on potential violations of supervisory provisions.

In the event of a violation, BaFin issues a warning to the institution or company and requires it to take measures to prevent future defects. If there are organisational defects, it works to ensure organisational changes and subsequently monitors their implementation.

Investors should conduct their own careful checks to establish whether the offerings are trustworthy and financially plausible in order to protect themselves against fraud, dubious products, or the total loss of the invested capital. Unfortunately, it is impossible to provide total protection against insolvency and criminal offences.

Internet sweep on consumer credit.

In autumn 2011, BaFin took part for the first time in an Internet sweep on consumer credit led by the European Commission in the EU and EEA member states. Together with the Federal Office of Consumer Protection and Food Safety (*Bundesamt für Verbraucherschutz und Lebensmittelsicherheit* – BVL) and the Centre for Protection against Unfair Competition (*Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V. (Wettbewerbszentrale)* – WBZ), it examined for this purpose the websites and online credit offerings of 26 providers for possible violations of the advertising rules and information requirements governing consumer credit.

For example, the providers of credit on the Internet are obliged to state the total cost of a loan, i.e. in addition to the pure loan amount they also have to disclose the interest charges as well as origination fees and selling expenses. Moreover, the consumer must be able to ascertain immediately who is offering the loan and where the provider is domiciled. In addition, the advertising must be based on representative terms and conditions, i.e. those actually offered in the contracts of at least two-thirds of interested consumers. In the past, providers often advertised interest rates granted to only a small proportion of those interested because of their special financial standing.

The analysis of the Internet sweep revealed that many providers violate the information requirements and advertising rules. For this reason, BaFin called on the umbrella associations of the German banking industry to warn their members to comply with the legal framework applicable to consumer credit. At the same time, the WBZ, which is the primary designated office within the meaning of the Consumer Protection Enforcement Act

(*Verbraucherschutzdurchsetzungsgesetz* – VSchDG), pursued the violations and issued formal warnings to the providers concerned. BaFin will check regularly whether the consumer protection regulations are being complied with. In accordance with the VSchDG, it is responsible for enforcing the law in case of national and cross-border violations of consumer protection requirements for financial services.

BaFin consumer protection forum

BaFin held its second consumer protection forum in October 2011. The event put the spotlight on "consumer protection and supervision" and "out-of-court dispute resolution in the finance industry". The approximately 200 high-ranking representatives from politics, academia, the corporate sector and associations, as well as supervisory authorities, exchanged views on the possibilities and limits of supervision in financial consumer protection as well as the advantages and disadvantages of extra-judicial arbitration bodies. The significance of consumer protection in financial services is increasing for supervisory authorities, in part in view of the developments in Europe. Greater transparency for consumers, higher quality of advice provision and more information for clients – these are the key demands voiced time and again in response to the financial crisis. BaFin is closely involved at the interface between consumers and supervised entities. If there are problems between providers and clients, the ombudsman services are an important contact point for many consumers.

Consumer hotline

BaFin's consumer hotline received a total of 27,313 enquiries in 2011 (previous year: 28,518). In view of the financial crisis, the main focus was deposit protection. For example, many worried customers of the Greek insurance undertaking VDV Leben International S.A. (VDV), which also conducted its business in Germany until the beginning of 2011, contacted the consumer hotline to enquire about the latest situation and ways to make a complaint. The Greek insurance supervisory authority had frozen the assets of the life insurance undertaking and prohibited it from renewing existing policies and from writing new business. Overall, the calls were relatively evenly split between the insurance sector (42.2%) and the banking sector (41.8%). Only 10% of the enquiries related to the securities sector. Since March 2011, consumers have also been able to contact BaFin under the Germany-wide government hotline number 115. Consumers can also find help on BaFin's website. The FAQs under the Consumers navigation point were completely revised at the beginning of 2011.

5.1 Complaints about credit and financial services institutions

In 2011, BaFin processed a total of 6,660 submissions relating to credit and financial services institutions (previous year: 6,575), of which 6,073 were complaints and 587 general enquiries. The figure includes 39 cases where 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 favour of clients in 1,215 cases (including 4 petitions).

Table 37
Complaints by group of institutions

Private commercial banks	3,298
Savings banks	1,194
Public-sector banks	119
Cooperative banks	827
Mortgage banks	19
Building and loan associations	308
Financial services providers	80
Foreign banks	228
Total	**6,124**

Selected cases

As in previous years, the complaints related to all major segments of the banking business.

Tax certificate delays continue.

In 2011, some institutions again sent out annual tax certificates with a delay. BaFin took action to ensure that these institutions institute measures to avoid this in future. Other submissions related to the taxation of investment income from securities transactions. Here, BaFin was able to arrange in various cases that clients obtained a transaction statement they could understand.

Garnishment protection account.

Launched in July 2010, the garnishment protection account (*Pfändungsschutzkonto* – P account) allows debtors affected by bank account garnishment to participate in non-cash payment transactions and dispose over the non-garnishable portion of their income with relative ease. The introduction of the P account has led to improved consumer protection against garnishment; nevertheless, 96 consumers complained about the incorrect collection of non-garnishable amounts. A continuing problem is that only clients who already have a current account with a credit institution are entitled to convert it into a garnishment protection account. There is still no statutory right to open a current account. In cases where a consumer – for whatever reason – cannot open an account with a credit institution, the new garnishment protection account tool is not helpful. In addition, there were frequent complaints about the permitted level of account management fees and the – in some cases limited – range of services (for example no girocard and no online banking). The law does not provide any guidance in this regard. For accounts

managed on a credit-only basis, such restrictions are necessary, however.

Early repayment penalty.

The issue of the permissible amount of an early repayment penalty was again the subject of some enquiries and complaints in 2011. Consumers repaying their mortgages before the end of the agreed contract term because they had sold their house contacted BaFin because they found the early repayment penalty levied by their bank unreasonably high. The bank is entitled to make this charge if a loan is repaid early because the mortgaged property is sold (section 490 (2) of the BGB). However, the bank cannot set the amount at its own discretion. Based on a number of rulings[90], legal precedents have established clear guidance: the loss must be calculated on the basis of reinvesting the amount repaid early in mortgage *Pfandbriefe*, i.e. the interest income from the loan the bank has foregone is offset against the income from the reinvestment. The resulting loss amount is reduced by deducting the risk and administrative costs the bank has saved as a result of the early repayment. At the same time, the bank is entitled to charge a fee for calculating the loss. In the cases that bank clients had submitted for examination, BaFin had no reason to object to the calculated compensation amounts. The banks had adhered to the criteria specified for calculating the loss and the charges were within the corridor set by court rulings.

Fees for sending account statements.

In its judgement of 8 April 2011, the Regional Court in Frankfurt am Main ruled that banks may not charge fees for sending customers unsolicited account statements.[91] Banks have a general obligation to inform customers with payment transaction accounts of payment transactions on a monthly basis. Institutions send out mandatory account statements whenever customers fail to retrieve them in good time using the agreed method (online or on the bank's statement printer). The question of whether clients have to pay for the postage costs incurred by sending the statements has not yet been resolved. Many bank customers complained to BaFin about the fees they had been charged. The complaints revealed, however, that the institutions did not levy any fees other than postage, and in some cases even waived that.

Account management fees for loan accounts.

The BGH declared account management fees for loan accounts inadmissible in its judgement of 7 June 2011[92]. Bank customers enquired of BaFin for what period the credit institutions were required to make a refund. The regular limitation period in these cases is three years. Other customers pointed out that the credit institution was now charging a fee for an annual account statement. These complaints have not yet been finalised.

Fees for using other credit institutions' ATMs.

Since 15 January 2011, the fee for using an ATM is determined by the institution that operates the machine and is displayed on the screen. This allows customers to see all the fees they will be

[90] BGH, judgements dated 1 July 1997 (case ref.: XI ZR 267/96) and 7 November 2000 (case ref.: XI ZR 27/00).
[91] Case ref.: 2-25 O 260/10.
[92] Case ref.: XI ZR 388/10.

charged before they use the ATM and to decide on this basis whether they want to proceed. In addition, many institutions now charge a significantly lower usage fee than before. BaFin received a few complaints from customers that the advance displays had not worked and ensured this was corrected.

Recall of benefits overpaid by public authorities.

One submission related to a case where a job centre had on two occasions transferred subsistence benefits of approximately €42,000 to a customer. It was clearly evident that the customer could not be entitled to amounts of this magnitude. The customer withdrew €35,000. After that, the institution blocked the account and returned the remaining amount of €49,000 at the job centre's request. Although in principle direct credit transfers are final, there are agreements between public authorities and the associations of credit institutions for payments from public authorities, under which overpayments, for example pension payments made after the death of the beneficiary, can be recalled. The customer's lawyer complained to BaFin that the account had been blocked without an enforceable order or court order awarding title having been issued. BaFin considered these accusations unfounded. It was evident that the customer had disposed over funds to which she was not entitled and attempted to dispose over additional amounts. In such cases it must be possible to block an account temporarily until a formal order is available. The institution received this order subsequently and filed a complaint against the customer's lawyer with the Chamber of Lawyers (*Rechtsanwaltskammer*), because he had attempted to enforce claims by his client that clearly did not exist.

Termination of home savings contracts with savings levels that exceed the targeted savings amount.

Various building and loan associations have started to terminate home savings contracts where the amount saved has exceeded the targeted savings amount. Several home savings customers complained that this practice was not compliant with the contract. The general home savings contract terms and conditions do not contain any guidance on this matter. The institutions invoke the principles of the BGB.

In the cases of which BaFin is aware, the ombudsmen of the Federation of Private Building and Loan Associations (*Verband der Privaten Bausparkassen e.V.*) and individual courts regarded a notice period of three months as legitimate. The matter has yet to be ruled on at the highest instance.

New authentication process for online banking.

To improve online banking security, most credit institutions are discontinuing the iTAN procedure. For generating transaction numbers (TANs), their customers have the option to use either a TAN generator or what is known as the mTAN system. The TAN generator can be purchased from the institutions at a fee. Alternatively, bank customers may have the transaction number sent to a mobile phone via SMS.

Several customers complained about the cost they incur as a result of the new procedures. The credit institutions argue that in most cases customers use a mobile phone to generate TANs and would

therefore not incur any additional costs for receiving notification by SMS. Besides, as an alternative, TAN generators are available at subsidised prices.

Customers who find the cost of buying a TAN generator too high or for whom the number of planned payment instructions does not justify the purchase can use the free mTAN procedure as an alternative. The question of which procedure is more appropriate for the customer depends ultimately on individual user behaviour.

5.2 Complaints about insurance undertakings

In 2011, BaFin processed slightly more complaints year-on-year, finalising 13,616 compared with 13,258 in 2010. The submissions received comprised 11,485 complaints, 630 general enquiries not based on a complaint and 113 petitions that BaFin received via the Bundestag or the Federal Ministry of Finance. In addition, it received 1,388 submissions that did not fall within its remit.

Among the completed procedures, 1,991 complaints related to the mass complaints procedure about mutual funds, which falls under liability insurance. Because the facts and the legal situation are unclear and final clarification is reserved for the courts, BaFin is unable to make a final assessment of the content.

Taking this special factor into account, the complainants were successful in a total of 24.8% of the proceedings (previous year: 30.7%), while 63.3% of the submissions were unfounded and in 11.9% of the cases BaFin was not the competent authority.

Table 38
Submissions received by insurance class (since 2007)

Year	Life	Motor	Health	Accident	Liability	Legal expenses	Building/ household	Other classes	Other complaints*
2007	4,919	1,687	1,924	973	1,144	1,045	1,532	505	1,696
2008	4,941	1,600	2,157	870	949	1,004	1,387	569	1,634
2009	4,490	1,431	2,259	726	907	913	1,372	568	1,608
2010	3,512	1,640	2,326	606	755	763	1,118	413	2,125
2011	**3,230**	**1,390**	**2,218**	**459**	**674**	**741**	**898**	**400**	**1,615**

* Wrong address, brokers, etc.

At 39.02%, the most common complaint by consumers related to claims administration or the adjustment of life insurance benefits (previous year: 29.6%). These were followed by complaints on contract handling (20.48%; previous year: 24.3%), contract termination (12.17%; previous year: 14.6%) and contract negotiation (7.26%; previous year: 8.5%). Within these general categories, the following reasons were the most commonly given.

Table 39
Reasons for complaints

Reason	Number
Liability issues (reason/ratio)	2,331
Amount of insurance payment	1,150
Termination	1,103
Claims handling/delays	1,070
Coverage issues	999
Advertising/advice/application processing	729
Policy alterations and extensions	576
Changes and adjustments to premiums	564
Tariff issues/no-claims classes	470
Contributions, dunning	427

Selected cases

Limited entitlement insurance that takes provision for increasing age into account.

One insured person applied to have their existing fully comprehensive health insurance suspended. They referred in this case to the fact that they were now required to insure under the statutory health insurance system. Policyholders can continue their private health insurance policy as entitlement insurance (section 204 (4) of the Insurance Contracts Act (*Versicherungsvertragsgesetz* – VVG)). In this way, they retain the rights acquired under the contract. To this end, the insurance undertaking had proposed to the insured person a limited entitlement insurance policy (without retaining the provision for increasing age already accrued) or alternatively a comprehensive entitlement insurance policy (with accrual of an additional provision for increasing age). BaFin called on the insurance undertaking to offer limited entitlement insurance in such cases, but in a version that already takes into account (preserves) the accrued provision for increasing age, without at the same time providing for the accrual of an additional provision for increasing age. The undertaking said it was prepared to develop a corresponding product. It gave an assurance that the insured persons affected up to that point would not be disadvantaged as a result of this delay.

Retention has no impact on premium level in basic tariff.

When increasing premiums, health insurance undertakings have to inform their clients that they have the right to change tariffs under section 204 of the VVG. If clients switch to the basic tariff, the way the tariff is calculated may result in constellations where a retention does not have any impact on the premium payable. Although the contribution for the basic tariff is also determined dependent on the insured person's age and gender, the premium calculated in this way must not exceed the maximum contribution (recalculated each year) for the statutory health insurance system.

Consumer complaints alerted BaFin to the fact that some insurers had not pointed this out clearly in their adjustment notices. If the insured persons had been informed, they could have dispensed with their retention without any negative impact on their premiums. BaFin has advised the insurance undertaking of this defect. The undertaking has promised to inform its clients in future and in addition to review its client base and pay financial compensation to the policyholders affected.

Certificate of continuing insurance when contract is cancelled.

One complainant applied for health insurance cover starting on 1 June. The insurance undertaking confirmed this cover in an insurance policy dated 29 June. On 8 July – and therefore within the 14-day revocation period specified in section 8 (1) of the VVG – the insurer received notice of contract revocation. Subsequently, in view of the existing compulsory insurance requirement, the undertaking asked the complainant to submit a certificate of continuing insurance. The certificate revealed that she had only been covered by compulsory insurance since 17 June, so that there was a gap in coverage for the period from 1 to 16 June. The insurance undertaking charged a proportionate premium for this period.

BaFin advised the insurer that, in accordance with section 205 (6) of the VVG, a certificate of continuing insurance may only be demanded in the case of termination, but not in the case of revocation. BaFin did not agree with the undertaking's argument that the policyholder could evade the compulsory insurance requirement in this way. When cancelling a policy, the policyholders were themselves responsible for meeting their compulsory insurance requirements. If they do not meet this requirement in time, they have to pay a premium supplement after resumption of cover in accordance with section 193 (4) of the VVG. This significantly limits the possibility of evading the compulsory insurance requirement.

At BaFin's request, the insurance undertaking will in future refrain from requesting submission of a certificate of continuing insurance. The insurer cancelled the complainant's contract and refunded the proportionate premium it had withheld up to that point.

Incorrect benefit statements for funeral expenses insurance contracts.

A complaint alerted BaFin to the fact that an insurer had sent out incorrect benefit statements for approximately 59,000 policies in a certain tariff category. They showed not the profits that had accrued, but the profits extrapolated to a final age of 101 years. In response to pressure by BaFin, the insurer subsequently sent out corrected benefit statements. BaFin had actuarially verified the amended figures and raised no objections.

However, insured persons cannot normally derive claims in excess of the contractual arrangements from incorrect benefit statements, providing that the non-binding nature of future profit performance has been sufficiently highlighted.

BaFin informed the complainant of this fact as well as of the option of asserting any claims against the insurer through the courts.

Level of origination and other fees for Riester contracts.

Some insured persons complained about the level of origination and other fees charged for their Riester contracts. Since a mathematical check had revealed inconsistencies in the fee calculations, BaFin asked the insurer in question for comment. The insurer confirmed that an error in the administration system had led to incorrect fee calculations for calendar years 2006 and 2009. The undertaking announced that it would correct all of the approximately 4,100 contracts affected and inform the policyholders accordingly.

Compensation procedure for VDV Leben International S.A.

In 2010 and 2011, BaFin received numerous complaints relating to the Greek insurance undertaking VDV. Many complainants took exception to the fact that payments had not been made after expiry or termination. BaFin subsequently informed the Greek insurance supervisory authority, the Private Insurance Supervisory Committee (PISC), which, following further checks, placed a restriction on VDV and prohibited it from writing new business. After PISC's responsibilities had been transferred to the Bank of Greece, the latter withdrew VDV's licence to conduct insurance business on 10 January 2011.

In March 2011, after repeated queries, BaFin was finally informed by the Bank of Greece that the former policyholders of VDV could submit claims to Greece's Private Life Insurance Guarantee Fund (PLIGF). It therefore informed all complainants that they would have to register on the Guarantee Fund's website and make their claims in writing, with submission of the relevant documents, by 1 April 2011 (subsequently extended to 8 April 2011). Following the announcement at the beginning of September 2011 that PLIGF had calculated the compensation claims, BaFin received an increased number of complaints about claims that had not been paid or about the amount of settlement. On several occasions, complainants voiced their concerns in writing or by telephone that the requested original insurance policy documents might have been lost. Since BaFin does not have any influence on how the compensation procedure is conducted and progresses, it had to refer the affected policyholders to the Greek authorities.

Mass complaints procedure about mutual funds.

2,200 investors, as injured third parties, complained to BaFin in 2011 about two professional indemnity insurers of an audit firm. From the 1990s onwards, the investors had invested in various mutual funds indirectly through the audit firm. As a trustee acting as a limited partner, the audit firm was the link between the investors and the fund companies.

When the expected profits failed to materialise, the investors demanded damages from the audit firm. Years of litigation ensued, which went through several rounds of appeals and ended with the BGH affirming in principle, in its judgement of 29 May 2008[93], the claims for damages of the applicant investors against the audit firm because it had failed to provide clear information. The decisive criterion in this regard was that the amount of sales commission and soft commissions at the time the investments were purchased

[93] Case ref.: III ZR 59/07.

had been incorrectly disclosed or disclosure had been unduly withheld. These points were of key significance for the direct interest to be acquired by the investors. The audit firm has since become insolvent.

The complainants objected to the, in their view arbitrary, decision by the professional indemnity insurers covering the audit firm, as the policyholder, to stop providing insurance coverage after they had initially approved payments.

On the basis of insights gained in the meantime, both insurers argue that the "knowing breach of duty" provides grounds for exclusion, because the policyholder had breached its professional duties as an audit firm. From the insurers' perspective, the audit firm would have been required to inform the investors of all included costs and commissions and, in the insurers' opinion, had positive knowledge that this requirement existed. These disputed factual issues can only be clarified by the courts after taking evidence. BaFin has therefore referred the investors accordingly.

Coverage of extraneous risk by a specialist underwriting agent.

On the basis of a general agreement between a specialist underwriting agent and an insurer, under which only insurance contracts with transport risks up to a certain insured amount could be issued without prior registration, the agent entered into insurance contracts with extraneous risk, i.e. for eyewear insurance. The insurer had not noticed that its authority had been exceeded. BaFin was alerted to this case by a complaint made by an optical store customer. The complainant had entered into an eyewear insurance contract there and complained to BaFin about the way a claim was being processed. The insurance undertaking remedied the complaint and adjusted the loss.

In the process, it was revealed that over 22,000 insurance contracts were affected. The insurer called on the underwriting agent to enter into these types of insurance contracts with other insurers in future. As for the unauthorised eyewear insurance contracts entered into in the past, the insurance undertaking promised to BaFin that it would honour the contracts until expiry, but not after 31 December 2011, and fulfil the contract if there was any claim.

Unilateral contract extension and premium increase.

One policyholder complained to BaFin because their insurer had increased the premiums for the repair cost insurance of their television set without obtaining their prior consent. The terms and conditions did not contain any price adjustment clause. The policyholder had entered into this contract directly at the time of buying the television set.

The insurer later terminated the contracts and at the same time sent out new insurance policy documents with increased premiums and collected the increased amounts from the bank accounts the insurer had on file. Almost 28,000 contracts were affected by this unilateral contract amendment. BaFin called on the undertaking to obtain retrospective consent to continue the contracts from all affected policyholders and to release from their contracts those

policyholders who did not give their consent. 77% of the customers either refused to give their consent to the contract amendment or objected to it. Only 23% of customers gave their consent. The undertaking therefore had to release most of the customers from their contracts and refund the premiums.

5.3 Complaints relating to securities transactions

In 2011, BaFin received 917 complaints about credit and financial services institutions (previous year: 787) and 332 written enquiries by investors (previous year: 310).

In addition, 22 written complaints about investment research were received (previous year: 11). These related mainly to the manner in which the research was disseminated rather than its content. In many cases, investors complained that they had received unsolicited faxes, for example.

Selected cases

No obligation to pass on information about additional compensation rights under squeeze-outs after termination of the custodian agreement.

In one case, an investor complained that their former custodian bank had not informed them in good time about a court settlement reached in award proceedings. The subject of the award proceedings was to determine the compensation for shareholders of a company that had merged with another stock corporation. In the court settlement, the acquiring stock corporation undertook to pay the former shareholders of the acquired company higher compensation than had been granted up to that point. The complainant was also a shareholder of the acquired company. However, at the time the court settlement was announced in the *Wertpapier-Mitteilungen*, they no longer maintained their securities account with the bank that had held their shares at the time of the merger of the two stock corporations, but with another bank, to which their securities account was only transferred after the merger. The complainant argued that their former bank should have informed the receiving institution of their possible right, as an outside shareholder, to additional compensation under the settlement at the time their securities account was transferred. This would have given the receiving custodian bank the opportunity to inform the complainant about the outcome of the award proceedings and the improved compensation. BaFin was unable to remedy the complaint. Under supervisory law, the previous custodian bank was not required to inform the other bank of a possible additional compensation right when the securities account was transferred. Such a requirement does not arise from either the Safe Custody Act (*Depotgesetz*) or the Safe Custody Notice (*Depotbekanntmachung*). Likewise, it did not have to inform the complainant that the court settlement had, in fact, led to the offer being improved. The information requirement in accordance with number 5 the Safe Custody Notice ceased to apply when the custodian agreement ended.

In another case, an investor complained that their custodian bank had not informed them in good time about a bond buy-back offer from a foreign issuer. The investor received the offer through their custodian bank only after the deadline for acceptance had passed. The foreign issuer had set such a short period for accepting the offer that the custodian bank was unable to inform the complainant by post in good time. BaFin took up this complaint and discussed it with the associations representing the issuers and the banking industry.

Investment Act arbitration board

To settle consumer law disputes out of court in accordance with the Investment Act, BaFin established an arbitration board effective 1 July 2011. This aims to give consumers an easily accessible option for settling disputes cost-effectively, efficiently and comparatively quickly. BaFin's arbitration board has two mediators, who act independently and are not subject to instruction.

The arbitration tasks have also been transferred to the ombudsman service for investment funds of BVI Bundesverband Investment und Asset Management e.V. The BVI ombudsman service performs arbitration for those companies that have joined its arbitration system. BaFin's arbitration board is responsible for all disputes not dealt with by the ombudsman service for investment funds.

By the end of 2011, BaFin's arbitration board had received a total of 28 enquiries. In most cases, consumers wanted to know how the responsibilities are distributed between the arbitration bodies. The other enquiries related to applications for arbitration for which other arbitration bodies are responsible, such as the Customer Complaints Office of the Association of German Banks or the Ombudsman Service for Closed-End Funds (*Ombudsstelle Geschlossene Fonds e.V.*). The arbitration board publishes an annual report on its activities.

5.4 Enquiries under the Freedom of Information Act

Increasingly complex procedures.

Court rulings continued to focus on the blocking orders of the Federal Ministry of Finance in response to enquiries under the German Freedom of Information Act (*Informationsfreiheitsgesetz* – IFG). In 2010, the Administrative Court in Frankfurt am Main and the Hesse Higher Administrative Court had requested BaFin to submit the documents in dispute to the courts so that they could assess for themselves whether they needed to be kept confidential. Because of the plaintiff's procedural right of access to documents, this would amount to anticipating the disputed access to the documents, so BaFin requested blocking orders from the Federal Ministry of Finance in these proceedings.

Similar blocking orders by the Federal Ministry of Finance are, among other things, the subject of two rulings of the Federal Administrative Court (*Bundesverwaltungsgericht* – BVerwG) dating from 2011.[94] According to these rulings, the obligation of confidentiality under section 9 of the KWG is not suitable for justifying a blocking order. In the opinion of the court, section 9 of the KWG does not have the special relevance to basic rights needed for such justification. These legal precedents have met with justified criticism in the literature, with the result that the direction court judgements take will be of particular importance in 2012. However, the Federal Administrative Court has confirmed the protection of information that constitutes business and trade secrets of credit and financial services institutions, although the court qualifies this by stating that such information has to have relevance to competition even after some time has passed. Clarification will have to be sought in future how this relevance to competition is to be demonstrated and proven in detail. Whatever the case, BaFin will need the support of the affected persons and companies whose information is to be protected, as it is only on this basis that BaFin can make its own appropriate assessment of the existence of a business and trade secret and demonstrate it convincingly before the courts.

In addition to court rulings on blocking orders issued by the Federal Ministry of Finance, there is another significant ruling of the Federal Administrative Court[95], according to which the obligations of confidentiality under section 9 of the KWG and section 8 of the WpHG expressly justify in terms of substantive law refusal by BaFin to permit access to documents. Apart from this ruling, there were again no final rulings in main proceedings by the Hesse Higher Administrative Court in 2011. Although in its orders to take evidence the court specifically recognises that BaFin may in principle invoke its obligation of confidentiality, it has to date not demonstrated how this obligation of confidentiality can be implemented in view of the new rulings by the Federal Administrative Court on the blocking orders. BaFin hopes that a clarifying ruling will be made in 2012 that will take ample account of the possible supervisory consequences of information transparency.

Mass actions cause sharp rise in number of applications.

The number of new applications received by BaFin rose to the highest level since the IFG entered into force (492, previous year: 87). This is due to the circumstance that investor protection lawyers increasingly represent several hundred clients in cases involving banks or financial services institutions that have already been liquidated and, on their clients' behalf, file a large number of applications for access to information or documents under the IFG. In 2011 alone, for example, a total of 485 initial applications were filed by one law firm in connection with establishing the compensation event for a credit institution in 2003. As in previous years, BaFin had to reject most applications for access to

[94] Rulings dated 23 June 2011 (case ref.: 20 F 21.10, DVBl. 2011, p. 1092) and 5 October 2011 (case ref.: 20 F 24.10).
[95] Judgement dated 24 May 2011 (case ref.:7 C 6/10).

information in 2011 since there were grounds for exclusion. In the area of securities supervision, the number of new applications rose slightly (75, previous year: 59). In this area, BaFin issued responses that were at least partially positive in more than half of the cases and provided applicants with information that had been requested.

Table 40

Enquiries under the IFG

Supervisory areas	Number	Application withdrawn	Access to information granted	Access to information partially granted	Access to information denied	In process	Objection filed	Action filed
Banking supervision	492	0	0	0	491	1	488	253
Insurance supervision	2	0	0	0	1	1	1	0
Securities supervision	75	5	40	13	13	4	16	4
Other	8	0	1	2	2	3	2	0
Total	**577**	**5**	**41**	**15**	**507**	**9**	**507**	**257**

VIII About BaFin

1 Human resources and organisational issues

Human resources

As at 31 December 2011, BaFin had 2,151 employees (previous year: 1,976) divided between its offices in Bonn (1,593) and Frankfurt am Main (558). Approximately 64.5% (1,388) are civil servants and approximately 35.5% (763) are public service employees covered by collective wage agreements.

Women make up almost half of BaFin's workforce (1,007) and are also represented in senior management. Around 25% of management positions are held by women. 19 BaFin employees are on long-term assignment to international institutions and supervisory authorities.

Table 41
Personnel
as at 31 December 2011

Career level	Employees			Civil servants ("Beamte")	Public service employees
	Total	Female	Male	Total	Total
Higher Civil Service	881	321	560	750	131
Upper Civil Service	725	330	395	569	156
Middle/ Basic Civil Service	545	356	189	69	476
Total	**2,151**	**1,007**	**1,144**	**1,388**	**763**

249 new staff recruited.

To manage its steadily growing workload, BaFin recruited a total of 249 new members of staff in 2011 (previous year: 210). 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 42
Recruitment in 2011

Career level				Qualifications			
	Total	Female	Male	Fully qualified lawyers	Econo-mists	Mathemati-cians/Sta-tisticians	Other
Higher Civil Service	111	34	77	70	21	11	9
				Business lawyers	Econo-mists	IT specialists	Other
Upper Civil Service	60	25	35	15	22	6	17
Middle Civil Service	54	36	18				
Candidates for entry to the Upper Civil Service/ vocational trainees	24	13	11				
Total	**249**	**108**	**141**				

Vocational training at BaFin.

As in the previous year, 24 people started vocational training or preparation for the Civil Service with BaFin in 2011. In collaboration with Deutsche Bundesbank, BaFin prepares candidates for entry to the Upper Civil Service for their future responsibilities (36). BaFin currently also provides vocational training in two careers: office communication specialists (34), and media and information services specialists (1). At the end of 2011, BaFin thus had a total of 71 vocational trainees and candidates (previous year: 70).

Staff appointment scheme.

BaFin's Administrative Council approved a total of 244 additional staff positions and posts as part of the 2011 budget to perform new statutory tasks and cope with a rise in the number of cases handled.[96] Of these, 169 were subject to a qualified freeze, meaning that BaFin was initially not allowed to fill them. In June 2011, the Administrative Council lifted the freeze on these 169 posts, most of which BaFin was able to fill by the end of the year. The Administrative Council has approved 30 new positions for 2012.

Organisation

New BaFin office in Frankfurt am Main.

BaFin Frankfurt am Main relocated to the "Undine" office building at Marie-Curie-Str. 24–28 at the beginning of 2012.

[96] The term 'positions' refers to posts for civil servant employees contained in the staff appointment scheme forming part of the budget, 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, broken down by pay grade.

The old Frankfurt offices no longer offered enough space to accommodate the increase in personnel in Frankfurt. Switching to a single-building arrangement meant that units that were spread across several buildings could be housed together. The building also offers a central meeting and conference centre on the ground floor featuring modular meeting rooms, which are suitable for a variety of uses.

"Undine" also permits a better integration of work and family life, with a company day care centre now also having been set up for the Frankfurt location.

Internal control system optimised.

BaFin successfully implemented a major innovation project – its internal control system (ICS). This is an end-to-end, analytically-based control system that complies with generally accepted auditing standards. The focus is on systematic safeguards and control activities that permit BaFin to take the appropriate risk mitigation measures to ensure it can perform its duties and reach its goals. Following the completion of the first stage of the project from 2006 to 2008, BaFin auditors confirmed that the system, the first ICS to be developed by a federal authority, has adequate controls in place overall and that the control system complies with the principles set out in Auditing Standard 261 issued by the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer in Deutschland e.V.* – IdW). The system was then further optimised with the completion of the second stage of the project.

All workflows across BaFin are now fully documented in process manuals, which provide an explicit description of all of the control activities to be performed.

The ICS has attracted a great deal of interest – BaFin has already presented the system to a large number of domestic authorities and foreign institutions at their request.

Ideas management.

BaFin implemented an ideas management programme on 2 February 2011 in line with the general guidelines for ideas management in the Federal Administration issued by the Federal Ministry of the Interior (*Bundesministerium des Innern* – BMI). This is directed at BaFin employees and aims to channel their knowledge and experience above and beyond their actual duties for the benefit of BaFin by enabling them to make suggestions for improvement. In particular, ideas management promotes and rewards measures that help BaFin to

- increase efficiency;
- strengthen its service focus;
- improve general working conditions and cooperation among employees;
- improve occupational safety; and
- promote environmental protection.

A total of 141 suggestions had been submitted as at 31 December 2011. These mainly related to "conserving energy and resources"

and "optimising internal processes and workflows". The commission set up to evaluate these suggestions met six times in 2011. It voted on a total of 35 suggestions, of which seven were adopted.

CPD courses.

In 2011, 1,409 employees took part in at least one of a total of 578 CPD sessions offered (previous year: 1,307 employees). Most of the offerings related to the internal integrated financial supervision programme and specialist multipart seminars, for example on Solvency II, although they also included language courses and courses on soft skills. On average, each employee received 5.12 days of training (previous year: 5.76 days).

Cost measurement model for regulatory compliance.

In 2006, the Federal Government introduced a bureaucracy reduction programme and adopted the Standard Cost Model (SCM) to measure the administrative costs arising from information requirements. Since then, the model has been used to assess the cost of all new regulatory requirements ex ante. These assessments are reviewed by the National Regulatory Control Council (*Nationaler Normenkontrollrat* – NKR).

The Council's mandate was expanded in early 2011. In future, the full cost of complying with new laws will be assessed ex ante and submitted to the NKR for review. Measuring the compliance costs results in an increase in the requirements to be met by the ex ante cost assessments. Alongside the obligations on businesses to provide information such as reports, applications and documentation, all content-based and organisational obligations – such as those relating to the configuration of risk management systems – have now also been quantified. Furthermore, in addition to legislative costs for the private sector, the costs to citizens and the public sector must also be assessed in future. The basic procedure is laid down in the Guidelines on the Identification and Presentation of Compliance Costs (Compliance Costs Guidelines), which were developed by the Better Regulation Unit within the Federal Chancellor's Office and the Federal Statistical Office, in cooperation with BaFin.

The Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF) entrusted BaFin with measuring bureaucracy costs in the financial sector in 2006. BaFin will therefore continue to measure compliance costs in future. BaFin developed expanded Standard Cost Models for both the private and public sectors to ensure that the assessments can be made in a timely and transparent manner. It was possible to expand the existing model as the requirements in the financial sector are still relatively homogenous and can therefore be standardised. The basic model creation procedure is set out in the draft of the Compliance Costs Guidelines. In addition, the details were fleshed out in consultation with the Federal Statistical Office and with the support of the Better Regulation Unit within the Federal Chancellor's Office.

First practical test successful.

The model passed its first practical test with the bill to amend the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) to implement Solvency II (Tenth Act Amending the VAG). The NKR deemed the cost assessment, which covered over 200 new and

amended requirements, as "transparent and methodologically appropriate" and explicitly praised the cooperation with the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e.V.* – GDV) during the assessment.

Expanded Standard Cost Models in detail

BaFin developed expanded Standard Cost Models for both the private and the public sectors in 2011. The models in detail:

1. Standard Cost Model for the private sector

Previously, the cost of information requirements to the private sector was essentially determined using a table of times issued by the Federal Statistical Office. This table assigned standard times for 16 standard activities to varying levels of complexity. To permit the cost of compliance to be measured, BaFin has now also identified standard processes for content-related or organisational activities resulting from regulatory requirements. To do this, it first identified individual requirements categories, which were derived from existing norms for institutions. This led to the definition of a maximum of thirteen standard processes that undertakings must perform. Some of these standard processes correspond to processes in the previous present value table and some relate to new activities. The times for all standard processes were then reviewed or calculated, as appropriate. This was done in cooperation with the relevant industry interest group representatives and with the support if the Federal Statistical Office. The personnel unit costs that were also required were taken from a list compiled by the Federal Statistical Office.

In addition to costs that can be generated from the present value table, IT and operating expenses also have to be estimated for the private sector. These were initially set at 55% following discussions with the associations and the Federal Statistical Office. Both these flat rates and the times for the standard processes are to be reviewed starting in the first half of 2012.

2. Standard Cost Model for the public sector

Previously, the information requirements to be met by public administration were documented but their costs were not quantified, but now compliance costs incurred by the public sector are to be quantified as well. BaFin analysed its activities with the assistance of its process manuals to identify standard processes performed during application processing and in risk-based supervision of all areas.

BaFin discussed these processes with the Federal Statistical Office and included some of them as sample processes in the Better Regulation Unit's Compliance Costs Guidelines. It then assigned average times to these standard processes on the basis of departments' experience before defining average times across

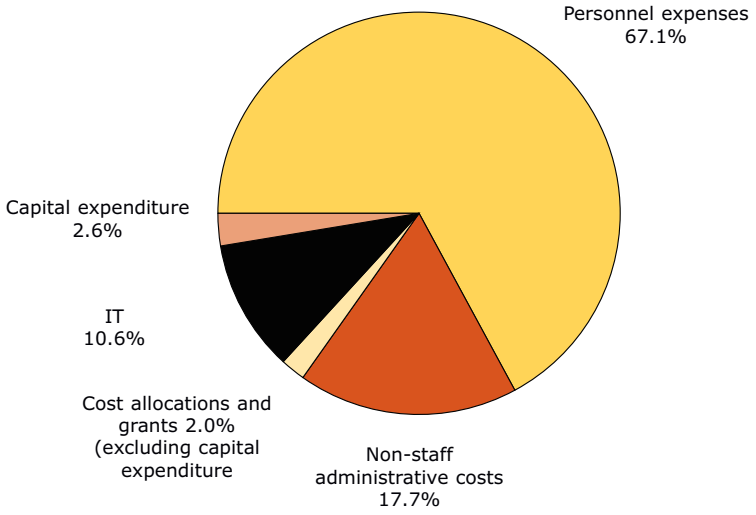
BaFin as a whole. To determine the cost of compliance, the times obtained using this table are multiplied by the average personnel expenses for civil servants as laid down in the Compliance Costs Guidelines. The model is also to be revised in 2012 with the assistance of the Federal Statistical Office.

2 Budget

2011 budget: €160.57 million.

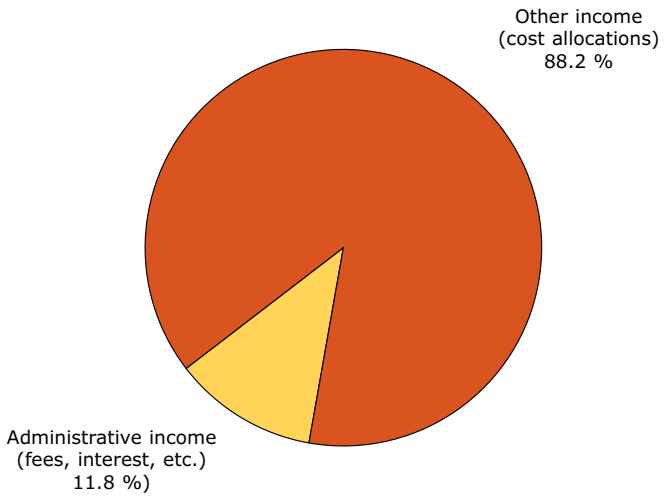
BaFin's Administrative Council approved a budget of €160.57 million for 2011 (previous year: €143.24 million). Personnel expenses accounted for around 67.1% of the projected expenditure (€107.7 million; previous year: €97 million) and non-staff costs for around 17.7% (€28.5 million; previous year: €25.9 million).

Figure 36
2011 budget expenditure



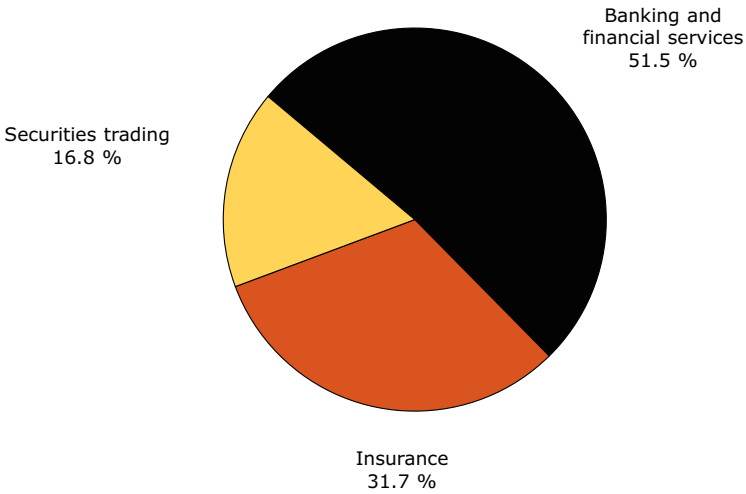
BaFin is fully financed by cost allocations levied on the companies it oversees (projected figure for 2011: €141.6 million; previous year: €107.5 million) and administrative income (projected figure for 2011: €18.9 million; previous year: €35.8 million). It does not receive any grants from the federal budget.

Figure 37
2011 budget income



The banking industry contributed slightly over half (51.5%) of the total income from cost allocations. The insurance sector financed 31.7% and the securities trading sector 16.8%. This breakdown corresponds to the final cost allocation for 2010; the final cost allocation for 2011 will be performed in the course of 2012.

Figure 38
Cost allocations by supervisory area in 2010



Federal Administrative Court: official liability costs incurred by BaFin are allocable

On 23 November 2011, the Federal Administrative Court (*Bundesverwaltungsgericht* – BVerwG)[97] dismissed, in three parallel test cases, the leapfrog appeals brought by a credit institution against judgements by the Administrative Court in Frankfurt am Main dated 30 September 2010.[98] In doing so, the Court confirmed the legality of BaFin's advance payment notices for the 2009 cost allocations, which included a 2% notional contribution to financing the costs of damages incurred as a result of an official liability claim.[99]

According to the reasons given by the BVerwG for its judgement, the term "costs" as defined in section 16 (1) of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungs-aufsichtsgesetz* – FinDAG) also includes budgetary estimates of payments due on account of breaches of official duty incurred by BaFin in the course of the performance of its duties. This interpretation is not precluded by article 34, sentence 1 of the Basic Law (*Grundgesetz*), which merely aims to provide the injured party with a liquid debtor. This applies irrespective of whether the claimant is concurrently required to contribute to the financing of government expenses – which include compensation – as a taxpayer or via cost allocations. In addition, the BVerwG saw the constitutional law requirements regarding special levies as being satisfied, as the official act founding the claim served to perform BaFin's supervisory tasks. According to the Court, these are significantly more relevant to the homogenous group of supervised companies and institutions than to the general taxpaying public. The Eighth Senate of the BVerwG did not rule on the question of whether this would also apply if an official misused his or her office by intentionally acting ultra vires and caused damage to third parties as a result. Such a constellation clearly did not apply in the case at hand.

A constitutional complaint[100] has been lodged against this decision.

Income of €162.6 million, expenditure of €155.1 million.

BaFin's actual expenditure in 2011 was approximately €155.1 million (previous year: €136 million). Its income amounted to approximately €162.6 million (previous year: €142.8 million). The Administrative Council still has to approve the annual financial statements.

[97] Judgement dated 23 November 2011, case ref.: 8 C 20.10. The grounds for the decision were published in ZIP 2012, 313 = BKR 2012, 74, among others, as well as at www.bundesverwaltungsgericht.de.
[98] Judgement dated 30 September 2010, case ref.: 1 K 1059/10.F (published in WM 2010, 2357, among others), 1 K 1060/10.F, 1 K 1061/10.F.
[99] See also the BaFin 2010 Annual Report, p. 263.
[100] Case ref.: 2 BvR 355/12.

Separate enforcement budget.

BaFin drew up a separate enforcement budget of €7.8 million (previous year: €8 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 €7.4 million (previous year: €7.6 million), while income (including advance cost allocation payments for 2012) stood at approximately €15.1 million (previous year: €15.8 million).

3 Public relations

Enquiries about the bank stress test.

BaFin answered a total of approximately 3,791 press enquiries in 2011. The number one topic in the field of banking supervision was the impact of the sovereign debt crisis on the banks. In particular, the stress test carried out by the European Banking Authority (EBA) in summer 2011 and the EBA's recapitalisation survey in August attracted a great deal of media attention. BaFin also received a large number of enquiries relating to the new capital and liquidity requirements for banks, which are laid down in the international Basel III framework and are to be implemented at European level as part of the CRD IV package. Another important topic was the expanded capital requirements for systemically important banks.

Quality of investment advice minutes.

In the area of securities supervision, the focus was on the quality of the investment advice minutes and product information documents, as well as the closure of several open-ended real estate funds. The regulation of exchange-traded funds, short sales and the prohibition on these in several EU countries, court cases on (high-profile) instances of market manipulation, as well as repeated cases of spam faxes also generated considerable media attention. In addition, a large number of journalists had questions about the proposed merger between Deutsche Börse and the New York Stock Exchange.

Impact of the financial market crisis on insurers.

BaFin once again received a large number of enquiries relating to insurance supervision in 2011, primarily on the impact of the financial market crisis. Many questions concerned the exposure of German insurers to heavily indebted eurozone countries, the consequences of the ratings downgrade of Greece and other countries, as well as BaFin's tolerance of (Greek) government bonds with a "default" rating held as part of insurers' restricted assets. By contrast, the stress test carried out by the European Insurance and Occupational Pensions Authority (EIOPA) was more of a side issue. There were a large number of enquiries about how the low interest rate phase is affecting life insurers, which BaFin again examined in a study. The results were published in early 2012. In addition, journalists were interested in the unisex tariffs offered by private health and life insurers, commissions in both insurance classes and the issue of non-payers in private health

insurance schemes. Another important topic was the new European regulatory framework, Solvency II, and related issues such as the QIS5 study. BaFin also received a large number of enquiries about the ban on passing on commissions.

Electronic payment methods.

Press representatives also wanted to know about monitoring of the increased due diligence requirements and electronic payment methods under the Money Laundering Act (*Geldwäschegesetz* – GWG) and – as in 2010 – the new authorisation obligations relating to cash logistics and supply (cash recycling) laid down in the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG). Journalists were also interested in the ruling of the Federal Administrative Court in which it upheld BaFin's view that official liability claims are apportionable. The same applied to the conviction of former hedge fund manager Helmut Kiener for fraud. BaFin's recruitment of additional personnel was also a frequent topic.

Cooperation with the Bundesbank and the Federal Criminal Police Office.

As in the previous year, Deutsche Bundesbank and BaFin invited media representatives to a joint press conference in July 2011, where they presented the results of the EU-wide stress test for German credit institutions. In September 2011, BaFin and the Federal Criminal Police Office (*Bundeskriminalamt* – BKA) presented the annual report of the BKA's Financial Intelligence Unit Germany to the press. In it, the two agencies reported on their work to combat money laundering and terrorist financing and issued a strong warning against acting as a financial agent.

Forum on White-collar Crime and the Capital Market.

BaFin held its eighth two-day Forum on White-collar Crime and the Capital Markets at the German National Library in Frankfurt am Main at the end of September 2011. The event was attended by nearly 400 participants, including a large number of judges, public prosecutors and economic advisors, as well as representatives from the police force, state criminal police offices, the BKA and the Bundesbank. Participants discussed recent court rulings, new forms of criminal behaviour and spectacular cases from the field with a focus on securities trading and on combatting illegal financial transactions.

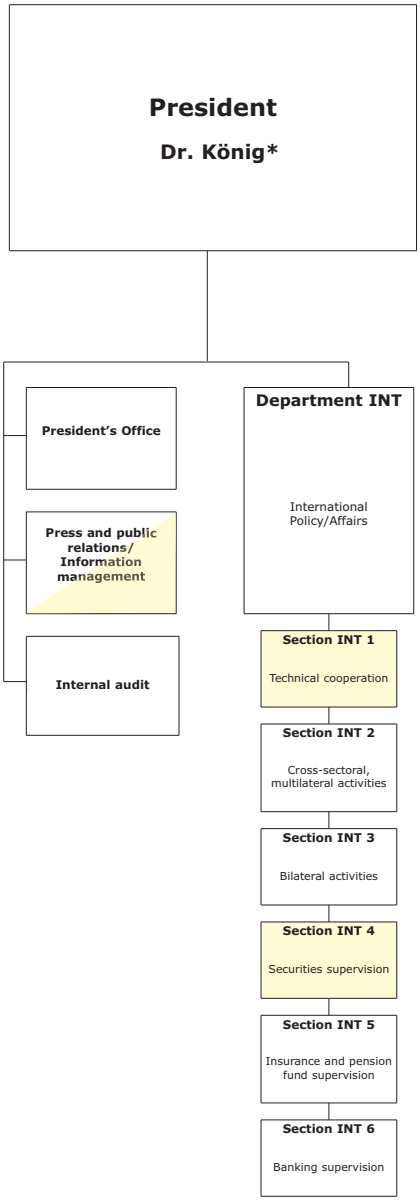
Information for investors and other interested parties.

BaFin again took part in the "Invest" fair for investors held in Stuttgart in April 2011, as well as participating in stock exchange days in Dresden, Hamburg and Berlin last year. BaFin primarily used the events to inform investors about its work and activities. It also took the opportunity to warn against providers of illegal financial transactions and the practices of market manipulators. For example, BaFin fielded a large number of questions about spam faxes designed to induce investors to buy worthless shares. For this reason, BaFin regularly posts warnings about these faxes on its website.

BaFin reissued its "*Geldanlage – Wie Sie unseriöse Anbieter erkennen*" brochure ("Investing – How to recognise untrustworthy providers" – only available in German) in October 2011. The brochure calls on retail investors to obtain in-depth information before deciding on an investment. In addition, a new brochure on the Consumer Law Disputes Arbitration Board under the Investment Act (*Investmentgesetz* – InvG), which was set up by BaFin in 2011, will be available (in German only) from mid-2012.

Appendix

Organisation chart



Notes:

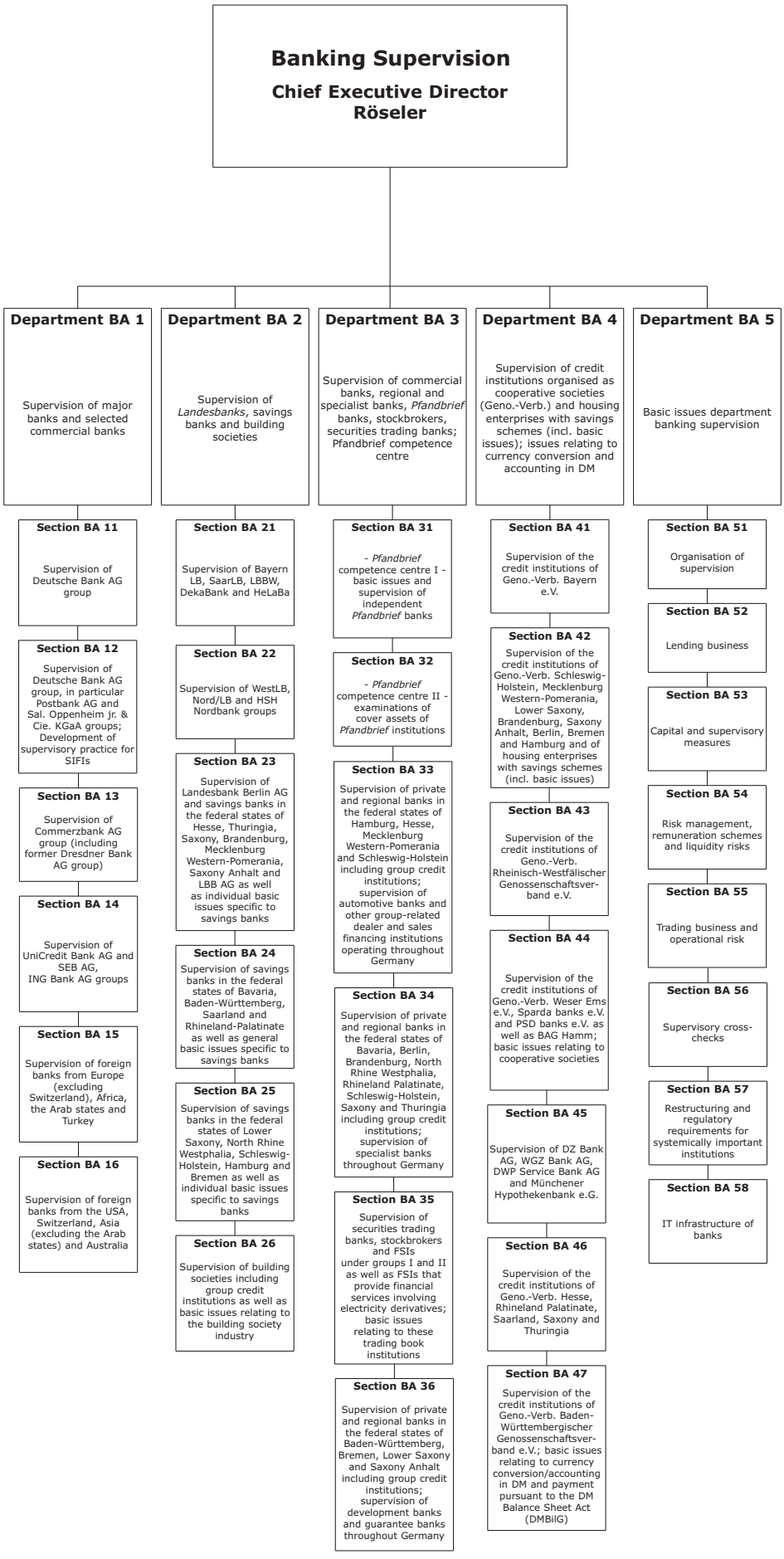
Bonn office

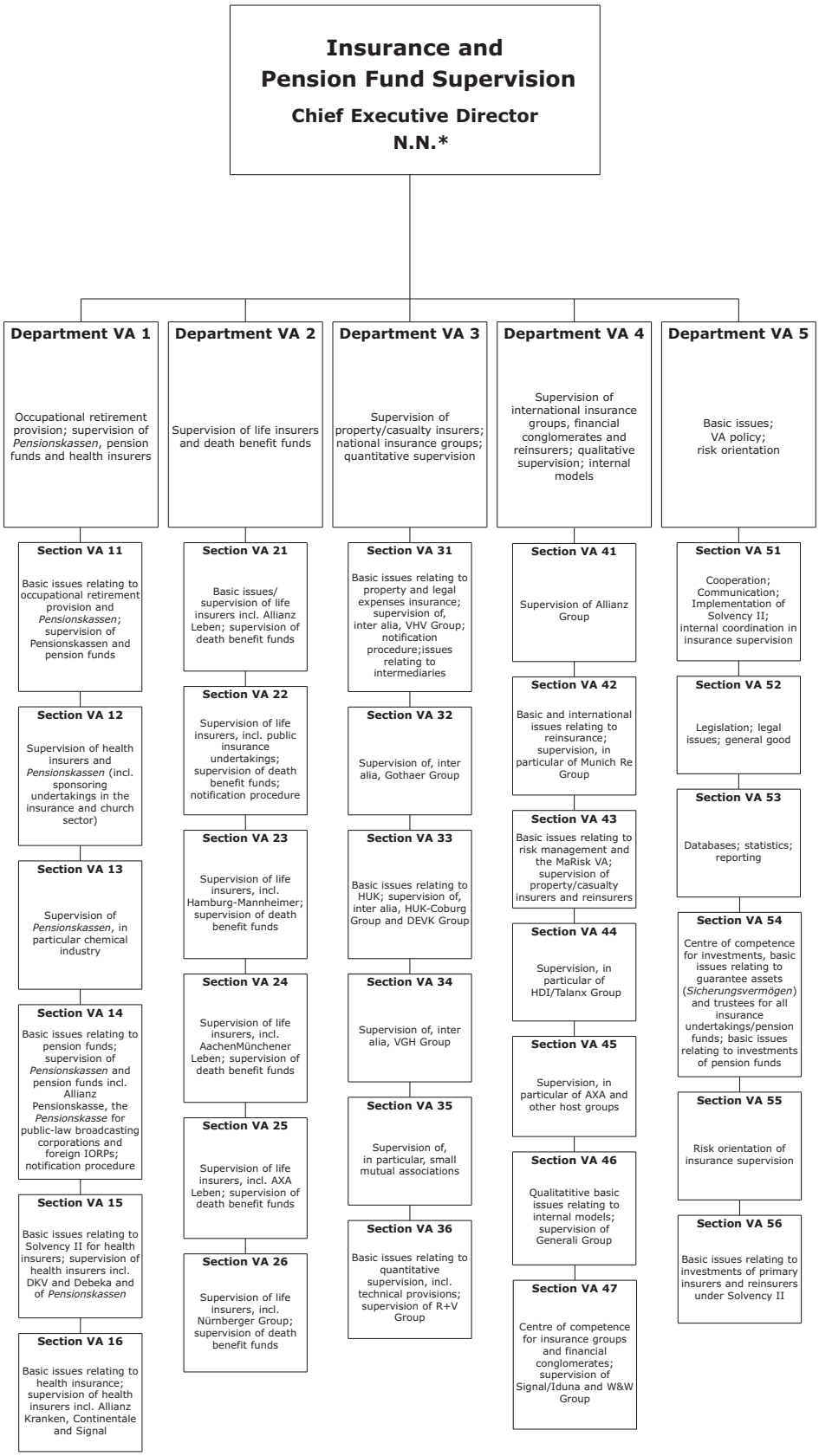
Frankfurt office

Offices in Bonn and Frankfurt

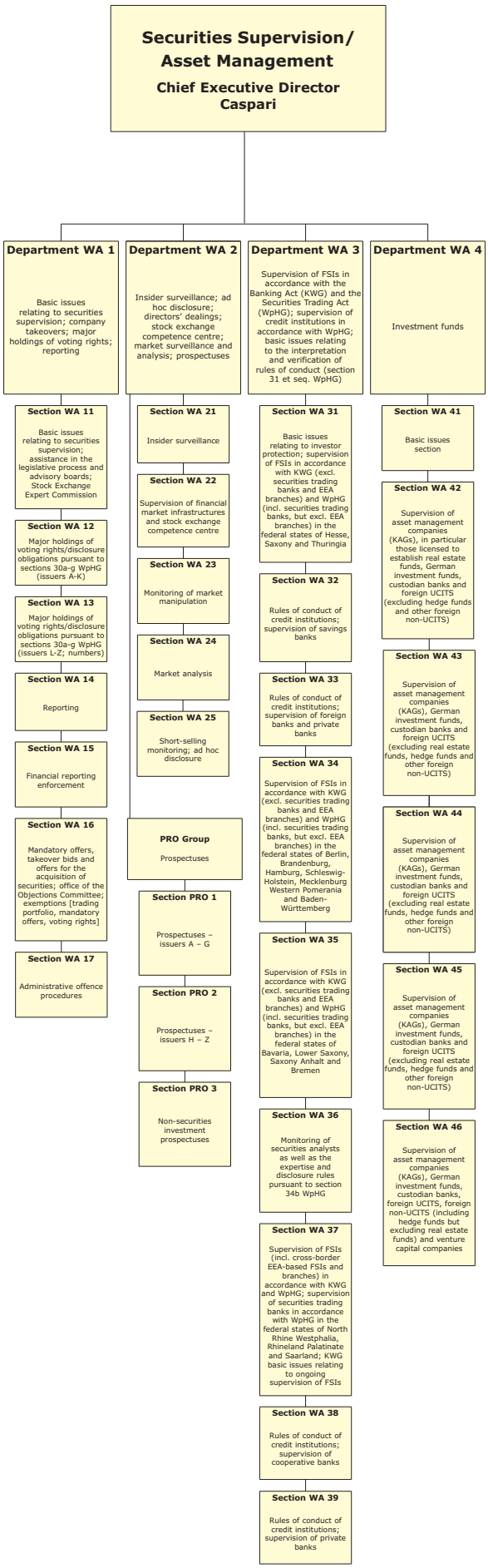
As at July 2012

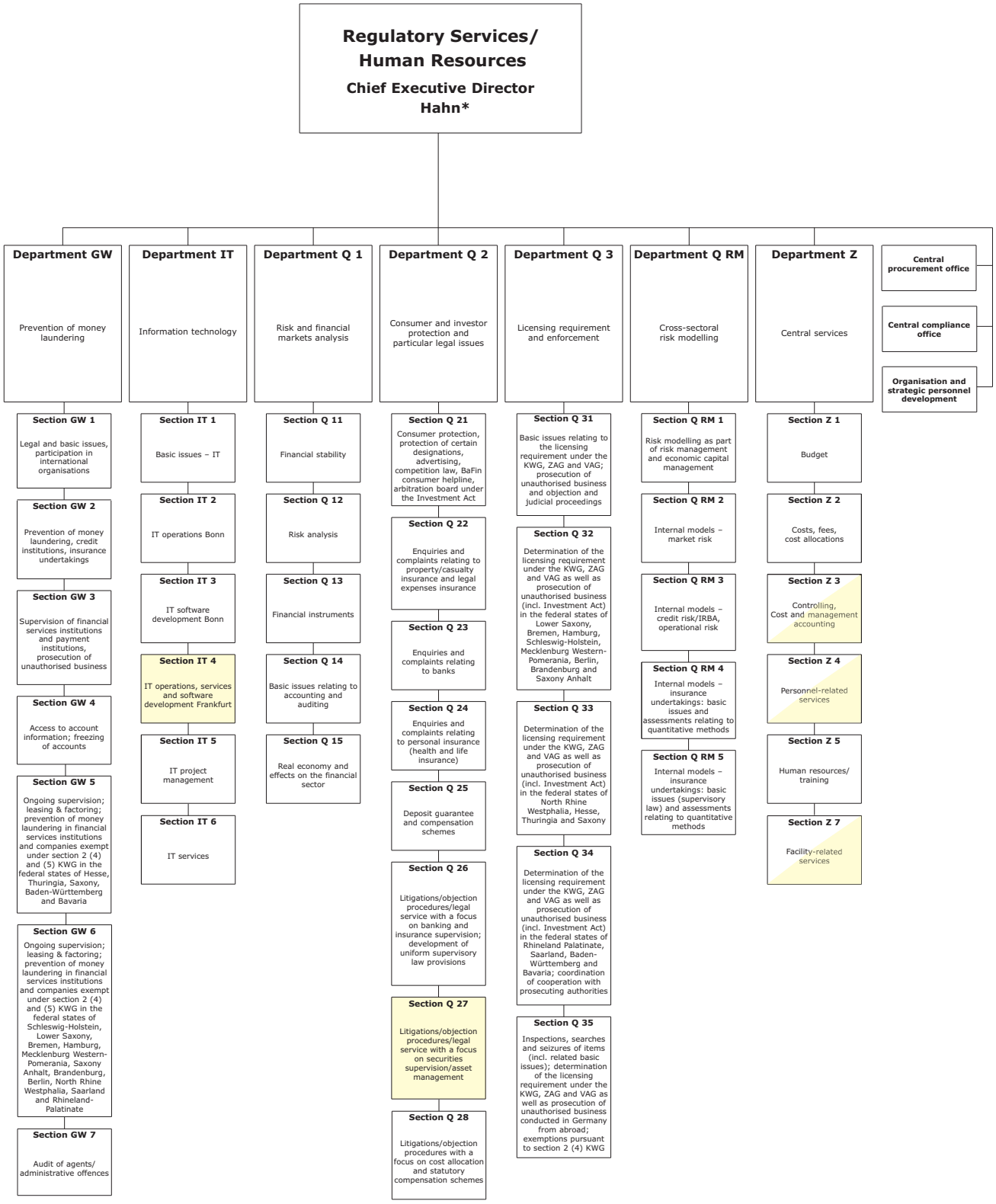
* BaFin president since 1 January 2012.


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 Bank AG group, in particular Postbank AG and Sal. Oppenheim jr. & Cie. KGaA groups; Development of supervisory practice for SIFIs
Section BA 13
Supervision of Commerzbank AG group (including former Dresdner Bank AG group)
Section BA 14
Supervision of UniCredit Bank AG and SEB AG, 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 Bayern LB, SaarLB, LBBW, DekaBank and HeLaBa
Section BA 22
Supervision of WestLB, Nord/LB and HSH Nordbank groups
Section BA 23
Supervision of Landesbank Berlin AG and savings banks in the federal states of Hesse, Thuringia, Saxony, Brandenburg, Mecklenburg Western-Pomerania, Saxony Anhalt and LBB AG as well as individual basic issues specific to savings banks
Section BA 24
Supervision of savings banks in the federal states of Bavaria, Baden-Württemberg, Saarland and Rhineland-Palatinate as well as general basic issues specific to savings banks
Section BA 25
Supervision of savings banks in the federal states of Lower Saxony, North Rhine Westphalia, Schleswig-Holstein, Hamburg and Bremen as well as individual basic issues specific to savings banks
Section BA 26
Supervision of building societies including group credit institutions as well as basic issues relating to the building society industry
Department BA 3
Supervision of commercial banks, regional and specialist banks, Pfandbrief banks, stockbrokers, securities trading banks; Pfandbrief competence centre
Section BA 31
- Pfandbrief competence centre I - basic issues and supervision of independent Pfandbrief banks
Section BA 32
- Pfandbrief competence centre II - examinations of cover assets of Pfandbrief institutions
Section BA 33
Supervision of private and regional banks in the federal states of Hamburg, Hesse, Mecklenburg Western-Pomerania and Schleswig-Holstein including group credit institutions; supervision of automotive banks and other group-related dealer and 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 organised as cooperative societies (Geno.-Verb.) and housing enterprises with savings schemes (incl. basic issues); issues relating to currency conversion and accounting in DM
Section BA 41
Supervision of the credit institutions of Geno.-Verb. Bayern e.V.
Section BA 42
Supervision of the credit institutions of Geno.-Verb. Schleswig-Holstein, Mecklenburg Western-Pomerania, Lower Saxony, Brandenburg, Saxony Anhalt, Berlin, Bremen and Hamburg and of housing enterprises with savings schemes (incl. basic issues)
Section BA 43
Supervision of the credit institutions of Geno.-Verb. Rheinisch-Westfälischer Genossenschaftsverband e.V.
Section BA 44
Supervision of the credit institutions of Geno.-Verb. Weser Ems e.V., Sparda banks e.V. and PSD banks e.V. as well as BAG Hamm; basic issues relating to cooperative societies
Section BA 45
Supervision of DZ Bank AG, WGZ Bank AG, DWP Service Bank AG and Münchener Hypothekenbank e.G.
Section BA 46
Supervision of the credit institutions of Geno.-Verb. Hesse, Rhineland Palatinate, Saarland, Saxony and Thuringia
Section BA 47
Supervision of the credit institutions of Geno.-Verb. Baden-Württembergischer Genossenschaftsverband e.V.; basic issues relating to currency conversion/accounting in DM and payment pursuant to the DM Balance Sheet Act (DMBilG)
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, remuneration schemes and liquidity risks
Section BA 55
Trading business and operational risk
Section BA 56
Supervisory cross-checks
Section BA 57
Restructuring and regulatory requirements for systemically important institutions
Section BA 58
IT infrastructure of banks



* Chief Executive Director of Regulatory Services/Human Resources, Gabriele Hahn, was Chef Executive Director of Insurance and Pension Fund Supervision until June 2012.


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
Section WA 22
Supervision of financial market infrastructures and stock exchange competence centre
Section WA 23
Monitoring of market manipulation
Section WA 24
Market analysis
Section WA 25
Short-selling monitoring; ad hoc disclosure
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



* Chief Executive Director of Regulatory Services/Human Resources, Gabriele Hahn, was Chef Executive Director of Insurance and Pension Fund Supervision until June 2012.

BaFin bodies

2.1 Members of the Administrative Council

Representing Federal Ministries
Dr. Thomas Steffen (Chairman – BMF)
Dr. Levin Holle (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 2012

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
Rolf-Peter Hoenen
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 (Deputy chairman)

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 the liberal professions
Frank Rottenbacher (AfW)

Representing associations for SMEs
Dr. Peter König (DVFA)

Representing the trade unions
Uwe Foullong (ver.di)

Representing industry
Folkhart Olschowy (Wacker Chemie AG)

As at April 2012

2.3 Members of the Insurance Advisory Council

Dr. Helmut Aden

Prof. Dr. Christian Armbrüster

Dr. Alexander Barthel

Beate-Kathrin Bextermöller

Dr. Georg Bräuchle

Lars Gatschke

Ira Gloe-Semler

Norbert Heinen

Michael H. Heinz

Werner Hölzl

Sabine Krummenerl

Uwe Laue

Dr. Ursula Lipowsky

Dr. Torsten Oletzky

Prof. Dr. Catherine Pallenberg

Prof. Dr. Petra Pohlmann

Prof. Dr. Heinrich R. Schradin

Reinhold Schulte

Ilona Stumm

Prof. Dr. Manfred Wandt

Elke Weidenbach

Michael Wortberg

Dr. Maximilian Zimmerer

Prof. Dr. Jochen Zimmermann

As at April 2012

2.4 Members of the Securities Council

Baden-Wuerttemberg State Ministry for Finance and Economics

Bavarian State Ministry for Economics, Infrastructure, Transport and Technology

Berlin Senate Department of Economics, Technology and Research

Ministry of Economics and European 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, Transport and Innovation

Ministry of Economics, Transport and Regional Development of the State of Hesse

Ministry of Economics, Construction 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, Labour and Transport of the State of Saxony

Ministry of Science and Economics 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 2012

3 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 2011 is compared with the number of policies in the respective insurance class as at 31 December 2010. 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 giving rise to the 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 group insurance relates to the number of insurance contracts. Existing health insurance business is based on the number of natural persons with health insurance contracts, rather than the number of insured persons under each premium rate, which is usually higher. As in the past, 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 2010 exceeded €10 million in the respective insurance classes or types can be included. The tables give no information on existing business (n.a.) 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 2010	Complaints
1001	AACHENMÜNCHENER LEB.	5,444,437	84
1162	AGEAS DEUTSCHLAND	126,623	1
1006	ALLIANZ LEBEN	10,277,961	270
1007	ALTE LEIPZIGER LEBEN	1,064,893	19
1035	ARAG LEBEN	332,676	12
1303	ASSTEL LEBEN	326,518	20
1020	AXA LEBEN	1,778,207	39
1011	BARMENIA LEBEN	238,571	6
1012	BASLER LEBEN	156,703	5
1013	BAYER. BEAMTEN LEBEN	305,848	15
1015	BAYERN-VERS.	1,761,473	36
1122	CONCORDIA LEBEN	141,966	1
1021	CONDOR LEBEN	202,861	8
1078	CONTINENTALE LEBEN	n.a.	3
1335	CONTINENTALE LV AG	633,245	10
1022	COSMOS LEBEN	1,392,744	30
1146	DBV DEUTSCHE BEAMTEN	1,840,042	44
1023	DEBEKA LEBEN	3,374,473	21
1167	DELTA DIREKT LEBEN	75,389	2
1017	DELTA LLOYD LEBEN	521,932	28
1136	DEVK ALLG. LEBEN	752,685	12
1025	DEVK DT. EISENBAHN LV	722,088	4
1113	DIALOG LEBEN	256,551	2
1148	DT. LEBENSVERS.	331,816	5
1028	DT. RING LEBEN	879,176	45
1180	DT. ÄRZTEVERSICHERUNG	197,520	9
1130	ERGO DIREKT LEBEN AG	1,243,397	26
1184	ERGO LEBEN AG	5,892,458	147
1107	EUROPA LEBEN	453,851	5
1310	FAMILIENFüRSORGE LV	275,868	9
1139	GENERALI LEBEN AG	5,037,975	107
1108	GOTHAER LEBEN AG	1,180,672	71
1040	HAMB. LEBEN	24,383	5
1312	HANNOVERSCHE LV AG	859,239	28
1114	HANSEMERKUR LEBEN	211,550	5
1033	HDI-GERLING LEBEN	2,645,637	104
1158	HEIDELBERGER LV	453,800	25
1137	HELVETIA LEBEN	134,351	3
1055	HUK-COBURG LEBEN	706,126	9
1047	IDEAL LEBEN	538,769	3
1048	IDUNA VEREINIGTE LV	1,993,991	44
1119	INTERRISK LEBENSVERS.	91,167	2
1330	INTER LEBENSVERS. AG	163,802	4
1045	KARLSRUHER LV AG	113,163	1
1054	LANDESLEBENSHILFE	20,321	3
1062	LEBENSVERS. VON 1871	710,573	26
1112	LVM LEBEN	773,924	8
1198	MAMAX LEBEN	13,961	1
1109	MECKLENBURG. LEBEN	164,050	2

Reg. no.	Name of insurance undertaking	Number of life insurance policies in 2010	Complaints
1064	MÜNCHEN. VEREIN LEBEN	146,583	6
1164	NEUE LEBEN LEBENSVERS	853,506	14
1147	NÜRNBG. LEBEN	2,976,036	114
1177	OECO CAPITAL LEBEN	27,529	1
1056	OEFF. LEBEN BERLIN	205,547	2
1194	PB LEBENSVERSICHERUNG	364,943	19
1145	PBV LEBEN	897,407	19
1123	PLUS LEBEN	127,023	5
1309	PROTEKTOR LV AG	154,947	11
1081	PROV. LEBEN HANNOVER	853,729	8
1083	PROV.NORDWEST LEBEN	1,814,937	22
1082	PROV.RHEINLAND LEBEN	1,356,623	18
1085	R+V LEBEN	6,939	1
1141	R+V LEBENSVERS. AG	4,057,054	44
1018	RHEINLAND LEBEN	281,197	7
1150	SAARLAND LEBEN	149,342	1
1157	SKANDIA LEBEN	361,475	20
1153	SPARK.-VERS.SACHS.LEB	476,060	8
1104	STUTTGARTER LEBEN	417,443	11
1091	SV SPARKASSENVERS.	1,742,381	24
1090	SWISS LIFE AG (CH)	888,891	29
1132	TARGO LEBEN AG	1,595,153	28
1152	UELZENER LEBEN	13,420	1
1092	UNIVERSA LEBEN	199,553	4
1093	VER.POSTVERS.	24	2
1140	VICTORIA LEBEN	1,665,798	84
1099	VOLKSWOHL-BUND LEBEN	1,308,448	16
1151	VORSORGE LEBEN	141,101	6
1160	VPV LEBEN	1,023,880	29
1103	WWK LEBEN	964,177	34
1005	WÜRTT. LEBEN	2,617,632	67
1138	ZURICH DTSCH. HEROLD	3,805,085	131

3.3 Health insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31 Dec. 2010	Complaints
4034	ALLIANZ PRIV.KV AG	2,411,605	173
4142	ALTE OLDENBURGER	149,049	2
4112	ARAG KRANKEN	461,297	17
4095	AXA KRANKEN	1,458,768	161
4042	BARMENIA KRANKEN	1,259,167	69
4134	BAYERISCHE BEAMTEN K	1,038,828	81
4004	CENTRAL KRANKEN	1,841,425	182
4118	CONCORDIA KRANKEN	82,696	1
4001	CONTINENTALE KRANKEN	1,311,946	68
4028	DEBEKA KRANKEN	3,687,670	83
4044	DKV AG	4,388,757	262
4013	DT. RING KRANKEN	652,343	32
4121	ENVIVAS KRANKEN	313,746	4
4126	ERGO DIREKT KRANKEN	1,266,491	15
4053	FREIE ARZTKASSE	29,803	2
4119	GOTHAER KV AG	548,370	96
4043	HALLESCHE KRANKEN	609,860	58
4144	HANSEMERKUR KRANKEN_V	1,268,297	48
4122	HANSEMERKUR S,KRANKEN	4,384,110	3
4117	HUK-COBURG KRANKEN	892,836	40
4031	INTER KRANKEN	379,250	29
4011	LANDESKRANKENHILFE	403,659	21
4109	LVM KRANKEN	294,773	8
4123	MANNHEIMER KRANKEN	77,264	9
4037	MÜNCHEN.VEREIN KV	247,699	35
4125	NÜRNBG. KRANKEN	232,233	9
4116	R+V KRANKEN	495,489	4
4002	SIGNAL KRANKEN	1,986,093	57
4039	SÜDDEUTSCHE KRANKEN	587,445	10
4108	UNION KRANKENVERS.	1,040,434	49
4045	UNIVERSA KRANKEN	361,121	24
4115	VIGO KRANKEN	n.a.	3
4139	WÜRTT. KRANKEN	172,593	4

3.4 Motor vehicle insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5342	AACHENMüNCHENER VERS.	1,854,978	9
5135	ADAC AUTOVERSICHERUNG	821,884	13
5312	ALLIANZ VERS.	13,824,972	171
5441	ALLSECUR DEUTSCHLAND	480,516	7
5405	ALTE LEIPZIGER VERS.	466,541	9
5455	ARAG ALLG. VERS.	n.a.	5
5397	ASSTEL SACH	n.a.	17
5515	AXA VERS.	4,783,169	65
5317	BARMENIA ALLG. VERS.	379,732	2
5633	BASLER SECURITAS	443,949	8
5310	BAYER. BEAMTEN VERS.	251,378	4
5324	BAYER.VERS.VERB,AG	2,047,166	8
5146	BGV-VERSICHERUNG AG	425,784	2
5098	BRUDERHILFE SACH.AG	385,013	2
5338	CONCORDIA VERS.	1,264,322	6
5340	CONTINENTALE SACHVERS	427,063	12
5552	COSMOS VERS.	573,336	14
5343	DA DEUTSCHE ALLG.VER.	1,449,956	38
5311	DBV DT. BEAMTEN-VERS.	526,992	6
5549	DEBEKA ALLGEMEINE	734,079	5
5513	DEVK ALLG. VERS.	3,508,701	37
5344	DEVK DT. EISENB. SACH	990,218	6
5129	DFV DEUTSCHE FAM VERS.	n.a.	1
5055	DIRECT LINE	742,777	20
5084	DTSCH. INTERNET	n.a.	5
5562	ERGO DIREKT	n.a.	3
5472	ERGO VERSICHERUNG	2,557,971	33
5508	EUROPA VERSICHERUNG	443,155	13
5470	FAHRLEHRERVERS.	305,163	3
5024	FEUERSOZIETÄT	191,537	9
5505	GARANTA VERS.	831,346	7
5473	GENERALI VERSICHERUNG	2,551,080	34
5858	GOTHAER ALLGEMEINE AG	1,187,706	20
5585	GVV-PRIVATVERSICH.	254,958	3
5131	HANNOVERSCHE DIREKT	n.a.	7
5085	HDI DIREKT	2,619,428	34
5512	HDI-GERLING FIRMEN	1,143,419	21
5096	HDI-GERLING INDUSTRIE	886,332	12
5044	HDNA VVAG	n.a.	2
5384	HELVETIA VERS.	259,243	5
5375	HUK-COBURG	6,911,116	44
5521	HUK-COBURG ALLG. VERS	6,127,735	44
5086	HUK24 AG	2,156,852	33
5401	ITZEHOER VERSICHERUNG	824,980	8
5078	JANITOS VERSICHERUNG	262,762	8
5058	KRAVAG-ALLGEMEINE	1,452,552	22
5080	KRAVAG-LOGISTIC	824,633	13
5399	KRAVAG-SACH	n.a.	1

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5402	LVM SACH	4,987,670	32
5061	MANNHEIMER VERS.	192,859	2
5412	MECKLENBURG. VERS.	780,238	4
5414	MÜNCHEN. VEREIN ALLG.	103,192	2
5426	NÜRNBG. ALLG.	175,564	2
5519	OPTIMA VERS.	n.a.	3
5787	OVAG - OSTDT. VERS.	n.a.	28
5446	PROV.NORD BRANDKASSE	713,352	1
5095	PROV.RHEINLAND VERS.	1,204,547	7
5438	R+V ALLGEMEINE VERS.	3,829,634	32
5137	R+V DIREKTVERSICHER.	144,408	7
5798	RHEINLAND VERS. AG	221,589	4
5051	S DIREKTVERSICHERUNG	160,717	2
5773	SAARLAND FEUERVERS.	164,663	1
5690	SCHWARZMEER U. OSTSEE	n.a.	3
5125	SIGNAL IDUNA ALLG.	1,061,648	13
5781	SPARK.-VERS.SACHS.ALL	179,696	3
5036	SV SPARK.VERSICHER.	846,659	5
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VERSICHERUNGSK.BAYERN	157,022	1
5400	VGH LAND.BRAND.HAN.	1,839,660	10
5862	VHV ALLGEMEINE VERS.	4,287,125	43
5484	VOLKSWOHL-BUND SACH	n.a.	2
5093	WESTF.PROV.VERS.AG	1,397,435	7
5525	WGV-VERSICHERUNG	809,406	7
5476	WWK ALLGEMEINE VERS.	318,079	4
5479	WÜRTT. GEMEINDE-VERS.	1,058,323	4
5783	WÜRTT. VERS.	2,424,381	25
5050	ZURICH VERS. AG	n.a.	1

3.5 General liability insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5342	AACHENMüNCHENER VERS.	1,231,165	8
5370	ALLIANZ GLOBAL AG	4,089	3
5312	ALLIANZ VERS.	4,586,478	90
5405	ALTE LEIPZIGER VERS.	220,218	4
5455	ARAG ALLG. VERS.	21,152,582	9
5397	ASSTEL SACH	n.a.	7
5515	AXA VERS.	3,170,946	40
5633	BASLER SECURITAS	264,246	3
5319	BAYER. HAUSBESITZER	n.a.	1
5324	BAYER.VERS.VERB,AG	1,043,526	6
5146	BGV-VERSICHERUNG AG	118,674	1
5098	BRUDERHILFE SACH.AG	218,859	4
5338	CONCORDIA VERS.	342,089	6
5340	CONTINENTALE SACHVERS	335,765	4
5552	COSMOS VERS.	316,523	6
5343	DA DEUTSCHE ALLG.VER.	n.a.	2
5311	DBV DT. BEAMTEN-VERS.	497,552	2
5549	DEBEKA ALLGEMEINE	1,207,346	5
5513	DEVK ALLG. VERS.	1,087,645	5
5344	DEVK DT. EISENB. SACH	601,379	1
5472	ERGO VERSICHERUNG	1,828,703	55
5024	FEUERSOZIETÄT	147,894	1
5365	GEGENSEITIGKEIT VERS.	n.a.	1
5473	GENERALI VERSICHERUNG	1,902,312	31
5858	GOTHAER ALLGEMEINE AG	1,352,135	26
5372	GOTHAER VERS.BANK	n.a.	1
5485	GRUNDEIGENTÜMER-VERS.	n.a.	5
5469	GVV-KOMMUNALVERS.	2,862	5
5585	GVV-PRIVATVERSICH.	n.a.	1
5374	HAFTPFLICHTK.DARMST.	832,875	7
5501	HANSEMERKUR ALLG.	n.a.	2
5085	HDI DIREKT	677,961	4
5512	HDI-GERLING FIRMEN	678,330	22
5096	HDI-GERLING INDUSTRIE	15,367	49
5384	HELVETIA VERS.	354,821	5
5375	HUK-COBURG	1,900,268	9
5521	HUK-COBURG ALLG. VERS	1,090,630	4
5086	HUK24 AG	302,977	3
5573	IDEAL VERS.	n.a.	2
5546	INTER ALLG. VERS.	143,609	4
5057	INTERLLOYD VERS.AG	n.a.	1
5401	ITZEHOER VERSICHERUNG	166,676	1
5078	JANITOS-VERSICHERUNG	185,065	3
5058	KRAVAG-ALLGEMEINE	n.a.	2
5402	LVM SACH	1,163,842	8
5412	MECKLENBURG. VERS.	273,379	6
5426	NÜRNBG. ALLG.	317,960	7
5446	PROV.NORD BRANDKASSE	393,164	7

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5095	PROV.RHEINLAND VERS.	840,768	9
5438	R+V ALLGEMEINE VERS.	1,670,539	17
5798	RHEINLAND VERS. AG	96,402	8
5121	RHION VERSICHERUNG	112,139	3
5125	SIGNAL IDUNA ALLG.	681,328	10
5781	SPARK.-VERS.SACHS.ALL	111,499	2
5586	STUTTGARTER VERS.	n.a.	3
5036	SV SPARK.VERSICHER.	873,361	4
5459	UELZENER ALLG. VERS.	166,971	2
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VERSICHERUNGSK.BAYERN	16,586	4
5400	VGH LAND.BRAND.HAN.	703,295	1
5862	VHV ALLGEMEINE VERS.	922,677	16
5484	VOLKSWOHL-BUND SACH	131,164	2
5461	VPV ALLGEMEINE VERS.	n.a.	2
5093	WESTF.PROV.VERS.AG	803,839	4
5525	WGV-VERSICHERUNG	324,508	4
5476	WWK ALLGEMEINE VERS.	n.a.	6
5479	WÜRTT. GEMEINDE-VERS.	268,611	1
5783	WÜRTT. VERS.	1,180,770	15
5050	ZURICH VERS. AG	n.a.	1

3.6 Accident insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5342	AACHENMüNCHENER VERS.	1,651,306	12
5498	ADAC-SCHUTZBRIEF VERS	3,317,565	4
5312	ALLIANZ VERS.	4,773,321	64
5455	ARAG ALLG. VERS.	21,014,437	7
5397	ASSTEL SACH	n.a.	1
5515	AXA VERS.	848,180	8
5792	BADEN-BADENER VERS.	278,001	3
5317	BARMENIA ALLG. VERS.	131,087	3
5310	BAYER. BEAMTEN VERS.	167,912	6
5324	BAYER.VERS.VERB,AG	657,147	4
5338	CONCORDIA VERS.	317,764	7
5340	CONTINENTALE SACHVERS	675,574	5
5552	COSMOS VERS.	191,439	4
5343	DA DEUTSCHE ALLG.VER.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	211,995	3
5549	DEBEKA ALLGEMEINE	1,805,396	4
5513	DEVK ALLG. VERS.	817,212	4
5344	DEVK DT. EISENB. SACH	266,386	1
5350	DT. RING SACHVERS.	368,466	8
5562	ERGO DIREKT	298,686	2
5472	ERGO VERSICHERUNG	2,759,287	83
5505	GARANTA VERS.	n.a.	1
5473	GENERALI VERSICHERUNG	3,973,501	20
5858	GOTHAER ALLGEMEINE AG	742,725	17
5372	GOTHAER VERS.BANK	n.a.	1
5374	HAFTPFLICHTK.DARMST.	132,141	1
5085	HDI DIREKT	175,396	4
5512	HDI-GERLING FIRMEN	371,652	4
5375	HUK-COBURG	1,008,581	2
5521	HUK-COBURG ALLG. VERS.	520,169	2
5573	IDEAL VERS.	n.a.	1
5546	INTER ALLG. VERS.	136,335	1
5780	INTERRISK VERS.	390,813	3
5078	JANITOS VERSICHERUNG	141,083	2
5402	LVM SACH	883,846	10
5061	MANNHEIMER VERS.	73,112	1
5412	MECKLENBURG. VERS.	138,514	4
5070	NECKERMANN VERS.	n.a.	1
5015	NV-VERSICHERUNGEN	n.a.	1
5426	NÜRNBG. ALLG.	601,621	18
5686	NÜRNBG. BEAMTEN ALLG.	97,820	1
5074	PB VERSICHERUNG	n.a.	2
5446	PROV.NORD BRANDKASSE	339,385	4
5095	PROV.RHEINLAND VERS.	928,483	3
5583	PVAG POLIZEIVERS.	311,215	1
5438	R+V ALLGEMEINE VERS.	1,537,764	15
5798	RHEINLAND VERS. AG	n.a.	1
5121	RHION VERSICHERUNG	n.a.	3
5125	SIGNAL IDUNA ALLG.	1,773,237	10

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5781	SPARK.-VERS.SACHS.ALL	n.a.	1
5586	STUTTGARTER VERS.	453,754	11
5036	SV SPARK.VERSICHER.	276,566	1
5790	TARGO VERSICHERUNG	141,965	4
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VESICHERUNGSK. BAYERN	n.a.	2
5400	VGH LAND.BRAND.HAN.	5,496,076	3
5862	VHV ALLGEMEINE VERS.	318,610	2
5484	VOLKSWOHL-BUND SACH	180,074	3
5461	VPV ALLGEMEINE VERS.	n.a.	1
5093	WESTF.PROV.VERS.AG	956,986	1
5525	WGV-VERSICHERUNG	n.a.	1
5476	WWK ALLGEMEINE VERS.	231,356	5
5479	WÜRTT. GEMEINDE-VERS.	146,207	1
5783	WÜRTT. VERS.	726,492	6
5590	WÜRZBURGER VERSICHER.	n.a.	1

3.7 Household contents insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5342	AACHENMüNCHENER VERS.	875,098	8
5312	ALLIANZ VERS.	2,628,624	55
5405	ALTE LEIPZIGER VERS.	145,790	6
5068	AMMERLÄNDER VERS.	n.a.	2
5455	ARAG ALLG. VERS.	359,060	8
5397	ASSTEL SACH	n.a.	7
5515	AXA VERS.	1,207,937	11
5357	BAD. BEAMTENBANK	n.a.	1
5324	BAYER.VERS.VERB,AG	540,829	5
5317	BARMENIA ALLG. VERS.	n.a.	1
5098	BRUDERHILFE SACH.AG	190,332	3
5338	CONCORDIA VERS.	219,199	5
5340	CONTINENTALE SACHVERS	168,891	2
5552	COSMOS VERS.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	262,249	1
5549	DEBEKA ALLGEMEINE	726,443	7
5513	DEVK ALLG. VERS.	860,523	4
5344	DEVK DT. EISENB. SACH	184,039	3
5129	DFV DEUTSCHE FAM.VERS	n.a.	2
5562	ERGO DIREKT	n.a.	2
5472	ERGO VERSICHERUNG	1,173,086	38
5024	FEUERSOZIETÄT	n.a.	1
5473	GENERALI VERSICHERUNG	1,408,436	17
5858	GOTHAER ALLGEMEINE AG	741,500	14
5372	GOTHAER VERS.BANK	n.a.	1
5557	HÄGER VERS.VEREIN	n.a.	1
5374	HAFTPFLICHTK.DARMST.	n.a.	1
5085	HDI DIREKT	352,852	6
5512	HDI-GERLING FIRMEN	308,757	7
5375	HUK-COBURG	1,331,974	7
5086	HUK24 AG	158,502	2
5521	HUK-COBURG ALLG. VERS	656,866	2
5573	IDEAL VERS.	n.a.	1
5546	INTER ALLG. VERS.	n.a.	4
5075	INTERLLOYD VERS.AG	143,890	2
5401	ITZEHOER VERSICHERUNGEN	n.a.	1
5078	JANITOS VERSICHERUNG	n.a.	3
5362	LANDESSCHADENHILFE	n.a.	1
5404	LBN	n.a.	1
5402	LVM SACH	700,176	6
5412	MECKLENBURG. VERS.	171,820	6
5686	NÜRNB. BEAMTEN ALLG.	n.a.	1
5426	NÜRNBG. ALLG.	159,310	7
5787	OVAG - OSTDT. VERS.	n.a.	2
5583	PVAG POLIZEIVERS.	n.a.	1
5446	PROV.NORD BRANDKASSE	294,207	5
5095	PROV.RHEINLAND VERS.	530,150	4
5121	RHION VERSICHERUNG	n.a.	1
5438	R+V ALLGEMEINE VERS.	881,557	5

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5491	SCHLESWIGER VERS.V	n.a.	1
5125	SIGNAL IDUNA ALLG.	337,780	4
5036	SV SPARK.VERSICHER.	438,272	2
5042	VERSICHERUNGSK.BAYERN	n.a.	1
5400	VGH LAND.BRAND.HAN.	478,924	2
5862	VHV ALLGEMEINE VERS.	309,738	1
5461	VPV ALLGEMEINE VERS.	173,887	2
5525	WGV-VERSICHERUNG		1
5476	WWK ALLGEMEINE VERS.	n.a.	1
5783	WÜRTT. VERS.	774,588	10

3.8 Residential building insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5342	AACHENMüNCHENER VERS.	341,684	3
5581	ADLER VERSICHERUNG AG	n.a.	1
5312	ALLIANZ VERS.	2,012,188	82
5405	ALTE LEIPZIGER VERS.	139,503	5
5455	ARAG ALLG. VERS.	n.a.	1
5515	AXA VERS.	678,211	14
5633	BASLER SECURITAS	162,373	5
5043	BAYER.L-BRAND,VERS.AG	2,349,222	16
5324	BAYER.VERS.VERB,AG	620,474	5
5338	CONCORDIA VERS.	183,003	6
5339	CONDOR ALLG. VERS.	35,839	1
5340	CONTINENTALE SACHVERS	87,951	4
5552	COSMOS VERS.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	137,203	2
5549	DEBEKA ALLGEMEINE	226,510	6
5513	DEVK ALLG. VERS.	329,512	5
5344	DEVK DT. EISENB. SACH	171,707	2
5522	DOLLERUP.FREIE BRANDG	n.a.	1
5472	ERGO VERSICHERUNG	540,546	25
5024	FEUERSOZIETÄT	88,340	2
5365	GEGENSEITIGKEIT VERS.	n.a.	1
5473	GENERALI VERSICHERUNG	588,354	30
5858	GOTHAER ALLGEMEINE AG	307,667	21
5485	GRUNDEIGENTÜMER-VERS.	70,025	2
5032	HAMB. FEUERKASSE	158,972	1
5085	HDI DIREKT	146,246	5
5512	HDI-GERLING FIRMEN	109,477	4
5096	HDI-GERLING INDUSTRIE	n.a.	2
5384	HELVETIA VERS.	171,294	2
5086	HUK24,AG	n.a.	1
5375	HUK-COBURG	587,953	6
5521	HUK-COBURG ALLG. VERS	191,994	4
5057	INTERLLOYD VERS.AG	46,339	1
5546	INTER ALLG. VERS.	n.a.	1
5780	INTERRISK VERS.	n.a.	3
5078	JANITOS VERSICHERUNG	n.a.	2
5402	LVM SACH	501,356	11
5412	MECKLENBURG. VERS.	100,086	6
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5414	MÜNCHEN. VEREIN ALLG.	n.a.	1
5014	NEUENDORFER BRAND-BAU	n.a.	1
5426	NÜRNBG. ALLG.	72,305	3
5786	OKV - OSTDT. KOMMUNAL	n.a.	1
5017	OSTANGLER BRANDGILDE	n.a.	4
5446	PROV.NORD BRANDKASSE	320,366	5
5095	PROV.RHEINLAND VERS.	584,208	28
5583	PVAG POLIZEIVERS.	n.a.	1
5121	RHION VERSICHERUNG	n.a.	1
5438	R+V ALLGEMEINE VERS.	921,497	14

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5798	RHEINLAND VERS. AG	n.a.	5
5491	SCHLESWIGER VERS.V.	n.a.	2
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5125	SIGNAL IDUNA ALLG.	144,042	1
5781	SPARK.-VERS.SACHS.ALL	n.a.	1
5036	SV SPARK.VERSICHER.	2,156,628	26
5459	UELZENER ALLG. VERS.	n.a.	2
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VERSICHERUNGSK.BAYERN	n.a.	1
5400	VGH LAND.BRAND.HAN.	473,676	2
5464	VHV	n.a.	1
5862	VHV ALLGEMEINE VERS.	95,982	3
5484	VOLKSWOHL-BUND SACH	n.a.	1
5461	VPV ALLGEMEINE VERS.	64,472	2
5093	WESTF.PROV.VERS.AG	1,962,059	6
5783	WÜRTT. VERS.	455,798	6
5050	ZURICH VERS. AG	n.a.	1

3.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2010	Complaints
5826	ADAC-RECHTSSCHUTZ	2,590,810	5
5809	ADVO CARD RS	1,483,049	56
5312	ALLIANZ VERS.	2,449,048	59
5405	ALTE LEIPZIGER VERS.	427,404	67
5800	ARAG ALLG. RS	1,378,643	60
5455	ARAG ALLG. VERS.	n.a.	5
5801	AUXILIA RS	506,243	11
5838	BADISCHE RECHTSSCHUTZ	159,142	4
5310	BAYER. BEAMTEN VERS.	n.a.	12
5098	BRUDERHILFE SACH.AG	100,308	4
5831	CONCORDIA RS	411,068	21
5340	CONTINENTALE SACHVERS	86,518	5
5802	D.A.S. ALLG. RS	2,827,677	91
5311	DBV DT. BEAMTEN-VERS.	n.a.	1
5549	DEBEKA ALLGEMEINE	358,238	6
5803	DEURAG DT. RS	1,150,144	63
5513	DEVK ALLG. VERS.	n.a.	1
5829	DEVK RECHTSSCHUTZ	1,047,209	8
5129	DFV DEUTSCHE FAM.VERS	n.a.	3
5834	DMB RECHTSSCHUTZ	799,885	15
5365	GEGENSEITIGKEIT VERS.	n.a.	1
5858	GOTHAER ALLGEMEINE AG	n.a.	1
5512	HDI-GERLING FIRMEN	n.a.	3
5827	HDI-GERLING RECHT.	478,950	16
5818	HUK-COBURG RS	1,545,882	19
5086	HUK24 AG	n.a.	3
5573	IDEAL VERS.	n.a.	1
5401	ITZEHOER VERSICHERUNG	n.a.	3
5812	JURPARTNER RECHTSSCH.	n.a.	1
5534	KS VERSICHERUNGS AG	n.a.	1
5815	LVM RECHTSSCHUTZ	724,180	11
5402	LVM SACH	n.a.	1
5412	MECKLENBURG. VERS.	142,439	2
5334	MEDIENVERS. KARLSRUHE	n.a.	1
5805	NEUE RECHTSSCHUTZ	412,213	14
5813	OERAG RECHTSSCHUTZ	1,339,565	29
5438	R+V ALLGEMEINE VERS.	n.a.	4
5836	R+V RECHTSSCHUTZ	664,569	3
5807	ROLAND RECHTSSCHUTZ	1,289,111	44
5125	SIGNAL IDUNA ALLG.	n.a.	1
5459	UELZENER ALLG. VERS.	n.a.	1
5093	WESTF.PROV.VERS.AG	n.a.	1
5525	WGV-VERSICHERUNG	424,299	17
5479	WÜRTT. GEMEINDE-VERS.	n.a.	1
5783	WÜRTT. VERS.	641,807	16

3.10 Insurers based in the EEA

Reg. no.	Abbreviated name of insurance undertaking	Complaints
5902	ACE EUROPEAN (GB)	5
9053	ADMIRAL INSURANCE(GB)	8
5636	AGA INTERNATION. (F)	14
5029	AIOI NISSAY (GB)	3
1306	ALICO LIFE INT. (IRL)	2
7671	ASPECTA ASSUR. (L)	3
7323	ASPIS PRONIA (GR)	2
5119	ASSURANT ALLG. (GB)	3
5118	ASSURANT LEBEN (GB)	1
7203	ATLANTICLUX (L)	6
1324	ATLANTICLUX LEBEN (L)	7
5064	ATRADIUS KREDIT (NL)	1
5090	AXA CORPORATE S. (F)	3
7595	AXA FRANCE IARD (F)	1
7775	AXA FRANCE VIE (F)	1
7909	AXA INSURANCE UK (GB)	1
1319	AXA LIFE EUR.LTD(IRL)	12
7842	BTA INSURANCE (LV)	1
5145	BTA INSURANCE (LV)	3
7811	CACI LIFE LIM. (IRL)	1
7807	CACI NON-LIFE (IRL)	7
1300	CANADA LIFE (IRL)	12
1182	CARDIF LEBEN (F)	4
5056	CARDIF VERS. (F)	14
5595	CHARTIS EUROPE (F)	12
5142	CHUBB INSUR. (GB)	1
1189	CIGNA LIFE INS. (B)	1
7453	CLERICAL MED.INV.(GB)	20
7724	CREDIT LIFE INT. (NL)	29
7985	CSS VERSICHERUNG (FL)	46
7474	DTSCH.POST INS.(IRL)	1
7281	DKV BELGIUM (B)	1
5048	DOMESTIC AND GEN.(GB)	7
1161	EQUITABLE LIFE (GB)	1
5115	EUROMAF SA (F)	1
7229	EUROPAEISKE REJSE(DK)	1
7229	EUROPEESCHE VERZ.(NL)	1
7813	FINANCELIFE (A)	1
5053	FINANCIAL INSUR.(GB)	4
7410	FOYER INTERNAT. (L)	1
7814	FRIENDS PROVID. (GB)	3
7270	HANSARD EUROPE (IRL)	1
7896	HARTFORD LIFE (IRL)	1
7214	HELVETIA VERS. (A)	2
5788	INTER PARTNER ASS.(B)	3
7587	INTERN.INSU.COR.(NL)	15
7031	LEGAL/GENERAL ASS (GB)	1
9031	LIBERTY EURO.(IRL/E)	10
7899	LIGHTHOUSE LIFE (GBZ)	1

Reg. no.	Abbreviated name of insurance undertaking	Complaints
7007	LLOYD'S OF LONDON(GB)	1
5592	LLOYD'S VERS. (GB)	1
5130	MAPFRE ASISTENC.(E)	1
7806	NEW TECHNOLOGY (IRL)	3
7897	NUCLEUS LIFE AG (FL)	1
7723	PRISMALIFE AG (FL)	39
7455	PROBUS INSURANCE(IRL)	1
7159	QBE Insurance (Europe)	1
7894	QUANTUM LEBEN AG(FL)	1
1317	R+V LUXEMB. LV (L)	8
7415	R+V LUXEMBOURG L (L)	6
9158	RCI INSURANCE (M)	1
7730	RIMAXX (NL)	21
5127	SOGECAP RISQUES (F)	1
1320	STANDARD LIFE (GB)	11
7763	STONEBRIDGE (GB)	2
9000	SWISSLIFE ASS. (F)	37
7883	TELEFONICA INSURANCE (LU)	1
7308	UNIQA Personenversicherung AG	1
1311	VDV LEBEN INT. (GR)	29
7456	VDV LEBEN INTERN.(GR)	194
7643	VIENNA-LIFE (FL)	8
7483	VORSORGE LUXEMB. (L)	9
5088	XL INSURANCE (GB)	2
5151	ZURICH INSURANCE(IRL)	76
7929	ZURICH INSURANCE(IRL)	2
		738

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List of abbreviations

A	**ABCP**	asset-backed commercial paper
	ABS	asset-backed securities
	AfW	*Bundesverband Finanzdienstleistung e.V.* (Federal Financial Services Association)
	AG	*Aktiengesellschaft* (German stock corporation)
	AGB	General Terms and Conditions
	AICPA	American Institute of Certified Public Accountants
	AIF	Alternative Investment Fund
	AIFM	Alternative Investment Fund Managers
	AIG	American International Group
	AKIM	*Arbeitskreis Interne Modelle* (Internal Models Working Group)
	ALM	asset-liability management
	AMA	Advanced Measurement Approach
	AMLEG	Anti Money Laundering Expert Group
	AnIV	*Anlageverordnung* (Investment Regulation)
	AnsFug	*Anlegerschutz- und Funktionsverbesserungsgesetz* (Act to Increase Investor Protection and Improve the Functioning of the Capital Markets)
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 Versicherungswesen* (Federal Insurance Supervisory Office)
	BAWe	*Bundesaufsichtsamt für den Wertpapierhandel* (Federal Securities Supervisory Office)
	BCBS	Basel Committee on Banking Supervision
	BdB	*Bundesverband deutscher Banken* (Association of German Banks)
	BGB	*Bürgerliches Gesetzbuch* (Civil Code)
	BGH	*Bundesgerichtshof* (Federal Court of Justice)
	BIS	Bank for International Settlements
	BKA	*Bundeskriminalamt* (Federal Criminal Police Office)
	BMF	*Bundesfinanzministerium* (Federal Ministry of Finance)
	BMI	*Bundesministerium des Innern* (Federal Ministry of the Interior)
	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 e.V.)
	BVL	*Bundesamt für Verbraucherschutz und Lebensmittelsicherheit* (Federal Office of Consumer Protection and Food Safety)
	BVR	*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* (National Association of German Cooperative Banks)
C		
	C	Circular
	CBS	cross-border provision of services
	CBSG	Cross-Border Stability Group
	CCG	Committee on Corporate Governance
	CCP	central counterparty
	CDO	collateralised debt obligation
	CDS	credit default swap
	CEBS	Committee of European Banking Supervisors
	CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
	CESR	Committee of European Securities Regulators
	CI	capital investment(s)
	CLNs	credit-linked notes
	CLO	collateralised loan obligation
	CMBS	commercial mortgage backed security
	CMG	Crisis Management Group
	Co.	Company
	CO_2	carbon dioxide
	ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
	COREP	Common Reporting
	COREPER	Committee of Permanent Representatives
	CPD	Continuing Professional Development
	CPSS	Committee on Payment and Securities Settlement Systems
	CRA	credit rating agency
	CRD	Capital Requirements Directive
	CRM	comprehensive risk measure
	CRR	Capital Requirements Regulation
	CRSA	Credit Risk Standardised Approach
D		
	DAX	*Deutscher Aktienindex*
	DeckRV	*Deckungsrückstellungsverordnung* (Regulation on the Principles Underlying the Calculation of the Premium Reserve)
	DerivateV	*Derivateverordnung* (Derivatives Regulation)
	DFDC	Depository Trust & Clearing Corporation
	Dir.	Directive
	DM	Deutsche Mark
	DSGV	*Deutscher Sparkassen- und Giroverband* (German Savings Banks Association)
	DVFA	*Deutsche Vereinigung für Finanzanalyse und Asset Management* (Society of Investment Professionals in Germany)

E

e.v.	*eingetragener Verein* (registered association)
EAA	*Erste Abwicklungsanstalt*
EAInvV	*Verordnung zum elektronischen Anzeigeverfahren für richtlinienkonforme inländische Investmentvermögen nach dem Investmentgesetz* (Regulation on the Electronic Notification Procedure under the Investment Act for German Investment Funds Complying with Directive 2009/65/EC)
EBA	European Banking Authority
EBIT	earnings before interest and taxes
EC	European Community
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Economic and Financial Council
ED	Exposure Draft
EdB	*Entschädigungseinrichtung deutscher Banken* (Compensation Scheme of German Banks)
EdBBeitrV	*Beitragsverordnung der gesetzlichen Entschädigungseinrichtung deutscher Banken* (Regulation on Contributions to the Compensation Scheme of German Banks)
EdW	*Entschädigungseinrichtung der Wertpapierhandelsunternehmen* (Compensatory Fund of Securities Trading Companies)
EEA	European Economic Area
EECS	European Enforcersí Coordination Sessions
EFET	European Federation of Energy Traders
EFSF	European Financial Stability Facility
EFTA	European Free Trade Association
EG	*Einführungsgesetz* (Introductory Act)
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
e-money	electronic money
ESE	European Supervisor Education Initiative
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
et seq.	and the following
ETCs	exchange-traded commodities
ETFs	exchange-traded funds
ETNs	exchange-traded notes
ETPs	exchange-traded products
EU	European Union
EUR	euro

F

FAQ	frequently asked questions
FASB	Financial Accounting Standards Board
FATF	Financial Action Task Force on Money Laundering
FDIC	Federal Deposit Insurance Corporation
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)
	FINREP	Revised Guidelines on Financial Reporting
	FISC	Financial Innovation Standing Committee
	FMS	*Finanzmarktstabilisierungsfonds* (Financial Market Stabilisation Fund)
	FMStFG	*Finanzmarktstabilisierungsfondsgesetz* (Act Establishing a Financial Market Stabilisation Fund)
	FREP	Financial Reporting Enforcement Panel (*Deutsche Prüfstelle für Rechnungslegung*)
	FSA	Financial Services Authority
	FSAP	Financial Sector Assessment Program
	FSB	Financial Stability Board
	FSC	Financial Stability Committee
	FSF	Financial Stability Forum
	FSI	Financial Stability Institute
	FSS	Financial Supervisory Service
G	**G20**	The Group of Twenty Finance Ministers and Central Bank Governors
	GAAP	Generally Accepted Accounting Principles
	GbR	*Gesellschaft bürgerlichen Rechts* (German civil law partnership)
	GDP	gross domestic product
	GDV	*Gesamtverband der deutschen Versicherungswirtschaft e.V.* (German Insurance Association)
	GenG	*Genossenschaftsgesetz* (Cooperative Societies Act)
	GIZ	*Deutsche Gesellschaft für Internationale Zusammenarbeit* (German Agency for International Cooperation)
	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)
	G-SIBs	global systemically important banks
	G-SIFIs	global systemically important financial institutions
	G-SIIs	global systemically important insurers
	GW	*Geldwäsche* (money laundering)
	GwAG	*Gemeinsame Arbeitsgruppe zur Geldwäscheprävention* (Anti-Money Laundering Working Group)
	GwG	*Geldwäschegesetz* (Money Laundering Act)
	HessVGH	*Hessischer Verwaltungsgerichtshof* (Higher Administrative Court in Hesse)
H	**HGB**	*Handelsgesetzbuch* (Commercial Code)

I	**IAIS**	International Association of Insurance Supervisors
	IASB	International Accounting Standards Board
	IASs	International Accounting Standards
	ICAAP	Internal Capital Adequacy Assessment Process
	ICE	Intercontinental Exchange Inc.
	ICPs	Insurance Core Principles
	ICS	internal control system
	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 and Cross-Sectoral Issues Subcommittee
	IIF	Institute of International Finance
	IMF	International Monetary Fund
	Inc.	incorporated company
	InhKontrollV	*Inhaberkontrollverordnung* (Holder Control Regulation)
	InvG	*Investmentgesetz* (Investment Act)
	InvMaRisk	*Mindestanforderungen an das Risikomanagement für Investmentgesellschaften* (Minimum Requirements for Risk Management in Asset Management Companies)
	InvSchlichtV	*Investment-Schlichtungsstellenverordnung* (Investment Arbitration Board Regulation)
	IOPS	International Organisation of Pension Supervisors
	IORP	institution for occupational retirement provision
	IOSCO	International Organization of Securities Commissions
	IP	investment portfolio
	IPO	initial public offering
	IRBA	Internal Ratings Based Approach
	ISAs	International Standards on Auditing
	IT	information technology
	IU	insurance undertaking
J	**JCFC**	Joint Committee on Financial Conglomerates
	JF	Joint Forum
K	**KAG**	*Kapitalanlagegesellschaft* (asset management company)
	KfW	*Kreditanstalt für Wiederaufbau*
	KG	*Kommanditgesellschaft* (German limited partnership)
	KWG	*Kreditwesengesetz* (Banking Act)
L	**LBB**	Landesbank Berlin Holding AG
	LBBW	Landesbank Baden-Württemberg
	LCR	liquidity coverage requirement; liquidity coverage ratio
	LG	*Landgericht* (Regional Court)
	LI	life insurance
	LIBOR	London Interbank Offered Rate
	LIU	life insurance undertaking

	LKA	*Landeskriminalamt* (State Bureau of Investigation)
	Ltd.	Limited
M	**M&A**	mergers & acquisitions
	MaAnzV	*Mitarbeiteranzeigeverordnung* (Employee Notification Regulation)
	MaComp	*Mindestanforderungen an die Compliance* (Minimum Requirements for the Compliance Function)
	MaKonV	*Marktmanipulations-Konkretisierungsverordnung* (Market Manipulation Definition Regulation)
	MaRisk	*Mindestanforderungen an das Risikomanagement* (Minimum Requirements for Risk Management)
	MdB	*Mitglied des Bundestags* (Member of the Bundestag)
	MiFID	Markets in Financial Instruments Directive
	MiFIR	Markets in Financial Instruments Regulation
	MoU	Memorandum/a of Understanding
	MPSWG	Macroprudential Policy and Surveillance Working Group
	MTF	multilateral trading facility
	MVP	*Melde- und Veröffentlichungsplattform* (reporting and publication platform)
N	**n.a.**	not applicable
	Nasdaq	National Association of Securities Dealers Automated Quotations
	NKR	*Nationaler Normenkontrollrat* (National Regulatory Control Council)
	NLPosV	*Netto-Leerverkaufspositionsverordnung* (Regulation on Net Short Positions)
	no.	number
	NSFR	net stable funding ratio
	NYSBD	New York State Banking Department
	NYSE	New York Stock Exchange
O	**OCI**	other comprehensive income
	OECD	Organisation for Economic Cooperation and Development
	OIS	overnight index swap
	OJ	Official Journal
	OLG	*Oberlandesgericht* (Higher Regional Court)
	OPEC	Organization of the Petroleum Exporting Countries
	ORSA	Own Risk and Solvency Assessment
	OTC	over-the-counter (OTC)
	OTFs	organised trading facilities
	OTS	Office of Thrift Supervision
	OVG	*Oberverwaltungsgericht* (Higher Administrative Court)
P	**P account**	garnishment protection account (*Pfändungsschutzkonto*)
	p.	page
	p.a.	per annum
	PF	pension fund

	PfandBG	*Pfandbriefgesetz* (Pfandbrief Act)
	PIIGS	Portugal, Ireland, Italy, Greece, Spain
	PLIGF	Private Life Insurance Guarantee Fund (Greece)
	PRAs	price reporting agencies
	PrüfbV	*Prüfungsberichtsverordnung* (Audit Report Regulation)
Q	**QIS**	quantitative impact study
	RechKredV	*Kreditinstituts-Rechungslegungsverordnung* (Regulation on the Accounting of Banks and Financial Services Institutions)
R	**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
	RoE	return on equity
	RRPs	recovery and resolution plans
	RWAs	risk-weighted assets
S	**S&P**	Standard & Poor's
	S.A.	Société Anonyme
	S.a.r.l.	Société à Responsabilité Limitée
	SCAV	Standing Committee on the Assessment of Vulnerabilities
	SCM	Standard Cost Model
	SE	Societas Europaea
	SEC	Securities and Exchange Commission
	SGB	*Sozialgesetzbuch* (Social Code)
	SIBs	systemically important banks
	SIFIs	systemically important financial institutions
	SIIs	systematically important insurers
	SoFFin	*Sonderfonds Finanzmarktstabilisierung* (Financial Market Stabilisation Fund)
	SolvV	*Solvabilitätsverordnung* (Solvency Regulation)
	SPEs	special purpose entities
	SPVs	special purpose vehicles
	SREP	Supervisory Review and Evaluation Process
	SROs	self-regulatory organisations
	SSC	Solvency and Actuarial Issues Subcommittee
	StGB	*Strafgesetzbuch* (Criminal Code)
	StPO	*Strafprozessordnung* (Code of Criminal Procedure)
T	**TANs**	transaction numbers
U	**UCITS**	Undertakings for Collective Investment in Transferable Securities
	UN	United Nations
	US	United States
	US GAAP	United States Generally Accepted Accounting Principles

	USA	United States of America
	USD	US dollars
V	**VA**	*Versicherungsaufsicht* (Insurance Supervision)
	VAG	*Versicherungsaufsichtsgesetz* (Insurance Supervision Act)
	VaR	value at risk
	ver.di	Vereinte Dienstleistungsgewerkschaft
	VermAnlG	*Vermögensanlagengesetz* (Capital Investment Act)
	VG	*Verwaltungsgericht* (Administrative Court)
	VGH	*Verwaltungsgerichtshof* (Higher Administrative Court)
	VO	*Verordnung* (Regulation)
	VSchDG	*Verbraucherschutzdurchsetzungsgesetz* (Consumer Protection Enforcement Act)
	VVG	*Versicherungsvertragsgesetz* (Insurance Contract Act)
	VwGO	*Verwaltungsgerichtsordnung* (Rules of the Administrative Courts)
W	**WA**	*Wertpapieraufsicht* (Securities Supervision)
	WBZ	*Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V. (Wettbewerbszentrale)* (Centre for Protection against Unfair Competition)
	WGZ	Westdeutsche Genossenschafts-Zentralbank
	WpDPV	*Wertpapierdienstleistungs-Prüfungsverordnung* (Investment Services Examination Regulation)
	WpDVerOV	*Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung* (Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises)
	WpHG	*Wertpapierhandelsgesetz* (Securities Trading Act)
	WpHGMaAnzV	*WpHG-Mitarbeiteranzeigeverordnung* (WpHG Employee Notification Regulation)
	WpPG	*Wertpapierprospektgesetz* (Securities Prospectus Act)
	WpÜG	*Wertpapiererwerbs- und Übernahmegesetz* (Securities Acquisition and Takeover Act)
Z	**ZAG**	*Zahlungsdiensteaufsichtsgesetz* (Payment Services Supervision Act)
	ZKA	*Zentraler Kreditausschuss* (Central Credit Committee)

Published by
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
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Bonn and Frankfurt am Main | May 2012

Design
André Gösecke, DruckVerlag Kettler

Printed by
DruckVerlag Kettler GmbH, Bönen

Photos
BaFin/Kai Hartmann photography (Cover, Preface, p. 9, 46, 69, 96, 99, 133, 152, 183, 192, 222, 237, 243, 263, 267), BaFin/photothek (p. 32, 62, 82, 120, 141, 158, 202, Cover), fotolia/marog-pixcells (p. 25), Piotr Bizior (p. 35), Mattilda (p. 55), Falko Matte (p. 109), svort (p. 129), Kzenon (p. 169), Franz Pflügel (p. 178) drubig-photo (p. 207), PhotoSG (p. 233), Frog974 (p. 253), Pressmaster (p. 275)