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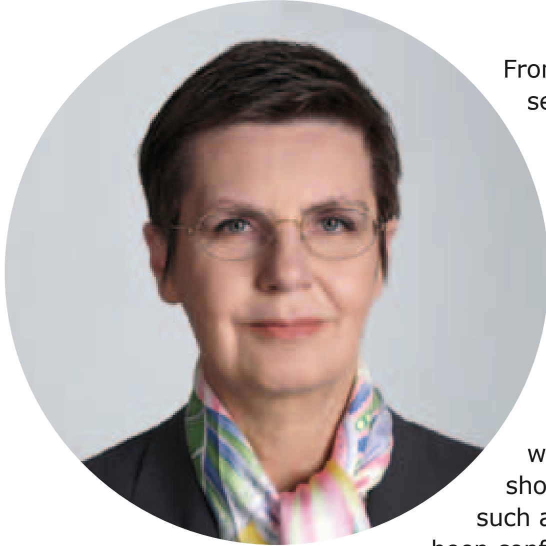
'12

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

# Preface



From the perspective of an integrated financial services supervisor, 2012 was a year of ups and downs. For example, the cheap money policy that the European Central Bank has been pursuing for some time now benefited not only indebted countries, but also banks. Above all, it bought time for both sides – time that the banks, for instance, must use to review their business models and improve their earnings. On the other hand, the low level of interest rates caused and continues to cause problems for other companies, especially life insurers. The good news is that they will be able to meet their benefit obligations in the short to medium term, thanks to various measures such as, for instance, the *Zinszusatzreserve.* This has been confirmed by BaFin's stress tests and projections.

These and many other issues that occupied us in 2012 will continue to accompany us in 2013 – and beyond. Chief among them are a number of regulatory reform projects. For example, the question of how to deal with systemically important banks has not been finally answered. Although we have made some progress in the regulation of the shadow banking sector, we still have a long way to go. Another European reform project that we have carried over into 2013 is the revision of the Markets in Financial Instruments Directive (MiFID). Unfortunately, even major projects that were already at an advanced stage have slipped behind schedule. Examples include the European CRD IV regulatory package that is intended to implement Basel III, among other things. Solvency II is another project that is taking its time.

Another issue that is keeping us busy well into the current year is the planned establishment of a single supervisory mechanism for banks in the eurozone led by the European Central Bank. Although the final decisions have yet to be taken in Brussels, work is already progressing on the development of this new European banking supervisor. My goal for BaFin is to play an active role in shaping this new supervisory environment. This represents a challenge for us not only in 2013, but also beyond.

Bonn/Frankfurt am Main | March 2013

Dr Elke König
President

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# I Highlights

## Dealing with systemically important banks

The question of how to deal with systemically important banks was again a focus of banking supervision in 2012. If such institutions were to collapse, the resulting shockwaves could also significantly impact the real economy. That is why they continue to enjoy a unique form of protection: they can rely on governments bailing them out in an emergency. This entails a risk of moral hazard: the "de facto insolvency protection" can tempt banks into entering into extremely risky transactions so that they can entice investors with promises of substantial returns. At any rate, it reduces their capital costs. Core aspects of a market-based economic system – the notion that enterprises should be responsible and liable for their own actions – are thus circumvented.

For a long time, the supervisory options available in this area were limited. However, key regulatory steps have now been taken – or at least initiated – here in Germany, at European level and globally. The focus so far has been on the issues of capitalisation and recovery and resolution planning. The goal is firstly to strengthen the individual banks so as to reduce the possibility of their getting into difficulties and dragging down other market participants with them. And secondly, to eliminate the risk of moral hazard, which cannot be achieved merely by imposing a capital add-on for global and domestic systemically important banks.

Restoring market economy rules.

To ensure that large banks, too, can function once more in line with market economy rules, there must be a credible threat of allowing them to become insolvent in the worst-case scenario. However, this threat can only be made if – ideally – there is a cross-border recovery and resolution regime that allows distressed institutions to recover or be resolved in an orderly manner. With its Restructuring Act *(Restrukturierungsgesetz),* Germany is a pioneer in this field.

The "Key Attributes of Effective Resolution Regimes for Financial Institutions" issued by the Financial Stability Board (FSB) are the cornerstone for an effective cross-border resolution regime. The European Union intends to follow suit with a directive that aims – among other things – to implement the FSB's requirements at European level. The draft directive also envisages preparatory and preventive measures such as recovery and resolution plans, but it also goes beyond the FSB's Key Attributes by stipulating measures that govern intervention at an early stage. Moreover, the European directive will expand the reach of the measures significantly, while bearing in mind the proportionality principle: it will apply to all banks, whereas the FSB mainly had the global systemically important institutions in its sights. The draft directive sets out considerable powers of ex ante intervention: supervisors will be able to intervene in the structure, business model and management especially of large banks, and will be able to ensure that they can be resolved more easily in an emergency. The potential intervention measures go as far as the economic and organisational ringfencing

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of critical business activities. It will also be possible to restrict or prohibit certain business activities.

BaFin circular on recovery planning.

In the autumn of last year, BaFin published the draft of a circular containing a detailed regulatory framework for recovery plans that aims to flesh out the FSB's requirements and the planned European directive. These Minimum Requirements for the Design of Recovery Plans *(Mindestanforderungen an die Ausgestaltung von Sanierungsplänen* – MaSan) will not only apply to banks classified as global systemically important institutions by the FSB. German domestic systemically important banks must also comply with them.

Ideally, recovery planning is a preventive measure that forms part of an appropriate risk management strategy. Both sides – BaFin and the banks – will have to examine preventive measures at an early stage at both an organisational and a strategic level. The aim is to be able to act quickly and effectively in crisis situations. Among other things, the recovery plans will also indicate to BaFin whether an institution is so complex that the supervisor will have to insist on structural changes to increase that institution's resolvability.

Liikanen Report.

In the autumn of 2012, a group headed by the Finnish central bank president Erkki Liikanen looked further into the issue of how the too-big-to-fail and the moral hazard problem can be solved: among other things, Liikanen wants to require banks to ringfence their credit and deposit business from their trading activities. This would prevent their deposit business, which is so important for the real economy and benefits from a de facto state guarantee, from being used to fund the risky trading business. At the same time, any future resolution would be made easier by the legal, organisational and economic separation of trading activities, whilst the benefits of the "universal banking" model would be retained by combining the ownership rights in a holding company structure.

In terms of the realisation of the Liikanen goals, Germany is a pioneer (similar to the situation with the Restructuring Act), this time together with France. The planned Act on Ringfencing and Recovery and Resolution Planning for Credit Institutions *(Gesetz zur Abschirmung von Risiken und zur Sanierung und Abwicklung von Kreditinstituten)* is designed to require financial groups that operate deposit business to use a separate financial trading entity to execute risky transactions, with non-compliance a criminal offence. In addition to the general supervisory requirements, this entity would be subject to a special supervisory regime. For example, no company in the financial group would be obliged to offset any loss incurred by the trading entity. The trading entity would be autonomous so that exposures arising there cannot directly impact the other companies in the group. The autonomy of the trading entity would also make it easier to resolve.

**Dealing with systemically important insurers**

The International Association of Insurance Supervisors (IAIS) and the FSB are currently debating whether there are systemically important insurers and what the relevant criteria are. A core issue is how regulators should deal with systemic risks that are typical for

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insurers. From BaFin's perspective, it does not make sense to define flat-rate capital add-ons on capital requirements, which currently differ significantly across the globe. Group-wide capital add-ons also do not appear to be the best way to stem systemic risk. Selective measures are the better choice, and these do not have to relate solely to capital.

Recovery planning for insurers.

As far as the issue of recovery and resolution is concerned, consideration is being given to applying the Key "Attributes of Effective Resolution Regimes for Financial Institutions" adopted by the FSB in November 2011 not only to global systemically important insurers, but also – at least in some cases – to internationally operating insurance groups, national systemically important insurers and insurers with a high proportion of non-traditional or non-insurance activities. Certain elements of the FSB's Key Attributes are already to be found in the IAIS Insurance Core Principles that apply to all insurance undertakings. At European level, the European Commission has published a consultation document on the recovery and resolution regime for non-bank financial institutions, which include insurers. BaFin, too, is examining whether insurers should develop recovery plans and what minimum requirements they would have to meet. It believes that recovery plans are a useful preventive risk management tool that can help – indirectly – to further curtail systemic risk.

### Future common European banking supervisor

The planned Single Supervisory Mechanism (SSM) for banks in the eurozone was and remains a core topic in banking supervision. The finance ministers of the European Union agreed in December 2012 that the European Central Bank (ECB) will in future be responsible for all banks whose total assets exceed €30 billion or 20% of the GDP of their home country. The ECB will supervise a minimum of three banks from each member state participating in the Single Supervisory Mechanism. Around 30 German banks are likely to be covered by the SSM. Although the decision on the new European banking supervisor has been taken, BaFin believes that a number of fundamental issues still have to be clarified before the new supervisor can start operating in 2014. The arrangements governing cooperation between the ECB and the national supervisory authorities must also be clearly defined by then. BaFin's goal is to actively help shape both the development and the subsequent work of the European banking supervisor. In doing so, it will also aim to ensure at all times that the principle of proportionality is safeguarded: supervision must be appropriate and tailored to the institution and its risk profile.

### Implementation of Basel III in Europe

Another major regulatory project in the field of banking supervision was not completed in 2012: the CRD IV package, consisting of a directive and a regulation that – among other things – will implement the global Basel III rules at European level. This means that the German CRD Implementation Act *(CRD-Umsetzungsgesetz),* whose development – with significant

input from BaFin – was already at an advanced stage, was also not completed. CRD IV is designed to improve the quantity and above all the quality of institutions' own funds and will impose liquidity requirements that for the first time are harmonised across the EU. The goal is to make both individual banks and the entire financial market more stable. The EU has also addressed other key points as part of the CRD IV project, for example issues of corporate governance and the harmonisation of the powers of supervisors to intervene and impose sanctions. Additionally, CRD IV is intended to become part of a comprehensive single rule book that will standardise banking regulation across Europe and is thus one of the key conditions for the planned European banking supervisor. The Irish Presidency of the Council of the European Union is therefore striving to bring the European negotiations to a conclusion quickly, among other things due to the legal certainty necessary for the institutions and supervisors.

### Revision of the MaRisk in 2012

At the latest since Basel II, banks' internal risk management systems have played just as important a role in banking supervision as their capital resources. The requirements for risk management have grown steadily since the start of the financial crisis. For example, new international requirements regarding banks' risk management and internal governance, among other things, prompted BaFin to undertake another revision to its Minimum Requirements for Risk Management for Banks and Financial Services Institutions *(Mindestanforderungen an das Risikomanagement von Banken und Finanzdienstleistungsinstituten* – MaRisk). Lessons learned from BaFin's administrative practice were also incorporated into the revision. One new requirement in the MaRisk, for example, is that the head of the risk control function must be involved in key risk policy-related decisions by management. That function should therefore have as high a place in the hierarchy as possible, and the person concerned should be a member of the board at large, international institutions. The MaRisk also now contains an explicit requirement for a capital planning process to be established. This planning tool adds a more forward-looking component to the risk-bearing capacity concept, enabling institutions to identify any capital requirements at an early stage.

### Benchmarks and indices

One regulatory project that has been keeping numerous global and European bodies busy since the summer of 2012 runs under the heading of "benchmarks and indices". In response to the problems surrounding benchmark interest rates such as LIBOR and Euribor, the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the International Organization of Securities Commissions (IOSCO) are currently developing principles to improve supervision of the way various benchmarks are calculated and used. BaFin welcomes the measures initiated by the EBA, ESMA and IOSCO as an interim step. In the longer term, however, calculation of interest rates such as LIBOR and Euribor should rather be replaced by a new system.

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EBA requirements for Euribor banks.

In January 2013, the EBA issued initial recommendations for the supervision of the banks represented on the Euribor panel. The content of these recommendations is largely in line with the requirements that BaFin already imposes under its MaRisk for banks on the quoting processes of the German institutions involved. BaFin takes the view that the question of whether a bank participates in the calculation of such a private-sector benchmark is solely a matter for that bank. If it does participate, however, it must implement appropriate processes.

The European Commission has proposed amendments to the Market Abuse Directive under which the manipulation of benchmarks such as LIBOR would be a criminal offence. Further legislative initiatives are planned at EU level.

**Regulating the shadow banking sector**

One of the most important international projects remains the regulation of the shadow banking sector. In November 2010, the G20 heads of state and government tasked the FSB with developing recommendations, together with the standard-setting bodies, on how to strengthen the regulation of this sector. The FSB has already submitted concrete regulatory recommendations for some areas. In October, for example, IOSCO published recommendations on behalf of the FSC on reducing the susceptibility of money market funds to runs and other systemic risks. Money market funds play a significant role as a source of finance, especially for banks. They suffered from massive cash outflows during the 2007/2008 financial crisis. The IOSCO recommendations now have to be implemented nationally. The European Commission already announced an initiative to ensure their standardised implementation at EU level. By contrast, the FSB has still not completed its work in other areas, such as the regulation of the shadow banking activities of finance companies and hedge funds, and the regulation of the securities lending and repo markets. BaFin is strongly advocating the adoption of a coherent overall package in the autumn of 2013.

Direct and indirect regulation.

BaFin’s goal continues to be to ensure that the entire shadow banking system is identified and regulated – both directly by regulating and supervising the entities themselves, and indirectly, meaning that the connections between the regulated sector and the shadow banking sector must be identified. Although this goal can only be reached through incremental steps, these must now, finally, be taken.

**Solvency II later than planned**

Solvency II, the across-the-board reform of European insurance supervision, will also be delayed. In their negotiations on the Omnibus II Directive, the European Commission, the Council of the European Union and the European Parliament have addressed important, complex issues that have to be resolved. One of these is how to treat the insurance products with long-term guarantees. A number of instruments have been proposed, and their suitability

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and any side-effects will now be tested in a quantitative impact study.

Fast-tracking the ORSA.

There are currently deliberations – in part also because of BaFin's urging – to fast-track parts of Solvency II. The focus here is on the undertakings' Own Risk and Solvency Assessment (ORSA). The European Insurance and Occupational Pensions Authority (EIOPA) is currently developing interim guidance for the ORSA, which will be part of the risk management system. For example, the ORSA will require insurers to prepare projections spanning several years when calculating their capital requirements as part of their risk-bearing capacity concept, and to be aware from the outset of the impact of their strategic decisions on their capital requirements. Forward-looking capital planning and risk-bearing capacity assessment is indispensable for insurers – especially when the economic environment is tough. Germany already has the statutory basis for introducing the core requirements of the ORSA prior to the effective date: section 64a of the Insurance Supervision Act *(Versicherungsaufsichtsgesetz* – VAG), which requires the insurers to have a proper business organisation. BaFin has set out the requirements of section 64a of the VAG in greater detail in the Minimum Requirements for Risk Management in Insurance Undertakings *(Mindestanforderungen an das Risikomanagement VA* – MaRisk VA). BaFin believes that the entire scope and depth of the ORSA cannot yet be implemented because it is closely linked in some areas to the quantitative requirements of Pillar 1, which are still being negotiated.

No new reporting obligations before Solvency II.

BaFin is sceptical about EIOPA's plans for reporting obligations, under which the majority of undertakings would already have to prepare annual and quarterly Solvency II reports to a certain extent as of the beginning of 2015. However, only a very few of these reporting obligations can be separated out from the quantitative requirements that have still to be resolved. As in the case of the ORSA, BaFin takes the view here that the Pillar 1 quantitative requirements should not be introduced by the back door. Quite apart from this, Germany does not currently have a statutory basis for requiring insurers to participate in a fast-tracked Solvency II reporting regime.

**Low interest rates weighing on insurers and pension funds**

Zinszusatzreserve is a useful tool.

Interest rates have remained at persistently low levels for almost four years. Although they are not the only ones to suffer, insurers and pension funds that have issued long-term guarantees, or whose ability to meet their obligations depends in other respects on the performance of their investments, have also been hit. The lawmakers have already taken an important step towards remedying this situation: since 2011, life insurers have been required to establish a *Zinszusatzreserve* (an additional provision to the premium reserves introduced in response to the lower interest rate environment) to offset their expected lower investment income. BaFin actively supported this requirement when it was introduced. In 2012, the life insurance sector spent around five billion euros on the *Zinszusatzreserve.* Unless the situation on the capital markets changes, a similar amount will have to be spent in 2013. Although

the *Zinszusatzreserve* is currently a burden for the German life insurers, it is unavoidable and complies with market economy rules. The *Zinszusatzreserve* is a provision for unexpired risks that represents the costs of the guarantee obligations in the current environment, and serves to ensure that those obligations can be met in the long term.

Participation of insureds in the valuation reserves.

One topic that also has its roots in the low interest rates and has enjoyed considerable public attention is the participation of policyholders in the valuation reserves funded by fixed-income securities. The Bundestag resolved in early November 2012 to amend the current statutory provisions on this as part of the SEPA Accompanying Act *(SEPA-Begleitgesetz).* After the Bundesrat referred the matter to the Mediation Committee, the lawmakers decided against the new rule at the end of February 2013 because they wanted first to undertake a fundamental review of the supervisory framework.

As a general principle, valuation reserves funded by fixed-income securities arise only if capital market rates are falling. As the law stands today, this forces life insurers to pay out extremely high amounts to their outgoing customers precisely in an environment of declining – and now very low – interest rates. Another problem is that the valuation reserves funded by fixed-income securities automatically reverse by the maturity date without any increase in the meantime in the coupon income on the securities and their repayment at maturity over their term. This siphons off funds from the remaining policyholders. There is therefore still a need for an appropriate solution that respects the interests of all policyholders. The planned amendment to the law would have balanced the interests of the outgoing customers with those of the policyholders as a whole and would have ensured the stabilisation of the discretionary bonuses.

### Partial collectivisation of the provision for bonuses and rebates

The Bundestag and the Bundesrat agreed on the partial collectivisation of the provision for bonuses and rebates *(Rückstellung für Beitragsrückerstattung* – RfB) that was also planned as part of the SEPA Accompanying Act. The background to this is that the insurance contracts of the life insurers had been split into existing and new contracts in the course of deregulation in 1994. This division led to differences in the way the RfB for the existing contracts and the RfB for the new contracts developed. In terms of the discretionary bonuses of the policyholders, this threatened to lead to the unequal treatment of the two groups, which would have been unacceptable. Partial collectivisation has now solved this problem. This new arrangement ensures a fair balance of interests between the two groups of policyholders.

### AIFM Directive: all fund managers will be supervised

The European Alternative Investment Fund Managers (AIFM) Directive is one of the many major regulatory projects in the field

of securities supervision. The directive came into force in mid-2011, and it must be transposed into national law by July 2013. The AIFM Directive will help improve supervision of the shadow banking sector in Europe. It covers the managers of funds that are not already regulated by the UCITS Directive, for example hedge fund managers. The directive also regulates the managers of closed-end funds who were not previously subject to any supervision. The market participants covered by the directive will be subject to extensive obligations to provide information, including to the supervisory authorities. Supervisors can require supplementary information if this is necessary for the effective supervision of systemic risks. The Federal Government adopted the draft Act Implementing the AIFM Directive *(Gesetz zur Umsetzung der AIFM-Richtlinie)* on 12 December 2012, and it is now making its way through parliament. At the heart of the Act Implementing the AIFM Directive is the future Investment Code *(Kapitalanlagegesetzbuch* – KAGB), which for the first time will create a comprehensive regulatory framework for both open-ended and closed-end funds and their managers.

**EMIR Implementation Act has entered into force**

The German EMIR Implementation Act *(EMIR-Ausführungsgesetz)* entered into force on 16 February 2013. It brings for example the Banking Act *(Kreditwesengesetz* – KWG) and the Securities Trading Act *(Wertpapierhandelsgesetz* – WpHG) into line with the European regulation on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR). The EMIR came into force on 16 August 2012 and governs the main requirements for over-the-counter (OTC) derivatives transactions within the EU. For example, it introduces a central clearing requirement for standardised OTC derivatives. Protection from the default risk of one or more parties is provided even in difficult market conditions, because the central counterparty is subject to stringent risk management requirements and demands collateral for the risks assumed. Special risk management and collateralisation requirements will apply to contracts that are not subject to the clearing requirement, for instance because they cannot be standardised. The regulation also specifies how central counterparties have to organise credit and liquidity risk. To increase transparency, derivatives transactions will in future have to be reported to a trade repository. The reporting requirement will not be limited to OTC derivatives, but will also cover exchange-traded derivatives. The European supervisory authorities will be able to access the data stored.

**Employee and Complaints Register now live**

At the beginning of November 2012, BaFin went live with its database for the new Employee and Complaints Register. By the end of March 2013, institutions had reported 176,142 advisers, 27,532 sales officers and 2,436 compliance officers to BaFin. BaFin has also received customer complaints: around 5,000 by the end of March. Where clusters of complaints have emerged, BaFin has taken the opportunity to speak to the advisers in question. BaFin

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makes a clear distinction between cases where an individual adviser has behaved inappropriately and cases where the company's organisation of its sales management activities is fundamentally wrong. Because the Register also captures the employees who manage sales, BaFin can analyse the sales structures precisely and identify any misdirected incentives. BaFin has increased its staff in this area considerably so as to be able to perform these activities on site more frequently. The Employee and Complaints Register has further strengthened supervision in the field of collective consumer protection.

**Establishment of a Consumer Consultative Panel**

BaFin has always had responsibility for the community of consumers, meaning that it protects consumers in their entirety. The Act on the Strengthening of German Financial Supervision *(Gesetz zur Stärkung der deutschen Finanzaufsicht)* requires BaFin to take even greater account of consumer issues in the future without allowing these to collide with the goals of solvency and market supervision, which also serve to protect consumers. To achieve this, BaFin is establishing a Consumer Consultative Panel that will advise it on issues relating to consumer protection. The twelve members of the panel will be appointed by the Federal Ministry of Finance and will be drawn from the fields of academia, consumer or investor protection organisations, out-of-court dispute resolution entities, trade unions and the Federal Ministry of Food, Agriculture and Consumer Protection.

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# II Economic environment

## 1 Sovereign debt crisis

Public finances represent main threat to Europe's financial stability.

The sovereign debt crisis spread in 2012 and remained by far the greatest threat to Europe's financial stability. At first, the crisis centred on individual eurozone countries. Greece and Ireland had already accepted financial aid in 2010. Portugal followed suit in spring 2011, after the markets had increasingly questioned the solidity of its public finances and spreads had risen sharply. Subsequently, more countries, including larger nations like Italy and Spain, repeatedly came under pressure. In the summer of 2012, the crisis threatened to escalate, putting the future of the European Monetary Union temporarily in the balance. In many places, the effects of the sovereign debt crisis, banking crisis and economic crisis converged.

Haircut in Greece.

Despite the bailout packages and drastic austerity measures, Greece did not manage to get its public finances on a sustainable footing in 2012. A second Greek bailout package was therefore made conditional on a significant improvement in the country's debt sustainability. Consequently, in March 2012, Greece restructured its government bonds in a Private Sector Involvement deal (PSI). 97% of private creditors took part, accepting a 53.5% write-down of the nominal value of their bonds. The actual economic value of the debt waiver was significantly higher, because the new bonds issued had longer maturities and a lower coupon rate. As a result, the restructuring led to a €107 billion reduction in Greek sovereign debt. However, the Greek government had to provide additional funding to support domestic banks that were particularly heavily impacted by the haircut, which lessened the scale of the debt reduction. Overall, the country's debt declined from €356 billion to €280 billion over the first quarter of 2012. Implementation of the programme was considerably delayed by the two elections. The lower proceeds from privatisations, growth that was weaker than forecast in spring 2012 and the accompanying reduction in income created a funding gap in the programme. The donors agreed to grant the Greek government an additional two years to implement the austerity measures. The bailout funds were finally formally approved in December following the successful government bond buyback programme. Around €31.9 billion of bonds were repurchased at an average of 33.8% of their face value. This will cut Greece's net debt by 9.5% of GDP by 2020. The gross financing requirement for the bond buyback amounted to €11.3 billion (including accrued interest).

Oversized financial sector in Cyprus.

As a result of its oversized banking sector, which also suffered losses in Greece, Cyprus fell into financial difficulty as well. The government was unable to implement the necessary support measures using its own resources and applied to the European Financial Stability Facility (EFSF) for financial aid in June 2012.

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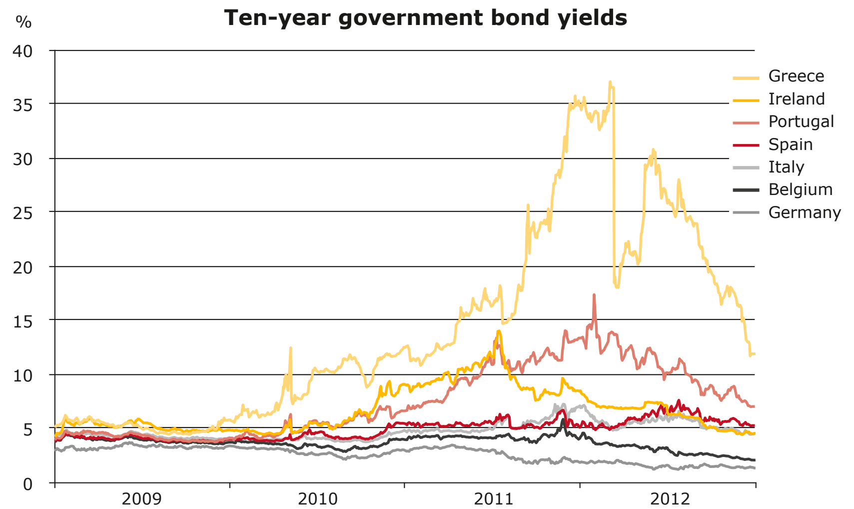
Figure 1
## Interest rate differentials in Europe




Source: Bloomberg

Italy and Spain come under pressure on the capital markets.

Spain and Italy's financial problems also flared up again in the summer. The two countries' funding costs on the capital market increased sharply. The part-nationalisation of Bankia – the fourth-largest bank in Spain, which was created through the merger of several savings banks – shook the markets and fuelled doubts about the robustness of the Spanish banking sector. In July 2012, Spain was offered aid of up to €100 billion for bank restructuring. Five months later, the Spanish government made its first official application for loan assistance in the amount of €39.5 billion. The funds were paid from the European Stability Mechanism (ESM) to the Spanish bank rescue fund, FROB (Fondo de Reestructuración Ordenada Bancaria). The government is liable for the aid repayment. In Italy, fears again mounted that the government might abandon its strict austerity programme, which would cause banks to suffer as a result of their high domestic government bond holdings.

ECB monetary policy measures.

In this tense environment, the European Central Bank (ECB) announced that it would purchase an unlimited volume of the problem countries' government bonds on the secondary market, subject to certain conditions (defined by the ECB), so as to safeguard appropriate monetary policy transmission and the singleness of the monetary policy. The Outright Monetary Transactions (OMT) purchase programme resolved in September 2012 replaced the Securities Markets Programme (SMP), which was launched in May 2010. However, the OMT programme was not used in the period up to the end of the year. This was not the first time the ECB had taken unconventional measures. In December 2011 and February 2012, it conducted two refinancing operations with a maturity of up to three years at an interest rate of 1%. Banks drew down a total of more than €1 trillion in central bank liquidity. In addition, the ECB gradually relaxed the eligibility requirements for securities provided as collateral in its ongoing refinancing operations with banks and reduced the key interest rate from 1% to 0.75% in

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July 2012. The ECB's monetary policy measures helped to calm the eurozone's financial markets and had a stabilising effect.

Policymakers work to create stable financial architecture.

The reform efforts hinge on measures intended to ensure fiscal policy discipline in the EU member states and prevent inflated budget deficits and debt levels. A stricter version of the Stability and Growth Pact in existence since the Maastricht Treaty was signed was introduced in 2012. The Fiscal Compact, which was ratified by 25 member states, also specifies that each country must implement restrictive financial policy rules in national law. These national debt ceilings are based on uniform standards.

A further stabilising anchor was created in autumn 2012 in the form of the ESM. This is designed to be a permanent crisis mechanism for the eurozone and is to replace the interim EFSF rescue facility. There will be a transitional period during which both institutions are active. The ESM can provide funding to its members in crisis situations, subject to strict conditions. The subscribed capital amounts to €700 billion, of which €80 billion will be paid in directly in stages. The remaining €620 billion consists of callable capital and guarantees. The ESM's effective lending capacity is limited to €500 billion. Together with the extended EFSF, potential funding of €700 billion is available. Of this amount, around €200 billion has already been utilised through ongoing programmes.

At the peak of the sovereign debt and banking crisis in June 2012, the eurozone heads of state and government demanded the establishment of a single supervisory mechanism (SSM) for banks as part of a banking union.[1] The strengthening of fiscal discipline, the creation of a permanent crisis mechanism and the work on a banking union have made the shape of long-term institutional reform in Europe clearer.

Ireland and Portugal heading in the right direction.

The sovereign debt crisis did not intensify everywhere in Europe in 2012. As in the previous year, Ireland continued to make tangible progress towards consolidating its public finances. In November 2010, it became the first country to accept help from the EFSF, after a failed attempt to stabilise the domestic banking sector solely through its own funds. Credible austerity measures and strong exports helped Ireland gradually to regain the confidence of the markets. The yield on ten-year Irish government bonds had declined to below 4.5% at the end of 2012, the lowest level for almost three years. In July 2011, the yield was more than three times higher, at over 14%. During 2012, Ireland managed to again meet part of its funding requirements through the capital markets, with a number of smaller bond issues. Having successfully passed this test, the country is on track to leave the bailout programme and make a full return to the capital market in the foreseeable future. Portugal also made a tentative step towards returning to the market to raise funds, swapping short-dated bonds in October 2012. The yield on ten-year Portuguese government bonds also declined sharply in 2012. However, at 7% at the year-end, it was still significantly higher than before the sovereign debt crisis.

[1] See chapter III 4.

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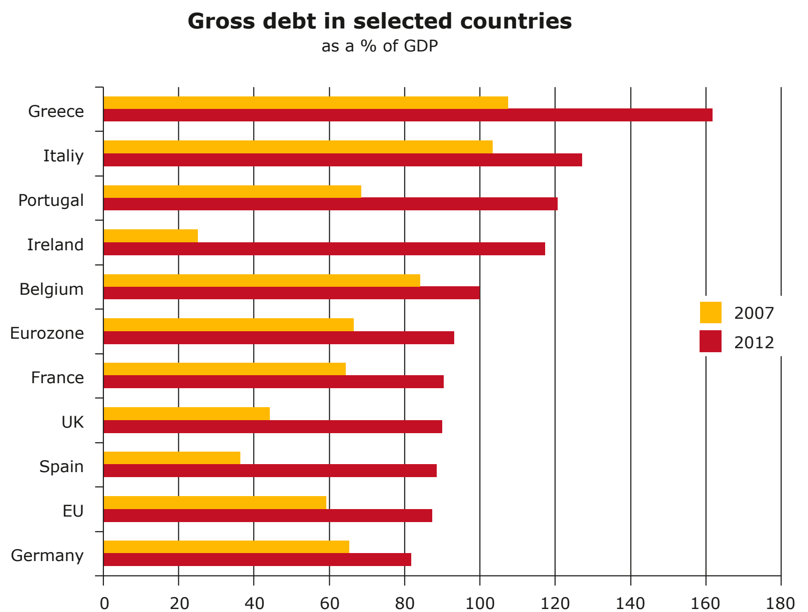
Increase in sovereign debt continues throughout Europe.

Since the start of the financial crisis, 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 more than 87% in 2012. Despite the ongoing austerity programmes, the trend of rising sovereign debt ratios has not yet been reversed. In the crisis-hit countries, in particular, this is partly attributable to the major economic downturn caused by the strict consolidation course coupled with the severe banking crisis. This has placed an additional burden on public finances, due both to lower tax income and to higher expenses resulting from rising unemployment, in particular. According to the European Commission's autumn forecast, the debt ratio in Spain jumped from around 69% to more than 88% in the course of 2012 due to the bank recapitalisation. Despite the haircut and bond buyback, Greece was still at the top of the list of debtor nations by a wide margin. In Ireland, whose government finances had been very healthy before the crisis, the debt ratio has increased by a factor of almost five since 2007. Even in the United Kingdom, which is not a member of the eurozone, the ratio has almost doubled in the past five years, to just under 90%. The increase in sovereign debt in Germany was relatively moderate, rising from 65% of GDP in 2007 to just under 82%. Nevertheless, it 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 win back the confidence of the capital markets.

Figure 2
**Sovereign debt ratios in Europe**




Source: Eurostat/European Commission estimate (February 2013)

High sovereign debt outside Europe, too.

As in the two preceding years, the financial markets were dominated in 2012 by the European sovereign debt crisis. However, the national debt of other world economies was also at high levels. For example, at almost 240%, Japan's leverage ratio in 2012 was

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significantly higher than that of Greece. The fact that Japan has not come under greater pressure on the capital market is largely attributable to its lower level of external debt. The vast majority of Japanese government bonds are held by domestic bondholders. This poses considerable risks to financial stability, as the country's credit institutions have large holdings of Japanese government bonds on their balance sheets. If the Japanese government's credit quality deteriorates or interest rates increase for any other reason, this cluster risk could have a negative impact on the Japanese banking sector.

Public finances in the United States, where the financial crisis had its origins in the subprime mortgage market, also deteriorated rapidly. In 2012, debt already amounted to around 107% of annual GDP, whereas before the start of the crisis in 2007 it had been just 62%. The Democrats and Republicans reached a last-minute budget compromise at the end of 2012. Automatic tax increases and spending cuts, which could potentially have tipped the US economy into recession, were temporarily averted. However, finding a solution to the budgetary problems has only been delayed. There is still no sign of a strategy to sustainably reduce government debt.

Economy continues to slow down.

The measures to rebuild public finances taken in many crisis-hit European countries also had an impact on the economy in 2012. Tax increases, redundancies in the public sector as well as wage and pension cuts dampened private consumption, as in the previous year. In addition, government demand declined due to public-sector spending cuts. Greece sank into a deep economic depression. Total economic output in Italy, Spain, Portugal and Cyprus contracted sharply in 2012. Ireland was the only crisis-hit country to find its way back to growth, although its economic recovery was tentative. France's economy suffered increasingly from a decline in price competitiveness and found itself in a long phase of stagnation. In Germany, too, the pace of growth slowed in the course of the year. The economic environment for key trading partners deteriorated, which had a detrimental effect on exports and investment. On the whole, however, the German economy was comparatively healthy in 2012.

Flight to safe investments.

The capital markets remained very nervous, particularly in the first half of 2012. The concern that the sovereign debt crisis could spread to core European countries and would ultimately be impossible to contain repeatedly arose. Investors restructured their portfolios and there was brisk demand for German government bonds as a safe haven. The ten-year Bund yield temporarily fell below 1.2% in July 2012, reaching a new all-time low. Investors' risk aversion abated slightly in the second half of the year, following the announcement of the ECB's plan to purchase distressed government bonds if necessary.

Upturn in German real estate market.

The German real estate market also benefited from the flight to low-risk assets and the exceptionally low interest rates. Investment options offering healthy returns with a reasonable level of risk remained scarce. The rising demand for houses and flats met with relatively rigid supply, causing the cost of residential properties to rise sharply from 2010 onwards. However, the trend varied widely between regions. Properties in densely populated areas of big

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cities were particularly popular, while structurally weak areas were largely untouched by the market upturn. Although the price rises showed little sign of slowing in 2012, the risk of a price bubble was not acute. Instead, after many years of creeping real (inflation-adjusted) price declines, the increases represent a slight correction of the previously undervalued German real estate market. Most of the recent price rises are attributable to fundamental factors. In addition, lending for home purchases increased only moderately and banks have not significantly relaxed their lending conditions. Speculative excesses on the residential real estate market are limited thanks, in large part, to Germany's conservative lending culture. However, BaFin needs to monitor developments closely to ensure that it is able to identify any slowly emerging risks to financial stability at an early stage and to take any necessary measures.

**Financial crisis: chronology of important events in 2012**

**January**

Rating agency Standard & Poor's downgrades the credit ratings of nine eurozone countries. France, Austria and the European Financial Stability Facility (EFSF) lose their prime AAA ratings.

The EU countries with the exception of the United Kingdom and the Czech Republic agree to sign up to a **Fiscal Compact.** At the heart of this compact is an obligation to introduce debt ceilings into national law.

**February**

Eurozone countries agree to a second bailout package for **Greece** in the amount of €144.6 billion.

Banks borrow a record sum of around €530 billion at an interest rate of 1% in the second three-year tender from the European Central Bank (ECB).

**March**

The European Commission approves Commerzbank's restructuring plan for its **Eurohypo** subsidiary. The bulk of the lending business is to be transferred to an internal resolution unit.

The European bailout facility is expanded. In addition to the new permanent European Stability Mechanism **(ESM)** to be established, its temporary predecessor **EFSF** is to remain active for a transitional period.

As part of a Private Sector Involvement (PSI) deal, private creditors waive 53.5% of their receivables from **Greece** (€107 billion).

**April**

The Financial Market Stabilisation Fund *(Sonderfonds Finanzmarktstabilisierung* – **SoFFin)** reports a loss of €13.1 billion for 2011. This was mainly attributable to the significant provisions recognised for the write-down made by the nationalised Hypo Real

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Estate's bad bank **(FMS Wertmanagement)** as part of the Greek haircut.

The G20 countries resolve to increase the funding for the International Monetary Fund **(IMF)** by US$430 billion.

**May**

The Eurogroup finance ministers declare they are in favour of **Greece** remaining in the eurozone. The four largest Greek banks receive €18 billion from the EFSF bailout fund.

**Bankia,** Spain's fourth-largest credit institution, becomes distressed and is part-nationalised.

The Organisation for Economic Co-operation and Development (OECD) warns of a severe **recession** in the eurozone.

**June**

The financial crisis peaks. Spreads on Spanish and Italian government bonds rise sharply.

**Spain** declares that it is prepared in principle to officially request aid from the European bailout fund to recapitalise the Spanish banking sector.

**Cyprus** applies for financial support to stabilise its banking sector.

**Portugal** props up three banks with €6.6 billion in funding from the 2011 bailout package.

A **common banking supervisor** for the eurozone is planned.

**July**

The ECB reduces its **key interest rate** to 0.75%, the lowest level since the introduction of the euro.

The Eurogroup approves the bailout package of up to €100 billion to **recapitalise the Spanish banking sector.**

**August**

**Spain** increases the national **austerity measures** in place until 2014 from €65 billion to €102 billion.

**September**

The ECB introduces a programme to **buy unlimited amounts of bonds** of distressed eurozone countries that have requested funds from the European bailout facility.

The **Federal Reserve** announces plan to purchase US$40 billion of residential mortgage-backed securities per month.

**October**

The permanent **ESM** rescue facility is officially launched.

**Spain** plans to create a **bad bank** to which distressed real estate loans of up to €60 billion will be transferred for subsequent processing.

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**November**

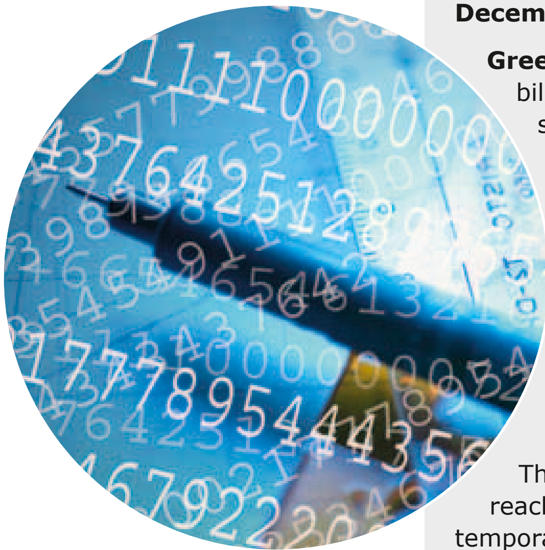
The Bundestag resolves to extend **SoFFin,** the bank rescue fund, for a further two years.

**Greece** is to receive an additional two years to implement the agreed austerity measures.

The troika comprising the EU, the ECB and the IMF considers **Portugal** to be heading in the right direction, despite its high debt levels and shrinking economy.

**Spain:** The first progress report on the financial sector reform programme is released. Based on this report, the first tranche of €39.5 billion, which is mainly to be used to recapitalise so-called Group 1 banks (banks in which the Spanish restructuring fund, FROB, holds a majority stake), is disbursed in the form of ESM notes on 11 December 2012.

**December**



**Greece** buys back own bonds with a nominal value of €31.9 billion on the market. On average, the bondholders receive slightly more than one-third of the nominal value. Following the successful **buyback programme,** the credit tranche of €49.1 billion under the second bailout deal is formally approved.

The plans for a **common banking supervisor** as an initial step towards a **banking union** take shape. From spring 2014, the ECB will have oversight of 130 to 150 large and government-supported banks in the eurozone. Other EU member states may opt to come under ECB supervision if they wish.

The **fiscal cliff** looms in the **USA.** The political parties reach a last-minute compromise in their budget dispute, which temporarily averts massive automatic tax increases and spending cuts.

# 2 Financial markets

Financial markets in thrall to the sovereign debt crisis.

The financial markets were negatively affected by the European debt crisis in the first half of 2012 in particular. Signs of improvement became visible in the second half of the year, as concrete measures to strengthen Europe's financial architecture were agreed and the ECB announced its intention of purchasing government bonds of crisis-hit countries on the secondary market, subject to certain conditions specified by the ECB.

International share indices gain ground.

The upward trend on the international stock markets, which had started to emerge at the end of the previous year, continued in the first few months of 2012. Prices rose sharply until mid-March, more than compensating for the steep losses suffered in the previous

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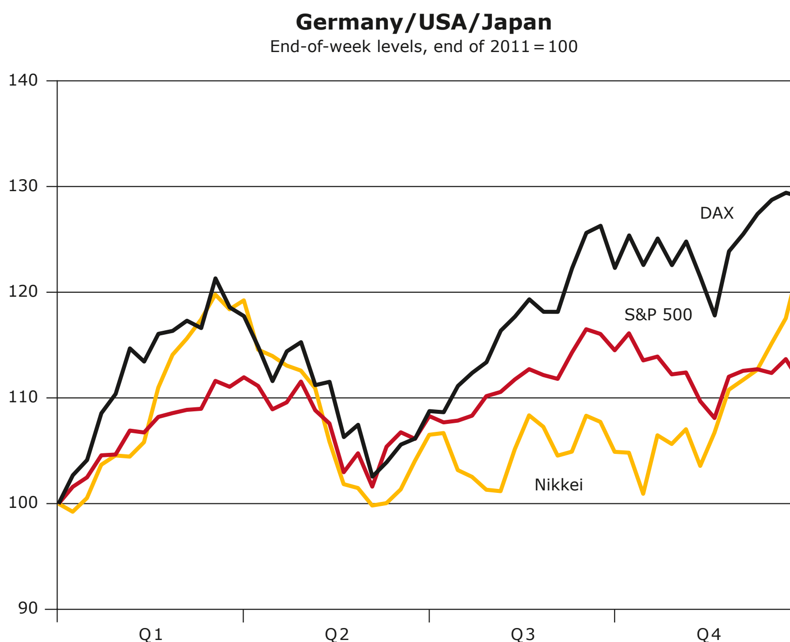
summer. However, negative factors then impacted the stock markets for the following two months, with Europe's sovereign debt crisis reaching its peak, poor labour market figures from the USA, a weaker economic outlook in China and, not least, the conflict in Syria temporarily sending the markets on a downward slide. Share prices rose again throughout the second half of the year. Investors were probably prompted to buy shares not only by the progress made towards resolving the debt crisis, but also due to the lack of investment alternatives as a result of the extremely low interest rates coupled with high market liquidity.

The surge in Japan's Nikkei equity index towards the end of 2012 was particularly noteworthy. This was attributable, firstly, to the electoral victory of the business-friendly Liberal Democrats, who had raised the prospect of an expansionary monetary policy. Secondly, a decline in the yen led to cheaper Japanese exports. The jump in the Nikkei was therefore largely driven by export stocks. The USA's S&P 500 rose by a comparably moderate 10% from early June to the end of the year. The US budget dispute, which could have seen the country fall off the fiscal cliff, was a major cause of uncertainty.

Figure 3

**Comparison of stock markets in 2012**




Source: Bloomberg/BaFin calculations

The performance of Germany's DAX equity index was broadly in line with that of the world's other major indices in the first half of 2012. However, the DAX broke away in the third and fourth quarters to end the year at 7,612 points, up nearly 30% over the year. This exceptionally strong performance was due not least to Germany's relatively stable economy.

Renewed downward shifting in the yield curve.

The yield curve again shifted downward in 2012, flattening at the short end in particular. The expected continuation of the ECB's

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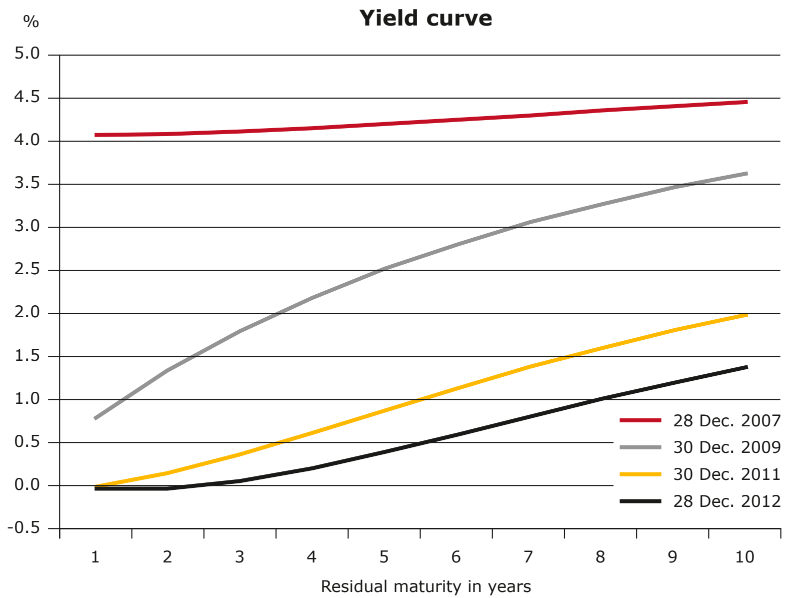
expansionary monetary policy and Germany's safe-haven status pushed down yields across all maturities. The yields on one- and two-year bonds with no default risk were even slightly negative at the end of the year.

Figure 4
**Yield curve for the German bond market***




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

Source: Deutsche Bundesbank

Central banks keep the floodgates open.

In addition to the low key interest rates, the bond purchase programmes by leading international central banks had considerable influence on general monetary policy conditions in Europe and worldwide in 2012, as they significantly pushed down market interest rates. At the start of January, the ECB purchased Italian and Spanish government bonds under the Securities Markets Programme (SMP), following a spike in their yields. Further measures were implemented in the autumn: in September, the ECB published the conditions for its Outright Monetary Transactions (OMT) programme, which authorises the unlimited purchase of government bonds of crisis-hit countries on the secondary market and which replaced the SMP. Shortly after, the Federal Reserve announced a bond purchase programme in the amount of up to US$40 billion per month. The Bank of Japan also massively expanded its securities purchase programme in stages in the second half of the year.

Yields reach historic lows.

At the beginning of 2012, the yields on German and US ten-year government bonds initially rose slightly. However, the spring again saw a flight to safety as the European debt crisis flared up again. The high demand for low-risk assets caused yields on German and US bonds to fall to historic lows. The impact on German bonds was somewhat more significant, with yields remaining below the 1.5% mark for most of the past three quarters. By contrast, US bond yields only dipped below this level for a short while. Adjusted for inflation, the German ten-year government bond yield was negative for the whole year.

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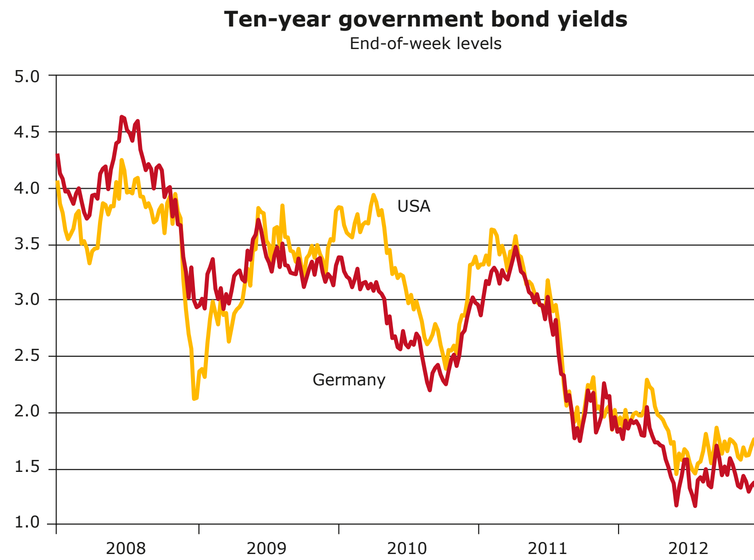
Figure 5
## Capital market rates

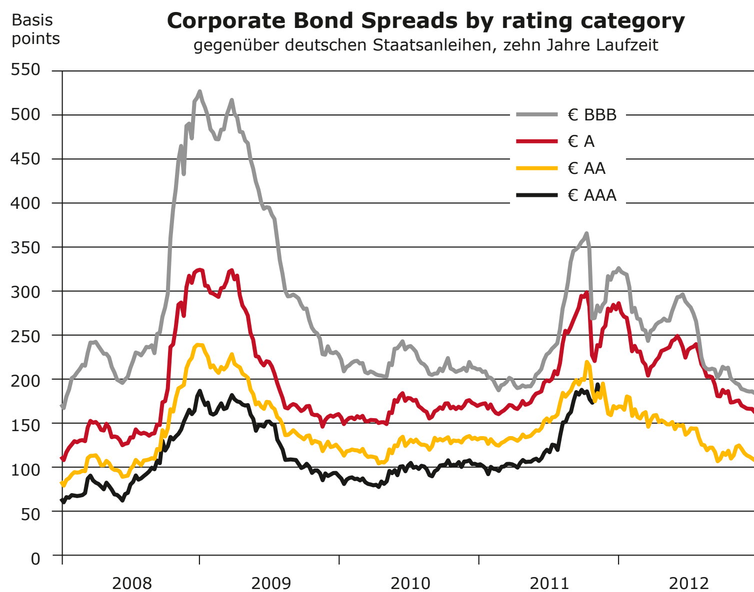



Source: Bloomberg

Significant easing of corporate sector spreads.

European corporate bond spreads narrowed significantly in the course of 2012, delivering a similarly positive performance to that of the equity markets. In particular, yields on corporate bonds of issuers with high credit ratings declined continuously and steadily during the year. European corporate bonds won back investors' trust in 2012, evidently offering them an attractive alternative to safe government bonds.

Figure 6
## Corporate bond spreads in Europe*




* Given the lack of representative data, bond spread for the AAA rating category have not been calculated since November 2011.

Source: Bloomberg

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Euro stronger at year-end.

As in the previous year, the euro/US dollar exchange rate was dominated in 2012 by the development of the European sovereign debt crisis. In the spring, the escalating crisis put pressure on the euro exchange rate. The downward trend then reversed in the summer months on the back of the measures implemented to resolve the debt crisis. At the end of the year, the US budget dispute caused the dollar to weaken slightly, while the euro again appreciated somewhat. The euro closed the year stronger at slightly over US$1.30/€. Although the exchange rate was a little higher than a year earlier, it was far from its peak of around US$1.60/€ in 2008.

Figure 7

**Exchange rate movements**

Source: Bloomberg

# 3 Banks

Banks – between the sovereign debt crisis and a robust economy.

The position of the banks remained difficult in 2012 and continued to be dominated by the sovereign debt crisis, which deepened until the middle of the year. The resulting write-downs of government bonds are still negatively affecting bank balance sheets. By contrast, the more robust economy in Germany compared with other EU member states led to relatively stable business. The main winners in this environment were those banks that had been able to contain their losses since the beginning of the financial 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 continued to gain customers from other institutions and increase their business volumes thanks to a growing aversion to risk. However, the extremely low long-term interest rates resulted in lower income from maturity transformation, while interest rate risk rose at the same time. The

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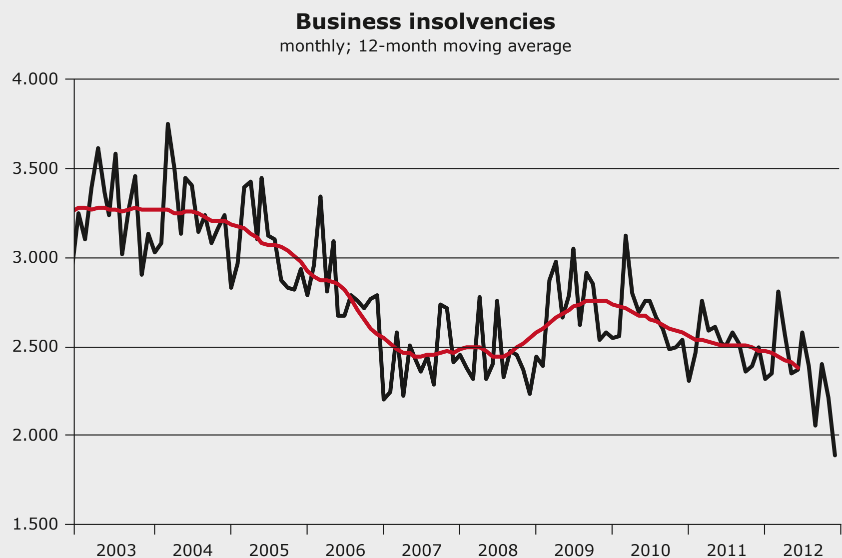
situation for banks that had already experienced steep losses in the preceding years remained difficult, since the capital and deposits needed to write new business were particularly expensive for them. Some institutions also had to scale back their business activities to be able to achieve the capital ratios required by the European Banking Authority (EBA).

**Insolvency trend**

The number of business insolvencies declined in 2012 for the third year in succession. German local courts reported around 28,300 business insolvencies, 6% fewer than in 2011. The slowing pace of German economic growth has not yet had a lasting effect on the insolvency trend, although the downward movement accelerated towards the end of the year. However, the amount of debt owed to creditors, a measure of the potential financial loss, doubled from €20 billion in 2011 to €41 billion due to a number of major insolvencies. Among others, drugstore chain Schlecker and mail-order firm Neckermann filed for insolvency in 2012.

Figure 8

**Number of business insolvencies in Germany**




Source: Federal Statistical Office

Around 97,600 consumers filed for personal insolvency in Germany in 2012, 5.5% fewer than in the previous year and more than 10% fewer than the peak of 108,800 in 2010. Although low unemployment and a marked increase in wages had a positive impact on the financial position of private households, the problem of over-indebtedness eased only slightly. The volume of outstanding debt declined from €5.8 billion in the previous year to just under €5.4 billion.

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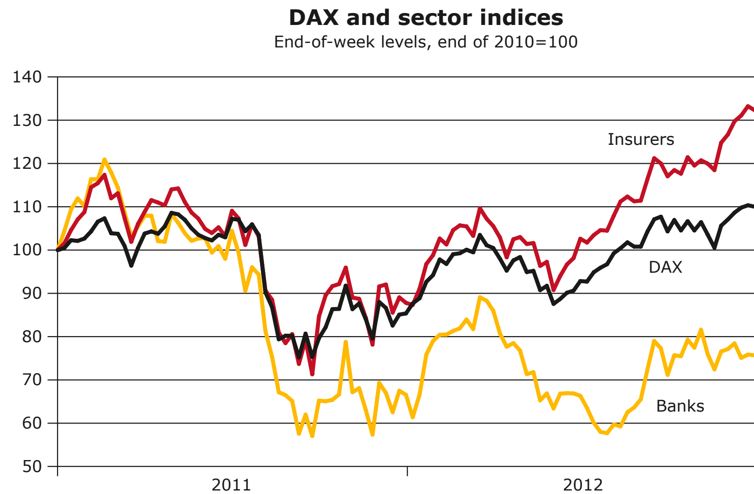
Bank stocks stabilise from the middle of the year onwards.

The German banking shares index rose sharply at the beginning of 2012, only to lose substantial ground as the sovereign debt crisis worsened in the middle of the year, before recovering again from August onwards. Despite closing up 14% at the end of 2012, it was still well below the levels achieved at the beginning of 2011. Because of their close correlation with the government sector, bank stocks suffered particularly heavy losses from the sovereign debt crisis in Europe.

Figure 9

**Share indices for the German financial sector**




Source: Bloomberg/BaFin calculations

The banking index climbed by more than 30% in the few weeks up to the middle of March 2012 thanks to easing uncertainty following the ECB's two three-year tenders. However, it suffered an initial setback 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 summer. Although all German banks participating in the EU-wide recapitalisation survey satisfied the EBA's higher capital ratio requirements, the German banking index declined by around one-third in the period from March to July. The slump was partly due to the fact that banks had to waive part of their receivables from Greece. However, the fact that the crisis had taken on a new quality as a result of the growing economic and funding problems experienced by two large eurozone countries, Italy and Spain, seems to have been more significant. The banking index then recovered sharply from August 2012 onwards, mainly thanks to the announcement of further emergency measures by the ECB.

Significant decline in CDS spreads.

The partial stabilisation of the banking sector was reflected in the steep decline in credit default swap (CDS) spreads in 2012. CDS spreads are market prices for accepting the default risk of a loan. After reaching a historic high of more than 300 basis points at the end of 2011, CDS spreads for major German banks narrowed significantly to around 100 to 200 basis points in the course of the year.

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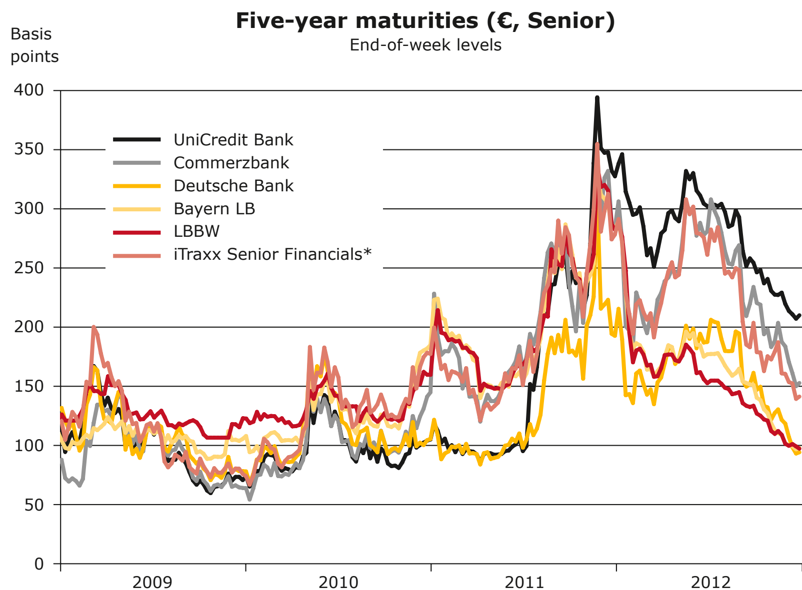
CDS spreads for German and other European banks narrowed in the first quarter of 2012 thanks to improved financing conditions. Landesbank Baden-Württemberg (LBBW) and Bayerische Landesbank (BayernLB) saw a better than average improvement in their CDS spreads, which were just above 150 basis points. However, risk exposure surged in the European banking sector in the second quarter as the troubles of southern eurozone countries increased. This development was mirrored, at least in approximate terms, by the iTraxx Senior Financials credit default index, which rose to more than 300 basis points and temporarily exceeded its level at the beginning of the year. However, by the end of the year, this figure had halved to below 150 basis points on the back of the support measures introduced by the EU and the ECB, and the banks' increased capital ratios. German bank spreads also contracted sharply, in some cases declining to just under 100 basis points. As the subsidiary of a major Italian bank, UniCredit Bank AG (formerly HVB) has particularly high exposure to the risk in peripheral European states. Consequently, its CDS spread remained above 200 basis points despite declining significantly in the second half of the year.

Figure 10
**Credit default swap spreads for major German banks**




* Unweighted average of CDS spreads for 25 major European financial institutions (including 16 banks).

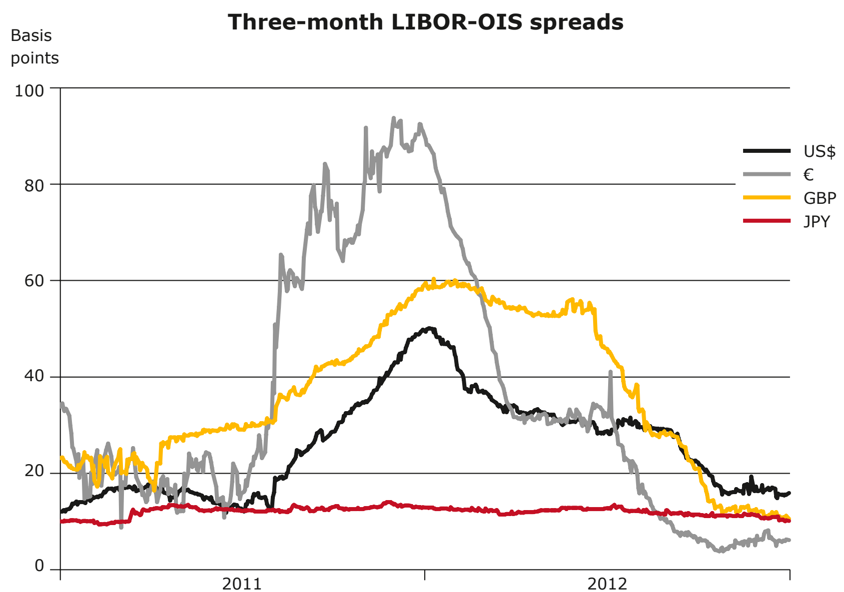
Source: Bloomberg

Weak interbank market.

The various measures implemented by the ECB substantially improved the liquidity supply to credit institutions. Banks continued to park considerable amounts of their sometimes high liquidity surpluses in the ECB deposit facility, despite the interest rate being reduced to 0% in June. Many European institutions are no longer able to refinance via the interbank market and therefore rely on central bank loans.

The interbank market remained disrupted, with most transactions taking place at national level, if at all. Central money market indicators such as the overnight indexed swap rate (OIS) and the three-month London Interbank Offered Rate (LIBOR) declined to historic lows in 2012. In addition, the LIBOR-OIS spread, which is the difference between three-month LIBOR and the interest rate for a three-month revolving overnight index swap (based on the OIS) and can therefore be taken as an indicator of the credit risk on the interbank market, declined to just six basis points in Europe at the end of the year. However, the extremely narrow LIBOR-OIS spread cannot really now be taken as indicating proper functioning of the interbank market. Instead, it is a reflection of the surplus liquidity provided by central banks.

Figure 11
**Interbank market indicators**




Source: Bloomberg

German credit criteria tightened.

German banks applied stricter lending criteria for corporate clients and private households in 2012, according to the quarterly Bank Lending Survey conducted by Deutsche Bundesbank. The much tighter standards for residential building loans were particularly striking. The trend in demand for credit differed between companies and private households. Whereas demand from corporate clients declined, particularly for short-term loans, there was higher demand for consumer and, especially, residential building loans. This trend reflects the popularity of real estate in Germany. In contrast, the economic weakness of other eurozone countries led to a slump in demand for credit from both households and companies.

**Non-performing loans (NPLs)**

There is no specific definition of the English term “non-performing loans” (NPLs) in Germany. Since 2009, the rough volume of NPLs

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has been determined using the definition of “leistungsgestörte Kredite” contained in the German Audit Report Regulation *(Prüfungsberichtsverordnung* – PrüfbV). Since then, therefore, the German definition of NPLs is more readily comparable with the commonly accepted international standard.

In 2011 – the audit reports for the 2012 annual financial statements were not yet available in all cases at the time of writing this report on 31 March 2012 – the volume of NPLs in the German banking sector had declined by 6.5% from €192 billion in the previous year to €179 billion. This corresponds to 3.0% of lending to non-banks (previous year: 3.2%; definition of a loan in accordance with section 19 of the German Banking Act, *Kreditwesengesetz* – KWG). The ratio of NPLs to balance sheet capital declined in 2011 from 34.2% to 31.2%. The NPL amounts are net amounts less risk provisions already recognised. The total lending volume used to calculate the NPL ratio is a gross amount before the deduction of risk provisions.

The robust German economy, with declining insolvency and unemployment rates, is probably largely to thank for the improved credit quality in 2011.

# 4 Insurers

Premium income stable.

In its sixth year, the financial crisis continued to pose an enormous challenge for the insurance sector. The sustained low level of interest rates and continued volatility on the capital markets weighed particularly heavy on life insurers. However, the German insurance sector again proved robust in this difficult environment. Steady demand for insurance cover led to a stable investment and earnings trend in the sector. After a slight decline in premium income in 2011 due to the normalisation of the previous extraordinary growth in the single-premium business, the German Insurance Association (GDV) is expecting a moderate increase by 1.5% to €181 billion in 2012.

Until early summer 2012, the performance of the German insurance index was in line with that of the DAX. The gains built up at the beginning of the year were then almost completely eliminated by early summer by the worsening European sovereign debt crisis and negative economic news from the USA and China. As the year progressed, however, the share price performance of German insurers outperformed the DAX’s positive trend, which was bolstered primarily by the monetary policy and fiscal rescue packages. The German insurance index rose by more than 50% over the course of 2012, while the DAX recorded an increase of almost 30%. Insurance stocks also outperformed banking shares, which rose 14% in value in the course of the year.

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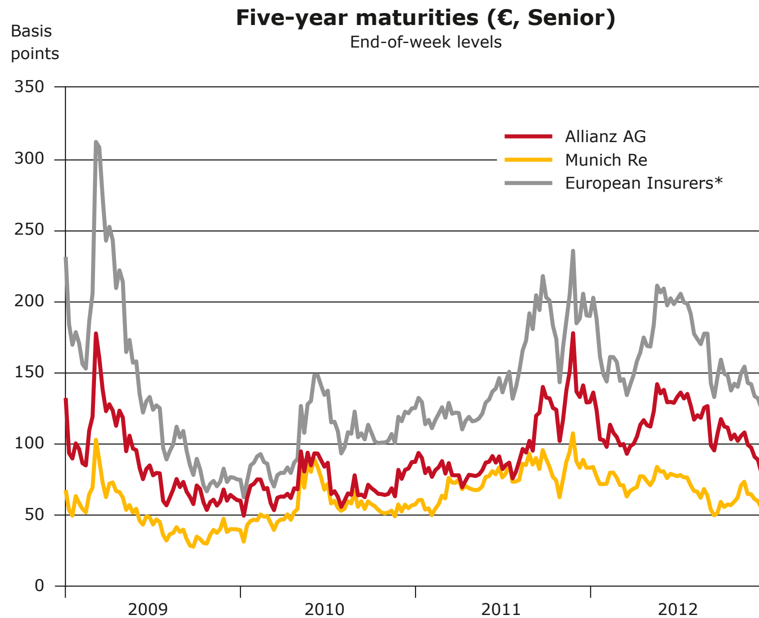
Credit default swap spreads contract sharply.

CDS spreads for European insurers narrowed by an average of more than 30% in 2012, mirroring the trend in share prices. The CDS spreads for the two major German insurers, Allianz and Munich Re, were significantly below the average for other major European insurers throughout the entire year.

Figure 12
**CDS spreads for selected insurers**




* Unweighted average CDS spreads for the nine European Insurers included in the iTraxx Europe Series 18 index.

Source: Bloomberg/BaFin calculations

Rating agencies downgrade insurers.

The three big American rating agencies downgraded significantly more German insurers than they upgraded in 2012. The outlook for Germany's insurance sector was also largely rated as negative. Although the agencies specifically stressed the resilience of German insurers, they believe that sustained low interest rates and the weaker economic outlook are likely to negatively impact the industry.

Low interest rate environment intensifies.

Long-term interest rates continued to decline in Germany in 2012. The ten-year Bund yield fell to a fresh all-time low of 1.17% in the summer. Bunds were used by investors as a safe haven in the uncertain environment caused by the ongoing European sovereign debt crisis. The reduction in interest rates led to further price gains on fixed-income securities, but also reduces insurers' future opportunities to generate revenue from new investments. The low interest environment does not endanger life insurers' ability to generate the guaranteed return over the short to medium term. However, a prolonged low interest phase harbours the risk that they will not be able to meet the guarantee payments promised through investment income, which mainly comes from fixed-income securities, in the long term.

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Loss levels normalise.

After a record year in 2011, loss levels largely normalised in 2012. The devastating natural disasters in Japan, Australia, New Zealand and Thailand had caused economic losses of US$400 billion and insured losses of US$119 billion in 2011. In 2012, the corresponding figures were economic losses of US$160 billion and insured losses of US$65 billion. Economic losses were 3% lower than the ten-year average in 2012, while insured losses were 30% higher. By far the worst natural disaster happened in the USA. Hurricane Sandy caused economic losses of US$50 billion and estimated insured losses of US$25 billion.

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Table 1

## Overview of the German economy and financial sector*

| Selected economic data | Unit | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Economic growth [1] | | | | | | | | | | | |
| Global economy | % | 3.6 | 4.9 | 4.6 | 5.3 | 5.4 | 2.8 | -0.7 | 5.2 | 3.9 | 3.2 |
| USA | % | 2.5 | 3.5 | 3.1 | 2.7 | 1.9 | -0.3 | -3.5 | 3.0 | 1.8 | 2.3 |
| Eurozone | % | 0.7 | 2.2 | 1.7 | 3.3 | 3.0 | 0.4 | -4.3 | 1.9 | 1.4 | -0.4 |
| Germany | % | -0.4 | 1.2 | 0.7 | 3.7 | 3.3 | 1.1 | -5.1 | 3.7 | 3.1 | 0.9 |
| Corporate insolvencies | Number | 39,320 | 39,213 | 36,843 | 34,137 | 29,160 | 29,291 | 32,687 | 31,998 | 30,099 | 28,304 |
| DAX (end of 1987=1,000) | Points | 3,965 | 4,256 | 5,408 | 6,597 | 8,067 | 4,810 | 5,957 | 6,914 | 5,898 | 7,612 |
| Money market rate [2] | % | 2.33 | 2.11 | 2.19 | 3.08 | 4.28 | 4.63 | 1.22 | 0.81 | 1.39 | 0.57 |
| Capital market rate [3] | % | 4.08 | 4.04 | 3.36 | 3.78 | 4.27 | 4.09 | 3.27 | 2.77 | 2.67 | 1.57 |
| Euro exchange rate | 1 €=US$ | 1.13 | 1.24 | 1.24 | 1.25 | 1.37 | 1.47 | 1.39 | 1.33 | 1.39 | 1.28 |
| Gross sales of fixed-income securities [4] | € bn | 959 | 990 | 989 | 926 | 1,022 | 1,337 | 1,534 | 1,375 | 1,338 | 1,341 |
| **Credit institutions** | | | | | | | | | | | |
| Individual institution [a) 5)] | Number | 2,466 | 2,400 | 2,349 | 2,301 | 2,276 | 2,169 | 2,128 | 2,093 | 2,080 | 2,056 |
| Branches [a) 5)] | Number | 47,244 | 45,467 | 47,333 | 40,332 | 39,817 | 39,565 | 38,881 | 38,183 | 37,719 | |
| Lending volume [a) 6)] | € bn | 2,242 | 2,224 | 2,227 | 2,242 | 2,289 | 2,358 | 2,358 | 2,353 | 2,416 | 2,436 |
| Net interest margin [7] | % | 1.16 | 1.18 | 1.17 | 1.15 | 1.12 | 1.09 | 1.14 | 1.14 | 1.02 | |
| Net commission income | € bn | 24.4 | 25.3 | 27.8 | 29.9 | 31.7 | 29.7 | 27.4 | 28.6 | 28.8 | |
| Administrative expenses | € bn | 77.3 | 75.8 | 78.8 | 81.5 | 81.6 | 78.7 | 82.2 | 80.2 | 80.1 | |
| Risk provisions | € bn | 21.8 | 17.3 | 14.0 | 14.0 | 23.6 | 36.6 | 26.9 | 15.4 | -2.3 | |
| Cost-income ratio [8] | % | 66.5 | 65.5 | 61.0 | 62.3 | 64.9 | 73.4 | 65.1 | 63.7 | 63.9 | |
| Return on equity (RoE) [9] | % | 0.7 | 4.2 | 13.0 | 9.4 | 6.6 | -7.7 | -0.8 | 5.2 | 8.4 | |
| Equity ratio [a) 10) 21)] | % | 13.4 | 13.3 | 13.1 | 13.3 | 12.5 | 14.0 | 15.0 | 15.9 | 16.5 | 18.0 |
| ***Private commercial banks*** | | | | | | | | | | | |
| Lending volume [a) 6)] | € bn | 579 | 575 | 580 | 587 | 627 | 662 | 654 | 642 | 670 | 675 |
| Net interest margin [7] | % | 1.17 | 1.25 | 1.27 | 1.33 | 1.30 | 1.20 | 1.20 | 1.14 | 0.85 | |
| Cost-income ratio [8] | % | 74.0 | 73.5 | 59.8 | 66.0 | 65.5 | 93.6 | 73.4 | 72.5 | 67.9 | |
| Return on equity (RoE) [9] | % | -6.2 | -0.4 | 21.8 | 11.2 | 19.1 | -15.5 | -5.8 | 3.0 | 1.8 | |
| Equity ratio [a) 10)] | % | 14.5 | 13.7 | 12.7 | 13.7 | 11.8 | 14.8 | 15.0 | 14.6 | 15.6 | 17.8 |
| ***Savings banks*** | | | | | | | | | | | |
| Lending volume [a) 6)] | € bn | 577 | 573 | 574 | 576 | 578 | 589 | 598 | 612 | 625 | 644 |
| Net interest margin [7] | % | 2.40 | 2.35 | 2.30 | 2.23 | 2.06 | 2.00 | 2.13 | 2.20 | 2.21 | 2.10 |
| Cost-income ratio [8] | % | 66.4 | 64.9 | 66.0 | 65.8 | 69.5 | 68.8 | 66.6 | 62.8 | 62.7 | 62.3 |
| Return on equity (RoE) [9) 22)] | % | 10.9 | 9.7 | 10.4 | 8.9 | 7.2 | 4.0 | 8.5 | 11.4 | 27.3 | 9.5 |
| Equity ratio [a) 10)] | % | 11.5 | 12.1 | 12.6 | 13.1 | 13.1 | 14.4 | 14.7 | 15.1 | 15.8 | 15.9 |
| ***Cooperative banks*** | | | | | | | | | | | |
| Lending volume [a) 6)] | € bn | 338 | 342 | 348 | 353 | 360 | 369 | 382 | 398 | 416 | 434 |
| Net interest margin [7] | % | 2.51 | 2.51 | 2.46 | 2.30 | 2.15 | 2.06 | 2.23 | 2.33 | 2.30 | 2.22 |
| Cost-income ratio [8] | % | 69.6 | 68.7 | 70.0 | 64.3 | 70.5 | 68.3 | 68.3 | 63.7 | 63.9 | 66.9 |
| Return on equity (RoE) [9] | % | 10.6 | 10.3 | 13.8 | 11.0 | 8.1 | 5.5 | 9.0 | 12.1 | 16.4 | 15.5 |
| Equity ratio [a) 10)] | % | 11.7 | 12.1 | 12.2 | 12.2 | 12.8 | 14.2 | 14.0 | 14.7 | 15.6 | 15.9 |
| **Insurance undertakings** | | | | | | | | | | | |
| ***Life insurers*** | | | | | | | | | | | |
| Hidden reserves in the investment portfolio (IP) [11] | € bn | 14.9 | 35.6 | 44.0 | 35.2 | 14.7 | 9.0 | 22.7 | 29.5 | 43.0 | 103.0 |
| as a percentage of the IP carrying amount | % | 2.4 | 5.5 | 6.5 | 5.3 | 2.0 | 1.2 | 3.0 | 3.7 | 5.4 | 13.4 |
| Percentage of investment units in IP [12] | % | 23.3 | 22.0 | 23.2 | 23.1 | 22.7 | 23.5 | 23.0 | 24.5 | 24.8 | 27.8 |
| Percentage of promissory notes and loans in IP [12] | % | 19.3 | 22.0 | 22.2 | 23.0 | 21.9 | 22.1 | 21.0 | 20.4 | 19.2 | |
| Net rate of return on IP [13] | % | 5.0 | 4.8 | 5.0 | 5.4 | 4.5 | 3.4 | 4.0 | 4.0 | 3.9 | |
| Premium reserve | € bn | 520.6 | 536.2 | 551.2 | 566.5 | 586.1 | 599.6 | 621.0 | 647.2 | 659.8 | |
| as a percentage of total assets | % | 79.4 | 78.8 | 78.1 | 77.3 | 77.6 | 79.7 | 77.2 | 77.0 | 77.8 | |
| Surplus [14] | € bn | 9.2 | 9.7 | 14.2 | 14.1 | 13.5 | 6.6 | 11.6 | 11.8 | 9.9 | |
| as a percantage of gross premiums earned | % | 13.6 | 14.1 | 19.5 | 18.8 | 17.8 | 8.6 | 14.1 | 13.6 | 11.9 | |
| Eligible own funds (A+B+C) | € bn | 42.3 | 43.9 | 49.1 | 54.6 | 57.5 | 54.4 | 55.0 | 55.6 | 55.7 | |
| Solvency margin [15] | € bn | 24.0 | 24.8 | 25.9 | 26.8 | 27.8 | 28.4 | 29.5 | 30.8 | 31.4 | |
| Solvency margin cover [16] | % | 176.2 | 177.4 | 190.0 | 203.8 | 206.8 | 191.5 | 186.4 | 180.9 | 177.4 | |
| Return on equity [17] | % | 5.7 | 5.8 | 9.7 | 9.5 | 8.8 | 7.4 | 9.6 | 9.8 | 9.8 | |
| ***Property/casualty insurers*** | | | | | | | | | | | |
| Hidden reserves in the investment portfolio (IP) [11] | € bn | 26.0 | 26.6 | 27.7 | 29.8 | 28.9 | 21.4 | 24.6 | 26.1 | 25.6 | 31.1 |
| as a percentage of the IP carrying amount | % | 23.8 | 22.6 | 22.2 | 22.4 | 20.7 | 15.7 | 17.8 | 18.9 | 20.9 | 21.5 |
| Percentage of investment units in IP [12] | % | 27.3 | 26.5 | 29.8 | 30.5 | 31.0 | 30.7 | 30.5 | 31.9 | 31.8 | 32.2 |
| Percentage of promissory notes and loans in IP [12] | % | 14.1 | 16.6 | 18.3 | 15.6 | 19.4 | 20.2 | 19.6 | 18.0 | 18.4 | |
| Net combined ratio [18] | % | 94.7 | 92.2 | 92.6 | 90.6 | 92.7 | 92.0 | 95.0 | 99.0 | 98.9 | |
| Eligible own funds (A+B) | € bn | 27.1 | 24.1 | 22.5 | 27.4 | 28.3 | 26.8 | 27.8 | 29.0 | 29.3 | |
| Solvency margin [15] | € bn | 7.8 | 8.4 | 8.8 | 8.8 | 8.8 | 8.5 | 8.6 | 9.0 | 9.4 | |
| Solvency margin cover [16] | % | 346.0 | 286.3 | 255.3 | 310.7 | 321.6 | 315.3 | 323.3 | 323.6 | 312.1 | |
| Return on equity [17] | % | 4.2 | 3.0 | 4.5 | 4.6 | 4.1 | 3.6 | 4.2 | 3.3 | 2.8 | |
| ***Reinsurers*** | | | | | | | | | | | |
| Hidden reserves in the investment portfolio [11] | € bn | 34.3 | 37.2 | 49.9 | 57.7 | 63.6 | 33.7 | 33.4 | 35.4 | 35.7 | 39.2 |
| as a percentage of the carrying amount | % | 15.6 | 17.2 | 22.0 | 26.4 | 27.6 | 14.7 | 14.7 | 15.4 | 14.7 | 16.6 |
| Net combined ratio [18] | % | 92.8 | 93.5 | 93.8 | 89.2 | 94.1 | 94.1 | 94.0 | 101.1 | 105.9 | |
| Eligible own funds (A+B) | € bn | - | - | - | - | 66.9 | 68.8 | 69.3 | 68.6 | 69.1 | |
| Solvency margin | € bn | - | - | - | - | 6.2 | 6.4 | 6.1 | 6.2 | 6.7 | |
| Gross technical provisions | € bn | 135.8 | 140.8 | 154.4 | 143.1 | 131.1 | 126.4 | 118.2 | 122.4 | 133.2 | |
| as a percentage of gross premium income | % | 264.4 | 298.5 | 340.0 | 330.3 | 329.7 | 328.4 | 289.7 | 295.4 | 285.0 | |
| Net profit for the year [19] | € bn | 1.4 | 3.4 | 1.8 | 7.3 | 8.0 | 5.7 | 6.5 | 5.6 | 4.7 | |
| Available capital [20] | € bn | 51.4 | 55.1 | 57.6 | 66.3 | 71.0 | 70.5 | 72.0 | 70.2 | 71.4 | |
| Return on equity [17] | % | 2.7 | 6.1 | 3.1 | 11.0 | 11.2 | 8.1 | 9.0 | 7.9 | 6.6 | |

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, preliminary figures for 2012 (only change related to savings banks and cooperative banks).
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 and 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 claims and net operating expenses/net premiums earned.
19) Corresponds to item II.14 in financial statement form 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) 10.5% was actually generated from market operations in 2011. The higher value is based on the reclassification of hidden reserves to recognised reserves.

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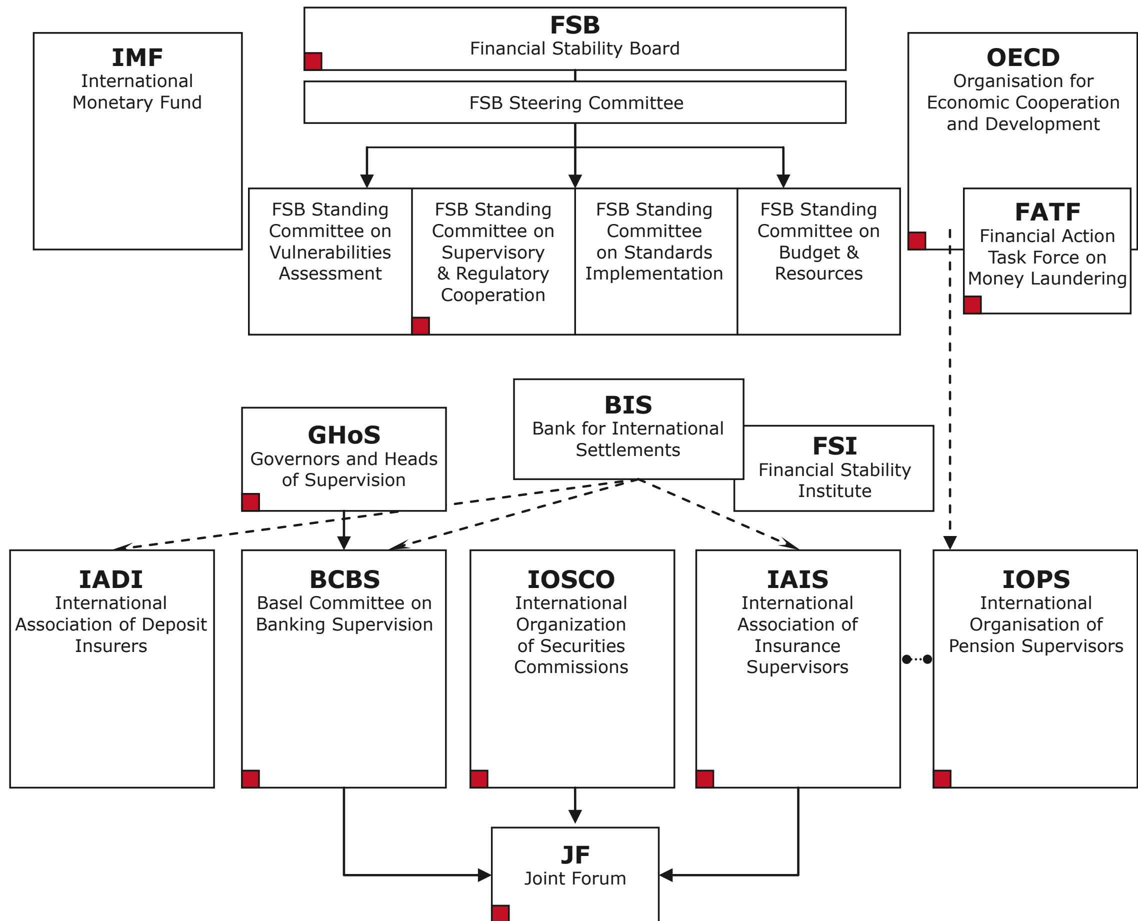
# III International issues

Figure 13
**International institutions and committees**



Key:
Proposes and approves new initiatives
Provides the secretariat
Sub-/working groups in which BaFin takes part
Close working relationshops

# 1 Systemic risks

## 1.1 Banks

The G20 is proposing a three-pronged approach to stemming the specific risks associated with systemically important financial institutions (SIFIs): higher loss absorption capacity through additional capital, ensuring bank resolution has as little market impact as possible, and more intensive and effective supervision.

### Capital add-ons

International banking supervisors and regulators focused on the regulation of domestic systemically important banks (D-SIBs) in 2012, after the development, approval and final publication of a regulatory framework for global systemically important banks (G-SIBs)[2] took centre stage in 2011. The G20 heads of state and government explicitly asked the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) to present a draft regulation for banking groups that are systemically relevant on a national level immediately after finalisation of the G-SIB framework. In October 2012, the BCBS published a corresponding set of provisions entitled “A framework for dealing with domestic systemically important banks”.

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 (the International Monetary Fund, the World Bank, the Bank for International Settlements, the European Central Bank, etc.). 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. The FSB’s main tasks include monitoring the international financial system for vulnerabilities, identifying whether there is any need for action, and coordinating and promoting the exchange of information among the various authorities. The FSB is also to play a greater role in (cross-border) crisis management.

Key elements of the D-SIB framework.

In contrast to the G-SIB regime, which is more rule-based, the D-SIB framework is more principles-based, so it offers greater flexibility. The aim is to allow more account to be taken of specific

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

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national considerations by giving the supervisory authorities in the individual countries latitude in the drafting of their regulations. The regulatory text is based on 12 principles: the first seven focus on the assessment methodology, while the remaining five deal with potential regulatory measures for domestic systemically important banks. The assessment methodology is largely based on the process for identifying global systemically important banks, which was published by the BCBS in November 2011 and also includes the criteria of size, interconnectedness, substitutability and complexity. In addition, country-specific indicators and parameters to identify domestic systemically relevant banks can be applied. The only regulatory measure explicitly mentioned in the text is the higher loss absorbency requirement that D-SIBs will also have to comply with in future. The regulatory text consciously expresses the assessment of these additional loss absorbency requirements (capital add-ons) in abstract terms and only in the form of guidelines to ensure the individual jurisdictions have sufficient room for manoeuvre. However, the banks must meet the entire additional loss absorbency requirement from Core Tier 1 capital to ensure comparability with the G-SIB capital requirements. National supervisors may also implement further regulatory measures on a case-by-case basis at their discretion.

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 the central banks and supervisory authorities of 27 countries. The Basel Committee develops global 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 help improve cooperation between national supervisory authorities.

Foreign subsidiaries.

Global or domestic systemically important institutions may have significant entities, for example subsidiaries, in another country that are also classified as systemically relevant in that country. The D-SIB framework places great importance on the role of the host supervisory authority in such cases. The host supervisor can determine the amount of the subsidiary's additional loss absorbency requirement in cooperation with the home authority, but may ultimately make the decision independently. Consequently, it will be important to establish a smooth information and coordination mechanism between the home and host supervisory authorities in future to ensure that the loss absorbency requirements at group and subsidiary level are balanced.

FSB publishes G-SIB update.

In November 2012, the Financial Stability Board published an updated list of global systemically important banks based on data gathered in financial year 2011. Unlike the 2011 publication, which just listed the G-SIBs in alphabetical order, the banks in the updated group are allocated to different categories of systemic importance (buckets). The list also shows the required level of additional loss absorbency corresponding to each bucket. These additional loss absorbency requirements will be phased in starting in 2016. The current list comprises a total of 28 global systemically important

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banks, which have been allocated to four buckets. Bucket 1 represents the lowest level. A currently empty fifth bucket exists for banks whose global systemic importance may increase in future periods. Among German banks, Deutsche Bank is allocated to bucket 4 and Commerzbank is no longer included in the group of G-SIBs, as the consolidation measures implemented by the bank have reduced its global systemic relevance.

In future, the FSB will publish an annual update in November of the group of G-SIBs based on the data of the previous financial year. Banks included in the 2014 G-SIB list will have to comply with the additional loss absorbency requirements described above for the first time, subject to the phase-in regulations. In addition, the methodology for identifying G-SIBs is to be reviewed and enhanced on an ongoing basis. In the course of 2013, the BCBS will also produce a set of guidelines, according to which banks classified as G-SIBs will be required to disclose the data used in the assessment.

**Resolvability**

The FSB implemented the second building block of the G20 agenda to limit the risks of systemically important banks with the adoption of the Key Attributes of Effective Resolution Regimes for Financial Institutions. The aim of these standards is to resolve systemically important banks without impacting public finances in order to more effectively combat the too-big-to-fail problem and the resulting moral hazard. They now need to be implemented in national law. The FSB is supporting and monitoring the implementation process by producing guidelines and developing a methodology to systematically review implementation in cooperation with the International Monetary Fund (IMF) and the standard-setting bodies. The FSB also conducted its own peer review in the middle of 2012, with more to follow. Through this process, the FSB expects to identify any implementation difficulties and unresolved issues.

The Key Attributes include provisions on the general legal framework for the recovery and resolution of SIFIs, the powers of national resolution authorities and their cross-border cooperation, the administration of compensation agreements and dealing with creditors' claims. In addition, the FSB recommends that the supervisory authorities establish institution-specific crisis management groups and cooperate with each other based on corresponding written agreements. The institutions and supervisory authorities should also establish recovery and resolution plans.[3] Guidance on how the competent authorities should assess the resolvability of global systemically important banks is also provided.

Implementation of the Key Attributes.

The Key Attributes must be implemented at national level in several stages by the second half of 2013. The FSB has drafted implementation guidance, which it released for consultation in November 2012. Following the recent insolvency of several financial institutions whose own assets were mixed with those of their clients, the FSB has also established provisions to protect client assets

[3] See chapter III 2.1.

in cooperation with the International Organization of Securities Commissions (IOSCO).

The IMF and the World Bank will review the national implementation of the Key Attributes in the medium term through their Financial Sector Assessment Programs (FSAPs). The methodology for these assessments is expected to be released for public consultation in the second half of 2013 and will likely be adopted at the end of 2013.

**More intensive supervision**

In 2012, members of the FSB's Supervisory Intensity and Effectiveness Group (SIE) from BaFin and other national supervisory authorities again initiated numerous measures that will contribute to more intensive and effective supervision of systemically important financial institutions (SIFIs) and banks (SIBs). These measures relate to key areas where enhanced supervision is particularly important. These areas include risk management using internal models, the monitoring of management and supervisory boards, in-depth reviews (deep dives), supervisory cross-checks, stress tests, supervisory colleges and the supervision of macro-prudential risk.

Senior Supervisors Group.

BaFin is also a member of the Senior Supervisors Group (SSG). The members of this group represent the supervisory authorities responsible for the world's largest banks. The SSG's objective is to exchange information on supervisory issues, identify potential risk areas and, where necessary, jointly implement cross-border initiatives. This involves gathering data on the counterparty credit risk of internationally active major banks, which the SSG then uses to produce reports presenting the counterparty exposures of the participating banks and their interconnectedness. In 2012, the SSG also examined governance issues, liquidity management challenges – including in light of the planned Basel III liquidity requirements – and the role of supervisory authorities in events arising in connection with the determination of reference interest rates and cyber security.

## 1.2 Insurance undertakings

The International Association of Insurance Supervisors (IAIS) took various steps in relation to global systemically important insurers (G-SIIs) in 2012 to stem systemic risk in the insurance sector. It developed a methodology for identifying G-SIIs, used this to draw up a list of insurance undertakings that potentially qualify as G-SIIs, and proposed the implementation of special supervisory measures. If the FSB approves this package, it will be presented to the G20 finance ministers at the summit in July 2013.

Identification of G-SIIs.

The IAIS developed the methodology for identifying G-SIIs in consultation with the FSB. According to this methodology, insurers are assessed based on their size, global activity, substitutability and interconnectedness with the financial system, as well as in relation to their non-traditional and non-insurance activities. The last two factors are the most important considerations.

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Established 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 also represented in the IAIS working groups.

In order to identify G-SIIs, in early 2013 the IAIS selected 48 globally active insurance undertakings that, based on their size and international activity, were potential G-SII candidates. At the request of the China Insurance Regulatory Commission (CIRC), this list was extended to include two Chinese insurers. The IAIS then gathered data from these 50 insurers in the autumn of 2012. The data was evaluated according to the methodology mentioned above to assess the insurers' systemic risk and identify potential G-SII candidates. During this phase, the methodology was reworked and adjusted. The greatest challenge was presented by the fact that products and potential risks often varied widely between countries.

Supervisory judgement and validation process.

The G-SII candidates underwent a supervisory judgement and validation process from December 2012 to February 2013. The IAIS will use the findings to support its decision on whether, how many and which of the 50 insurance undertakings should be proposed to the FSB for classification as G-SIIs. The aim of the process was to determine the source of the risks identified by the IAIS, as well as to assess the potential impact of a given insurer's default on other market participants or clients. In addition, the G-SII candidate was compared with other undertakings in its market segment (peer group analysis). A comparison with already designated G-SIBs was also valuable, where possible in accordance with confidentiality requirements. The BCBS's findings were also helpful to the IAIS, although not directly transferable to the insurance sector. If the FSB and G20 approve the list of G-SIIs, it will probably be published in the middle of 2013.

At the same time, the IAIS is developing proposals for supervisory measures to curtail the systemic risks potentially posed by G-SIIs. The measures were exposed for public consultation until December 2012. They are likely to focus on non-traditional and non-insurance activities. Where possible and desirable, the respective supervisory authorities should press for undertakings to separate these activities from their traditional business. Although this is usually possible with subsidiaries in the banking sector, there are doubts that activities such as securities lending could be separated in the insurance sector. The IAIS is also proposing capital surcharges for separated

activities, the restriction or prohibition of problematic activities and – as a last resort – group-wide capital add-ons as possible measures. In BaFin's view, flat-rate capital requirements would not be effective, as capital requirements are not the same all over the world. BaFin is therefore still focussed on preventing competitive disadvantages arising for German insurers. According to the IAIS, the planned measures are to provide insurers with targeted incentives to eliminate systemic risks as far as possible, without impacting their traditional activities.

### 1.3 Non-banks

In November 2011, the G20 instructed the FSB and IOSCO to develop a methodology to identify systemically important financial institutions outside of the banking and insurance sector, referred to as non-bank SIFIs.

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 into their national regulatory frameworks.

The FSB and IOSCO are developing detailed methodologies for each of the individual subsets of non-bank SIFIs. These will probably be presented to market participants as a consultation report in the autumn of 2013. The methodologies will be based on the same factors used to assess banks' systemic importance, namely size, cross-border activity, interconnectedness, substitutability and complexity. These factors will be quantified by means of indicators and thresholds will then be determined. Once these thresholds are reached, the financial institution will be classified as systemically important. Finally, the methodologies will be fine-tuned based on the data gathered and back-testing. This detailed work will be challenging, particularly due to the heterogeneity and complexity of the financial institutions.

## 2 Recovery and resolution

### 2.1 Banks

The collapse of systemically important banks can have grave consequences for the financial markets, as well as impacting the real economy. As a result, systemically important banks occupy a special position. There is also an expectation that the government will rescue them in an emergency – even at the expense of the taxpayer. This can create misguided incentives that can only be

avoided if there are mechanisms in place that make it possible for distressed institutions to recover or be resolved in an orderly manner. The German Restructuring Act *(Restrukturierungsgesetz)* offers such possibilities. In the case of internationally active banks, however, this can only be achieved through an effective cross-border resolution regime.

On 6 June 2012, the European Commission published a proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (Recovery and Resolution Directive). This will transpose parts of the Key Attributes[4] into European law and provides for certain measures also covered by the German Restructuring Act. Among these are the establishment of a restructuring fund, early intervention measures – such as the appointment of a special manager – and the option of transferring an institution's essential and systemically important business activities to a bridge bank. The tool used to write down and convert an institution's debt (bail-in tool), the maintenance of recovery and resolution plans, and the provisions on coordinating the resolution of cross-border groups are also noteworthy.

Content of the Recovery and Resolution Directive.

The Recovery and Resolution Directive is aimed at all credit institutions and investment firms, as well as certain holding companies. It is expected to be transposed into national law by 31 December 2014. The implementation deadline just for the bail-in provisions is 1 January 2018.

Provisions on the development and maintenance of recovery and resolution plans are a key component of the Directive. Recovery plans represent preparation for a crisis: at an early stage, credit institutions should consider the organisational and business policy measures, among others, to be taken to overcome a crisis as quickly and effectively as possible using their own resources, in order to avoid resolution. The recovery plan must describe the measures the institutions would implement to rebuild their financial strength, and they must prepare these measures. The plans are to be assessed by the supervisory authorities with regard to their credibility, feasibility and compatibility with system stability. Resolution plans must be prepared by the authorities. They also represent preparation for a crisis and comprise the measures to be taken if the credit institution cannot overcome the crisis from its own resources using the measures specified in the recovery plan. The main objective of resolution plans is to avoid threats to the financial system and the loss of public funds by making it possible to resolve or reorganise the institution.

Assessment of resolvability.

The Directive specifies that the resolution authority must assess whether an institution is resolvable without state aid. If it seems that there are barriers to this, measures should be implemented at the institution concerned as soon as possible, including at the instruction of the resolution unit in emergency situations.

The Recovery and Resolution Directive also specifies that agreements may be entered into on the provision of financial support by other subsidiaries. This should reduce the financial

[4] See chapter III 1.1.

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problems at group level, but must not lead to the company granting the financial assistance itself becoming distressed.

Preventive measures.

According to the Directive, supervisory authorities are to be given additional powers allowing them to intervene at an early stage if an institution's financial situation deteriorates. Among other things, they should be able to instruct the institution to implement the provisions and measures set out in the recovery plan, find solutions to specific problems and hold restructuring talks with creditors. If the supervisory authority considers an institution's solvency to be at risk, it can appoint a special manager for a limited period. The special manager's role is to restore financial stability to the institution.

Resolution tools.

The Recovery and Resolution Directive also introduces new resolution tools. In crisis situations, these tools should be used to ensure the continuation of critical – i.e. systemically important – functions, avoid significant disruption to financial stability, minimise the recourse to taxpayers' money and protect investors. Losses should first be allocated to shareholders and then to creditors. However, as in insolvency law, certain protective mechanisms will probably also apply when using these tools, with secured creditors enjoying particular protection, for example.

The resolution tools include:

- sale of business,
- bridge institution,
- asset separation,
- bail-in.

European system of restructuring funds.

In principle, owners and creditors should bear the costs that arise when an institution becomes insolvent. If this is insufficient, the additional costs must be covered by funds from other sources. The Directive therefore provides for the establishment of a system of restructuring funds that are supported by the institutions themselves. Such a system already exists in Germany.

The national restructuring funds should allow the respective supervisory authorities to make effective use of their tools. When necessary, these restructuring funds should lend to each other, subject to certain requirements. As in the case of insolvency, the deposit guarantee schemes should also be used for funding purposes where the resolution measures guarantee clients continued access to their deposits.

Supervisory colleges.

Colleges will be established for specific tasks that supervisory authorities are required to perform at group level. They are intended to promote cross-border cooperation.

## 2.2 Insurance undertakings

Systemic importance of insurers.

Unlike banks, most insurers do not lack liquidity even in times of crisis. The main issue tends to be the value of their financial investments. Different recovery measures therefore apply for insurance undertakings, with the particular aim of protecting

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policyholders. These include portfolio transfers to another insurer or the use of an insurance guarantee scheme as a bridge institution. Further-reaching intervention, such as capital increases, is also possible for insurers with non-traditional or non-insurance activities. In December 2012, the European Commission published and exposed for consultation a paper dealing with these issues. It is expected to be adopted in 2013.

Crisis management.

The three European Supervisory Authorities (ESAs) have extensive powers in the event of a crisis. These are governed by Article 18 of the ESA Regulations. According to this provision, the ESAs can actively facilitate and coordinate any actions undertaken by the competent national supervisory authorities. The national authorities must keep the ESAs informed of all relevant developments and allow them to participate in any pertinent meetings as an observer. For their part, the ESAs are required to closely cooperate and reach agreement with the national authorities.

The European Insurance and Occupational Pensions Authority (EIOPA) and the national supervisory authorities have established two bodies to control and prepare for crisis management: the Task Force on Crisis Management (TFCM) and the Internal Monitoring Group (IMG). In 2011 and 2012, the TFCM developed an institutional framework for EIOPA, with the aim of making it easier to identify crisis or risk situations. It provides for both preventive and reactive measures. The TCFM also looks in-depth at legal, procedural and analytical issues relating to crisis management and is involved in the preparation and follow-up work for the associated EIOPA decisions. The Internal Monitoring Group (IMG) is the body responsible for monitoring. It produces regular and ad hoc risk analyses, based on which it puts specific policy action proposals to EIOPA. To optimise efficiency, the IMG only has around ten members and is headed up by EIOPA’s first chairperson, Gabriel Bernardino.

# 3 Shadow banks

Extensive regulatory measures were implemented in response to the financial crisis in order to make banks more resilient to internal and external shocks. However, this simultaneously created incentives to circumvent the requirements or shift credit activities to other less regulated or totally unregulated areas. This system of credit activities outside of the traditional banking sector is commonly referred to as the shadow banking system. However, it is the FSB’s definition that is relevant for supervisory and regulatory authorities.

The FSB defines the **shadow banking system** as: “[...] the system of credit intermediation that involves entities and activities outside the regular banking system”. The definition therefore only

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covers activities and entities that are directly or indirectly related to credit intermediation and to which the banking sector's regulatory standards are not applicable or do not apply to the same extent.

According to the FSB, the shadow banking sector was worth around US$67 trillion at the end of 2011. Given that it amounted to just US$26 trillion in 2002, the sector's growth has been enormous and it now accounts for around one-quarter of the global financial system. However, its significance varies widely between countries. Whereas the shadow banking sector plays a prominent role in the USA and the UK, it is less significant in Germany and France, for example.

As a rule, the shadow banking system's credit intermediation chains involve a large number of companies, which all contribute to maturity and liquidity transformation and the creation of leverage. It is not sufficient to just assess individual companies, however. Instead, the system needs to be considered as a whole in order to determine its systemic importance for the financial sector. The connections of the shadow banking companies to each other and to other parts of the financial sector must be identified, and the resulting risks assessed and, where necessary, controlled accordingly. In mid-November 2012, the FSB issued its first preliminary recommendations for enhanced indirect and direct regulation of the shadow banking sector.

Indirect regulation.

The regulation of the relationships between banks and shadow banks is also known as indirect regulation. In essence, this involves scrutinising the prudential regulations applicable to the banking sector and improving any areas where risks to banks arising from the shadow banking sector are not adequately addressed. The Basel Committee on Banking Supervision is responsible for these measures. It is revising the large exposure rules to take account of typical shadow banking considerations, such as opaque interconnections. In addition, it is standardising the capital requirements for fund investments. The aim of these revisions is to more accurately reflect the actual risks. At the same time, it will be more difficult to circumvent the rules in future, as the transactions conducted by the company will be the key consideration, rather than its legal form.

Regulation of money market funds.

The direct regulations centre on money market funds (MMFs). Money market funds with a constant net asset value (CNAVs) are the main focus. The net asset value of these funds is always 100%. The funds' assets and, therefore, their net asset value, are/ is not assessed at the current market price, but using amortised cost accounting. Consequently, neither the market risk of the investments nor the losses sustained are reflected in the net asset value.

**Money market funds** (MMFs) are key components of the shadow banking system. They offer the possibility of redeeming units on a daily basis and, as a highly liquid instrument, are used by investors

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for their cash management. Money market funds also invest in instruments that have longer maturities. This means that they undertake maturity transformation and thus come under the FSB's definition of the shadow banking system.

Systemic risks.

Investors who redeem their fund units receive the constant value (100%). If many investors redeem their units at the same time, this may lead to the MMF selling assets at their market value and consequently realising losses. The constant net asset value differs from the actual value of the fund assets. If this variance reaches a critical level, the MMF "breaks the buck", resulting in its closure and liquidation. In such cases, investors who have remained invested in the fund suffer disproportionately high losses.

Systemic risk also arises from the financial support provided to such MMFs by banks (sponsor support), which creates a sort of implicit guarantee. Due to the nature of these funds and the constant net asset value, in certain circumstances investors can assume that their investment is guaranteed. Unlike bank deposits, investors themselves bear the investment risk in the case of investment funds. This system of implicit guarantees reached its limits during the financial crisis. The USA's Reserve Primary Fund, which had invested heavily in Lehman bonds, saw a massive outflow of funds following the bank's collapse. Because the parent company was unable to cover the losses, the units had to be repriced. This caused confidence in money market funds to plummet and a complete collapse was only prevented by the US authorities' support measures.

IOSCO policy recommendations for money market funds.

In October 2012, IOSCO adopted a set of recommendations on the regulation of money market funds. Among other things, it proposes that MMFs should be explicitly defined within investment funds (collective investment schemes). In addition, the asset classes in which money market funds are permitted to invest should be restricted and the weighted average maturity and maximum weighted average life limited. IOSCO also recommends compliance with the principle of fair value when valuing the assets. The aim is to reduce the risk of a run. Further recommendations are intended to help enhance liquidity management. For example, MMF managers should be better informed about the investor structure. Stress testing using scenarios for asset liquidity and redemption behaviour should be regularly carried out. Opportunities for dealing with runs in extreme cases should also be created. In addition, the funds should maintain a minimum level of liquidity.

Critics in the USA, in particular, are concerned that these recommendations could push down demand for money market funds. They also point out that evasive action could lead to a higher demand for unregulated products. In response, IOSCO recommends addressing the specific risks of CNAV MMFs. Where possible, all MMFs should move over to variable net asset value. If this is not possible, other equivalent measures could be implemented, which should also include capital requirements, according to IOSCO. The G20 approved these recommendations at the start of November

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2012. IOSCO will review the extent to which the recommendations have been implemented within two years.

Framework for identifying and regulating other shadow banking entities.

The FSB uses the term "other shadow banking entities" to refer to entities other than money market funds that operate in the shadow banking sector. These include hedge funds, securitisation vehicles, credit intermediaries and finance companies. Since this group is highly heterogeneous and often uses the same terms to refer to different activities, the FSB has decided to assess these companies mainly according to their activities and to a lesser extent by their legal form. The competent FSB working group has developed a framework that establishes overarching principles and divides the activities into five economic functions. The working group has produced a policy toolkit for each of the five functions. The FSB intends for these policy toolkits to be used by national authorities in the regulation and supervision of shadow banking entities and their activities.

Since only application of the overarching principles is mandatory – and not specific individual measures – peer reviews will have to be carried out in due course to establish whether all states have adequately implemented the rules. The FSB exposed the concept of the framework for consultation in November 2012. It will finalise the individual components and test the practicability of the framework in the course of 2013.

Regulation of securitisation activities.

In principle, the securitisation markets can support economic growth and contribute to risk diversification. Securitisation offers finance companies an alternative, market-based source of funding. However, the financial crisis showed that especially the originate-to-distribute model, where loans are originated for subsequent sale on the capital markets as securities, harbours its own significant risks. Since the loans were originated with a view to their immediate securitisation, they often underwent inadequate risk assessment processes. In particular, many originators neglected to check borrowers' creditworthiness. Added to this, rating agencies awarded the securitisation products prime credit ratings, which subsequently proved unsustainable. This severely dented investor confidence.

Consequently, the G20 heads of state and government resolved on a series of measures. The originator or sponsor must now bear part of the risk (retention). Together with the Basel Committee on Banking Supervision, IOSCO was called upon to assess the retention regulations and the transparency and disclosure requirements implemented nationally. It published its final report in mid-November 2012. According to the report, in places there are significant differences in the national approaches to aligning the interests of originators, sponsors and investors. This can give rise to risks and inefficiencies, particularly in cross-border transactions. IOSCO has proposed ways the different approaches could be further harmonised. Among other things, it recommends the establishment of a cross-sectoral working group to develop a set of general principles by the middle of 2013. IOSCO will check the implementation of the recommendations through peer reviews. According to IOSCO, the possibility of permitting cross-border transactions for which only the rules of the home country apply could be considered in the medium term – following implementation

of equivalent approaches – through mutual recognition or passporting regimes.

In order to restore confidence in the securitisation markets, IOSCO also recommends the provision of more information to investors to make their investment decisions easier. IOSCO wants the national supervisory authorities to work with industry to develop standard templates for the presentation of investor information. To ensure that these are as consistent as possible, IOSCO and the BCBS are to jointly develop appropriate guidelines.

Securities lending and repo market regulation.

The FSB has established a working group on the risks to financial stability posed by securities lending and repos (sale and repurchase agreements). The working group released an interim report for consultation in April 2012. This report presented an overview of the securities lending and repo markets, as well as their role in the shadow banking system; it also identified and explained potential financial stability problems. At the end of November 2012, the group published a further consultation report, presenting the possibilities for regulating the securities lending and repo markets. The main aim is to reduce the regulatory arbitrage between regulated and unregulated market participants and prevent undue market distortions.

The securities lending and repo markets play a crucial role in price discovery and secondary market liquidity for a variety of securities. They are also central to financial intermediaries' ability to make markets and facilitate the implementation of various investment, risk management and collateral management strategies. In addition, repo markets are an important refinancing instrument in many countries. Notwithstanding these undisputed benefits, securities lending and repo transactions can lead to the emergence of more and more credit-equivalent liabilities outside of the regular banking sector. Maturity and liquidity transformation is carried out through the short-term financing of longer-term assets. In the banking sector, capital, liquidity and leverage ratio requirements are in place to rein in excessive maturity and liquidity transformation. Outside the banking sector, these regulations are inconsistent or do not apply.

Procyclical effect.

Fluctuations in the value of securities generally have a procyclical effect, whether in the banking or shadow banking sector. However, in a system that uses repos and securities lending to meet a large part of its refinancing requirements – such as the shadow banking sector – this procyclical effect is much stronger. This is due to the fact that the refinancing costs are directly dependent on the fluctuations in securities prices and haircuts. The risk of panic sales of securities that serve as collateral is therefore particularly high in the shadow banking sector. If large numbers of creditors simultaneously sell their securities, they decline in value, leading to losses for the securities holders. This can in turn lead to panic sales of other companies' securities and trigger a downward spiral in securities prices.

Cash collateral reinvestment in securities lending can also harbour risks. Worldwide, these activities amount to around US$1 trillion and are usually settled by custodian banks, which act as the lenders'

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agents. The risk is that cash collateral reinvestment can involve maturity and liquidity transformation. If left unchecked, this can cause negative effects for the firms involved and the economy in stress situations. This was clearly demonstrated by US insurance group AIG, which had to be bailed out using taxpayers' money in 2008.

The FSB is examining these risks and preparing policy action proposals for the G20. The aim is to create greater transparency and establish limits to prevent excessive leverage and liquidity and maturity transformation. One of the main challenges is the fact that the global repo and securities lending market is very heterogeneous and comprises various market segments with different objectives. In addition, there is a risk that market participants will seek out other types of transaction if the regulations are too strict.

# 4 Banking union

A major shift in the European supervisory landscape has been on the horizon since the second half of 2012. Some banking supervision responsibilities are to be transferred to the European Central Bank (ECB). In the closing statement to their meeting on 29 June 2012, the eurozone heads of state and government asked the European Commission to draw up proposals for the creation of a single supervisory mechanism (SSM) for the eurozone with the involvement of the ECB. On 12 September 2012, the European Commission met this request with a proposal for a regulation. It also presented a further draft regulation whose scope includes the alignment of the EBA's decision-making rules with the new supervisory architecture.

New supervisory structure in the European Union.

Following extensive negotiations, the European finance ministers reached an agreement on the structure of the single supervisory mechanism on 12 December 2012. The single supervisory mechanism is also open to EU member states that have not joined the eurozone, but wish to work closely with the ECB banking supervisor on a voluntary basis. In future, the ECB will have direct oversight of all banks in the participating member states whose total assets exceed €30 billion or 20% of the GDP of the respective country of domicile. The ECB will also supervise banks that have received or applied for direct aid from the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM). A minimum of three banks in each participating member state will be supervised by the ECB.

The respective national supervisory authorities will be required to support the ECB in the performance of its supervisory functions and will in principle still be responsible for the supervision of the relevant participating member state's other banks. However, the ECB is establishing common supervisory standards and will be able to issue general instructions.

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The ECB will also be entitled to assume direct oversight of individual eurozone banks if this is necessary to ensure compliance with the supervisory standards.

The ECB's decision-making process will differ from BaFin's. A new supervisory board will be created, comprising a chairman, a vice chairman, four ECB representatives and one member from each participating member state. It will be responsible for developing proposals for decisions to be presented to the ECB's Governing Council. The decision will be considered adopted if the proposal is not rejected by the Governing Council. In the event of a dispute between the supervisory board and the Governing Council, a mediation panel can be set up. Each of the participating member states will assign one representative to the mediation panel, either from the Governing Council or the supervisory board.

The ECB is expected to assume its supervisory function one year after the Regulation's entry into force. It will be possible for the ECB to assume oversight of individual banks that have applied for aid from the ESM at an earlier date. However, many of the details first need to be finalised. According to the text of the regulation, the ECB and the national supervisory authorities must establish the specific terms of their future cooperation, particularly the division of day-to-day supervisory duties. The ECB's internal workflows and general procedural rules still need to be developed. BaFin intends to actively share its experience to help ensure that the new supervisor is fully operational from the outset.

# 5 CRD IV/CRR

CRD IV/CRR delayed.

The proposed Capital Requirements Directive IV and Capital Requirements Regulation (CRD IV/CRR), govern the transposition of Basel III into European law, among other things. The European Commission published the proposal in July 2011.[5] The final version of the legislative package has been under discussion in the trialogue between the Council of the European Union, the European Commission and the European Parliament since June 2012. It was originally meant to enter into force on 1 January 2013. However, the negotiations were not concluded in 2012 and will continue this year.

In addition to the transposition of Basel III into European law, the CRD IV/CRR package also aims to harmonise European banking supervision as far as possible, creating a single rule book. In an initial stage, the largely quantitative Pillar 1 requirements and the Pillar 3 disclosure requirements from the existing CRD and its annexes will be transferred to the directly applicable CRR. The qualitative Pillar 2 requirements will continue to be contained in the directive component, as will the provisions on granting authorisation and supervisory measures. However, the national options and discretions will be further reduced. In many cases, the remaining

[5] See BaFin's 2011 Annual Report, pp. 61-67.

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options and discretions available to the national supervisory authorities will be supplemented by EBA mandates to establish binding interpretation and implementation guidelines.

Intervention and sanction powers to be harmonised.

The CRD IV/CRR package also provides for the comprehensive revision of supervisors' intervention and sanction powers. The stated aim is to further harmonise the widely varying measures and sanctioning regimes, to provide national supervisory authorities with a standard, EU-wide minimum toolbox of intervention powers and measures, and to establish a standard list of fines.

In addition, the governance provisions are currently being revised. In particular, this is a reaction to the deficiencies in institutions' internal risk management and the failures of management and supervisory bodies exposed by the financial crisis. The core element of the new regulations is strengthening risk oversight by managers and management and supervisory boards. They also place greater importance on entities' risk management function. In addition, stricter requirements regarding the composition and qualifications of managers and management or supervisory boards are being implemented.

# 6 Solvency II

**Legislative process**

Implementation of Solvency II delayed.

The trialogue negotiations between the Council of the European Union, the European Parliament and the European Commission on the Omnibus II Directive were not concluded in 2012. The Omnibus II Directive aligns the Solvency II Directive[6] with the EU's new supervisory architecture and contains transitional provisions. The Omnibus II negotiations also covered technical aspects whose organisation has not yet been agreed by the trialogue parties. These include the treatment of insurance products with long-term guarantees. An impact study on a variety of potential regulations was launched in January 2013 and the findings are currently being assessed. The Omnibus II Directive is to be finalised as soon as the results are available. EIOPA plans to publish the final report in July 2013. According to the information currently available, the Omnibus II Directive will probably not be able to be adopted before the start of 2014.[7]

The new deadlines for Solvency II implementation, which had been amended by the "Quick Fix" Directive[8], have already become obsolete as a result of the Omnibus II delays. New dates for the transposition and entry into force of Solvency II have not yet been

[6] Directive 2009/138/EC, OJ EU L 335, p. 1 ff.
[7] See chapter IV 1.1.
[8] Directive 2012/23/EU, OJ EU L 249, p. 1 ff., Solvency II was originally expected to enter into force on 1 November 2012. The Quick Fix Directive deferred the date for transposition into national law to 30 June 2013 and the application date to 1 January 2014.

proposed. There are strong indications that Solvency II will not be applicable until 2016 at the earliest. Due to the amendments to the content of the Omnibus II Directive, the EU institutions also have to revise parts of the implementing measures.

### Early application of certain elements

Elements of Solvency II to be applied early.

Due to the delay to the Solvency II timetable, EIOPA plans to allow the national supervisory authorities to apply elements of Solvency II starting in 2014. Implementation in stages would have the advantage of allowing insurers and supervisors to work on Solvency II implementation on an ongoing basis and having several years' experience, at least in certain areas, by the final application date. In order to ensure a consistent Europe-wide approach, EIOPA specified these elements at the end of 2012.[9] These elements, such as the Own Risk and Solvency Assessment (ORSA), are not directly affected by the Omnibus II negotiations.

### Quantitative requirements

EIOPA's activities and initiatives.

EIOPA dealt with numerous issues related to the quantitative requirements under Pillar 1 of the Solvency II framework in 2012. It has produced actuarial guidelines for the calculation of technical provisions intended to support undertakings' actuarial function. In addition, in cooperation with the insurance industry, EIOPA has developed a technical standard to be applied when determining contract limitations for insurance liabilities. However, this will only be applicable once adopted by the European Commission.

The development of technical standards to determine the risk-free yield curve is a further focal point. This curve is a key parameter when calculating technical provisions. EIOPA will finalise the standard in 2013, taking into account the findings of the impact study on long-term guarantees.

EIOPA has also initiated comprehensive work on the standard formula used to calculate undertakings' solvency requirements. BaFin representatives provided considerable support to EIOPA on critical issues such as undertaking-specific parameters, deferred taxes, the look-through principle, the market risk of exotic investments, basis risk and the eligibility of reinsurance. They also contributed insights into business practice to the discussion.

Own funds guidelines and standards.

EIOPA also made progress in the area of "own funds". Almost all technical standards, guidelines and recommendations were revised and brought up to a firm draft stage, with the exception of the rules for equity investments and affiliated undertakings. The discussions are still ongoing.

[9] See grey box in chapter IV 1.1.

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## Qualitative requirements and reporting obligations

Guidelines and standards on capital add-ons.

With regard to the qualitative requirements of Solvency II, EIOPA last year focused on finalising the guidance on capital add-ons and improving the existing draft guidelines and technical standards.

The revised system of governance guidelines were made clearer. In particular, EIOPA reviewed whether due consideration had been given to proportionality. The guidelines also include information on the "prudent person" principle, which will replace the current quantitative limits on investments. EIOPA also revised the guidelines on extending the recovery period for breaches of the Solvency Capital Requirement (SCR) in the event of an exceptional fall in the financial markets.

ORSA guidelines revised.

All undertakings must perform an Own Risk and Solvency Assessment (ORSA) at least once a year as part of their risk management. The public consultation on the ORSA guidelines ran from November 2011 to January 2012. After assessing the comments received, EIOPA published a report on the consultation and the revised guidelines in July 2012. This version of the ORSA guidelines might not be the final version to be applied when Solvency II enters into force. However, undertakings can use it as a basis to prepare for Solvency II.

EIOPA also addressed supervisory transparency, clarifying the disclosure requirements applicable to supervisory authorities under the Directive by developing draft technical standards.

Consultation on reporting and disclosure requirements.

EIOPA also released the proposals for the future reporting and disclosure requirements for consultation. It published a revised version in July 2012. This describes the reporting and disclosure requirements and presents the obligations visually in the form of templates. The undertakings concerned can use this to prepare for the new requirements, ensuring that these are satisfied when Solvency II enters into force. Since its publication in July 2012, the supervisory authorities have been reviewing the reporting package for consistency, clarity and any deficiencies on an ongoing basis. EIOPA publishes the amendments in separate documents.

## Group supervision

Many group topics relate directly to the requirements on individual undertakings. To ensure the consistency of the interrelated reporting, ORSA and supervisory review process requirements, the requirements contained in the guidelines that are applicable to groups, but were developed for individual undertakings or supervisors of individual undertakings, are specified separately. In addition, EIOPA has developed discrete guidelines for purely group-specific issues, namely the exchange of information and workflows within colleges, the supervision of branches of third-country insurance undertakings, the calculation of group solvency, and intra-group transactions and risk concentrations.

Third-country equivalence.

Third countries have the opportunity to be covered by the transitional provisions of the Solvency II Directive if they wish.

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Eight countries made use of this equivalence procedure in 2012: Australia, Chile, China, Hong Kong, Israel, Mexico, Singapore and South Africa. The European Commission instructed EIOPA to assess these third countries. Among other things, the European insurance supervisor was asked to check whether the supervisory authorities and their employees were subject to confidentiality requirements consistent with those applicable under Solvency II. The European lawmakers also requested the identification of areas where the third-country supervisors do not yet meet the other equivalence requirements. EIOPA conducted these assessments in the course of 2012 and is expected to finish the work in the spring of 2013.

# 7 Securities supervision initiatives

**Regulation of OTC derivatives transactions**

Clearing derivatives transactions through central counterparties (CCPs) should mitigate contagion risks on the forex markets. However, the default of a CCP could itself trigger a crisis in the financial system. Supervisory standards for CCPs are one way of countering this systemic risk. Systemic risks can also be prevented by imposing own funds requirements on banks for their transactions with CCPs.

In April 2012, IOSCO and the Committee on Payment and Securities Settlement Systems (CPSS) agreed on the Principles for Financial Markets Infrastructures. According to these principles, a CCP must meet certain standards in respect of its own funds and the collateral it requires from its members. August 2012 then saw the entry into force of the European Market Infrastructure Regulation (EMIR), whose standards are based on the Principles for Financial Markets Infrastructures.

Default fund to cover any losses.

In July 2012, the BCBS published an interim solution for the own funds requirements applicable to banks in their transactions with CCPs, entitled Capital Requirements for Bank Exposures to Central Counterparties. In adverse circumstances, a CCP's exposure may exceed the collateral furnished by a clearing member if the member defaults. After deducting its own share of such losses, the CCP allocates the remainder to the other members. The members must contribute to a default fund in advance for this purpose. The interim rules specify two methods for banks to deal with the risk arising from their default fund contributions. To achieve a long-term solution, a way of measuring credit equivalent amounts is needed which, like the mark-to-market method, does not use modelling, but is better suited to the actual risks.

However, clearing through CCPs is generally only appropriate for standard transactions. For derivatives transactions that do not have to be cleared through a CCP, requirements on their collateralisation

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should help to stem systemic risk. IOSCO and the Basel Committee on Banking Supervision have agreed to require counterparties to post collateral to each other if the transactions are systemically important. In connection with this, a distinction is also made depending on whether the parties are financial or non-financial entities and whether their consolidated derivative volume is below a certain threshold.

Regulation on derivatives clearing through central counterparties.

The European Market Infrastructure Regulation (EMIR) transposes international standards for the supervision of CCPs and trade repositories and the central clearing of derivatives into European law. The clearing requirement, in particular, is uncharted supervisory territory for the EU lawmakers. The EMIR authorises the European Securities and Markets Authority (ESMA) to require all market participants, including real economy companies, to clear trades in certain classes of derivatives through central counterparties rather than on a bilateral basis. This does not apply to companies whose trading activities fall below certain thresholds. Transactions used to hedge commercial risk or for corporate finance purposes are not taken into account in the trading volume. In addition, intra-group transactions are exempt from the clearing requirement, subject to certain conditions. Market participants that exceed the clearing threshold are considered to be systemically important and are therefore subject to more stringent requirements. For example, they must perform marking-to-market for their derivatives on a daily basis, whereas companies below the threshold can apply nominal amounts. This differentiation reduces the burden on smaller companies and also applies to reporting.

Ultimately, it was not possible to cover all practical scenarios in the technical standards developed by ESMA to expand on the EMIR. Consequently, the European Commission published a list of questions and answers on the interpretation of the EMIR, which is updated on an ongoing basis.

Market participants that engage in cross-border transactions face a particular challenge if they are required to register in both the EU and in a third country. This can give rise to classification issues and conflicts – for example if the rules of two supervisory regimes contradict each other – that still need to be resolved. ESMA and the European Commission are conducting in-depth negotiations with supervisory authorities to find practicable solutions.

**Revision of the Markets in Financial Instruments Directive**

A key reform at European level is the revision of the Markets in Financial Instruments Directive (MiFID).[10] In October 2011, the European Commission presented its legislative proposals, which have been discussed by the Council of the European Union since November 2011. The European Parliament has also been involved in the legislative process and published a report at the end of October 2012 in preparation for the trialogue negotiations that will be held in 2013.

[10] Directive 2004/39/EC, OJ EU L 145, p. 1 ff.

The European lawmakers' revision of MiFID has three aims:

- strengthening the regulatory framework for investment services and securities markets;
- improving the integrity and efficiency of the financial markets;
- enhancing investor protection.

There will be significant changes to market structures. In particular, the proposed legislation provides for the introduction of a new category of trading venues: organised trading facilities (OTFs). This will encompass trading systems that are currently mainly operated by investment banks and are not classified as regulated trading venues under the existing legislation. In future, it is planned that OTFs will be subject to the same trading transparency as stock exchanges and multilateral trading facilities (MTFs). These requirements will also be extended to all financial instruments traded at a trading venue.

Tighter supervision of high-frequency trading.

The legislative proposals further specify the stricter regulation of high-frequency trading in future. For example, high-frequency traders will be subject to a licensing requirement. Trading venues and individuals who engage in high-frequency trading will also have to meet stricter organisational requirements. In particular, control mechanisms are to be put in place to prevent abusive market trading by individual high-frequency traders and breaches of the Market Abuse Directive.[11] Trading in commodity derivatives will also be more strongly regulated. Trading venues where commodity derivatives are traded (or their supervisory authorities) will be required to implement position limits and position management arrangements.

Investment services enterprises will also be subject to stricter requirements with regard to their client relationships. In future, they will have to inform their clients whether their advisory services are provided on an independent basis. If this is the case, the enterprise will, as a rule, be forbidden from accepting commissions from a third party. Investor protection is to be further enhanced by the fact that the national supervisory authorities and ESMA will be authorised to restrict or, if necessary, prohibit the distribution of financial products, subject to strict conditions.

**IOSCO consultation on trading technology**

Computer-based trading was a major theme for international bodies in 2012 and, as in the previous year, came under fire in the press. In August 2012, IOSCO published a consultation report on the technological challenges to market surveillance. The consultation report concludes with eight recommendations. Among other things, the competent supervisory authorities should regularly check that their supervisory capabilities are adequate in respect of technological advances in the market. In addition, it should be ensured that the supervisory authorities have efficient access to market data. Data should be available in compatible formats and, as far as possible, have a synchronous time stamp to ensure that

[11] Directive 2003/6/EC, OJ EU L 96, p. 16 ff.

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it can be traced effectively. IOSCO further recommends that the supervisory authorities review their expertise in the area of cross-border market supervision and make any necessary improvements. The consultation ended in October 2012.

# 8 Further regulatory initiatives

## 8.1 Directive on Deposit Guarantee Schemes

Reform of the Directive on Deposit Guarantee Schemes still in trialogue procedure.

The proposed amendment to the European Directive on Deposit Guarantee Schemes[12] has been in the informal trialogue procedure since the second half of 2011. In particular, the funding level is still being debated. The European Commission considers a funding level of 1.5% of the eligible deposits to be necessary; the European Parliament believes 1.5% of covered deposits is sufficient, and most European governments in the Council are of the opinion that 0.5% of the covered deposits represents an adequate funding level.

**Trialogue procedure**

Trialogue is a procedure used in EU institutional law. It refers to the negotiation conciliation procedure between the institutions involved in the EU legislative process, namely the European Commission, the Council and the European Parliament. The trialogue procedure 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 addition, the European Commission intends to make it possible to maintain a target funding level for deposit guarantee and restructuring purposes by means of the Recovery and Resolution Directive.[13] If a deposit guarantee scheme meets the Directive's funding requirements – particularly in respect of the target fund level, levying of contributions and the EU system of borrowing – the member states can use their deposit guarantee funds for recovery and resolution measures. A target fund level just needs to be set aside for restructuring and compensation purposes, without the need to adjust the overall amount.

[12] Directive 94/19/EC, OJ EU L 68, p. 3 ff.
[13] See chapter III 2.1.

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However, this connection, which is intended to reduce the financial burden on banks, is problematic, as it could impair the proper functioning of deposit guarantee schemes and restructuring funds. The aim of restructuring is to stabilise the financial markets. In contrast, the primary focus of deposit guarantee schemes' is on consumer protection, with financial market stability only a secondary concern. The deposit guarantee schemes must be in a position to meet their obligations to (retail) depositors. In addition, it is possible that the restructuring of banks that do not have any covered deposits could be financed with funds contributed by the institutions issuing the guarantee.

## 8.2 Occupational retirement provision

Implementing technical standards.

EIOPA held consultations on a draft implementing technical standard on the reporting of national provisions of prudential nature in the field of occupational pension schemes until 10 March 2013. This standard specifies the procedures, forms and templates to be used by the supervisory authorities of EU member states and signatories to the Agreement on the European Economic Area (EEA) to transmit information on national prudential provisions and updates to these provisions to EIOPA. The national prudential provisions include only those rules that are relevant to the field of occupational pension schemes and are not covered by national social and labour laws. EIOPA will evaluate the responses to the consultation and make any necessary amendments to the draft. The final version must be presented to the European Commission before 1 January 2014.

Impact study on institutions for occupational retirement provision (IORPs).

EIOPA conducted a quantitative impact study (QIS) at the request of the European Commission from the start of October to mid-December 2012. The objective was to obtain information on the potential impact of amendments to the quantitative provisions of the IORP Directive. Each participant of the study calculated 18 sets with each set representing a holistic balance sheet that reflected different combinations of the possible quantitative rules. EIOPA had previously proposed a holistic balance sheet approach as a potential framework for new quantitative rules for IORPs. In addition to the IORPs' assets and liabilities, the holistic balance sheet should include other mechanisms used to secure liabilities. These include the employer's obligation to provide additional funding if necessary and pension protection schemes, such as the Pensions-Sicherungs-Verein VVaG (PSVaG), which operates as a private mutual insurance association.

The impact study also covered the measurement rules applicable to the holistic balance sheet and the calculation of solvency capital requirements. The precise rules for the calculations to be carried out in the impact study were taken from the technical specifications issued by the European Commission when the study began. These technical specifications were largely developed by EIOPA. The actual implementation of the impact study in the participating member states was carried out by the national supervisory authorities. In Germany, 38 IORPs (27 *Pensionskassen* and 11 pension funds) participated in the impact study. Based on the premium reserve in accordance with the German Commercial Code *(Handelsgesetzbuch* – HGB), market coverage was higher

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than 70% in the case of *Pensionskassen* and over 85% for pension funds. BaFin aggregated the results of the participating IORPs and extrapolated them to the overall market. These figures will be taken into account in the EIOPA assessment report, which will be presented to the European Commission by June 2013. The European Commission will issue a proposal for a revised IORP Directive in the summer of 2013.

## 8.3 Financial conglomerates

New principles for the supervision of financial conglomerates.

Established in 1996, **the Joint Forum** is the joint body 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 supervisory issues including the regulation of financial conglomerates from a cross-sector perspective. Among other things, this aims to improve supervisors' understanding of the other sectors.

The international insurance, securities and banking supervisory bodies, the IAIS, IOSCO and the BCBS, adopted new principles for the supervision of financial conglomerates in 2012. A year earlier, the joint body – the Joint Forum – had prepared the ground by releasing enhanced principles for the supervision of financial conglomerates for public consultation. These new principles close regulatory and supervisory gaps and align the Joint Forum documents from 2001 with the current market circumstances.

For example, in future financial activities and undertakings that are not subject to supervision will be covered by the principles. The principles also include provisions on financial conglomerates' corporate governance for the first time. In addition, the standard-setters updated the outdated principles on capital and liquidity levels and risk management requirements. Stress tests must in future be carried out also at conglomerate level.

Developments at EU level.

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, and ensures cross-sectoral convergence through its work. Among other things, the JCFC aims to ensure that the Financial Conglomerates Directive is implemented fully and consistently by 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.

The Joint Committee on Financial Conglomerates (JCFC) presented its recommendations on the comprehensive revision of the Financial

Conglomerates Directive[14] to the European Commission in October 2012. It recommends extending the scope of the Directive to previously excluded non-regulated entities. These include special purpose entities (SPEs), special purpose vehicles (SPVs) and mixed financial holding companies. However, pension funds should not fall within the scope of the Directive. Based on the Joint Forum principles, the JCFC recommends that an entity that plays a dominant role within the overall group should be responsible for ensuring compliance with the rules for the supervision of financial conglomerates. This dominant entity should also meet certain corporate governance requirements. According to the JCFC, the supervisory authorities should be authorised to obtain information from and investigate the responsible entity. The JCFC did not recommend extending the list of sanctions provided in the Financial Conglomerates Directive. However, it argued for the consistent application of the existing sanctions throughout Europe.

## 8.4 Rating agencies

ESMA assumed full responsibility for the supervision of rating agencies in October 2011. However, BaFin had to deal with issues relating to rating agency supervision also in 2012. BaFin representatives worked with ESMA on developing the key objectives of supervisory practice in this area and participated in the preparation of new ESMA guidelines and regulatory technical standards. BaFin was careful to ensure that the specific concerns of small and medium-sized rating agencies were taken into account. Internationally, BaFin made a substantial contribution to the important work of IOSCO to enhance the cooperation between the individual national supervisors and develop international regulatory standards, including the revision of IOSCO's code of conduct for rating agencies.

New rating agency regulations.

The Council of the European Union, the European Commission and the European Parliament concluded their trialogue negotiations on the new regulation for credit rating agencies (CRA III) in December 2012. Among other things, the new rules reduce the reliance on external ratings and restrict the opportunities to invest in rating agencies.[15] Following final approval by the European Parliament, the new regulation is due to enter into force in the summer of 2013.

Endorsement procedure for third-country systems.

Together with the national supervisory authorities, ESMA reviewed the legal and supervisory systems in third countries in 2012. The intention is to ensure that ratings from these countries meet the requirements of the European Regulation. The decision is made either through ESMA's endorsement procedure or the European Commission's equivalence procedure. Companies may only use the ratings once these procedures have been successfully concluded.

Since the examination of third-country systems was very time-consuming, 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

[14] Directive 2011/89/EU, OJ L 326, p. 113 ff.
[15] See 2011 Annual Report, p. 83.

30 April 2012.[16] Since then, the third-country ratings may only be used if the requirements in the country in question are equivalent to those of the EU, the agencies are registered and supervised in that country, and the relevant supervisory authority has entered into a cooperation agreement with ESMA.

On 15 March 2012, ESMA announced the endorsability of ratings issued in the USA, Canada, Hong Kong and Singapore. Ratings from Argentina and Mexico were also given the green light on 18 April 2012.

Equivalence procedure.

Internationally active rating agencies mainly use the endorsement procedure. Third-country agencies that are not systemically important and do not have a branch in the EU can have their ratings authorised for use in the EU for regulatory purposes through the equivalence procedure. In his case, the European Commission must recognise the relevant country's legal and supervisory system – after it has been reviewed from a technical perspective by ESMA – as equivalent to that of the EU. The European Commission recognised the systems in the USA, Canada and Australia as equivalent on 5 October 2012.

## 8.5 Peer reviews

ESMA: three peer reviews.

BaFin participated in three ESMA peer reviews in 2012. The aim of these comparative analyses is to promote the coherence and effectiveness of the different European supervisory authorities' work. To this end, good practices are determined in the peer reviews. The analyses are managed by the ESMA Review Panel, which is composed of staff from the national supervisory authorities.

In 2012, ESMA launched and, in some cases, completed peer reviews on the following topics:

- supervisory practice with regard to the prevention of market abuse;
- supervision of money market funds;
- conduct of business rules to ensure consumers are provided with fair information that is not misleading.

The peer review on market abuse was largely completed in 2012; only the development of good practices is still outstanding. The review looked at whether the individual authorities are in a position to monitor potential instances of market abuse. The use of insider lists, cooperation between the individual authorities, investigation of market rumours and the use of alternative sources of information – such as alerts from market participants – were also examined. BaFin is fully compliant with the Market Abuse Directive in all of these areas. The same applies to the supervision of money market funds.

ESMA is currently still identifying examples of particularly good practice for the peer reviews on the supervision of money market funds and on the conduct of business rules to ensure consumers are

[16] See 2011 Annual Report, p. 82.

provided with fair information that is not misleading, in accordance with the MiFID.

The ESMA Review Panel is also conducting peer reviews of key supervisory topics in 2013.

The EIOPA Review Panel initiated peer reviews on the following topics in 2012:

- pre-application of internal models;
- supervisory practice in the application of Article 13 (Information to be provided to the competent authorities) and Article 14 (Powers of intervention and duties of the competent authorities) of the Directive on institutions for occupational retirement provision (IORP Directive)[17] in normal and crisis situations;
- supervision of branches of EEA entities by the home and host supervisors.

In each case, the first phase of the peer review consisted of the national supervisory authorities completing a self-assessment questionnaire. The responses were evaluated and then reviewed in the second phase of the peer review through visits, teleconferences and in writing.

EBA: Review of stress testing guidelines.

On the recommendation of the Review Panel, the EBA Board of Supervisors decided to review parts of the guidelines on stress testing. Stress tests examine the impact of hypothetical scenarios on institutions and help to assess whether the institutions' capitalisation is adequate. The conceptual work of the peer reviews was largely completed in 2012, allowing the actual review to begin in early 2013.

# 9 Consumer protection

The three European Supervisory Authorities (ESAs) have extensive consumer protection powers. Among other things, they are able to issue guidelines and warnings. The ESAs continued to develop their consumer protection activities in 2012. Each ESA now has its own committee for consumer protection and financial innovation. The Joint Committee has also been active in the area of consumer protection since the middle of the year. Examples of the ESAs' consumer protection measures include annual consumer trends reports and the Joint ESAs Consumer Protection Day, which will be organised for the first time in 2013.

Since 1 January 2011, there have been three **European Supervisory Authorities** (ESAs): the **European Banking Authority** (EBA) based in London, the **European Insurance and Occupational Pensions Authority** (EIOPA) based in Frankfurt

[17] Directive 2003/41/EC, OJ EU L 235, p. 10 ff.

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am Main and the **European Securities and Markets Authority** (ESMA) based in Paris. The ESAs have their own legal personality and are the legal successors to 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). Alongside the national supervisory authorities, they are responsible for institutional and market supervision, also referred to as micro-prudential supervision. Macro-prudential 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.

**EIOPA Guidelines on Complaints-Handling**

In the middle of 2012, EIOPA adopted Guidelines on Complaints-Handling by Insurance Undertakings. Complementary to the Guidelines, EIOPA also published interpretation guidance and a Best Practices Report. The Guidelines are aimed at national supervisory authorities, which must ensure insurance undertakings' compliance with them. The Guidelines include rules on the supervision of insurance undertakings' complaints-handling procedures, with the aim of achieving a minimum level of supervisory convergence. For example, the Guidelines specify that insurance undertakings must document their procedures for handling client complaints in writing. This includes complaints being registered and assessed by a neutral party within the undertaking. In addition, insurance undertakings are to regularly report the number of complaints it has received to the supervisory authority. The supervisory authorities determine the other information to be disclosed by the insurance undertakings. BaFin plans to transpose the Guidelines into national law in 2013.

Guidelines do not have legal force and are therefore not binding on national supervisory authorities. However, the authorities are required to make every effort to ensure that guidelines are followed. The supervisory authorities must confirm that they comply or plan to comply with the guidelines within two months of their publication. If they do not wish to apply the guidelines, they must inform EIOPA and give their reasons ("comply or explain" process). EIOPA publishes the decision and informs the European Parliament, the Council and the European Commission.

**European Commission publishes consumer retail legislative package**

In July 2012, the European Commission published a consumer retail legislative package. The package comprises three legislative proposals:

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- a proposed revision of the Insurance Mediation Directive (Insurance Mediation Directive 2 – IMD 2);
- a draft regulation on key information documents for packaged retail investment products (PRIPs);
- a proposal to improve protection for investors who buy units in investment funds. This is currently governed by the Directive on undertakings for collective investment in transferable securities (UCITS IV),[18] which is to be amended accordingly.

New Insurance Mediation Directive.

The current Insurance Mediation Directive (IMD 1) governs the authorisation of insurance intermediaries, the requirements regarding their professional and personal suitability and, to a certain extent, insurance intermediaries' obligation to provide information to their clients.

Like IMD 1, the new draft Insurance Mediation Directive (IMD 2), which is to be adopted in mid-2013, only aims to achieve a minimum degree of harmonisation. The member states are free to introduce stricter regulations for their insurance intermediaries. However, if they do, this could lead to intermediaries exercising their freedom to provide services and moving their head office to an EU state where they consider the regulations to be more favourable.

Definition of insurance mediation.

The Directive applies to the mediation of all insurance products. However, in the interests of proportionality, it provides for less strict regulations in certain situations: for example, if the mediation takes place in connection with another transaction, as is the case for fully comprehensive insurance offered when hiring a car, or travel cancellation insurance offered when booking a holiday.

If only information is provided, this is not considered mediation and is therefore not covered by the Directive. The extent to which websites that compare insurance products and often produce rankings fall within the scope of these regulations and, if so, how they can be effectively supervised, is still unclear. They play an important role in consumers' decision-making process.

The revised Directive will now also apply to the mediation of products by employees of insurance undertakings. In addition, if products are packaged, insurers must now expressly indicate that the products can also be individually purchased.

Disclosure requirements.

The draft Directive also specifies that intermediaries must disclose conflicts of interest. They must declare their status, which means that they must state whether they are acting as tied intermediaries, brokers, or employees of an insurance undertaking. In addition, they must disclose their remuneration.

For a transitional period of five years, these provisions will only apply in full to life insurance intermediaries. During this period, intermediaries of other insurance classes will only be required to disclose the information if requested by the client. This is intended to make the transition easier for small and medium-sized insurance undertakings.

[18] Directive 2009/65/EC, OJ EU L 302, p. 32 ff.

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Insurance products as PRIPs.

The European Commission also published a proposal on key information documents for packaged retail products (PRIPs) at the same time as the draft IMD 2. PRIPs are investment products offered to retail clients in “packaged” form, which are exposed to investment risk irrespective of whether the products in question are securities, insurance, or banking-based. Investors do not invest directly in the “packaged” investment products, instead the investment product provider combines, includes, or groups together different assets in the packaged product. Certain products are excluded from the definition in Article 2 of the draft PRIPs Regulation. These include simple products, such as savings accounts, as well as certain pension schemes and pension products for which a financial contribution from the employer is required by law and where the employee has no choice as to the pension product provider.

Under the draft Regulation, a standard key information document (KID), providing all relevant product information, will in future be provided for PRIPs. The fact that the information document must be used for all product types will facilitate product comparison. Thus, the key information document will enhance protection for small investors and create a level competitive playing field for investment product providers. As a rule, the KID should be provided to prospective investors in good time before the contract is entered into so that they can take the information into account when making their investment decision. The investment product provider is responsible for providing the KID.

The IMD 2 proposal also provides specific rules for insurance contracts with an investment element, which also come under the definition of PRIPs. In future, these contracts are to be subject to disclosure requirements relating to the insurance cover and, in particular, the investment risk. This concerns all unit-linked products. However, other insurance contracts that have the characteristics of PRIPs must also comply with these requirements.

Under the draft Insurance Mediation Directive, independent brokers will in future only be able to accept commission for the mediation of insurance contracts with an investment element from the client. A similar rule already exists in Scandinavia and the Netherlands. In Germany, however, it is customary for the insurance undertaking to pay commission, which it finances through the premiums paid by the policyholder.

The planned regulations for insurance contracts with an investment element are broadly similar to those provided in the draft Markets in Financial Instruments Directive (MiFID II).[19]

Enhanced protection for investment fund investors (UCITS V Directive).

The amendments to the current UCITS Directive have been proposed by the European Commission based on the experiences gathered from the financial crisis. The UCITS V Directive aims to enhance the European rules for undertakings for collective investment in transferable securities (UCITS) and align them with investors’ needs. The intention is to improve investor protection and promote the integrity of the markets.

[19] See chapter III 7.

The proposal focuses on three areas:

- Clarifying the tasks and obligations of custodian banks and depository institutions to safeguard quality standards and achieve a harmonised level of protection for deposits and securities held in custody.
- The regulation of fund managers' remuneration, with internal remuneration rules to be designed in such a way that they do not incentivise fund managers to take short-term risks at the investors' expense. This is intended to better align the remuneration policy with the long-term interests of investors.
- Harmonisation of the sanctions regime under the UCITS Directive throughout Europe. In the event of breaches of supervisory requirements, it must be ensured in particular that the sanctions (fines) eliminate the additional gains generated by the breach.

**Restriction of financial activities by the ESAs**

Article 9 of the ESA Regulations authorises the three European Supervisory Authorities to issue warnings in the event that financial activities pose a serious threat to the stability and effectiveness of the financial system in the EU. They may also temporarily prohibit or restrict financial activities.

At the end of 2012, EIOPA published procedures for applying these measures. These define the scope and content of EIOPA's powers and establish the structure of their involvement and decision-making processes. The aim is to achieve greater legal certainty and ensure EIOPA is able to take effective action in the event of a crisis. The Joint Committee of the three European Supervisory Authorities will use EIOPA's procedures to develop standard processes for all of the ESAs.

# 10 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 Financial Reporting Standards (IFRSs) and International Accounting Standards (IASs)– 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.

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## IFRS 9 Financial Instruments

Revision of IFRS 9 “Financial Instruments”.

In response to the financial crisis, and under pressure from the G20 and the European Union, the International Accounting Standards Board (IASB) decided to completely overhaul the requirements of IAS 39 “Financial Instruments: Recognition and Measurement”, and to replace them in their entirety by the future new standard, IFRS 9 “Financial Instruments”. This standard is designed to govern the recognition and measurement of financial instruments.

The IASB issued a revised exposure draft on the classification and measurement of financial assets and liabilities on 28 November 2012. This proposes a new measurement category for particular financial assets whose changes in fair value will be recognised through other comprehensive income. Previously, the insurance industry in particular had levelled the criticism that both the classification and the measurement model in the IASB’s original exposure draft differed significantly from those in the IASB’s project on insurance contracts (IFRS 4). By issuing the proposed changes, the IASB has eliminated most of the alleged problem areas. The comment period for the revised exposure draft ended on March 28, 2013.

New measurement category for particular financial assets.

Financial assets are allocated to the new measurement category if they meet the conditions defined by IFRS 9 for the business model and the contractual cash flow characteristics of the financial asset. Accordingly, financial assets are allocated to this category if their contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Additionally, the explicit objective of the business model may not be either to hold these assets or to sell them. Measurement gains and losses on a financial asset are recognised in other comprehensive income, except for impairment losses, income from application of the effective interest method, or foreign exchange gains and losses. If the financial asset is derecognised or is reclassified to another measurement category, this item of comprehensive income is reclassified from equity to profit or loss (recycled) and hence recognised in the income statement. The new measurement category is similar to the available-for-sale measurement category in the existing IAS 39. However, there are still significant differences. For example, financial assets that meet the conditions described above must be allocated to the new measurement category (i.e. there is no option to do this or not).

Fewer accounting mismatches at insurance undertakings.

The introduction of this category can reduce the number of accounting mismatches at insurance undertakings. Under the existing requirements of IFRS 9, these insurers would be forced to recognise short-term changes in the value of their long-term investments (assets) in profit or loss in future, although changes in the value of related liabilities of the insurers are currently recognised in other comprehensive income. It therefore makes sense for the insurance industry to apply the new measurement category so that they can accurately reflect their long-term business model in their financial accounting and reporting.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015. However, it has not yet been endorsed by the EU.

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The exposure draft sets out that, in future, only the full and final requirements of IFRS 9 may be applied six months after the full version of the standard is issued. The only exception permitted is that entities may early adopt parts of the requirements governing own credit risk.

IASB's exposure draft on insurance contracts.

There is still no date for publication of a final IFRS on accounting for insurance contracts. One of the reasons for the delay is the lack of consensus on how to account for volatility in the measurement of insurers' provisions. This applies in particular to the recognition of long-term business in the balance sheets of the life insurers. At present, the IASB's deliberations appear to suggest that short-term volatility that arises during the term of an insurance contract because of variations in interest rates will be recognised in other comprehensive income and will thus not affect profit or loss. The IASB had exposed for comment a draft IFRS on accounting for insurance contracts in July 2010.

In its exposure draft amending IFRS 9, the IASB also proposed accounting for changes in fair value of assets recognised in insurers' balance sheets in other comprehensive income. As a result, changes in interest rates affecting the measurement of debt instruments held by insurers could also be recognised in other comprehensive income. This alignment of the accounting treatment of assets and liabilities would eliminate the asymmetry or matching problems in insurers' financial reporting feared by users of the future IFRS on insurance contracts.

## Auditing

Improvements in the quality and independence of audits.

In November 2011, the European Commission published two draft documents on the subject of auditing: an amending directive and a regulation. The aim of this proposed legislation is to strengthen the independence of auditors and to enhance the quality of audits by means of measures directed specifically at the audits of public-interest entities[20]. In particular, the Commission is proposing mandatory rotation of audit firms, a requirement for joint audits, the separation of audit and non-audit services, and requirements relating to fees and the content of audit reports.

In September 2012, the Legal Affairs Committee of the European Parliament came out against most of the reforms proposed by the European Commission. Among other things, it objected to the fact that the Commission does not impose any explicit requirements for the level of non-audit fees. As far as rotation and the strict separation of audit and non-audit services are concerned, the Legal Affairs Committee is proposing a more moderate approach. The European Parliament's proposed amendments also show clearly that it wants the audit committees established by companies' non-executive directors or supervisory boards to have

[20] The term "public-interest entity" is defined in Article 2 (13) of the existing Directive 2006/43/EC, and transposed into German law by section 319a (1) of the German Commercial Code, which links the term to entities that are publicly traded.

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even greater responsibilities than the Commission does. At the same time, the Legal Affairs Committee supports and has fleshed out the proposals on the content of the audit report. For example, the report should not only contain the dates of the meetings with the audit committee or with the non-executive directors or supervisory board, but also a detailed description of the nature and extent of communication with those bodies. In addition, a mere description of the distribution of tasks among the auditors is not sufficient: there must also be a description of the scope and timing of the audit. This applies in particular if third-country auditors are involved. It should be emphasised that, for the first time, the objective is to establish rules aiming to standardise the content of audit reports across the EU.

IAASB's proposals.

In June 2012, the International Auditing and Assurance Standards Board (IAASB) published a consultation paper containing proposals for improving the auditor's report. In particular, the report should be more transparent. For example, the IAASB suggests that the auditor's report should be supplemented by an "Auditor Commentary" in which the auditor describes and explains important matters and provides a more detailed analysis of the appropriateness of the going concern assumption. Moreover, the statements in the auditor's report should be clearer and more transparent. The comment period ended in October 2012. The international and European financial supervisory bodies submitted comment letters. These back the IAASB's proposals in principle, but also draw attention to shortcomings. In its comment letter, for example, the EBA notes that the IAASB and the IASB do not have a common definition of a "going concern". The BCBS criticises that the definition of public-interest entities does not include all banks.

# 11 Supervisory cooperation

**Memoranda of Understanding (MoUs) and bilaterals**

BaFin signs further MoUs.

In 2012, BaFin agreed further 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.

For example, BaFin entered into an MoU with the Jersey Financial Services Commission (JFSC). The two financial supervisory authorities thereby updated two existing agreements, combining them in a single cross-sector MoU. In the area of insurance supervision, BaFin agreed an MoU on closer cooperation with the Georgia Department of Insurance (GADOI) during the year under review. The supervisory authorities formalised the exchange of information relevant to their respective supervisory and regulatory work. They also agreed on a procedure for on-site inspections. The year under review also saw BaFin sign an agreement with the Bank of Albania covering all areas of banking supervision.

Table 2

## Memoranda of Understanding (MoUs) in 2012

| Banking supervision | | Securities supervision | | Insurance supervision | |
|---|---|---|---|---|---|
| **Albania** | **2012** | Argentina | 1998 | Australia | 2005 |
| Argentina | 2001 | Australia | 1998 | California (USA) | 2007 |
| Armenia | 2011 | Brazil | 1999 | Canada | 2004 |
| Australia | 2005 | Canada | 2003 | China | 2001 |
| Austria | 2000 | China | 1998 | Connecticut (USA) | 2011 |
| Belgium | 1993 | Croatia | 2008 | Croatia | 2008 |
| Brazil | 2006 | Cyprus | 2003 | Czech Republic | 2002 |
| Canada | 2004 | Czech Republic | 1998 | Dubai | 2006 |
| China | 2004 | Dubai | 2006 | Egypt | 2010 |
| Croatia | 2008 | Estonia | 2002 | Estonia | 2002 |
| Czech Republic | 2003 | France | 1996 | Florida (USA) | 2009 |
| Denmark | 1993 | Guernsey | 2011 | **Georgia (USA)** | **2012** |
| Dubai | 2006 | Hong Kong | 1997 | Guernsey | 2011 |
| El Salvador | 2011 | Hungary | 1998 | Hong Kong | 2008 |
| Estonia | 2002 | Italy | 1997 | Hungary | 2002 |
| Finland | 1995 | **Jersey** | **2012** | **Jersey** | **2012** |
| France | 1992 | Jersey | 2001 | Korea | 2006 |
| Georgia | 2011 | Korea | 2010 | Latvia | 2001 |
| Greece | 1993 | Luxembourg | 2004 | Lithuania | 2003 |
| Guernsey | 2011 | Monaco | 2009 | Malta | 2004 |
| Hong Kong | 2004 | Poland | 1999 | Maryland (USA) | 2009 |
| Hungary | 2000 | Portugal | 1998 | Minnesota (USA) | 2009 |
| Ireland | 1993 | Qatar | 2008 | Nebraska (USA) | 2007 |
| Italy (BI) | 1993 | Russia | 2001 | New Jersey (USA) | 2009 |
| Italy (BI-Unicredit) | 2005 | Russia | 2009 | New York (USA) | 2008 |
| Jersey | 2000 | Singapore | 2000 | Qatar | 2008 |
| **Jersey** | **2012** | 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 (BoE/FSA) | 1995 | | | | |
| United Kingdom (BSC) | 1995 | | | | |
| United Kingdom (SIB/SROs) | 1995 | | | | |
| USA (NYSBD) | 2002 | | | | |
| USA (OCC) | 2000 | | | | |
| Vietnam | 2010 | | | | |

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Meetings with other supervisory authorities.

BaFin regularly meets with representatives of other supervisory authorities at bilaterals, either on a scheduled or ad hoc basis. The meetings are usually about regulated entities that operate or have a branch in the other country concerned. The meetings are also used to exchange information on current developments and enhance cross-border cooperation between the supervisory authorities.

In 2012, BaFin representatives met with a number of Asian supervisory authorities, including the Monetary Authority of Singapore (MAS), the Reserve Bank of India, the three Chinese supervisory authorities, the People's Bank of China, the Japanese supervisory authority and the Bank of Japan. Further bilaterals were held with a number of US supervisory authorities and the Israel Securities Authority.

In Europe, there were meetings with the Jersey Financial Services Commission (JFSC), the Swiss Financial Market Supervisory Authority (FINMA), the Austrian Financial Market Authority (FMA), Luxembourg's Commission de Surveillance du Secteur Financier (CSSF), the Central Bank of the Russian Federation, France's Autorité de Contrôle Prudentiel (ACP) and the Liechtenstein Financial Market Authority (FMA).

**Technical cooperation**

Cooperation with China continued to strengthen. Several joint seminars and workshops were held in Germany and China based on the declarations made between BaFin and the China Securities Regulatory Commission. The main themes were deposit protection and investor compensation, the MiFID report and oversight of financial services providers.

Greater exchange of information on insurance supervision.

BaFin also intensified the exchange of information on insurance supervision with other authorities in 2012. The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH initiated or supported many of the meetings. BaFin will strive to further improve the exchange of information in the area of insurance supervision in 2013.

In 2012, a delegation from India's insurance supervisory authority were guests of BaFin and were particularly interested in the supervisory reporting requirements applicable to insurers. BaFin also strengthened its already good relationship with the Polish financial supervisory authority *(Komisja Nadzoru Finansowego* – KNF). The meeting focused on BaFin's review of prospectuses. In addition, BaFin is supporting KNF in a temporary twinning project with Azerbaijan's State Committee for Securities. It also has good relations with South Korea's Financial Supervisory Service (FSS). Employees of FSS again completed multi-week internships in securities and insurance supervision at BaFin. The cooperation with Vietnam also strengthened. Numerous delegations from the State Bank of Vietnam (SBV) and the State Securities Commission (SSC) were guests of BaFin in 2012. In the Gulf region, BaFin has a new partner in the form of Saudi Arabia and its Capital Market Authority (CMA). The focus here was on issues related to insider trading and the supervision of financial services providers and investment companies.

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# IV Supervision of insurance undertakings and pension funds

Felix Hufeld
Chief Executive Director Insurance Supervision[21]

## 1 Bases of supervision

### 1.1 Implementation of Solvency II

The Solvency II Framework Directive[22] was scheduled to be transposed into national law in Germany by means of the Tenth Act Amending the Insurance Supervision Act *(Zehntes Gesetz zur Änderung des Versicherungsaufsichtsgesetzes).* The first draft had already been published in August 2011; it was released for consultation and subsequently revised with input from BaFin. The government draft for the new Insurance Supervision Act *(Versicherungsaufsichtsgesetz* – VAG-E[23]) was published in February 2012. The Act was scheduled to enter into force on 31 October 2012.

Mid-2012 saw the first indications that the introduction of Solvency II might be delayed. The European Parliament, the Council and the Commission did not reach agreement on the Omnibus II Directive[24] by the agreed deadline in the summer of 2012. However, the Omnibus II Directive is of particular significance for the introduction of the new supervisory regime. On the one hand, it will amend the existing Solvency II Directive in certain key areas, for example by incorporating the functions and rights of the European Insurance and Occupational Pensions Authority (EIOPA) and modifying the transitional arrangements, including as regards own funds. On the other hand, however, it will contain entirely new requirements, for example for the insurance products with long-term guarantees.

Delays at European level affect national implementation.

It was clear towards the end of 2012 that the effective date of Solvency II, and thus the national implementation of the directive, would have to be postponed by at least one year. The Tenth Act Amending the Insurance Supervision Act will no longer be enacted by the autumn of 2013, as originally planned. A new legislative initiative to implement the Solvency II Directive, as amended by the Omnibus II Directive, cannot be expected before 2014 because of the national elections in Germany.

[21] Felix Hufeld has been Chief Executive Director for Insurance Supervision since January 2013.
[22] Directive 2009/138/EC, OJ EU L 335, p. 1 ff. See chapter III 6 for further information.
[23] Draft of the Tenth Act Amending the Insurance Supervision Act of 15 February 2012.
[24] 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.

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However, the delayed implementation of Solvency II does not mean that individual aspects of Solvency II might not be introduced at an earlier date.

**Fast-tracking certain aspects of Solvency II**

At the suggestion of BaFin, among others, there are currently deliberations about whether implementation of parts of the Solvency II requirements, for example certain aspects of the Pillar II Own Risk and Solvency Assessment (ORSA), should be fast-tracked. EIOPA intends to issue guidelines on the governance and risk management requirements under Pillar II.[25]

Germany already has a statutory basis for introducing the core requirements of the ORSA prior to the effective date in the form of section 64a of the Insurance Supervision Act *(Versicherungsaufsichtsgesetz* – VAG): this provision, introduced in 2009, requires insurers to have a proper business organisation. These statutory requirements are set out in greater detail in the Minimum Requirements for Risk Management in Insurance Undertakings *(Mindestanforderungen an das Risikomanagement VA* – MaRisk VA). Among other things, these require the German insurers to address their risk-bearing capacity.

The ORSA also requires the insurance undertakings to assess all business-related risks and to determine the resulting capital requirements. To do this, they must prepare projections covering several years and must be aware from the outset of the impact of their strategic decisions on their capital requirements. This issue can also be viewed independently of the supervisory solvency requirements, as it does not matter initially whether Solvency I or Solvency II applies from a quantitative perspective. The ORSA thus establishes a stronger link between risk and capital management. It makes sense for the supervisor to stress this link already today, since it will be mandatory at some point in the future. Because Solvency II was originally scheduled to start on 1 January 2014, fast-tracking certain elements should also not impose an excessive burden on the undertakings.

BaFin continuing in-depth preparations for Solvency II.

Solvency II is set to be the most comprehensive Europe-wide reform of insurance supervision in the past few decades. BaFin is therefore faced with the task of creating all the conditions – including internally – needed to ensure that insurance supervision can operate in accordance with the requirements of the new regime. It had already launched its own internal Solvency II project in the previous year and pressed ahead with this project in the year under review, continuing its preparations for the new supervisory regime. The Solvency II project covers a total of five areas.

One of these areas relates to involvement in shaping the regulatory environment. For example, BaFin is participating in European consultations, contributing its ideas to them and working intensively to transpose the rules into national law. Another area concerns

[25] See chapter III 6.

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the definition and elaboration of tasks in the field of operational supervision. In addition to examination manuals and checklists, a concept for computerised evaluations must also be prepared for the new supervisory regime. The third area involves the modifications necessary for the IT environment and how to manage their implementation. Another area relates to preparing BaFin staff for the new supervisory regime: a large number of internal Solvency II training events were held in the year under review. In addition, work progressed on a concept for knowledge management in the future. Finally, the fifth area addresses the issue of preparing insurance undertakings for the new supervisory regime.

**BaFin Solvency II conference**

BaFin organised its fourth conference on the topic of Solvency II on 8 November 2012. Delegates from insurers and industry associations met with representatives from BaFin, the Federal Ministry of Finance (BMF) and EIOPA to discuss the revised timetable for implementing the new supervisory regime and the challenges this will bring for them. The complexity and practicability of the Solvency II requirements were also criticised. Nevertheless, all participants agreed that they would profitably use the time gained by the delay to the start of Solvency II. For example, it would allow certain regulatory requirements to be revised, improved, or fast-tracked.

## 1.2 Improving life insurers' risk-bearing capacity

The Federal Government and BaFin have long been aware of the risks posed to the insurance industry by any continuation of the period of low interest rates. The Federal Government already took a range of measures in the past to allow the life insurers to continue meeting their long-term payment obligations in a period of persistently low interest rates. Since 2011, for example, the life insurers have had to build up a *Zinszusatzreserve* (an additional provision to the premium reserve introduced in response to the lower interest rate environment) to offset their lower investment income in the future.

***Zinszusatzreserve***

Life insurers have had to establish and add to their *Zinszusatzreserve* since 2011. This is a precautionary measure. Low interest rates are negatively impacting the life insurers' return on investment. In the long term, it may happen that an insurer's net investment income is no longer sufficient for it to meet its guaranteed return obligations. As a result, funds must be appropriated now to the *Zinszusatzreserve* so that an insurer can use them to fund its guaranteed returns in subsequent years.

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The detailed requirements for the *Zinszusatzreserve* are governed by the Regulation on the Principles Underlying the Calculation of the Premium Reserve *(Deckungsrückstellungsverordnung* – DeckRV). Based on a ten-year average yield on government bonds, the first step is to calculate the uniform "reference interest rate" that applies to all insurers. The insurers must then establish the *Zinszusatzreserve* for policies whose guaranteed return is higher than this reference interest rate. In such a case, the insurer appropriates to the *Zinszusatzreserve* an amount equal to the interest shortfall that will arise over the next 15 years.

The reference interest rate in financial year 2011 was 3.92%. The *Zinszusatzreserve* therefore only had to be established for policies with a guaranteed return of 4%; this cost the industry as a whole around €1.5 billion. In the 2012 annual financial statements, the *Zinszusatzreserve* also affects only policies with a guaranteed return of 4%. Because of the low interest rates, however, the reference interest rate declined sharply to 3.64%, requiring an additional amount of more than €5 billion to be added to the *Zinszusatzreserve*. A similar expense can be expected for financial year 2013 if interest rates on the capital markets remain as low as they were in the fourth quarter of 2012.

Although building up the *Zinszusatzreserve* represents a considerable burden for the life insurers, this effort is indispensable to ensure that they can continue to meet their guaranteed return obligations in the long term.

Partial collectivisation of the provision for bonuses and rebates.

A decision was also taken to "partially collectivise" the provision for bonuses and rebates *(Rückstellung für Beitragsrückerstattung* – RfB). The insurance contracts of the life insurers had been split into existing and new contracts in the course of deregulation in 1994. This division led to differences in the way the RfB for the existing contracts and the RfB for the new contracts developed. Partial collectivisation will enable the levels of the RfB for the different groups of contracts to converge again.

Policyholder participation in the valuation reserves.

In case the unfavourable conditions for the insurers on the capital markets persist, the Bundestag decided at the beginning of November to amend the provisions governing the participation of policyholders in the valuation reserves as part of the SEPA Accompanying Act *(SEPA-Begleitgesetz).* In the end, though, the Bundestag and the Bundesrat decided to postpone the issue for the time being and to first conduct a fundamental review of the supervisory framework.

It had been planned to take greater account of the interests of all policyholders collectively as regards participation in the valuation reserves: where valuation reserves funded by fixed-income securities and interest rate hedges are necessary to safeguard the guaranteed return, they should not be included in participation in the valuation reserves, meaning that they should not be paid out successively to policyholders whose policies mature.

Since 2008, life insurers have had to allow their customers to participate in the valuation reserves when their policies mature. Any valuation reserves funded by fixed-income securities have to be included in this calculation. This requirement is based on a ruling by the Federal Constitutional Court in 2005. As a general principle, valuation reserves funded by fixed-income securities arise only if capital market rates are falling. Paradoxically, this has the economically irresponsible effect of forcing life insurers to pay out extremely high amounts to their outgoing customers precisely in an environment of declining – and now very low – interest rates. This runs counter to the objective of safeguarding funds for existing policyholders. Additionally, the current rule means that a considerable portion of interest due on securities in the future has to be paid out ahead of time to the outgoing policyholders. This siphons off funds from the remaining policyholders.

Industry-wide valuation reserves funded by fixed-income securities amounted to €2.7 billion at the end of the first quarter of 2011. They had already risen to €87.8 billion by the end of 2012 because capital market rates had fallen further. Payments to outgoing policyholders were correspondingly high. The amounts are now frequently in the order of 10 to 15% of the endowment benefit.

The amendment to the VAG originally resolved by the Bundestag would have eliminated the current mechanism for automatic participation in the valuation reserves, which is economically inappropriate. Under the planned revision, a life insurer would always have to determine the amount needed to safeguard the interests of the existing policyholders whenever it calculates the level of the valuation reserves. Put simply, the amount needed to safeguard the interests of the existing policyholders would have been the difference between a notional *Zinszusatzreserve* – based on a market-oriented reference interest rate – and the actual *Zinszusatzreserve*. Only those policies would be included in the calculation for individual policies whose guaranteed return is higher than the reference interest rate. Valuation reserves funded by fixed-income securities and interest rate hedges would only be included in participation in the valuation reserves to the extent that they exceed the amount needed to safeguard the interests of the existing policyholders.

The winners under this new arrangement would have been the policyholders as a whole, because there would have been a proper balance between the interests of outgoing policyholders and those of the remaining policyholders. On the one hand, the policyholders as a whole could have relied on the fact that funds would continue to be made available to ensure the insurers' long-term ability to meet their guaranteed return obligations, even in the event of a prolonged period of low interest rates. On the other hand, the outgoing policyholders would have continued to participate as before in the valuation reserves funded by equities and real estate, whilst the valuation reserves funded by fixed-income securities and interest rate hedges would have been only paid out in a responsible manner in a low interest rate environment.

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## 1.3 Consultation procedure on the ban on special allowances and preferential contracts

BaFin conducted consultation procedure 4/2012 – "The future of the ban on granting special allowances and entering into preferential contracts" – in April 2012. This consultation procedure was triggered by a ruling by the Administrative Court in Frankfurt[26] that addressed the issue of whether the ban on passing on commissions was lawful. The court took the view that the ban affecting life insurance is – among other things – too vague and therefore unlawful. BaFin initially appealed this ruling, but withdrew its appeal following a further, detailed examination because the specific case in question was not suitable for obtaining supreme court clarification overall on the legality of the ban on passing on commissions.

The ruling by the Administrative Court in Frankfurt resulted in a highly controversial public discussion about the future of both the ban on special allowances – in particular passing on commissions – and the ban on preferential contracts. In addition to legal considerations, the debate also focused on the actual impact of modifying the prohibitions.

Widely differing opinions about the future of the legislative prohibitions.

In addition to the associations representing intermediaries and the insurance industry associations, individual insurers and intermediaries, as well as consumer protection organisations, were the main participants in the consultation process. BaFin published 31 of the 34 comment letters received on its homepage once the consultation process had finished.[27] The analysis of the comment letters received showed clearly that there were very divergent opinions about the future of the prohibitions. Both advocates and opponents of the legislative prohibitions claimed that they were protecting the interests of consumers in order to justify their position.

After analysing the comment letters received and following a legal review, BaFin came to the conclusion that there were at least no compelling reasons for removing the legislative prohibitions. However, if they are to continue in force, they would have to be modified, including to reflect the ruling by the Administrative Court in Frankfurt. The alternative would be to abolish the legislative prohibitions in part or in full.

**Ban on special allowances and preferential contracts**

The ban on special allowances and preferential contracts applies to all major insurance classes and consists of two rules. First, it bans insurance undertakings and intermediaries from granting special allowances. The primary incidence of granting special allowances is that of passing on commissions, for example when an insurance

[26] Ruling dated 24 October 2011, case ref.: 9 K 105/11.F.
[27] www.bafin.de/dok/2835032. Three respondents expressly refused permission for their comment letters to be published.

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intermediary passes on part of its commission directly to the policyholder or the intermediary uses some of its commission to pay part of the premium owed by the policyholder.

As well as special allowances, preferential contracts are also banned, i.e. contracts that give an unreasonable and unjustified advantage to individual policyholders. Preferential treatment may arise, for instance, if an insurer grants a daily surrender right to individual policyholders or waives the first year's premium.

The BMF is authorised to issue statutory orders that prohibit insurance undertakings and insurance intermediaries from granting any form of special allowances to a policyholder. It can also ban insurance undertakings from entering into and extending preferential contracts. The BMF has transferred this function to BaFin (section 81 (3) sentence 2 of the VAG). BaFin's predecessor authorities first introduced corresponding legislative prohibitions in 1923.[28]

## 1.4 Revision of circulars addressing investments and guarantee assets

BaFin has to revise all circulars.

BaFin is having to comprehensively revise all circulars addressing investments and guarantee assets to align them with the principles-based supervisory system envisaged under Solvency II. This is the result of an examination conducted by BaFin in the year under review. Because the start date for Solvency II was delayed at the end of 2012, BaFin has also postponed the harmonisation of the circulars with the future supervisory system for the time being.

Three supervisory regimes, each addressing a separate regulatory area.

The examination was based on the draft act to transpose the Solvency II Framework Directive into German law presented by the Federal Government in February 2012. Under the draft, the future VAG will cover the following three supervisory regimes, each addressing a separate regulatory area: primary insurance and reinsurance undertakings that fall under the Solvency II Framework Directive; insurance undertakings that are excluded from the scope of the Solvency II Framework Directive (small undertakings and funeral expenses funds); and finally institutions for occupational retirement provision (IORPs).

[28] Announcement dated 10 August 1923, Official Gazette of the German Reich and Prussian State Gazette No. 186; announcement dated 14 May 1924, Official Gazette of the German Reich and Prussian State Gazette No. 118. Subsequently, the Regulation Banning Special Allowances and Preferential Contracts in Property/Casualty Insurance *(Verordnung über das Verbot von Sondervergütungen und Begünstigungsverträgen in der Schadenversicherung)* dated 17 August 1982, Official Bulletin of the Federal Insurance Supervisory Office (BAV) 82, p. 456; announcement of the Reich Private Insurance Supervisory Office dated 8 March 1934 relating to life insurance, Official Bulletin of the Reich Private Insurance Supervisory Office 34, p. 99; announcement of the Reich Private Insurance Supervisory Office dated 5 June 1934 relating to health insurance, Official Bulletin of the Reich Private Insurance Supervisory Office 34, p. 100.

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The investment circulars for primary insurance undertakings that fall within the scope of the Solvency II Framework Directive, especially Circular 4/2011 (VA), encapsulate the administrative practice as regards the Regulation on the Investment of Restricted Assets of Insurance Undertakings *(Verordnung über die Anlage des gebundenen Vermögens von Versicherungsunternehmen –* AnlV). The Federal Government issued this regulation in 2001. Among other things, it stipulates the types of assets permitted by law for the guarantee assets and the other restricted assets. It also contains quantitative diversification and spread limits, as well as provisions governing the matching currencies and location of the investments. The Federal Government issued the regulation on the basis of the authorisation set out in section 54 (3) of the VAG. The draft revision of the VAG does not contain an equivalent authorisation to issue qualitative and quantitative investment regulations for undertakings that fall within the scope of the Solvency II Framework Directive. Consequently, there will not be any regulation equivalent to today's Regulation on the Investment of Restricted Assets of Insurance Undertakings. This will have a substantial effect on the circulars that address areas governed by this Regulation, and it is even possible that individual circulars will be revoked.

For insurance undertakings that are excluded from the scope of the Solvency II Framework Directive because of their small business volume, and for institutions for occupational retirement provision (IORPs), the draft revision of the VAG envisages an authorisation to issue qualitative and quantitative investment regulations that is equivalent to the current section 54 (3) of the VAG. Nevertheless, BaFin will still have to comprehensively revise the circulars applicable to these undertakings that address investments and guarantee assets. The revision will be limited in part to formal amendments. However, BaFin assumes that there will also be a need to make content-related changes to the circulars.

BaFin discussed the results of its examination in initial talks with the associations representing the insurance industry and IORPs.

# 2 Ongoing supervision

## 2.1 Authorised insurance undertakings and pension funds

Decline in the number of 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 592 insurance undertakings (previous year: 600) and 30 pension funds. Out of the total number of insurance undertakings, 570 were engaged in business activities and 22 were not. In order to give as full a picture as possible of the insurance market in Germany, all of the information in the rest of this chapter also includes ten public-law insurance undertakings

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supervised by the *Länder* (nine conducting business activities and one without business activities). The breakdown by sector is shown in the following table:

Table 3

**Number of supervised insurance undertakings and pension funds***

As at 31 December 2012

| | Insurers with business activities | | | Insurers without business activities | | |
|---|---|---|---|---|---|---|
| | BaFin supervision | *Länder* supervision | Total | BaFin supervision | *Länder* supervision | Total |
| Life insurers | 93 | 3 | 96 | 9 | 0 | 9 |
| *Pensionskassen* | 148 | 0 | 148 | 1 | 0 | 1 |
| Funeral expenses funds | 37 | 0 | 37 | 1 | 0 | 1 |
| Health insurers | 49 | 0 | 49 | 0 | 0 | 0 |
| Property/casualty insurers | 211 | 6 | 217 | 6 | 1 | 7 |
| Reinsurers | 32 | 0 | 32 | 5 | 0 | 5 |
| **Total** | **570** | **9** | **579** | **22** | **1** | **23** |
| 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 *Länder* (BaFin 2011 statistics – Primary insurers and pension funds, p. 9, table 5).

## Life insurers

Two German life insurers supervised by BaFin ceased operating in 2012. Seven foreign life insurers from the European Economic Area (EEA) registered for the cross-border provision of services (CBS) in Germany (previous year: six). A number of service providers also expanded their business activities by adding new insurance classes.

Table 4

**Registrations by EEA life insurers in 2012**

As at 31 December 2012

| Country | CBS* |
|---|---|
| Ireland | 3 |
| Liechtenstein | 1 |
| Poland | 1 |
| Spain | 1 |
| United Kingdom | 1 |

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

## Health insurers

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

## Property and casualty insurers

Three property and casualty insurers started operating in the year under review and six undertakings ceased operating. Five foreign property and casualty insurers from the European Union established branch offices in Germany: two from the United Kingdom and one each from Sweden, France and Spain. Twenty-seven insurers from the EEA registered for the cross-border provision of services

in Germany (previous year: 34). Other insurers that had already registered for the cross-border provision of services in Germany notified an expansion in their business activity. Forty-eight insurers ceased providing services in Germany in 2012 (previous year: 21).

Table 5
**Registrations by EEA property and casualty insurers in 2012**
As at 31 December 2012

| Country | CBS* | BO** |
|---|---|---|
| Belgium | 1 | |
| Czech Republic | 1 | |
| Denmark | 2 | |
| France | 1 | 1 |
| Greece | 1 | |
| Ireland | 4 | |
| Malta | 3 | |
| Netherlands | 3 | |
| Romania | 1 | |
| Slovenia | 1 | |
| Spain | 3 | 1 |
| Sweden | 1 | 1 |
| United Kingdom | 5 | 2 |
| of which: Gibraltar | 2 | |

* 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

Three reinsurers ceased operating as independent German reinsurers in 2012 and one reinsurer started operating. Six branches of EU undertakings operated reinsurance businesses in Germany in the year under review. These related to undertakings from France, Ireland, Luxembourg and Spain.

### *Pensionskassen,* pension funds and funeral expenses funds

Four *Pensionskassen* ceased operating and one started operating. At the end of the year under review, one approval procedure to operate a pension fund was pending. One funeral expenses fund ceased operating.

## 2.2 Interim reporting

### 2.2.1 Position of the insurance sector

Germany's insurance industry remains stable.

The German insurance industry remained stable in the year under review, despite the continuing sovereign debt crisis in Europe. The economic environment remains dominated by the expansionary monetary policy pursued by the European Central Bank (ECB). The resulting sustained low interest rates are depressing insurers' income and making it more difficult for them to meet their contractual benefit obligations. The cheap money policy that has

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been pursued for some time represents a major challenge in particular for the German life insurers. As a result, in 2011 they had to establish a *Zinszusatzreserve* (an additional provision to the premium reserve introduced in response to the lower interest rate environment) for the first time amounting to €1.5 billion, in order to prepare themselves for the income shortfalls expected from the low interest rates.[29] For life insurance policyholders, the low interest rates are leading to declining discretionary bonuses; the guaranteed benefits are not affected. Despite the difficult environment, the life insurers will be able to meet their benefit obligations in the short to medium term. This has been confirmed repeatedly by BaFin's stress tests and projections.

Insurers searching for alternative investments.

As investors with substantial funds at their disposal and a long-term horizon, insurers mainly invested in government bonds in the past. Because the yields on government bonds with good ratings are now at an all-time low, insurers are having to invest in alternative, higher-yielding investments. Thus BaFin is noticing that a growing number of insurers wish to invest for example in financing for commercial real estate, in tangible assets such as infrastructure, renewable energies, or commodities. However, there have not been any significant shifts so far in the structure of their investments, nor have any systemic risks arisen. Equally, BaFin does not expect either of these to happen in the future, either.

### 2.2.2 Business trends

#### Life insurers

New direct life insurance business declined by 5.6% year-on-year, from 6.22 million to 5.87 million new policies in 2012. By contrast, the total value of new policies underwritten rose by 1.6% to €259.9 billion (previous year: €255.9 billion).

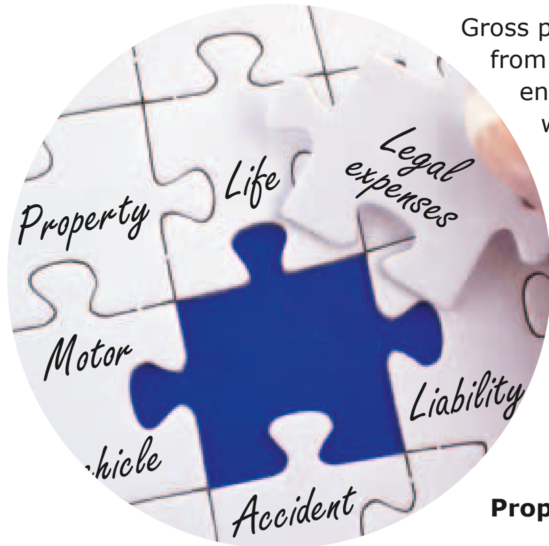
The share of the total number of new policies accounted for by term insurance policies increased by 6.8% year-on-year. The share accounted for by endowment insurance policies declined by 10.0% in the same period, from 789,532 policies to 710,846. The share attributable to pension and other insurance contracts also recorded a decrease, falling 10.4% from 3,761,807 to 3,371,055. Overall, the total number of new policies underwritten declined from 6,224,929 to 5,868,571.

Slight decline in early terminations.

Early terminations of life insurance policies (surrender, conversion to paid-up policies and other forms of early termination) declined slightly from 3.0 million contracts in 2011 to 2.9 million contracts in the year under review. At €109.1 billion, the sum insured under contracts terminated early was higher than in the previous year (€106.4 billion). The proportion of early terminations of endowment policies declined from 31.0% in the previous year to 28.0%, and the proportion of the total sum insured decreased from 19.9% to 17.7%.

[29] See chapter IV 1.2.

There were a total of 88.7 million direct insurance contracts in 2012, representing a 0.8% decrease compared with the previous year. By contrast, the sum insured rose to €2,735 billion (+3.1%). Term insurance policies recorded an increase both in the number of contracts – from 12.6 million to 13.7 million – and in the sum insured, which rose from €600.7 billion to €695.4 billion. Pension and other insurance contracts continued the positive trend recorded in the previous years. Their share of overall policies rose from 44.7% to 45.5%, although their share of the total sum insured declined from 47.9% to 47.7%.




Gross premiums written in the direct insurance business increased from €82.0 billion to €82.5 billion. The share attributable to endowment policies declined further from 32.4% to 30.2%, while the share of pension and other life insurance policies increased from 62.1% to 63.8%.

**Health insurers**

Gross premiums written in the direct insurance business increased from €34.7 billion in the previous year to €35.7 billion in 2012. The number of insured natural persons rose by 2.1% to 37.5 million.

**Property and casualty insurers**

Property and casualty insurers recorded a year-on-year increase in gross premiums written in the direct insurance business in 2012 to €62.0 billion (previous year:€59.6 billion).

Gross expenditures for claims relating to the year under review increased by 3.0% to €21.7 billion (previous year: €21.1 billion). By contrast, gross expenditures for claims relating to previous years declined from €15.4 billion in 2011 to €15.2 billion in the year under review. Gross provisions recognised for individual claims relating to the year under review amounted to €16.1 billion, compared with €15.7 billion in the previous year, while gross provisions recognised for individual claims relating to prior years amounted to €47.8 billion, compared with €47.4 billion in the previous year.

With gross premiums written amounting to €21.3 billion, motor vehicle insurance was by far the largest insurance class, rising by 5.6% compared with the previous year. Gross expenditures for claims relating to the year under review decreased by 1.8% year-on-year, accompanied by a 4.0% decline in gross expenditures for claims relating to previous years. Overall, gross provisions recognised for individual claims relating to the year under review declined by 0.2% year-on-year, while they increased by 0.9% for outstanding claims relating to the previous year.

Property and casualty insurers collected premiums of €8.0 billion (+3.4%) for general liability insurance. €0.9 billion (previous year: €1.0 billion) was paid out for claims relating to the year under review and €2.5 billion for claims relating to prior years (+5.5%). Gross provisions for individual claims, which are particularly

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important in this insurance class, rose by 2.4% 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 €14.4 billion (+2.2%).

Insurers recorded gross fire insurance premiums written of approximately €1.7 billion (–2.7%). Gross expenditures for claims relating to the year under review rose by 2.7% to €538.4 million.

Insurers collected premiums for comprehensive household insurance and comprehensive contents insurance contracts of €7.7 billion (+4.6%). Expenditures for claims relating to the year under review rose by 6.6% year-on-year, while provisions for individual claims decreased by 4.1%. Expenditures for claims relating to previous years increased by 11.5%, while provisions for claims relating to previous years rose by 2.9% compared with 2011.

Premium income for general accident insurance contracts rose marginally from €6.4 billion in the previous year to €6.5 billion in the year under review. 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 declined by 0.4% year-on-year.

### *Pensionskassen*

Renewed rise in premium income.

According to projections, premium income generated by the *Pensionskassen* was around €6.2 billion, a rise of approximately 4.5% year-on-year. The increase had only been 1.7% in 2011.

The premium income of *Pensionskassen* competing on the open market *(Wettbewerbspensionskassen),* which have been established since 2002, was approximately €2.8 billion, following a total of €2.7 billion in the previous year.

In the case of *Pensionskassen* funded largely by employers, premium income trends depend on the headcount at the sponsoring company in question. Premium income generated by these *Pensionskassen* rose to approximately €3.4 billion in 2012 (previous year: €3.2 billion).

### Pension funds

The number of beneficiaries rose to a total of 908,184 persons in the year under review (previous year: 777,378), with 574,804 beneficiaries being members of defined contribution plans and 40,808 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. With this form of benefit commitment, the employer is also obliged to pay contributions in the payout phase.

### 2.2.3 Investments

Further increase in investments by German insurers/continued high proportion of bonds.

The bond markets were again characterised by historically very low yields in the year under review. For example, yields on German and US government bonds reached all-time lows in the middle of the year. The prices of bonds issued by certain southern European countries – especially Spain and Italy – initially suffered considerable losses. Following the announcement by the European Central Bank that it would, if necessary, buy an unlimited amount of government bonds of EU member states affected by the crisis, European bond markets calmed down in the second half of the year.

As at 31 December 2012, aggregate investments by German insurers supervised by BaFin amounted to €1,480.1 billion (previous year: €1,403.2 billion). Broken down by insurance classes, reinsurers recorded the largest percentage increase. The carrying amount of their investments increased by 10% year-on-year to €236.6 billion (an increase of €21.5 billion). Aggregate investments by all primary insurers supervised by BaFin increased by 4.7% in 2012 to €1,243.5 billion (+€55.4 billion).

As in the previous year, insurers focused their investments on fixed-income securities and promissory note loans. At €257.5 billion, *Pfandbriefe,* municipal bonds and other debt instruments issued by credit institutions again comprised the largest single class of direct investments. Aggregate investments in directly held listed debt instruments increased by 24.9% or €37.9 billion in 2012 to €190.5 billion.

Increased corporate investments.

German insurers invested in corporate securities to a greater extent in the year under review. Aggregate holdings of corporate loans rose by 19.3% or €2.2 billion to €13.8 billion. Although the percentage increase in private equity investments was relatively large in 2012, at 17.4%, this asset class remains relatively insignificant in absolute terms.

Aggregate direct investments in property rose by 4.6% year-on-year to €30.8 billion.

Indirect investments held by insurance undertakings via investment funds recorded above-average growth in 2012, rising by 10.9%, and now account for almost a quarter of all investments, at €366.7 billion. The assets acquired via investment funds relate predominantly to listed securities.

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Table 6

## Investments by insurance undertakings

| Investments by insurance undertakings | Portfolio as at 31 December 2012 | | Portfolio as at 31 December 2011 | | Change in 2012 | |
|---|---|---|---|---|---|---|
| | 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 | 30,800 | 2.1 | 29,454 | 2.1 | 1,346 | 4.6 |
| Fund units, shares in investment stock corporations and investment companies | 366,654 | 24.8 | 330,626 | 23.6 | 36,028 | 10.9 |
| Loans secured by mortgages and other land charges and shareholder loans to real estate companies | 56,144 | 3.8 | 55,869 | 4.0 | 275 | 0.5 |
| Securities loans and loans secured by debt securities | 1,748 | 0.1 | 1,266 | 0.1 | 482 | 38.1 |
| Loans to EEA/OECD states, their regional governments and local authorities, and international organisations | 120,536 | 8.1 | 118,858 | 8.5 | 1,678 | 1.4 |
| Corporate loans | 13,758 | 0.9 | 11,529 | 0.8 | 2,229 | 19.3 |
| ABSs/CLNs | 5,195 | 0.4 | 4,888 | 0.3 | 307 | 6.3 |
| Policy loans | 4,408 | 0.3 | 4,626 | 0.3 | -218 | -4.7 |
| *Pfandbriefe,* municipal bonds and other debt instruments issued by credit institutions | 257,523 | 17.4 | 263,626 | 18.8 | -6,103 | -2.3 |
| Listed debt instruments | 190,517 | 12.9 | 152,569 | 10.9 | 37,948 | 24.9 |
| Other debt instruments | 18,703 | 1.3 | 14,802 | 1.1 | 3,901 | 26.4 |
| Subordinated debt assets/profit participation rights | 25,915 | 1.8 | 28,656 | 2.0 | -2,741 | -9.6 |
| Book-entry securities and open market instruments | 2,219 | 0.1 | 1,723 | 0.1 | 496 | 28.8 |
| Listed equities | 6,263 | 0.4 | 6,912 | 0.5 | -649 | -9.4 |
| Unlisted equities and interests in companies, excluding private equity holdings | 132,586 | 9.0 | 132,804 | 9.5 | -218 | -0.2 |
| Private equity holdings | 11,699 | 0.8 | 9,962 | 0.7 | 1,737 | 17.4 |
| Investments at credit institutions | 202,053 | 13.7 | 204,815 | 14.6 | -2,762 | -1.3 |
| Investments covered by the opening clause | 17,093 | 1.2 | 15,955 | 1.1 | 1,138 | 7.1 |
| Other investments | 16,312 | 1.1 | 14,309 | 1.0 | 2,003 | 14.0 |
| **Total investments** | **1,480,126** | **100.0** | **1,403,249** | **100.0** | **76,877** | **5.5** |
| Life insurers | 768,904 | 51.9 | 742,747 | 52.9 | 26,157 | 3.5 |
| *Pensionskassen* | 123,439 | 8.3 | 115,793 | 8.3 | 7,646 | 6.6 |
| Funeral expenses funds | 1,972 | 0.1 | 1,922 | 0.1 | 50 | 2.6 |
| Health insurers | 204,263 | 13.8 | 189,611 | 13.5 | 14,652 | 7.7 |
| Property/casualty insurers | 144,910 | 9.8 | 138,018 | 9.8 | 6,892 | 5.0 |
| Reinsurers | 236,638 | 16.0 | 215,158 | 15.3 | 21,480 | 10.0 |
| **All insurers** | **1,480,126** | **100.0** | **1,403,249** | **100.0** | **76,877** | **5.5** |
| Primary insurers | 1,243,488 | 84.0 | 1,188,091 | 84.7 | 55,397 | 4.7 |

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 €1,189 million to €1,372 million in the year under review, a rise of 15.4% (previous year: +14%). Pension fund portfolios were dominated by contracts with life insurers, bearer bonds and other fixed-income securities, and investment units. At the 31 December 2012 balance sheet date, net hidden reserves in the investments made by pension funds amounted to approximately €69 million. All 30 pension funds supervised by BaFin in 2012 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 2012, from €25 billion in the previous year to approximately €26.5 billion. Roughly 91% of these investments consisted of investment units. These investments are measured at fair value in accordance with section 341 (4) of

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the *Handelsgesetzbuch* (German Commercial Code – HGB). 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.

**Use of inflation swaps at insurance undertakings and pension funds**

BaFin decided in 2012 that insurance undertakings and pension funds can hedge inflation risk, and that they can also use inflation swaps to hedge their liabilities.[30] A condition for this is that the first time the undertaking uses inflation swaps, it must assess the related risks using the principles applied to the new product process and ensure that its risk assessment is documented appropriately. The new product process is part of the investment process. It offers insurers a procedure for comprehensively assessing the risk of products for which they have little or no experience in estimating the related risks. The aim is to minimise and manage the risks associated with new products.

As a general principle, inflation is a risk factor that affects the level of claim payments or claim cash flows and the related technical provisions. BaFin therefore believed it was necessary to depart from its previous administrative practice and to give insurers an instrument for hedging inflation risk.

Previously, BaFin took a different view and adopted a narrow interpretation of the requirements of section 7 (2) sentence 2 of the VAG in Circular 3/2000 (VA), which fleshed them out in greater detail, as regards hedges of liabilities. Under the former administrative practice, derivative transactions were therefore generally prohibited. The only derivatives that were allowed were transactions that hedged the carrying amounts of technical provisions and liabilities against the negative effects of exchange rate risk. This was not the case with inflation swaps, so it was not possible in the past to use inflation swaps to hedge liabilities.

Inflation swaps are used to hedge inflation risk. Two parties exchange cash flows when the swap matures. One party that seeks to hedge inflation risk (inflation buyer) pays the notional reference rate, adjusted for accrued interest. The other party (inflation seller) pays the relative cumulative increase in an inflation index when the swap matures. The term of the swap may be specified for each individual contract. The amount payable by the inflation seller is variable. It is determined at the maturity date by reference to the actual inflation rate as represented by the change in value of the reference inflation index.

External ratings less important in future.

External ratings will play a lesser role in insurance supervision in the future. The European Parliament and the Council already published a corresponding proposal to amend the regulation on

[30] www.bafin.de/dok/3028498.

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credit rating agencies (CRAs); this is expected to come into force in 2013. BaFin is preparing an announcement on the modification of its administrative practice to reflect the amendment to the regulation. This will be published as soon as the regulation comes into force.

Based on the proposed regulation, insurers and reinsurers, as well as institutions for occupational retirement provision, will in future themselves have to assess the credit quality of an enterprise or a financial instrument. This aims to ensure that they do not rely solely or automatically on external ratings. In future, the supervisory authorities will examine whether the processes used by the undertakings to assess credit quality are appropriate. These obligations imposed on insurers and supervisory authorities go far beyond the current practice.

The CRA Regulation[31], which came into force in 2010, did not solve a large number of existing problems. Among other things, this relates to the strong concentration on the rating market and the risk that financial market participants automatically rely too much on ratings. This is the background to the current revision of the regulation.

**Refinancing register: expanded group of eligible transferees**

With the agreement of the insurance industry associations, BaFin supported the proposal that insurance undertakings and institutions for occupational retirement provision should also be able to use the refinancing register. The German Banking Industry Committee *(Die Deutsche Kreditwirtschaft),* the umbrella association, already put forward this proposal in 2011.

The refinancing register was created in 2005 by the German Refinancing Act *(Refinanzierungsgesetz)* and is maintained in paper form or electronically by the relevant refinancing enterprise in accordance with section 1 (24) of the German Banking Act *(Kreditwesengesetz* – KWG). Refinancing assets to which a transferee has a claim are recorded in the register. If insurance undertakings and institutions for occupational retirement provision can use the refinancing register, this has the advantage that changes in the land register entries that would otherwise be necessary can be dispensed with. This makes the process faster and more economical. At the same time, the transferees enjoy a comparable level of legal certainty in the event of insolvency.

At present, the group of eligible transferees under section 1 (24) of the KWG is limited to special purpose entities, refinancing intermediaries and credit institutions domiciled in an EEA state, as well as entities mentioned in section 2 (1) no. 1 or no. 3a of the KWG. So that insurance undertakings and institutions for occupational retirement provision can also use the refinancing register, they have to be added to the group of eligible transferees. The proposal is still going through the legislative process. BaFin will publish corresponding guidance when the amendment to the law has taken effect.

[31] Regulation (EC) No. 1060/2009, OJ EU L 302, p. 1 ff.

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European government bonds in the restricted assets.

BaFin announced in early 2012 that the pronouncements on government bonds published in issues 05/10 and 06/11 of the BaFin Journal are no longer applicable in light of the bond swap for Greek government bonds.[32] If an insurer holds Greek bonds in its restricted assets, it must now make a distinction between bonds that Greece did not offer to swap and those that it did offer to swap. Additionally, in the case of bonds that Greece offered to swap, the insurer must distinguish between bonds that were swapped and those that were not swapped. By contrast, the pronouncements published in May 2010 and June 2011 continue to apply to bonds issued by other European governments.

The pronouncement in the 06/11 issue of the BaFinJournal was expected to continue to apply only for as long as the guarantee by the European Stability Mechanism (ESM) applies. Additionally, the European Financial Stability Facility (EFSF) will be replaced by the ESM in mid-2013. BaFin is therefore examining its future supervisory treatment of European government bonds in the restricted assets. It has already published the text of a pronouncement agreed with the BMF for public consultation[33], which ended on 1 March 2013.

## 2.3 Composition of the risk asset ratio

Primary insurers report the aggregate amount and composition of their investments to BaFin each quarter.

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 €1,199.0 billion as at 31 December 2012 (previous year: €1,114.2 billion).

[32] www.bafin.de/dok/2853534.
[33] www.bafin.de/dok/3617614.

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Table 7

## Composition of the risk asset ratio

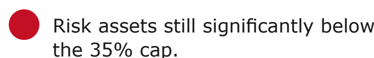
As at 31 December 2012

| Investment type pursuant to section 2 (1) no. … of the AnlV | Gebundenes Vermögen | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 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* | 748,862 | 100.0 | 201,800 | 100.0 | 125,839 | 100.0 | 122,547 | 100.0 | 1,199,048 | 100.0 |
| Of which attributable to: | | | | | | | | | | |
| Securities loans (no. 2), where equities (no. 12) are the subject of the loan | 153 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 153 | 0.0 |
| Subordinated debt assets and profit participation rights (no. 9) | 13,916 | 1.9 | 3,768 | 1.9 | 2,084 | 1.7 | 2,106 | 1.7 | 21,874 | 1.8 |
| Listed equities (no. 12) | 1,595 | 0.2 | 197 | 0.1 | 428 | 0.3 | 24 | 0.0 | 2,244 | 0.2 |
| Unlisted equities and interests in companies (no. 13) | 14,423 | 1.9 | 3,405 | 1.7 | 3,272 | 2.6 | 825 | 0.7 | 21,925 | 1.8 |
| Fund units (nos. 15–17, incl. hedge funds) that | | | | | | | | | | |
| – include equities, profit participation rights, etc. | 19,321 | 2.6 | 3,494 | 1.7 | 5,664 | 4.5 | 5,379 | 4.4 | 33,858 | 2.8 |
| – cannot be clearly assigned to other investment types; fund residual value and non-transparent funds | 11,213 | 1.5 | 2,057 | 1.0 | 2,072 | 1.6 | 2,168 | 1.8 | 17,510 | 1.5 |
| High-yield bonds and investments in default status | 11,400 | 1.5 | 3,538 | 1.8 | 1,835 | 1.5 | 1,807 | 1.5 | 18,580 | 1.5 |
| Increased market risk potential of funds** | 13,150 | 1.8 | 858 | 0.4 | 542 | 0.4 | 780 | 0.6 | 15,330 | 1.3 |
| Investments linked to hedge funds (partly already contained in other nos. of the AnlV) | 1,266 | 0.2 | 382 | 0.2 | 186 | 0.1 | 619 | 0.5 | 2,453 | 0.2 |
| Investments linked to hedge funds (partly already contained in other nos. of the AnlV) | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Total investments subject to the 35% risk asset ratio | 86,437 | 11.5 | 17,699 | 8.8 | 16,083 | 12.8 | 13,708 | 11.2 | 133,927 | 11.2 |

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 2012 for life, health and property/casualty insurers, as well as *Pensionskassen,* from financial statement forms 670 and 673, collective decree dated 21 June 2011.



Risk assets still significantly below the 35% cap.

In accordance with section 3 (3) sentence 1 of the AnlV, insurance undertakings can invest up to 35% of their restricted assets in investments associated with a higher level of risk. Specifically, these risk investments include directly or indirectly held investments in equities, profit participation rights and subordinated debt assets, as well as hedge funds and investments linked to commodity risks. In addition to high-yield bonds and investments in default status, the risk asset ratio also includes certain units in funds that are risky or cannot be clearly assigned to other investment types. The risk asset ratio for primary insurers was 11.2% at the end of 2012 (previous year: 10.6%). This means that insurance undertakings again fell well below the risk asset cap of 35% of the restricted assets stipulated in the AnlV.

The ratio of investments in listed equities held by insurance undertakings at the end of 2012 was 3.0% of their restricted assets, as in the previous year. Insurers held 93.8% of these investments in

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equities via funds. This means that the share of these investments has increased further compared with the previous year. Aggregate investments in directly held unlisted equity investments rose by 1.8% year-on-year.

Within the risk assets, the market risk capital that can arise through the use of derivatives in the case of investments in funds recorded the strongest growth, at 1.3% (previous year: 0.4%). This figure varies from class to class, ranging from 0.4% for health and property/casualty insurers to 1.8% for life insurers.

Table 8

**Share of total investments attributable to selected asset classes**

As at 31 December 2012

| 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* | 768,904 | 100.0 | 204,263 | 100.0 | 144,910 | 100.0 | 123,439 | 100.0 | 1,241,516 | 100.0 |
| Of which attributable to: | | | | | | | | | | |
| Investments in private equity holdings | 7,467 | 1.0 | 1,345 | 0.7 | 1,841 | 1.3 | 562 | 0.5 | 11,215 | 0.9 |
| Directly held asset-backed securities and credit-linked notes | 2,882 | 0.4 | 439 | 0.2 | 415 | 0.3 | 192 | 0.2 | 3,928 | 0.3 |
| Asset-backed securities and credit-linked notes held via funds | 3,533 | 0.5 | 830 | 0.4 | 1,265 | 0.9 | 670 | 0.5 | 6,298 | 0.5 |
| Investments in hedge funds and investments linked to hedge funds (held directly and via funds) | 2,496 | 0.3 | 982 | 0.5 | 540 | 0.4 | 895 | 0.7 | 4,913 | 0.4 |
| Investments with commodity risks (held directly and via funds) | 910 | 0.1 | 538 | 0.3 | 289 | 0.2 | 149 | 0.1 | 1,886 | 0.2 |

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.

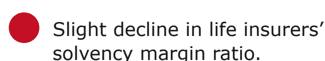
Source: Sector totals as at 31 December 2012 for life, health and property/casualty insurers, as well as *Pensionskassen*, from financial statement forms 670 and 673, collective decree dated 21 June 2011.

The table shows that there were changes in alternative investments compared with the previous year.

## 2.4 Solvency

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

### Life insurers



Slight decline in life insurers' solvency margin ratio.

In the projection as at 31 December 2012, all life insurers demonstrated that they comply with the solvency requirements. Whereas the solvency margin ratio requirement was still 175% in the previous year, it declined slightly to 167% in 2012.

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## Health insurers

Health insurers have good level of own funds.

All health insurers comply with the solvency requirements according to the projection as at 31 December 2012. At an estimated approximately 266%, the target solvency margin ratio for this sector is expected to be significantly above the 246%[34] reported in the previous year, as the health insurers have further increased their own funds. The sector continues to have a good level of own funds.

## Property and casualty insurers

Solvency margin ratio remains high.

At 306%, the solvency margin ratio for property and casualty insurers was only slightly below the previous year's figure of 314%. This decline is attributable to two offsetting trends: on the one hand, the business volume of these insurers increased. This resulted in particular in a significant rise in the premium index. On the other, the undertakings' own funds increased as a result of capital contributions by shareholders and earnings retention. This increase was slightly lower than the increase in the solvency margin to be established, reducing the solvency margin ratio. However, the sector's own funds are still at a very high level and significantly higher than the minimum capital requirements.

## Reinsurers

Continued highly satisfactory solvency margin ratio.

At the end of 2011[35], the supervised reinsurers in Germany had own funds amounting to €69.1 billion (2010: €68.7 billion). The solvency margin as at the same date was €6.8 billion (previous year: €6.4 billion). This reduced the solvency margin ratio slightly to 1,019% (2010: 1,080%).

As before, the main reason for the high level of own funds is the unusual feature of the German insurance industry that certain large German reinsurers are also holding companies for an insurance group or financial conglomerate. A considerable proportion of these undertakings' own funds serves to finance their holding company function, rather than backing their reinsurance activities with capital. Eliminating the figures relating to the holding companies produced an average solvency margin ratio of 273% in 2011 for reinsurers supervised in Germany (2010: 295%). In view of the record claims in 2011 (earthquakes in Japan and New Zealand, floods in Thailand), the continued high solvency margin ratio is remarkable, especially as the decline is due largely to higher solvency requirements.

[34] This refers to the figure as at 31 December 2011 that was forecast at 259% in the 2011 Annual Report. Among other factors, the difference is due to the scenarios assumed in the projection, which did not materialise exactly as assumed at the end of the year.

[35] No information for 2012 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.

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***Pensionskassen***

Slight decline in Pensionskassen solvency margin ratio.

The forecast solvency margin ratio for the *Pensionskassen* was an average of 132% as at the 2012 reporting date, slightly lower than the figure for the previous year (134%)[36]. According to the estimates, seven *Pensionskassen* were unable to meet the solvency margin ratio in full as at 31 December 2012 and were forecasting shortfalls of widely differing amounts. BaFin is in close contact with these *Pensionskassen.* It had already prohibited one of them from taking on new business in 2004 because it was unable to submit any plausible plans for restoring its financial health. Another *Pensionskasse* submitted a solvency plan a number of years ago, and BaFin continuously monitors compliance with this plan. Measures were also drawn up with two other *Pensionskassen* in order to eliminate the shortfall. In particular, they raised a subordinated loan and paid funds into their initial capital. BaFin is working together with three other *Pensionskassen* to develop measures to improve their risk-bearing capacity.

**Pension funds**

Adequate own funds at all pension funds.

The own funds required by supervisory law equalled the minimum guarantee funds of €3 million (for stock corporations) or €2.25 million (for mutual pension funds) at most 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 conducted or the type of business concerned. According to the results of the projection, all pension funds supervised had sufficient available uncommitted own funds in 2012, as in the previous year.

## 2.5 Stress test

BaFin conducted a stress test in 2012 as at the 31 December 2011 balance sheet date. As in the past, the stress test scenarios addressing 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 14% mark-down for the equities-only scenario, and a 12% mark-down for the equity component of the combined scenarios (equities/bonds and equities/property). The mark-downs for both the bond and the real estate components were unchanged, at 5% for bonds and 10% for real estate. The bonds-only scenario was also unchanged, with a 10% mark-down.

Starting in the 2011 financial year, the undertakings have to take account of the revised requirements of section 341c of the HGB, which restricts recognition at the principal amount. These require them to measure notes receivable and loans, as well as mortgage

[36] The solvency margin ratio forecast in the 2011 Annual Report was an average of 131%.

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loans, at cost (including any premiums or discounts). The premiums and discounts are successively amortised or reversed at least once a year during the term of the instrument until it matures. Previously, these investments were carried at their principal amounts, and the premium or discount was accounted for in a separate balance sheet heading. BaFin implemented the necessary adjustments in the stress test.

Section 272 (1) of the HGB changed the accounting treatment of unpaid capital contributions in 2011. Previously, unpaid contributions were recognised on the assets side of the balance sheet. Now, they are deducted from equity on the face of the balance sheet, and the remaining amount is presented in equity. BaFin modified the description of the composition of the "total assets", "other items of equity and liabilities", and "other items of assets" headings in the stress test in order to ensure that they are correctly modelled.

All life insurers ...

Ninety-one life insurers submitted a stress test in 2012. BaFin exempted three undertakings from this requirement due to the low-risk nature of their investments. Of these three insurers, one submitted a stress test voluntarily. All 91 life insurers reported positive results for the stress test in all four scenarios. One insurer had to take account of characteristics specific to that undertaking in two scenarios in the form of a lower decline in the fair value of fixed-income securities because their actual duration is shorter.

... and all health insurers reported positive results.

BaFin included 42 health insurers in its analysis of stress test results. Seven insurers were exempted from submitting their results 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.

Two property/casualty insurers ...

BaFin asked 180 of the 218 property/casualty insurers supervised by it to submit their stress test results. Thirty-eight undertakings were exempted from this requirement. Of the total figure, 178 property/casualty insurers reported positive stress test results in all four scenarios. Negative results were recorded for all four scenarios at two undertakings. The reason for this in one case was the greater extrapolation of the target values required by the stress test model. The increase in the liabilities to be covered, such as the provision for claims outstanding, is attributable to special factors at the insurer concerned. In the second case, the results were negative because of a shortfall in the minimum guarantee fund.

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

BaFin exempted 19 of the 150 *Pensionskassen* it supervised at the end of 2011 from their obligation to submit stress tests because of the low-risk nature of their investments. Of the 131 *Pensionskassen* subject to the stress test, 122 reported positive results in all four stress test scenarios. The nine *Pensionskassen* with negative results all reported minor shortfalls. BaFin is in close contact with these *Pensionskassen* to ensure that they improve their risk-bearing capacity.

## 2.6 Risk-based supervision

Under the new Solvency II insurance supervision regime, insurance undertakings will be able to calculate their solvency capital requirements using an internal model approved by the supervisor.

Uncertain timetable.

However, there is still legal uncertainty due in particular to delays in adopting the Omnibus II Directive, which modifies some of the provisions of the Solvency II Directive. Because Solvency II will not come into force on 1 January 2014 as planned, there are doubts as to when the undertakings will be able to start submitting applications for approval of their internal models. This date would have to be fixed to allow Solvency II to be introduced simultaneously across Europe.

Internal Models Working Group.

Once again, the Internal Models Working Group *(Arbeitskreis Interne Modelle* – AKIM) met twice in the course of 2012. 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).

Current issues addressed by the AKIM.

The first meeting in June addressed the problem that most of the internationally active insurers use English as their corporate language, while administrative law requires applications to be submitted in German as a general principle. Based on the provisions of the Securities Prospectus Act *(Wertpapierprospektgesetz* – WpPG), BaFin developed a solution that will allow insurers to submit documents in English in addition to the cover letter in German. One of the requirements for this is a summary in German. BaFin will also expect the insurers to commit to submitting German translations without delay or to assuming the cost of translating the documents if this proves to be necessary. This also applies to any subsequent proceedings in the (administrative) courts. The industry representatives generally welcomed this approach, although criticism was voiced in some quarters of the expected effort and costs.

Benchmark studies were another focus of the first AKIM meeting. The undertakings participating in the pre-application phase are provided with standardised portfolios whose risk content they have calculated using their internal models. The focus in 2012 was on equity risk. Because EIOPA coordinates the benchmark studies centrally, this provides a comprehensive overview of all the models used in Europe.

At the second meeting of the AKIM in November, the attendees discussed in particular difficult questions surrounding the independent validation and the calibration of capital market scenarios. Representatives of two undertakings used practical examples to demonstrate potential approaches.

Pre-application phase for internal models.

BaFin continues to offer undertakings that wish to submit an internal model for approval an opportunity to participate in a non-binding pre-application phase. The objective is to give participants an assessment of how ready their model is for approval. However,

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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 or are still in the consultation phase.

BaFin spoke to 22 insurers about the readiness of their internal models for approval in 2012. There were reviews at seven undertakings or groups of undertakings, some of which extended over several weeks. German subsidiaries of foreign parents were also reviewed. The results of the reviews indicate whether the internal model has weaknesses and the extent to which it meets the requirements.

### 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,* 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; and quality of management.

BaFin assesses the first two criteria using insurance-specific indicators, while it assesses management quality 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 performed as at the 31 December 2012 reference date:

Table 9

**Risk classification results for 2012**

| Undertakings in % | | Quality of the undertaking | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Market relevance | High | 1.0 | 6.4 | 2.9 | 0.0 | **10.3** |
| | Medium | 3.9 | 10.8 | 5.8 | 0.0 | **20.5** |
| | Low | 11.2 | 38.9 | 17.9 | 1.2 | **69.2** |
| | **Total** | **16.1** | **56.1** | **26.6** | **1.2** | **100.0** |

Slight rise in the number of good-quality insurers.

In its risk classification, BaFin rated 72.2% of the insurers as "A" or "B". This means that the proportion of insurance undertakings in this upper segment increased slightly compared with the previous year. The number of undertakings rated "C" declined slightly, while the proportion of undertakings with "D" ratings remained unchanged

year-on-year. As in the previous years, BaFin did not rate any insurers with high market relevance as having a low quality.

Results in the individual insurance classes.

BaFin rated more than 90% of health insurers “A” or “B”. This represented a further year-on-year improvement in the ratings of the health insurers.

Life insurers and funeral expenses funds mainly achieved mid-grade ratings: at around 95%, the proportion of life insurers rated “B” or “C” was on a level with the previous year.

A shift in the quality rating from “A” to “B” was evident for pension funds and *Pensionskassen*. The change ranged from 5% to 10%, depending on the class.

By contrast, there was an improvement in the ratings of the reinsurers. The proportion of undertakings with an “B” rating rose by 9%, while the proportion of undertakings with a “C” rating declined by the same amount.

There were no significant shifts for property/casualty insurers. As in the previous years, the proportion of undertakings with upper quality ratings was more than 80%.

Overall decline in number of insurers.

Overall, BaFin classified fewer (–1%) undertakings than in the previous year. As in the previous 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 again additionally classified the largest insurance groups at group level in 2012. In contrast to the purely mathematical aggregation of the classification results of the individual undertakings, this quality assessment uses additional qualitative and quantitative group-specific inputs, such as profit transfer and control agreements. The annual group-level risk classification reflects the growing importance of insurance group supervision. It provides BaFin with additional information and serves as a tool for assessing a group’s overall position.

## On-site inspections

Focus in 2012 on reviews of internal models.

On-site inspections are planned on the basis of a risk-based approach. As well as the results of the risk classification, BaFin’s inspection planning also considers when an insurer or pension fund was last subject to an on-site inspection. Ad hoc on-site inspections are also conducted. Additionally, as part of the preparations for Solvency II, BaFin is performing pre-application reviews of internal models. In the year under review, BaFin conducted 39 reviews of internal models and eight regular on-site inspections. The high number of internal model reviews reflects BaFin’s decision to support the insurers in their preparations for the new supervisory system.

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

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Table 10

**Breakdown of on-site inspections by risk class in 2012**

| On-site inspections | | Quality of the undertaking | | | | Total | Under-takings in % |
|---|---|---|---|---|---|---|---|
| | | A | B | C | D | | |
| Market relevance | High | 3 | 13 | 4 | 0 | 20 | 55.5 |
| | Medium | 2 | 6 | 3 | 0 | 11 | 30.6 |
| | Low | 1 | 3 | 1 | 0 | 5 | 13.9 |
| | Total* | 6 | 22 | 8 | 0 | 36 | 100.0 |
| | Undertakings in % | 16.7 | 61.1 | 22.2 | 0.0 | 100.0 | |

* There were eleven on-site inspections at unclassified undertakings in the year under review, bringing the total to 47 on-site inspections.

## 2.7 Group supervision

Supervision of cross-border insurance groups.

At the end of 2012, BaFin was involved in supervising a total of 31 insurance groups that have cross-border business activities via subsidiaries. The importance and size of these groups varies considerably. There are both globally active insurance and reinsurance groups and very small groups of companies. For 17 of the 31 groups, BaFin assumed the role of the authority responsible for group supervision. This meant that it had the lead role in exercising group supervision and also had to ensure that the supervisors involved work together effectively and efficiently. To achieve this, BaFin coordinates the exchange of information between the supervisors involved in institutionalised working groups, the supervisory colleges.

The main focus of these supervisory colleges in 2012 was on strengthening cooperation on content-related issues relating to both current supervisory activities and preparations for group supervision under Solvency II. To do this, BaFin specifically evaluated the entire working practices and organisation of the supervisory colleges and then established a standardised information exchange process between the authorities. Taking the lead in organising the pre-application phase relating to the future use of internal models was another focus of its work. The tight integration of EIOPA, the European Insurance and Occupational Pensions Authority, in these collaborative projects was indispensable. It participated in almost all supervisory colleges organised by BaFin.

BaFin also includes supervisory authorities from non-EU/EEA countries such as Japan, Switzerland and the USA in the exchange of information so that it can also meet the challenges posed by globally active undertakings in the German insurance industry. However, the sensitivity of the information and the obligation to maintain confidentiality means that this only happens on the basis of special agreements.

## 2.8 Developments in the individual insurance classes[37]

### Life insurers

Lower interest rates are leading to higher valuation reserves.

Gross premiums written in the direct insurance business of the life insurers supervised by BaFin amounted to €82.2 billion in 2012 (previous year: €81.6 billion). This represents a slight year-on-year increase of 0.7%. Aggregate investments increased from €739 billion to €761 billion (+3.0%). Because capital market rates have fallen further, valuation reserves in interest-bearing securities in particular recorded a significant increase. Net hidden reserves at the end of the year therefore more than doubled year-on-year to €102.6 billion (previous year: €42.6 billion). This corresponds to 5.8% of the aggregate investments, following 5.7% in the previous year.

All life insurers withstand defined projections.

BaFin surveyed the life insurers using two projections in the year under review: one as at 30 June, the other as at 31 October 2012. BaFin uses the projections to analyse how the four different capital market scenarios it stipulates affect the insurers' performance. In addition to the BaFin stress test, the projections represent another risk-based supervisory tool that allows BaFin to assess short-term changes in the insurers' business performance, solvency and valuation reserves. For the projection as at 31 October, 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 evaluation of the submitted projections indicated that all of the life insurers included in the projections would also have been able to meet their obligations in the worst-case scenarios.

Net investment return of 4.53%.

Preliminary figures put the average net investment return at 4.53% in 2012, higher than the previous year's level of 3.9%[38]. The reason for the higher net return is that the insurers have increasingly liquidated valuation reserves in order to fund the high cost of establishing the *Zinszusatzreserve*.

Life insurers reduce discretionary bonuses.

Because interest rates for new investments are still low, many life insurers reduced their discretionary bonuses for 2013. The current total return (the sum of the guaranteed technical interest rate and the interest surplus) for the tariffs available in the market for endowment insurance contracts is an average of 3.51% for the sector. This figure was 3.80% in 2012 and 3.95% in 2011.

### Private health insurance

Moderate new business with premium growth estimated at around 3%.

The 48 private health insurers supervised by BaFin generated premium income of around €35.7 billion in 2012, approximately 3% more than in the previous year. Consequently, premium income

[37] The 2012 figures are only preliminary. They are based on the interim reporting as at 31 December 2012.
[38] The (preliminary) average net return reported in the 2011 Annual Report was 4.09%.

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grew at a slower rate than the previous year (+4.2%). At least one cause of the slower premium growth was that a special factor affecting the previous year no longer applied: effective 2 February 2007, salaried employees who were voluntarily insured in the statutory health insurance system were only able to switch to private health insurance if their income was higher than the income limit for compulsory statutory insurance for three consecutive calendar years. This three-year limit was abolished at the turn of 2010/2011 by the Act Establishing the Sustainable and Socially Balanced Financing of the Statutory Health Insurance System *(Gesetz zur nachhaltigen und sozial ausgewogenen Finanzierung der gesetzlichen Krankenversicherung).* This had resulted in a slight revival in new business in 2011. On the other hand, the market for private health insurance is being heavily affected at present by political developments and debates about changes in the healthcare system. It is likely that this is tending to prompt potential customers to wait before taking out private health insurance.

Comprehensive health insurance, with almost nine million persons insured and premium income of €26 billion, continues to be the most important business line for the private health insurers. This type of insurance accounts for around 73% of all premium income. Including the other types of insurance, such as compulsory long-term care insurance, daily benefits insurance and other separate partial insurance types, the private health insurance undertakings insure more than 37 million people.

Investments focused on fixed-income securities.

The health insurers increased their investment portfolio by 7% to approximately €202 billion in the year under review. Investments remained focused on fixed-income securities. *Pfandbriefe,* municipal bonds and other debt instruments accounted for approximately 27% of all investments. These are also the largest single item in the portfolio of direct investments. Listed debt instruments accounted for a further 11%, while promissory note loans and registered bonds issued by credit institutions accounted for 21%. The health insurers invested around 20% of their total portfolio in investment funds. BaFin did not identify any significant shifts between the asset classes.

Improved reserve situation thanks to low interest rates.

The equity markets recovered further in the year under review: both the DAX, the lead German index, and the EURO STOXX 50 European equity index were in positive territory. Additionally, the impact of the debt crisis in several eurozone countries continued to be felt. The health insurers’ reserve situation improved significantly because interest rates fell further and are now at very low levels. Net hidden reserves contained in the investments amounted to almost €11 billion as at 31 December 2011 and rose by more than 150% to €28 billion in the course of 2012.

All health insurers withstand defined scenarios.

As at 30 June 2012, BaFin requested 37 health insurance undertakings to prepare a projection and report the results. It exempted twelve insurers from the requirement to submit a projection either because of the low-risk nature of their investment portfolio or because they only offer non-substitutive health insurance similar to property/casualty insurance.

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The projections are an additional risk-based supervisory tool on top of BaFin's stress tests. They simulate the impact of certain adverse capital market developments on the insurers' performance. As in the previous years, BaFin's 2012 projection defined four different scenarios based on market developments. Two scenarios exclusively addressed the impact of equity price risks on the insurers' performance. The first of these assumed constant share price growth up to 31 December 2012, while the second assumed a 13% drop in share prices. Additionally, the other two scenarios included interest rate risk in the projection, reflecting a 50 basis point increase in interest rates. All of the health insurers withstood the assumed scenarios financially.

If the worst-case scenarios in the projections were to occur, net investment income would decline slightly. Nevertheless, all health insurers would be able to meet their guaranteed return obligations in all four scenarios. In a small number of cases only, undertakings would not be able to finance the technical interest rate for the provision for increasing age entirely from net investment income. In such a case, however, the undertakings would be able to generate sufficient surpluses from other sources – such as safety loading – to guarantee the necessary addition to the provision for increasing age. Based on estimates, all health insurers subject to a notification obligation were able to report positive net income for the year.

Net investment return of slightly more than 4% expected for 2012.

BaFin believes that the sector will generate a net investment return of slightly more than 4% in 2012.

**Implementation of gender-neutral tariff ruling in health insurance**

The European Court of Justice (ECJ) decided on 1 March 2011 that the use of gender as a factor in the assessment of insurance risks in insurance contracts is discriminatory and therefore prohibited.[39] Gender may not play a role in the calculation of premiums and benefits. The provisions of the Anti-discrimination Directive, which allowed exceptions to this principle in the area of insurance, are no longer valid as at 21 December 2012. Contracts concluded before this date are not affecting by the ruling.

In the private health insurance sector, because of the right to switch tariffs under section 204 of the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG), the question arose as to whether – and if so, in what form – the ruling can also be implemented for existing contracts. There were efforts in the sector to switch to gender-neutral calculations as far as possible for existing contracts as well. The reason advanced for this was that, when calculating the new tariffs, it would be very difficult to estimate the number of women willing to switch tariffs – and hence the gender mix in those tariffs. However, extending the gender-neutral tariff ruling to existing contracts would have required a corresponding change in the law. The lawmakers decided against this because it would have let to unreasonable premium hikes, especially for existing older female policyholders. Consequently,

[39] ECJ, case C-236/09.

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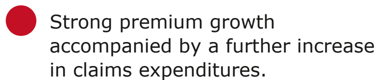
in the private health insurance sector as well, the obligation to calculate premiums and benefits on a gender-neutral basis only applies to new contracts.

German lawmakers transposed the requirements of the ECJ ruling into national law in the SEPA Accompanying Act *(SEPA-Begleitgesetz)*. This amends the General Equal Treatment Act *(Allgemeines Gleichbehandlungsgesetz)*, clarifying that, after 21 December 2012, gender-based calculations that result in different premiums for men and women are no longer permitted.

Another legislative amendment was incorporated into the draft Act Amending Provisions of Insurance Law *(Gesetz zur Änderung versicherungsrechtlicher Vorschriften)*. Since it will not be possible to switch from a gender-neutral tariff back to a gender-specific tariff, section 204 (1) of the VVG is to be amended. The Bundestag passed the amendment to the VVG on 31 January 2013; the Bundesrat decided on 1 March 2013 not to refer it to the Mediation Committee. The legislative process is expected to be completed in the second quarter of 2013. It will still be possible to switch in the other direction, i.e. from a gender-specific tariff to a gender-neutral tariff. Provisions for increasing age that have already been accumulated will be taken into account for such a switch.

BaFin also made changes to the Calculation Regulation *(Kalkulationsverordnung)*. Two aspects deserve particular mention: in future, the average insurance benefits (per capita claims) attributable to an insured person in the observation period will only be calculated depending on the age of the insured person, and no longer on their gender, for each new tariff. In the case of contracts concluded prior to 21 December 2012, the per capita claims for each tariff will continue to be calculated on the basis of the insured person's gender as well.

**Property and casualty insurers**




For property and casualty insurers, financial year 2012 was marked by two factors: both premium income and claims expenditures rose substantially.

Based on figures currently available, gross premiums written in the direct insurance business increased by 4.1% year-on-year to €62.0 billion. Almost all major insurance classes contributed to this increase: the traditionally important classes of motor vehicle insurance, transport insurance and technical insurance recorded particularly high growth rates. By contrast, fire insurance premiums declined slightly.

Although premium income increased overall in the year under review, it was offset by higher claims expenditures, continuing the trend seen in the previous years. A period of heavy frosts at the beginning of the year impacted the earnings of the household contents and residential buildings insurers, while the earnings of industrial property insurers were hit by a major loss event of historic proportions at the Marl Chemical Park. The credit insurers were

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also faced with higher claims expenditures because of a number of large insolvencies. By contrast, expenditures declined at the motor vehicle insurers for the first time in years.

Based on currently available knowledge, operating expenses of the property and casualty insurers also increased year-on-year, with the result that there was little change in the expense ratio.

Overall, the combined ratio for the direct insurance business remained largely constant. The underwriting profit of the property and casualty insurers remained roughly on a level with the previous year.

### Reinsurance

Considerable decline in overall claims compared with the previous year.

The claims expenditures of the reinsurers attributable to natural disasters were considerably lower in 2012 than in the record year 2011. On a global scale, natural disasters caused overall economic losses of approximately US$160 billion (previous year: approximately US$400 billion), of which approximately US$65 billion (previous year: approximately US$119 billion) was insured.[40] Whereas the previous year had been marked by geophysical events, and in particular the earthquake in Japan, around 67% of the entire losses, and around 90% of the insured losses, in 2012 were attributable to weather events in the USA. In the long-term average, only 32% of entire losses and 57% of insured losses are attributable to the USA.

Hurricane Sandy caused overall economic losses of approximately US$50 billion in October 2012, and was by far the largest single loss event in the year under review. The hurricane coincided with a full moon spring tide and hit the densely populated coastal strip between New Jersey and Massachusetts, causing significant flood damage, especially in New York. The insured losses are expected to amount to approximately US$25 billion.

The second-largest loss event in the year under review was the widespread summer drought in the Midwest. Almost half of the agricultural land under cultivation in the USA was affected by the drought, and only the droughts seen in the 1930s were more devastating. The losses caused by crop failures totalled approximately US$20 billion. Of this total, around US$15 to 17 billion will be covered by the multi-risk crop insurance protection scheme run by the private sector and the state; this means that the proportion to be shouldered by the private sector is considerably lower.

In Europe, two earthquakes in Emilia Romagna (Italy) were the most expensive events: taken together, they caused overall economic losses of US$16 billion and insured losses of US$1.6 billion. The earthquakes on 20 and 29 May 2012 measured 5.9 and 5.8 on the Richter scale.

[40] Estimates based on Munich Re, NatCatService.

### *Pensionskassen*

Rising premium income.

Based on BaFin's projections, premium income for all *Pensionskassen* rose by 4.5%, and thus faster than in the previous year. This applies both to the *Pensionskassen* competing on the open market *(Wettbewerbspensionskassen)* that have been established since 2002 and to the *Pensionskassen* funded largely by employers. In the case of the latter *Pensionskassen,* premium income trends depend on the headcount at the sponsoring company.

The aggregate investment portfolio of the 148 *Pensionskassen* supervised by BaFin amounted to approximately €123.4 billion (previous year: €115.6 billion), corresponding to an increase of approximately 5.4%. As in the previous years, the main focus of the investment types was on investment units, bearer bonds and other fixed-income securities, as well as registered bonds, notes receivable and loans. Because of the low interest rates, the sector reports high valuation reserves, especially in interest-bearing securities. The *Pensionskassen* had hidden reserves across all investments of approximately €16.7 billion at the end of the year under review (previous year: €7.7 billion), corresponding to approximately 13.5% of aggregate investments. This figure had been 6.7% in the previous year.

Higher premium reserves will result in higher expenditures.

In addition to investment risks, *Pensionskassen* must focus in particular on the longevity risk of the insured persons. If insured persons live longer than projected, *Pensionskassen* may have to adjust their actuarial assumptions and top up their premium reserves. It is increasingly difficult for the *Pensionskassen* to generate the surpluses needed to fund these adjustments. Because of the prolonged period of low interest rates, only assets offering relatively low yields are available for new investments.

Economic position of the Pensionskassen is stable overall.

BaFin also asked 135 *Pensionskassen* to prepare projections as at 30 June 2012 in which they projected their profit for the financial year in four equity and interest rate scenarios. For this projection, the insurers had to simulate the impact of a 13% drop in equity prices and a 50 basis point rise in interest rates on their profit for the year. BaFin exempted 15 *Pensionskassen* from this requirement due to the low-risk nature of their investments.

The assessment of the projections indicated that, as a rule, the *Pensionskassen* complied with the solvency requirements. However, there was a slight decline compared with the previous year in the solvency margin ratio – the ratio of available own funds to the target solvency margin. Overall, the short-term risk-bearing capacity of the sector continues to be assured. Based on the projections, the net return on investment for all *Pensionskassen* was approximately 4% in the year under review, up slightly on the figure for the previous year (3.9%).

The persistent low interest rates are proving to be a challenge for the *Pensionskassen* as well. The projections reveal clearly that the difference between the current return on investments and the average technical interest rate for the premium reserve is narrowing. As a result, the surpluses available to fund any necessary increases in reserves are lower.

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Pensionskassen investments in GIIPS countries and banks.

BaFin asked the *Pensionskassen* to report the extent to which they will be invested at the end of the year under review in bonds issued by Greece, Ireland, Italy, Portugal and Spain (the GIIPS countries) and in bonds issued by banks in those countries. The survey revealed that the *Pensionskassen* had invested 3.9% of the book value of their total projected investment assets in GIIPS countries and GIIPS banks. Investments in the individual countries were in single-digit percentages for all *Pensionskassen,* indicating that these investments are of little relevance for *Pensionskassen.*

**Gender-neutral calculations in occupational retirement provision**

In its judgement of 1 March 2011, the ECJ ruled that gender-based calculations of premiums and benefits are not permitted for insurance contracts concluded after 21 December 2012. In its guidance issued on 22 December 2011, the European Commission states that this ruling does not affect occupational retirement provision. Additionally, Directive 2006/54/EC[41], which permits gender-based calculations under certain conditions, applies to equal treatment issues in occupational pensions.

There are no national rules in Germany that specifically prescribe gender-neutral calculations for occupational retirement provision. It can therefore be assumed for the time being that gender-based calculations of premiums and/or benefits are permitted for occupational pensions in the vehicles supervised by BaFin.

### Pension funds

Pension funds recorded gross premium income of €831 million in the year under review. This represents a significant decline compared with the previous year (€2,154 million). The sharp drop in premium income is due to the fact that, in the previous year, 50% of the total amount for the sector comprised single premiums at a newly established pension fund. Benefit payouts increased from €1,458 million to €1,563 million in the year under review. The number of beneficiaries increased in the same period to 908,184 (previous year: 777,378), of whom 614,237 were vested employees and 294,569 were already pensioners.

Projections indicated stable economic position.

In the year under review, BaFin asked all 30 pension funds to submit a projection as at 30 June 2012. The particular focus of the projection was the expected profit for the year, the expected solvency and the expected valuation reserves at the end of the current financial year. The scenarios defined by BaFin were the capital market situation at the reference date and a negative equity scenario with a 13% drop in prices. In addition, it required scenarios to be calculated that combined the two above-mentioned scenarios with a 50 basis point increase in the yield curve.

[41] OJ EU L 204, p. 23 ff.

The assessment of the projections indicated that the 30 pension funds included would be able to withstand the four defined scenarios financially.

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

## 1 Bases of supervision

### 1.1 Implementation of CRD IV

Raimund Röseler,
Chief Executive Director
Banking Supervision

German banking supervisory law is set to be permanently changed by the Capital Requirements Directive (CRD IV).[42] This legislative package, comprising a directive and a regulation, implements Basel III among other things in the European Union. The regulation component, the Capital Requirements Regulation (CRR), is the first directly applicable European regulation to govern some of the prudential requirements on credit institutions and financial services institutions. The directive component, meanwhile, is limited primarily to rules requiring the participation of national supervisory authorities, such as granting and revoking authorisations, supervisory powers of intervention and sanctions, and the Supervisory Review and Evaluation Process (SREP) under Pillar 2.

Although the directly applicable European regulation is not being implemented nationally, existing national law must be amended to remove all competing provisions or provisions incompatible with the European regulation. As well as the Banking Act *(Kreditwesengesetz* – KWG), this affects 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 in relation to institutions within the meaning of the KWG that do not fall directly within the scope of CRD IV because they are not deposit-taking credit institutions.

CRD IV Implementation Act.

As it was originally planned to bring CRD IV and the CRR into force on 1 January 2013, Germany began work on national implementation early on. Following two rounds of consultations in spring and summer 2012, the German federal government introduced the draft act to implement CRD IV[43] into the parliamentary process on 22 August 2012.

Changes to regulations.

In October 2012, the drafts of the regulations affected by CRD IV and the CRR were issued for consultation. These are the SolvV, the GroMiKV, the Liquidity Regulation *(Liquiditätsverordnung* –

[42] See chapter III 5.
[43] Bundestag printed paper 17/10974.

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LiqV) and the Country Risk Regulation *(Länderrisikoverordnung).* In addition, the three existing Monthly Returns Regulations *(Monatsausweisverordnungen)* will in future be combined in the Financial Information Regulation *(Finanzinformationenverordnung* – FinaV) and a new solvency regulation will be adopted specifically for housing enterprises with savings schemes.

Key changes to the SolvV and the GroMiKV result from the two regulations' amendment to remove the substantive solvency and large exposures requirements, which in future will be governed by the CRR. The SolvV will then primarily retain procedural provisions and, insofar as the CRR permits or requires, supplementary provisions to the requirements arising from the CRR and CRD IV. Examples include:

- supplementary provisions on authorising, auditing and revoking internal risk measurement procedures (Internal Ratings-Based Approach – IRBA), market risk exposures, Advanced Measurement Approaches and ongoing monitoring
- partial use rules, particularly for the IRBA, remain valid
- rules on calculating the mortgage lending value of real estate to enable institutions to use the CRR provisions that are only applicable in member states that have laid down rigorous criteria
- more detailed provisions on the percentages of eligible capital components in the transition period required to be determined under the transitional arrangements contained in the CRR
- minimum ratios and the composition of capital during the transition period
- provisions on the use of national options with regard to the amount of deductions from own funds and the eligibility of minority interests during the transition period
- further details regarding the calculation and mutual recognition of the countercyclical capital buffer and the capital buffer for systemic risks and global systemically important institutions

With regard to the large exposures regime, the GroMiKV will in future contain supplementary provisions on decision-making requirements, reporting issues, and regulations on the implementation of the remaining national options and on exemptions for certain loans. The reporting system for loans of €1.5 million or more does not stem from European legal requirements. Changes to the reporting system for loans of €1.5 million or more in the GroMiKV are the result of the general overhaul of the reporting system and affect the calculation of loan amounts and the content of reports on loans of €1.5 million or more.

Further timeline.

The further law- and regulation-making process depends largely on the adoption of CRD IV and the CRR and the new timetable for their entry into force. Due to the delays that have occurred here, the further timeline for the national implementation projects remains unclear.

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## 1.2 Minimum Requirements for the Design of Recovery Plans

BaFin is asking national systemically important institutions to develop and implement recovery plans by the end of 2013. The Minimum Requirements for the Design of Recovery Plans *(Mindestanforderungen an die Ausgestaltung von Sanierungsplänen* – MaSan)[44] published for consultation at the beginning of November 2012 provide guidance for the institutions doing so. Interested groups had until 30 November 2012 to comment on the draft. BaFin wishes to publish the circular in the second half of 2013.

Purpose of recovery plans.

Recovery plans are intended to help institutions prepare for future crisis situations and make them more resilient. The objective is, at an early stage, for credit institutions and BaFin to look at preventive measures at both the organisational and the strategic level, to enable them to act as swiftly and effectively as possible and prevent a crisis. Should a crisis nevertheless occur, the recovery plan is intended to help restore the institutions' financial strength.

The draft is based on the proportionality principle: the design of the recovery plan depends on the size, complexity and interconnectedness of the credit institution or group of institutions as well as on the nature, scope and complexity of the business model and the risk associated with it.

The draft's key provisions require the institution to first analyse and depict its corporate structure, including its essential and systemically important business activities and its internal and external interconnectedness. Using this information, the institution and then BaFin will be able to assess whether and how general and specific options for action can be implemented in the event of a crisis.

BaFin requires stress test.

To enable it to overcome the crisis on its own, the institution will outline all general options for action which, in principle, are capable of safeguarding or restoring its financial strength in the event of a crisis. Using a stress test, the institution must then examine which risks could have a significant adverse effect on the credit institution or group and, were those risks to occur, whether it could restore its resilience by executing the options for action. The stress test must cover not only severe institution-specific and market-wide shocks but also developments that occur either suddenly or slowly.

Recovery indicators must then be determined based on the stress test and the expected amount of time required to implement the options for action. These indicators are designed to enable the credit institution to promptly select the options for action that are suited to safeguarding or restoring its financial strength and thus ensuring its ability to

[44] Consultation 12/2012, www.bafin.de/dok/3353480.

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survive. If the institution has identified any barriers to executing the options for action, it will remove them.

Recovery planning is also being addressed by regulatory initiatives at international level.[45]

**Crisis Management Groups**

In 2011, the Financial Stability Board (FSB) designated 28 institutions as global systemically important banks (G-SIBs). These included Deutsche Bank AG and Commerzbank AG, although the latter was removed from the list of G-SIBs again in 2012. A Crisis Management Group (CMG) has to be established for G-SIBs. This comprises the supervisors of the institution's key units and representatives of the finance ministries and central banks of the countries involved. The primary task of the CMG is to adopt a recovery and resolution plan for each group in question. As well as acting as home supervisors of the two abovementioned institutions, BaFin and Deutsche Bundesbank are also involved as host supervisors in CMGs of groups whose foreign parent operates a subsidiary important to the German financial system. The main task of the CMGs in 2012 was to assist institutions in developing recovery plans and to assess those plans; the recovery plans had to be finalised by the end of 2012. The CMGs also started to develop resolution plans. The plans aim to organise an institution's resolution so as to avoid the need for taxpayers' money and minimise the impact on the financial markets in question. In 2012, the work on the resolution plans focused mainly on establishing a resolution strategy. In 2013, it will focus on their structure, the resolvability assessments and agreeing memoranda of understanding between the institutions involved in the CMG.

## 1.3 Guidance notice on vetting administrative and supervisory bodies

Fundamental revision.

The Guidance Notice on Vetting Members of Administrative and Supervisory Bodies *(Merkblatt zur Kontrolle der Mitglieder von Verwaltungs- und Aufsichtsorganen)* was fundamentally revised in 2012 and the revised version published in December. The provisions governing the vetting of members of administrative and supervisory bodies were first introduced by the Act on Strengthening the Supervision of the Financial Markets and the Insurance Sector *(Gesetz zur Stärkung der Finanzmarkt- und der Versicherungsaufsicht)* of 29 July 2009[46]. The guidance notice contains information on the duty of disclosure and the documents required to be submitted to BaFin. BaFin's requirements regarding the members' expertise and reliability are described in detail and frequently asked questions discussed. The new version of the guidance notice originally published in 2010 sets out the supervisory requirements in more detail and stipulates, for example, that

[45] See chapters III 1.1 and 2.1.
[46] Federal Law Gazette (BGBl.) I 2009, p. 2305.

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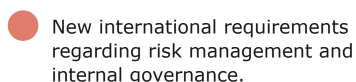
members of administrative and supervisory bodies must also undertake continuing professional development during their terms of office and that they must dedicate sufficient time to their duties. It also answers questions regarding the maximum number of positions a member may hold and introduces a new obligation to present certificates of good conduct and trade register extracts.

**Governance on supervisory bodies**

BaFin conducted a comparative study on the subject of "Governance on supervisory bodies at large banks", covering 14 institutions. Only 20% of the members of the supervisory bodies of the institutions included in the study come directly from the finance industry. Taken as a whole, therefore, the supervisory bodies are clearly dominated by people from outside the industry. In most cases, the supervisory bodies' remuneration takes the form of a fixed salary, with the amount involved varying substantially. It is significantly lower than the total remuneration granted to management boards in the same period.

No breaches of the statutory limit on the number of positions or other regulatory requirements were identified. The majority of the institutions obliged by the Stock Corporation Act *(Aktiengesetz* – AktG) to implement the German Corporate Governance Code (GCGC) do so, and there is also a trend towards doing so at most of the other banks. BaFin also investigated whether, on the whole, the supervisory bodies fulfil their monitoring role. On this, the findings differed considerably. In many cases, they revealed at the least a need for improvement, for example with regard to providing the members of supervisory bodies with information in good time ahead of meetings. Overall, therefore, the study shows that increased monitoring of supervisory bodies is entirely justified.

## 1.4 Minimum Requirements for Risk Management amended in 2012




In 2012, BaFin had to revise the Minimum Requirements for Risk Management *(Mindestanforderungen an das Risikomanagement* – MaRisk) in light of new international requirements regarding risk management at banks and internal governance. In addition to the fundamental amendments to the European Banking Directive, there were publications from the European Banking Authority (EBA), in particular on internal governance and the allocation of liquidity costs, benefits and risks.[47] Lessons learned from BaFin's administrative practice were also incorporated in the work to revise the requirements. In making all changes, BaFin ensured that the MaRisk's principles-based approach was preserved as far as possible so as to retain the flexibility required in implementing the requirements in practice. BaFin completed the work to revise the

[47] EBA Guidelines on Internal Governance, 27 September 2011; Committee of European Banking Supervisors (CEBS) Guidelines on Liquidity Cost Benefit Allocation, 27 October 2010.

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requirements with the publication of the new version of the MaRisk[48] on 14 December 2012.

Focus on governance aspects.

The work to revise the MaRisk focused on banks' internal governance. One new MaRisk module addresses the risk control function and another new module the compliance function. The requirements for the risk control function largely represent a compact, consolidated overview of what was already required in relation to this function under the MaRisk. One new requirement is that the head of the risk control function be involved in management's important risk policy-related decisions. This is intended to bring a greater risk perspective to important decisions setting the course of business policy. To ensure that this happens, the head of the risk control function should have as high a place in the hierarchy as possible; in keeping with international practice, a dedicated chief risk officer who is a member of the board should therefore head up the function at large, international institutions. The newly addressed compliance function aims to ensure that all departments in the institution observe all legal provisions and requirements that are material from a compliance perspective. Existing rules such as the Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 ff. of the WpHG *(Mindestanforderungen an die Compliance-Funktion und die weiteren Verhaltens-, Organisations- und Transparenzpflichten nach §§ 31 ff. Wertpapierhandelsgesetz (WpHG)* – MaComp) remain unaffected by the new version of the MaRisk.

Capital planning process to be established.

In the other amendments and additions made by BaFin in revising the MaRisk, two aspects in particular stand out. Firstly, there is now an explicit requirement for a capital planning process to be established, something which was previously mentioned only in passing in a MaRisk context. This planning tool adds a more forward-looking component to the risk-bearing capacity concept, the aim being to identify any capital requirements early on. However, this is not intended to extend the observation period of the risk-bearing capacity concept to several years. Secondly, the existing requirements for the allocation mechanism for liquidity costs, benefits and risks have been set out in greater detail and expanded in particular for large, international institutions with complex business structures. For smaller institutions with less complex business activities, on the other hand, the MaRisk contains an opening clause allowing them to implement the requirements proportionately.

## 1.5 Amendment of the Pfandbrief Act

Moderate amendments to the Pfandbrief Act *(Pfandbriefgesetz* – PfandBG) are also planned as part of the CRD IV Implementation Act. The main planned amendments can be outlined as follows:

[48] www.bafin.de/dok/3353480.

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- introduction of a provision stating that collective action clauses in the issue terms and conditions of public-sector bonds are not prejudicial to cover (section 4a of the PfandBG)
- amendments due to the replacement of the Banking Directive with the CRR and the act to implement CRD IV
- extension of the transparency disclosures under section 28 of the PfandBG together with the transitional provision under section 53 of the PfandBG
- more detailed explanations of the procedural provisions regarding the appointment and duties of the cover pool administrator in sections 30 f. of the PfandBG
- more detailed explanation of the effect of transfer orders under sections 48a ff. of the KWG on cover pool assets and Pfandbrief liabilities under section 36a of the PfandBG

Collective action clauses are not prejudicial to cover.

The provision stating that collective action clauses are not prejudicial to cover was necessitated by the Treaty establishing the European Stability Mechanism (ESM Treaty). In Article 12 (3) of the Treaty, the eurozone countries undertook to include collective action clauses in their debt securities with an original maturity of more than one year as at 1 January 2013. These enable significant amendments to be made to the issue terms and conditions by a quorum of holders of individual debt securities or groups of debt securities; these amendments extend as far as a waiver of principal and affect all holders of the debt security concerned. In Germany, this undertaking was implemented by inserting sections 4a to 4k into the Federal Debt Management Act (*Bundesschuldenwesengesetz*) in September 2012.[49] The debt securities potentially affected by the undertaking are of considerable importance for cover, particularly of public-sector Pfandbriefe. To remove possible doubts about whether such far-reaching clauses are prejudicial to cover, it is planned to stipulate that this is not the case in section 4a of the PfandBG.

Information content of the transparency disclosures extended.

The information content of the transparency disclosures under section 28 of the PfandBG is being extended considerably on the initiative of the banking industry, more specifically so that existing categories of disclosures are to be presented in much more granular form.

Amendments affecting the cover pool administrator.

The planned amendments regarding the appointment and duties of a cover pool administrator relate primarily to the following aspects:

- Greater separation of the capacity to act of the cover pool administrator of a Pfandbrief bank with limited business activities from that of the insolvency administrator of an insolvent Pfandbrief bank: it is clarified that the insolvency administrator cannot take action against acts required to be performed by the cover pool administrator by contesting the insolvency, even if this has the effect of reducing the insolvent Pfandbrief bank's claim for compensation from the Pfandbrief bank with limited business activities.
- Option of debtor-in-possession proceedings by the cover pool administrator in the subsequent insolvency of the Pfandbrief bank with limited business activities.

[49] Federal Law Gazette (BGBl.) I 2012, p. 1914.

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- Allocation of procedural responsibilities and rules under the insolvency statute of the Pfandbrief bank: the cover pool administrator of the Pfandbrief bank with limited business activities and any insolvency administrator of the Pfandbrief bank should be appointed and overseen by the same judge. As regards the procedure in relation to the cover pool administrator, BaFin is to be granted greater weight than the appointment of the insolvency administrator (right to submit proposals and be heard).
- Option to engage a prospective cover pool administrator to prepare the cover pool administrator's activities as a special representative under section 45c of the KWG for the sole purpose of gaining information. The prospective cover pool administrator engaged as a special representative is not consequently regarded as having prior involvement when it comes to the later appointment of a cover pool administrator.

Effect of a transfer order on Pfandbrief business.

The more detailed explanation of the effect of transfer orders under sections 48a ff. of the KWG on cover pool assets and Pfandbrief liabilities under section 36a of the PfandBG is ultimately intended to fine-tune the interplay between the protection mechanisms under sections 30 ff. of the PfandBG and a transfer order. Under section 36a of the PfandBG, the direct effect of a transfer order also affecting the Pfandbrief business (section 48g (2) no. 1 of the KWG) is currently suspended in relation to the Pfandbrief business; in such cases, the transfer order must instead be performed in accordance with the special provisions contained in sections 30 to 36 of the PfandBG, i.e. by appointing a cover pool administrator and usually by carrying out the transfer in accordance with section 32 of the PfandBG, provided the Pfandbrief holders concerned are not adversely affected as a result. The CRD IV Implementation Act contains an exception to the provision suspending the direct effect of a transfer order, according to which the cover pool administrator – as the means of performing the transfer order – is only deployed in accordance with the special provisions of Pfandbrief law if he or she is actually needed to safeguard the legal position of the Pfandbrief holders. This is only the case if the cover pool comprises assets located outside the European Economic Area (domicile of the debtor, place where the security is located or registered).

**Reform of trustee remuneration**

When the Pfandbrief Act was last revised in 2010, lawmakers also amended the provisions in section 11 of the PfandBG governing trustee remuneration. Among other things, the amendment states that trustee remuneration is payable by the Pfandbrief bank directly and not by BaFin. However, BaFin continues to set the amount of the remuneration. Over and above the set remuneration, the Pfandbrief bank is also required to refund the necessary expenses related to the trustee's activities.

The 2010 amendments prompted BaFin to fundamentally change its administrative practice with regard to trustee remuneration with effect from 1 January 2013. In doing so, BaFin continues to presume that trustee remuneration does not represent payment in

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the sense of a wage; it is assessed solely as compensation for the service performed as a trustee and expressed as a flat-rate amount based on certain criteria.

The remuneration now comprises a fixed basic amount and a variable component. The fixed basic amount represents the minimum remuneration, which, in line with the previous remuneration structure, is primarily intended to reward the fact that the trustee is constantly on call and the responsibility that goes with the role, and which is therefore payable to the trustee or the trustee's representative at all events. The variable component is intended to appropriately reflect the amount of work generally expected. Based on the previous provision, the variable component is linked to the total volume of the Pfandbrief bank's outstanding Pfandbriefe. This variable component linked to the outstanding amount can also be adjusted up or down if there are institution-specific circumstances that require such an adjustment.

Further changes concern any value added tax the trustee may have to pay. Subject to certain conditions, this is also payable by the institution as part of the remuneration.

As regards the planned reimbursement of necessary expenses by the Pfandbrief bank, BaFin will not object if the usual necessary expenses of trustees and representatives, mainly travel costs, are paid by way of an appropriate monthly flat-rate amount of up to €100. By contrast, usual expenses over and above that amount or necessary exceptional, one-time expenses may only be reimbursed if proof of the individual expenses is presented.

## 1.6 Minimum Requirements for the Compliance Function

In August and December 2012, BaFin published further new versions of its Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 ff. of the WpHG *(Mindestanforderungen an die Compliance-Funktion und die weiteren Verhaltens-, Organisations- und Transparenzpflichten nach §§ 31 ff. WpHG* – MaComp).

BaFin sets out in greater detail administrative practice regarding the obligation to keep records of inducements.

Inserted into the MaComp on 31 August 2012, module AT 8.2 sets out in greater detail the obligation to keep records of inducements. Investment services enterprises must record circumstances indicating that an inducement is designed to enhance the quality of services provided to clients (section 14 (2) no. 5 of the Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises *(Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung* – WpDVerOV)). Since 1 January 2013, they have had to keep a list of inducements and a list of inducement applications. In the list of inducements, they must record all monetary and non-monetary inducements with the sole exception of inducements that were forwarded to clients. In

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the list of inducement applications, investment services enterprises must disclose for which quality-enhancing measures they used the inducements. The new module contains a list of possible quality enhancement measures, although this is not exhaustive and can be added to by the investment services enterprises.

New BT 7 module.

The new BT 7 module introduced with effect from 21 December 2012 regarding suitability checks under section 31 (4) of the Securities Trading Act *(Wertpapierhandelsgesetz* – WpHG) sets out in greater detail the obligation to recommend suitable transactions or suitable investment services to clients. It contains details of the information investment services enterprises must obtain from and provide to their clients if they provide investment advice or portfolio management. The explanations are supplemented by requirements that have to be met if a representative is appointed.

MaComp II for multilateral trading facilities.

In December 2012, BaFin published its MaComp II, thereby addressing the increasing importance of multilateral trading facilities. Circular 8/2012 (Special Organisational Requirements for the Operation of a Multilateral Trading Facility pursuant to Sections 31f and 31g of the WpHG *(Besondere Organisatorische Anforderungen für den Betrieb eines multilateralen Handelssystems nach §§ 31f und 31g WpHG* – MaComp II) supplements the existing MaComp for investment services enterprises by adding the special requirements for multilateral trading facilities. Among other things, the circular explains control procedures for monitoring the orderly conduct of trading, price discovery and the settlement of transactions. It also points out the obligation to inform BaFin in the event of any serious breaches of the trading rules and if there are indications that sections 14 or 20a of the WpHG have been breached. The stock exchanges' regulated unofficial markets do not fall within the scope of the MaComp II. These are supervised by the stock exchange supervisory authorities of the *Länder.*

# 2 Preventive supervision

## 2.1 Risk-bearing capacity

As in previous years, credit institutions' risk-bearing capacity was also the focus of supervisory activities in 2012. On behalf of BaFin, for example, Deutsche Bundesbank once again conducted numerous audits at credit institutions of the internal procedures for managing risk-bearing capacity. This topic was also the subject of numerous supervisory interviews and workshops with credit institutions; in addition, there was a lively exchange of views on the topic with banking industry and auditing associations.

Guidance notice provides the basis for assessments.

When examining risk-bearing capacity, BaFin takes as its basis the guidance notice on the assessment of banks' internal risk-bearing capacity concepts published in December 2011. In the guidance

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notice, BaFin and Deutsche Bundesbank clarified the criteria according to which they usually assess the procedures used by credit institutions to manage their risk-bearing capacity.[50]

Audits reveal improvements and shortcomings.

In conducting its audits, BaFin frequently found that institutions had improved their internal risk-bearing capacity procedures. In many cases, however, the audits also revealed notable shortcomings in areas that could have a significant effect on the calculation of risk-bearing capacity. BaFin found the following shortcomings, for example:

- For example, some institutions did not examine in sufficient detail what diversification effects arose in their loan portfolio models during risk quantification, i.e. when assessing the relationships between risks.
- In the case of market risk exposures, the institutions sometimes made inappropriate assumptions about holding periods, which are a key driver of market risk.
- Inadequate consideration was also given to migration risk. This is the risk that internal ratings may change (and above all deteriorate in this case).
- When calculating risk-taking potential, inadequate consideration was sometimes given to hidden reserves that may be realised in the future.
- In some cases, BaFin also found that institutions had not integrated their risk-bearing capacity procedures sufficiently with other elements of risk management (strategies, stress tests, operational management), with the result that these procedures were not an integral part of risk management.

Risk-bearing capacity forum provides a platform for constructive dialogue.

These and many other aspects of the topic were discussed at the “Forum on Risk-bearing Capacity at Credit Institutions” held by BaFin in December 2012. Some 200 representatives of credit institutions, industry associations and auditing associations took part in the event. One conclusion drawn by all participants at the event was that all procedures for managing risk-bearing capacity examine the issue from a particular perspective and are subject to inherent limitations. In this respect, it is a good idea for banks to continue their work on improving the concepts. The importance of having the procedures in use regularly and properly validated was among the points emphasised in this context.

## 2.2 Reporting system

Redesigned reporting system.

The concept paper jointly developed by Deutsche Bundesbank and BaFin on the modernisation of the prudential supervisory reporting system provides for changes to interim financial data (Module A) and the reporting system for loans of €1.5 million or more (Module B). The relevant reporting requirements and the related new reporting formats were adapted following another consultation on the concept paper in the first half of 2012.

Regulatory implementation.

The requirements regarding financial data are governed by the new Financial Information Regulation *(Finanzinformationen-Verordnung –*

[50] www.bafin.de/dok/2680290.

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FinaV), which is currently due to be implemented with the CRD IV Implementation Act. The existing Monthly Returns Regulation *(Monatsausweisverordnung)* and the Aggregated Monthly Returns Regulation *(Zusammengefasste-Monatsausweise-Verordnung)* will be repealed as a result of being incorporated into the FinaV. Since separate requirements are no longer to be placed on lead brokers, the Monthly Returns Regulation for Lead Brokers *(Skontroführer-Monatsausweisverordnung)* will be abolished completely. For publicly traded parents that prepare consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs), the European Banking Authority (EBA) is to develop the FINREP (Financial Reporting) uniform reporting format as an implementing technical standard that is binding throughout Europe. The starting date for this is expected to be 1 January 2014.

The remaining changes will primarily be made by adapting the existing provisions of the KWG when implementing CRD IV. The exact implementation date for these reporting requirements therefore depends on the entry into force of the CRD IV Implementation Act. Once this happens, the first phase of the project to modernise the prudential supervisory reporting system will have been completed.

Second phase under way since mid-2012.

In the second half of 2012, BaFin began the equally important second phase, which involves developing extensive evaluation tools. The aim here is to effectively integrate the information obtained on the basis of the new reporting system into micro- and macro-prudential supervisory activities starting from the first reporting date.

## 2.3 Shareholder control

Dealing with institutions whose business model does not work.

Some – often relatively small – institutions have been operating at a loss for years without BaFin knowing how they successfully develop new business strategies and introduce business models to correct this situation for the long term. Provided that these banks comply with statutory minimum requirements, particularly with regard to capital and liquidity, BaFin does not have the legal capacity to intervene, as there is usually no risk of the institution ceasing to meet its liabilities to its creditors. However, BaFin normally requires such banks to report on their business performance during the year and has ideas on new business strategies explained to it at supervisory interviews.

Shareholders play an important role for BaFin.

Above all, it is crucial for these institutions to have a financially strong shareholder with the capacity to offset the accumulating losses through regular injections of additional capital. With the poor situation on the financial markets continuing, however, some shareholders are no longer willing or financially able to provide appropriate support.

At the same time, few shareholders are prepared to terminate their loss-making investment in a bank without a business model that works by supporting the institution in its orderly resolution, which ends with the institution returning its banking licence. Rather, BaFin is seeing a number of attempts to sell such institutions. Experience

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shows that prospective purchasers mostly see the value of an institution in its banking licence, which they sometimes intend to use in the name of a bank that is already known in the market.

Section 2c of the KWG governs shareholder control procedures.

Once BaFin is informed about the sale plans by the institutions themselves, their shareholders, or the prospective purchasers, it points out the requirement under section 2c of the KWG: any prospective purchaser wishing to purchase an interest of more than 10% in a credit institution must report this intention and submit to a shareholder control procedure by BaFin. This provision is intended to enable BaFin to check that institutions are not taken over by members of organised crime, that their ability to function properly is safeguarded and that creditors' interests are taken into account. In particular, the aim is to prevent unreliable shareholders from asserting their own interests and endangering the institution's existence. During the shareholder control procedure, BaFin must apply the strict criteria laid down in the Holder Control Regulation *(Inhaberkontrollverordnung)* and observe the statutory assessment period of 60 working days from completion of the notification.

Holder control procedure involves very intensive checks.

As regards the key prerequisites for a purchase, and in particular the personal reliability of the prospective purchasers and their financial soundness, it is often seen that prospective purchasers are unclear about how detailed and extensive the information they have to submit to BaFin must be. Firstly, BaFin must be able to check the structure of the prospective purchasers. Secondly, it has to assess their options and ability not only to finance the purchase in the short term, but also to inject capital into the acquired institution over the long term so that it is on a sound footing. This depends not least of all on the purchasers' ability to inject capital after the acquisition as well, if necessary.

## 2.4 IT infrastructure of institutions

Supervisory oversight of IT restructuring at banks.

In order to reduce the cost of their own IT infrastructures and leverage potential synergies, many institutions transfer some or all of their IT to central service providers or group units. This is a continuing trend. Furthermore, larger-scale restructuring projects usually entail standardising the IT infrastructure as well. However, the risks associated with forthcoming restructuring projects and the likely expense must be assessed realistically. In addition, concentrations of risk can arise in relation to central service providers. As a precaution, large restructuring projects are therefore closely supervised by BaFin.

Security in online payment transactions.

In 2012, BaFin devoted increased attention to IT security in online payment transactions. Although there are technical and organisational differences between payment transactions for commercial and retail clients, in both cases software errors or manipulation of IT systems by internal or external attackers can have devastating consequences. Payment errors may be triggered in any amount and the payment transaction system may break down entirely. To ensure the availability and reliability of payment

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transactions, it is therefore essential to develop secure software and have in place a well-functioning IT security management operation.

Cyber Security Strategy.

The Cyber Security Strategy for Germany developed by the Federal Ministry of the Interior (Bundesministerium des Innern – BMI) noted that attacks on information infrastructures have become ever more frequent and complex in recent years.[51] It is estimated that German businesses are subject to an average of 82 attacks a week, with a successful attack causing an average of €220,000 of damage.[52] In the USA in September 2012, for example, the IT systems of the largest banking institutions came under assault from distributed denial-of-service attacks, causing massive disruption to their business activities for several days.

The Cyber Security Strategy for Germany was developed in light of the constantly increasing threat. It states that the finance and insurance sector is a critical infrastructure in Germany. The Cyber Security Strategy therefore gives priority to preventive and reactive protection measures. For this reason, BaFin is committed to enhancing institutions' cyber security. It is also involved in developing the BMI's CIP (critical infrastructure protection) implementation plan, which aims to develop protective measures for information infrastructures.

# 3 Institutional supervision

## 3.1 Authorised banks

Number of authorised credit institutions falls to 1,854.

As in the previous year, the number of authorised banks in Germany declined in 2012. Whereas 1,883 institutions were under BaFin's supervision in 2011, just 1,854 and therefore around 1.5% fewer were being supervised in 2012.

BaFin divides the credit institutions it supervises into four groups: 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. A key criterion in assigning an institution to the savings bank sector or cooperative sector are its economic ties. As a result, DZ Bank and WGZ Bank also belong to the cooperative sector. As well as building and loan associations, Pfandbrief banks and securities trading banks, the group of other institutions also includes the development banks operated by the federal government and the *Länder.*

[51] Federal Ministry of the Interior, Cyber Security Strategy for Germany, February 2011.
[52] Ponemon Institute, The Impact of Cybercrime on Business, May 2012.

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Table 11
## Number of banks by group of institutions

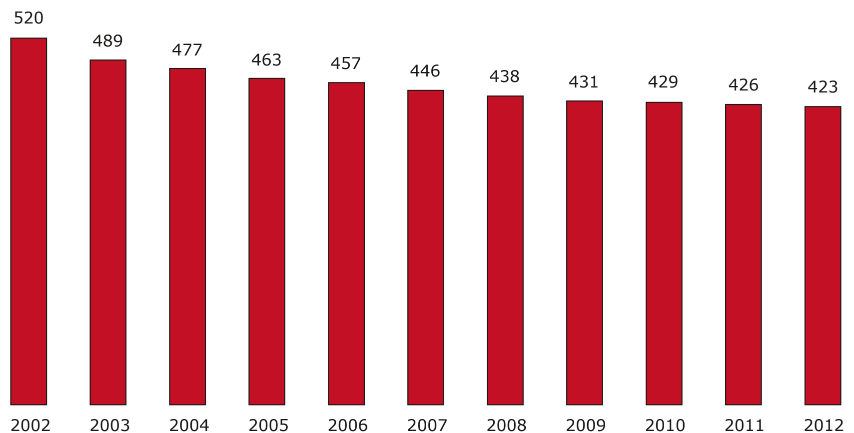
| Group of institutions | 2012 | 2011 |
|---|---|---|
| Commercial banks | 183 | 185 |
| Institutions belonging to the savings bank sector | 432 | 436 |
| Institutions belonging to the cooperative sector* | 1,106 | 1,125 |
| Other institutions | 133 | 137 |
| **Total:** | **1,854** | **1,883** |

* Supervision of institutions belonging to the cooperative sector also covers eight other institutions incorporated under private law which, for statistical purposes, are assigned to other sectors.

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

In the savings bank sector, 423 savings banks, eight Landesbanks and DekaBank, the central provider of fund services for the Sparkassen-Finanzgruppe, were under supervision at the end of 2012. The pace of mergers remained largely unchanged. The number of savings banks declined by three again (2011: 426; 2010: 429). This means that the number of supervised savings banks decreased by 0.7% year-on-year.

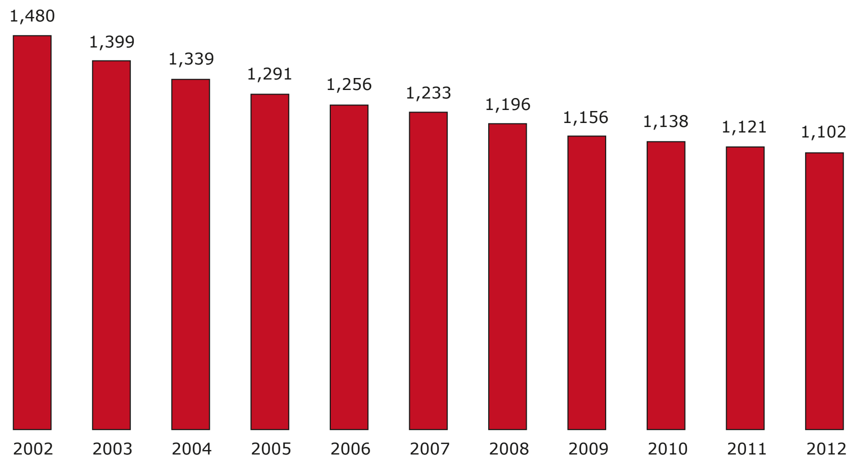
Figure 14
## Number of savings banks




... and comparable with merger activity in the cooperative sector.

In the cooperative sector, BaFin was supervising a total of 1,102 primary institutions, two cooperative central institutions, ten related institutions providing specialist services and 49 housing cooperatives with a savings scheme (which also belong to the cooperative segment) at the end of 2012. The number of cooperative primary institutions therefore dropped by 19 or 1.7%; the pace of mergers in this sector remained at a low level.

Figure 15
**Number of primary cooperative institutions**




Number of Pfandbrief banks rises.

The number of issuers continued to increase in 2012. At the end of the year, 76 institutions held a licence to issue Pfandbriefe (previous year: 70). The year-on-year increase of six institutions was again largely attributable to the savings bank sector. In addition, NATIXIS Pfandbriefbank AG was newly established in the year under review.

As domestic and foreign institutions continue to show considerable interest in the German Pfandbrief, the number of Pfandbrief issuers is expected to continue rising for the foreseeable future.

Number of building and loan associations drops slightly.

The number of supervised building and loan associations dropped from 23 to 22 institutions in the year under review. As a result of the merger of HUK-Coburg Bausparkasse AG with Aachener Bausparkasse AG, BaFin was supervising 12 private and ten public-sector building and loan associations at the end of the year under review.

**Authorisation for greenhouse gas emissions trading**

BaFin has been assigned new duties by the Greenhouse Gas Emissions Trading Act *(Gesetz über den Handel mit Berechtigungen zur Emission von Treibhausgasen (Treibhausgas-Emissionshandelsgesetz* – TEHG)) of 21 July 2011[53]. Section 8 (4) of the TEHG specifies that BaFin must authorise entities to participate in auctions of emission allowances (bidding). These authorisations relate to activities outside the scope of section 1 of the KWG. The authorisation procedure is a non-discretionary administrative act. The test applied is set out in Article 59 (5) of the European Auctioning Regulation, which contains rules of conduct and organisational requirements, for example regarding reliability and professional qualifications, client protection and prevention of money laundering. For this, BaFin is in contact with the Federal Environment Agency *(Umweltbundesamt).* No authorisations have yet been applied for, however.

[53] Federal Law Gazette (BGBl.) I 2011, p. 1475.

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Table 12

## Foreign banks in the Federal Republic of Germany

| Country | Subsidiaries | Branches | EU branch offices* | Representative offices |
|---|---|---|---|---|
| Australia | 1 | 1 | 1 | |
| Austria | 2 | | 10 | 3 |
| Azerbaijan | | | | 1 |
| Bahrain | | | 1 | |
| Belarus | | | | 1 |
| Belgium | 2 | | 1 | 1 |
| Bermuda | | | | |
| Brazil | 1 | 1 | | 2 |
| Canada | 1 | | | 1 |
| China | | 4 | | 2 |
| Czech Republic | | | | 1 |
| Denmark | | | 3 | 2 |
| Egypt | 1 | | | |
| Finland | | | 1 | |
| France | 10 | | 19 | 12 |
| Greece | 1 | | 1 | |
| Hungary | | | 2 | |
| India | | 1 | 1 | |
| Iran | 1 | 3 | | |
| Ireland | | | 1 | 1 |
| Israel | | | | 5 |
| Italy | 7 | | 5 | 1 |
| Japan | 5 | 3 | | 2 |
| Jordan | | | 1 | |
| Latvia | | | 1 | |
| Lebanon | | | 1 | |
| Liechtenstein | | | | |
| Luxembourg | 2 | | | |
| Mongolia | | | | |
| Morocco | | | 2 | |
| Netherlands | 6 | | 11 | |
| Norway | | | 1 | |
| Pakistan | | 1 | 1 | |
| Philippines | | | | 2 |
| Poland | | | | |
| Portugal | | | | 6 |
| Qatar | | | | 1 |
| Russia | 1 | | 1 | 3 |
| Singapore | | | | |
| Slovenia | | | | |
| South Korea/Rep. | 2 | | | 2 |
| Spain | 1 | | 2 | 6 |
| Sweden | 1 | | 3 | |
| Switzerland | 10 | | 2 | |
| Tajikistan | | | | |
| Turkey | 5 | | 3 | 4 |
| United Kingdom | 7 | | 6 | |
| USA | 17 | 4 | 10 | 3 |
| Vietnam | | 1 | | |
| **Total as at 31 December 2012** | **84** | **19** | **91** | **62** |
| Previous year | 84 | 19 | 93 | 64 |

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

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## 3.2 Economic development

### Results of the EBA recapitalisation survey

German banks successfully complete EBA recapitalisation survey.

In October 2012, the European Banking Authority (EBA) published the final results of its 2011 recapitalisation survey. As at 30 June 2012, all 12 German participants had a capital buffer in the required amount of at least 9% of Core Tier 1 capital. After deduction of the sovereign capital buffer, the Core Tier 1 ratio of all institutions averaged 10.7%; at no German institution was it less than 9.5%.

Table 13
**Core Tier 1 ratios of German banks**

| Bank | Core Tier 1 ratio net of the sovereign capital buffer* (in % or percentage points) | | |
|---|---|---|---|
| | **September 2011** | **June 2012** | **Change** |
| Bayerische Landesbank | 10.0% | 10.3% | 0.3 |
| Commerzbank AG | 6.9% | 10.3% | 3.4 |
| Deka Bank | 9.6% | 11.7% | 2.1 |
| Deutsche Bank AG | 8.2% | 10.1% | 1.9 |
| DZ Bank AG | 8.6% | 11.0% | 2.4 |
| Helaba | 6.3% | 9.7% | 3.4 |
| HSH Nordbank | 9.6% | 10.0% | 0.4 |
| Hypo Real Estate Holding AG | 18.6% | 13.2% | –5.4 |
| Landesbank Baden-Württemberg | 9.1% | 9.9% | 0.8 |
| Landesbank Berlin AG | 13.6% | 12.5% | –1.1 |
| Norddeutsche Landesbank | 6.0% | 9.5% | 3.5 |
| WGZ Bank AG | 10.2% | 10.4% | 0.2 |
| **Average** | **9.7%** | **10.7%** | **1.0** |

* Write-downs of receivables from a signatory state to the Agreement on the European Economic Area after 30 September 2011 were partially offset against the sovereign capital buffer.

Banks strengthen their Core Tier 1 capital.

German institutions covered over 80% of their capital requirement by strengthening their Core Tier 1 capital, for example through retained earnings and capital increases, by raising silent partnership contributions and by converting hidden reserves into recognised reserves. This aside, however, the institutions also reduced their riskier positions.

Of the 37 European institutions for which a capital requirement was identified in December 2011, 23 met the required capital ratio at the end of June 2012. Of the remaining 14 institutions, four have now been restructured. Four institutions – one from Italy, one from Slovenia and two from Cyprus – were unable to cover their capital requirement on their own at the effective date of the survey and were therefore reliant on government support. The six Greek participants were recapitalised separately, as part of the EU and International Monetary Fund programme for Greece.

**EBA recapitalisation survey**

In October 2011, the EU heads of state and government had resolved to strengthen institutions' capital position in order to

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restore confidence in the European banking sector. In December 2011, the European Banking Authority (EBA) had therefore published a recommendation that required the largest European institutions to build up a temporary buffer of Core Tier 1 capital by 30 June 2012. The buffer was made up of two components: firstly, institutions had to achieve a Core Tier 1 ratio of 9% of their risk-weighted assets. Secondly, they also had to establish a sovereign capital buffer in the amount of the hidden liabilities (difference between carrying amounts and fair values) from receivables due from member states of the European Economic Area as at 30 September 2011.

The recapitalisation requirement for 37 of the 71 banks participating across the EU totalled €114.7 billion. A capital requirement totalling €13.1 billion was also determined for six German institutions.[54] One of those institutions was WestLB, which has since been broken up and therefore ceased to be affected by the recapitalisation survey. The other institutions had to submit a capital plan to the German supervisory authorities and the EBA, illustrating the measures they intend to take to achieve the required capital ratio.

EBA capital requirements to remain in place for the time being.

The institutions that participated in the recapitalisation survey must continue to meet the EBA's increased capital requirements until further notice. When CRD IV enters into force, the EBA intends to publish a new recommendation on the maintenance of capital buffers to replace the recommendation it published in December 2011.

**Banks' internal risk mitigation measures**

In addition to the recapitalisation exercise launched by the EBA, German banks have also taken internal risk mitigation measures in order to prepare for a feared escalation of the sovereign debt crisis. As an emergency measure, the institutions developed and tested action plans, which they discussed with BaFin. They also performed specific reverse stress tests for the scenario in which several eurozone members default or the eurozone collapses, and analysed the impact of first-, second- and third-round effects.

Banks use ECB tenders to raise funding.

Institutions reduced the funding gap in the southern European countries particularly affected by the crisis by using the three-month tenders offered by the European Central Bank (ECB). In return, they pledged sovereign bonds to the central banks of the countries concerned as collateral. In addition, several German banks have resumed previously discontinued local treasury activities, i.e. the setting-up and administration of central bank accounts and depositories for securities, in the countries particularly affected by the crisis.

As part of the precautionary measures to tackle a feared escalation of the crisis, the banks also examined which legal system governs

[54] See BaFin's 2011 Annual Report, p. 150-151.

the individual contracts in place with counterparties. Contracts for new business were adapted so as to be subject to German or Anglo-Saxon legal norms.

Institutions reduce exposure to crisis-hit countries.

In addition to these short-term risk mitigation measures, German institutions mostly reduced their investments in the countries particularly affected by the sovereign debt crisis. However, these measures were limited in their effectiveness due to low market liquidity and high hedging costs (credit default swap spreads). After the ECB Governing Council resolved in September 2012 to buy unlimited quantities of bonds issued by crisis-hit European countries (Outright Monetary Transactions), several institutions again entered into short-term transactions involving the sovereign risk of southern European countries.

**Situation at the major private commercial banks**

Downward earnings trend in some cases.

The results achieved by German major private commercial banks varied considerably in 2012 due to the different focus of their business activities. As a result of the sovereign debt crisis, the mostly negative market environment caused two banks to suffer a sharp decline in earnings compared with the previous year. This was also despite the fact that write-downs of Greek government bonds – one of the main negative factors in 2011 – only depressed earnings to a small extent in the year under review.

There was a similar basic trend in net interest income, which declined due to low interest rate levels. In addition, all major banks responded to the subdued market environment by reducing their administrative expenses, albeit with varying degrees of success. Given the sovereign debt crisis and the cautious stance adopted by investors as a result, net fee and commission income also declined at all three banks; the more the retail client business was dominated by transaction-driven income, the sharper the decline, however. The trend in net trading income was driven by institution-specific circumstances and entirely heterogeneous in the year under review.

Allowances for losses on loans and advances up sharply in some cases.

The decline in allowances for losses on loans and advances seen in previous years came to a halt in 2012; at some institutions, there was even a sharp rise compared with 2011. This was due to the specific features of the individual institutions' portfolios. Since credit losses in Germany did not increase year-on-year, however, allowances for losses on loans and advances were still clearly below the highs recorded during the Lehman crisis.

In light of the ongoing market uncertainty resulting from the sovereign debt crisis, sustained low interest rates and the poor economic forecasts for 2013, it cannot be ruled out that the earnings of the major private commercial banks will continue to deteriorate. Moreover, due to the strategic direction of some major banks, the supervisory focus remains on analysing the sustainability of their business models.

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## Situation at the Pfandbrief banks

Sovereign debt crisis weighs on Pfandbrief banks.

The financial position of several Pfandbrief banks remains unsatisfactory due to the European sovereign debt crisis. Mark-to-market losses on bonds, particularly those issued by peripheral European states, and the impact of the Greek haircut left a clear mark on the balance sheets of several institutions.

First aircraft Pfandbrief issued.

There is nevertheless continued interest in issuing German Pfandbriefe. Alongside the traditional types of Pfandbrief – namely mortgage Pfandbriefe, ship Pfandbriefe and public-sector Pfandbriefe – the first aircraft Pfandbrief was issued in the year under review. The requirements for issuing aircraft Pfandbriefe were established in 2009 when the PfandBG was amended. NordLB was the first institution to take up this opportunity, successfully placing a €500 million aircraft Pfandbrief on the capital market.

Sales and outstanding volumes of Pfandbriefe decline overall.

As in the previous year, however, the number of issues continued to decline overall, with Pfandbriefe worth €56.56 billion being sold in 2012. New issues had amounted to €71.67 billion in the previous year and significantly more than €100 billion in each of the years before (see table 14).

While sales of mortgage Pfandbriefe rose slightly year-on-year to €42.22 billion, sales of public-sector Pfandbriefe declined by somewhat more than half. This was due to natural declines in portfolios and to institutions shunning certain government bonds. New issues of public-sector Pfandbriefe have been declining at an ever sharper rate for years now. In 2007, Pfandbrief banks issued public-sector Pfandbriefe worth some €108 billion; last year, the figure was just €14.34 billion.

New issues of mortgage Pfandbriefe rise.

Since 2009, sales of mortgage Pfandbriefe (the figures for all periods include ship Pfandbriefe and aircraft Pfandbriefe) have exceeded sales of public-sector Pfandbriefe. New issues of mortgage Pfandbriefe have risen markedly since the start of the financial crisis. Following a sharp leap in 2008, new issues of mortgage Pfandbriefe have remained at a comparatively high level in the years since then. BaFin is therefore upbeat about the outlook for mortgage Pfandbriefe. These continue to provide Pfandbrief issuers with comparatively cost-effective, reliable and crisis-proof access to the capital markets, while other forms of funding are subject to substantial fluctuations at least, particularly in price and marketable volume.

Table 14

**Overview: 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 |
| **2012** | **42.22** | **14.34** | **56.56** |

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Volume of outstanding Pfandbriefe declines slightly.

The total volume of outstanding Pfandbriefe declined slightly in the year under review. At the end of 2012, it stood at €525 billion. However, the rate of decline in the volume outstanding did slow year-on-year. The following table shows the changes in volumes of outstanding Pfandbriefe in recent years: the volume of outstanding public-sector Pfandbriefe has more than halved since 2007, while the volume of outstanding mortgage Pfandbriefe has increased slightly.

Table 15
**Overview: 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 |
| **2012** | **223.76** | **301.13** | **524.89** |

## Situation at the private commercial, regional and specialist banks

Several institutions weak; many benefit from the state of the economy.

The situation at the smaller and medium-sized private commercial, regional and specialist banks continues to be impacted by the effects of the financial market crisis. However, while several institutions remain in a difficult financial situation that requires close supervision, a large number of institutions are benefiting from the positive economic trend in Germany.

One supervisory focus in the year under review was the forthcoming implementation of Basel III into European law[55] and the numerous regulatory changes associated with it. For example, BaFin made institutions aware of its forthcoming implementation and in particular of the increased own funds requirements associated with it early on, at supervisory interviews. BaFin will continue to oversee the adjustment measures initiated by the institutions in 2013.

## Situation at the Landesbanks

Earnings performance varies depending on the business model.

Earnings at the Landesbanks also continued to be negatively impacted by the effects of the international financial market crisis in 2012. The institutions' earnings performance varied considerably depending on the focus of their business activities. In addition, the large rating agencies imposed further rating downgrades, which affected most systemically important European banks. Many Landesbanks continued to shorten their balance sheets in the year under review. One of the exceptions was Landesbank Hessen-Thüringen Girozentrale (Helaba), which in 2012 acquired the *Verbundbank* business (which provides centralised banking services to savings banks in the region in which it is based) of the former WestLB AG.

[55] See chapter III 5.

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EU state aid proceedings.

The aid that NORD/LB received from its guarantors in 2011 and 2012 was given final approval by the European Commission subject to conditions that do not have a significant adverse effect on the institution’s business model.

In the year under review, WestLB AG implemented the restructuring plan approved by the European Commission in 2011. Its Verbundbank business, including the Pfandbrief business, was transferred to Helaba retrospectively on 30 June 2012. All other assets that could not be sold, including the subsidiaries, were transferred to Erste Abwicklungsanstalt (EAA) on the same date. On 1 July 2012, WestLB was renamed Portigon AG. Portigon AG no longer engages in banking business, but only provides services for third parties, in particular EAA.

The European Commission settled the state aid proceedings involving Bayerische Landesbank (BayernLB) in a decision taken on 25 July 2012, but at the same time imposed compensatory measures on BayernLB. Firstly, these involve scaling back the bank’s business activities by the end of the restructuring phase on 31 December 2015. Secondly, BayernLB must repay around €5 billion of capital to the Free State of Bavaria by 31 December 2019.

### Situation at the savings banks

Savings banks on a par with the previous year.

Despite economic and regulatory challenges, the savings banks achieved satisfactory results overall in the past financial year. Net profit for 2012 was roughly on a par with the previous year, enabling further significant amounts to be allocated to reserves.

Corporate loans continue to be growth drivers for the savings banks, which were able to increase their market share again slightly in 2012. The Sparkassen-Finanzgruppe therefore remains the market leader in corporate finance with a market share of around 42%. Due to the transformation of energy supplies, funding to improve the energy efficiency of residential buildings and businesses is becoming increasingly important for the savings banks. The public sector gained further market share in this segment as well. Together, the savings banks and Landesbanks now account for over 50% of the state support programmes administered by Kreditanstalt für Wiederaufbau that provide funding for renewable energy.

Valuation reserves down, allowances for losses on loans and advances up.

While remeasurement losses in the savings banks’ securities business fell sharply in 2012, allowances for losses on loans and advances were up slightly on the previous year. Write-downs of association interests are also having an increasing impact. The interest in Landesbank Berlin Holding AG, which has been wholly owned by the savings banks since 2012, had to be written down for the third year in succession, for example. As a result, the write-downs now amount to around 40% of the original purchase price in total. In addition, savings banks in the north of Germany in particular are affected by further write-downs of their association interests due to the ongoing crisis in ship finance combined with several Landesbanks’ heavy exposure in this area.

Lower net interest income, higher interest rate risk.

2012 saw another slight decline in net interest income compared with the previous year. Due to the savings banks' business model, interest rate risk remains relatively high compared with other credit institutions. For example, numerous savings banks continue to generate a relatively large proportion of their income from maturity transformation, i.e. from exploiting the spread between short- and long-term capital market interest rates. Historically low interest rates point to further declines in net interest income in the future and will create increasing challenges for the business model of savings banks, whose success is determined to a significant extent by income from maturity transformation.

### Situation at the building and loan associations

New contracts on a par with the previous year, but home savings loans down.

The situation at the building and loan associations is being impacted by sustained low interest rates. The building and loan associations were able to keep both the number of new contracts and home savings volumes at the high prior-year level in 2012. Selling home savings loans, on other hand, remains difficult, as the building and loan associations are in competition with other providers of real estate finance, which frequently offer loans on comparatively more attractive terms. Overall, therefore, home savings loans continue to decline as a percentage of the building and loan associations' total lending volume.

### Situation at the credit cooperatives

Low interest rates depress earnings.

The very favourable earnings situation seen at the credit cooperatives in previous years weakened in 2012. This was mainly because of low absolute interest rates. These mean that primary credit cooperatives are able to generate little income from maturity transformation even though the yield curve is still attractive from their perspective. However, the stable economic situation, with employment rising and insolvency figures falling, is having a positive impact on the credit cooperatives' business.

The challenge for the cooperative banking sector remains to bolster the low net interest margins in their operating profit. There have been some clear successes on the cost management front. Overall, the credit cooperatives were again able to recognise adequate provisions in 2012. These achievements have also been acknowledged by the rating agencies FitchRatings and Standard & Poor's, which awarded the cooperative banking sector long-term ratings of A+ and AA- respectively.

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

Trading volumes decline.

The business environment for securities trading banks and exchange brokers continued to deteriorate last year. Trading volumes declined on almost all stock exchanges. As a result, competitive pressures continued to mount. Advances in exchange trading, the entry into the market of more high frequency traders and new trading platforms are also contributing factors. This is forcing institutions

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to combine to form larger entities with extended business lines or to structure their services as niche offerings to meet specialist client needs. At the end of the year, several smaller institutions discontinued activities requiring authorisation or announced their intention to do so. The environment for corporate finance remains weak, especially in the small and medium-sized enterprise business segment.

Energy derivatives trading fails to meet expectations.

The turnover generated by energy derivatives traders authorised by BaFin again fell short of the institutions' original expectations in 2012. Although the European Energy Exchange (EEX) in Leipzig continued to expand and cement its role as a European energy exchange, trading volumes in the course of 2012 were mixed. Volumes on the power derivatives market were slightly down on the previous year, while traders in the markets for natural gas and $CO_2$ emissions allowances were able to increase their trading volumes. Trading volumes on EEX account for only a proportion of the transactions executed, however. Interest in financial products remains relatively weak.

**FXdirekt Bank AG**

At the end of 2012, BaFin was forced to impose a ban on sales and payments by FXdirekt Bank AG, Oberhausen, in order to protect client money. BaFin also ordered the closure of the non-systemically important institution. FXdirekt Bank AG is a small securities trading bank. As a direct bank, it primarily offered retail clients from Germany and abroad products such as margin-based foreign exchange and precious metals transactions, share-based trading in contracts for difference, exchange traded funds and futures via its trading platforms. According to information provided by the bank itself, it had around 3,200 active clients at 18 December 2012, most of them retail clients or day traders.

At the beginning of January 2013, the Local Court (Amtsgericht) in Duisburg ordered preliminary insolvency proceedings in respect of FXdirekt Bank AG's assets at BaFin's request. On 22 January 2013, BaFin also declared a compensation event for FXdirekt Bank AG because the bank was no longer able to settle liabilities arising from securities transactions. Equally, there was no prospect of the liabilities being repaid or settled at a later date.

The clients' claims against FXdirekt Bank AG arising from securities transactions are protected under the Deposit Guarantee and Investor Compensation Act *(Einlagensicherungs- und Anlegerentschädigungsgesetz* – EAEG). The bank belongs to the Compensatory Fund of Securities Trading Companies *(Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW). This guarantees up to 90% of the bank's euro-denominated liabilities to its clients arising from securities transactions, subject to a cap of €20,000.

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## 3.3 Risk classification

Two dimensions of risk classification.

BaFin has performed a risk classification of credit institutions and securities trading banks since 2004. In doing so, it consolidates the findings and assessments it has gathered regarding individual institutions into two dimensions: a quality rating from “A” to “D” and a systemic importance rating ranging from “low” to “high”. It should be noted that the letter-based grading system 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 BaFin’s estimate of the institution’s importance. The Supervisory Authority uses the bank’s size, the intensity of its interbank relationships and the extent of its international connections to assess the impact on the financial sector if it were to experience distress. The Bundesbank and BaFin also use the classification of an institution or group of institutions as systemically important to structure workflows between the authorities.

Classification is based on risk profile.

As part of the ongoing institutional oversight role 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.

The following matrix (table 16) provides a summary of institution ratings for quality and systemic importance.

Table 16
**Risk classification results for 2012**

| Institutions in % | | Quality of the institution* | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Systemic importance | High | 0.2 | 0.7 | 1.0 | 0.2 | **2.1** |
| | Medium | 3.6 | 3.8 | 2.1 | 1.0 | **10.5** |
| | Low | 42.1 | 34.7 | 8.7 | 1.9 | **87.4** |
| | Total | **45.9** | **39.2** | **11.8** | **3.1** | **100** |

* 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.

Risk classification results stable.

In the past six years, there have barely been any changes in the systemic importance rating. Relatively speaking, a slightly higher percentage of institutions were rated as having medium and high systemic importance compared with 2011. The savings banks and cooperative banks in particular continue to show stable results, including for BaFin’s assessments. The banking sector’s quality rating is encouragingly stable overall.

## 3.4 Supervisory activities

Three types of special audit.

One excellent supervisory tool available to BaFin are special audits, which have their legal basis in section 44 (1) sentence 2 of the KWG. With respect to special audits, BaFin distinguishes between requested audits, audits initiated by BaFin and scheduled audits. In the first case, BaFin conducts the audit at an institution's request; in the second case, the audit is based primarily 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 of Pfandbrief banks, which must be performed at regular two-year intervals under the PfandBG.

Requested special audits/special audits initiated by BaFin.

Requested audits primarily include acceptance tests for internal risk measurement procedures used by institutions, e.g. for rating systems in the lending business in accordance with the Internal Ratings-Based Approach (IRBA), advanced methods for measuring operational risk under the Advanced Measurement Approach (AMA), 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 contained 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.

273 special audits in 2012.

BaFin continued to perform extensive audit activities in 2012. Of the total of 273 special audits (previous year: 270), 187 were initiated by BaFin, compared with 194 in the previous year. In addition, there were 66 requested special audits (previous year: 62) and 20 statutory cover audits (previous year: 14).

Among the audits initiated by BaFin, the number of valuation audits increased year-on-year, from 25 to 33. 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. The special audits initiated by BaFin focused once again on how the institutions have implemented the organisational and risk management obligations (section 25a of the KWG) that BaFin set out in more detail in the MaRisk. BaFin carried out a total of 154 of these MaRisk audits in the year under review, compared with 169 audits in the previous year.

Table 17
**Number of special audits**

| | 2012 | 2011 |
|---|---|---|
| Impairment-related special audits | 33 | 25 |
| Section 25a (1) of the KWG (MaRisk) | 154 | 169 |
| Cover | 20 | 14 |
| Market risk models | 7 | 10 |
| IRBA (credit risk measurement) | 54 | 47 |
| AMA (operational risk measurement) | 4 | 3 |
| Liquidity risk measurement | 1 | 2 |
| **Total** | **273** | **270** |

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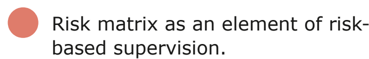
The following table shows a breakdown of the audits by groups of institutions. The significantly higher percentage of audits at commercial banks and institutions in the savings bank sector compared with the cooperative sector reflects the greater systemic importance of these institutions in accordance with the risk matrix. Moreover, the figures for these groups of institutions again comprise requested IRBA and AMA audits as well as statutory audits. In the cooperative sector, there were only four IRBA audits in 2012; no AMA audits at all were performed.

Table 18
## Breakdown of special audits in 2012 by groups of institutions

| | Commercial banks | Savings bank sector | Cooperative sector | Other institutions |
|---|---|---|---|---|
| Impairment-related special audits | 1 | 5 | 26 | 1 |
| Section 25a (1) of the KWG (MaRisk) | 33 | 51 | 59 | 11 |
| Cover | 2 | 14 | 1 | 3 |
| Market risk models | 4 | 2 | 1 | 0 |
| IRBA (credit risk measurement) | 33 | 10 | 4 | 7 |
| AMA (operational risk measurement) | 4 | 0 | 0 | 0 |
| Liquidity risk measurement | 1 | 0 | 0 | 0 |
| **Total** | **78** | **82** | **91** | **22** |
| **Audit ratio in %* (excluding cover audits)** | **18.6** | **13.0** | **7.7** | **9.0** |

* 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 include the Landesbanks (savings bank sector), DZ Bank and WGZ Bank (both cooperative sector). The "Other institutions" group includes, for example, the former mortgage banks, building and loan associations, special-purpose banks and guarantee banks. It also comprises a number of other specialist banks as well as 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 classifying risk matrix reveals that the special audits were risk-based. The table 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.

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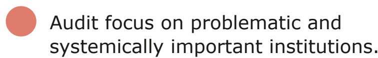
Table 19

## Breakdown of special audits initiated by BaFin in 2012 by risk class

| Special audits | | Quality of the Institution* A | B | C | D | Total | Institutions in %** |
|---|---|---|---|---|---|---|---|
| Systemic importance | High | 0 | 7 | 23 | 6 | **36** | 92.3 |
| | Medium | 5 | 9 | 12 | 5 | **31** | 16.1 |
| | Low | 32 | 54 | 26 | 8 | **120** | 7.5 |
| | **Total** | **37** | **70** | **61** | **19** | **187** | 10.0 |
| | **Institutions in %**** | 4.4 | 9.7 | 28.2 | 33.3 | 10.2 | |

* 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.



Audit focus on problematic and systemically important institutions.

The more critical BaFin's rating of an institution's quality, the greater its need to examine the facts in detail. Accordingly, in 2012, one in three problematic D-rated institutions was the subject of an audit initiated by BaFin. The proportion of audits at banks with high systemic importance was 92.3% and therefore significantly higher than in the previous year (57.9%). In 2012, BaFin again examined institutions rated as good based on random sampling, although audit activity was much less intense in this case: the percentage of A-rated institutions audited was just 4.4% in the year under review.

### Outlook: audit campaign targeting remuneration systems

In 2013, BaFin is conducting a broad range of special audits into institutions' internal implementation of prudential remuneration requirements. The aim of the audit campaign is to examine whether remuneration systems have been appropriately designed and whether institutions have appropriately implemented the requirements of the Remuneration Ordinance for Institutions (*Institutsvergütungsverordnung* – InstitutsVergV) adopted in 2010. The institutions to be audited were selected primarily according to risk-based criteria. The first audits were conducted in the first quarter of 2013; further audits have already been announced or are planned in the further course of 2013.

The requirements for remuneration systems are a key component of an institution's overall bank control and risk management. They are intended to help counteract adverse incentives to pursue unsustainable business activities in a timely manner. Remuneration systems thus make a key contribution to maintaining financial market stability.

The audits cover proper business organisation (section 25a (1) sentence 1 in conjunction with sentence 3 no. 4 of the KWG); more specifically, they examine the extent to which the remuneration systems in force at the institutions meet the requirements of the InstitutsVergV. The focus is on the legal requirements governing the design of remuneration systems and the institution-specific

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remuneration models for management board members and employees, with the following points being investigated in closer detail:

- the institution's own systems for identifying employees whose activities have a material impact on its overall risk profile (section 5 (1) of the InstitutsVergV)
- the criteria for variable remuneration with regard to the definition, selection and application of the parameters (section 5 (2) of the InstitutsVergV)
- the system of and material factors for calculating the total bonus pool (sections 4 and 5 (2) nos. 1-3 of the InstitutsVergV)
- whether adequate own funds are safeguarded (section 4 of the InstitutsVergV)
- the alignment of the remuneration systems as a corporate management tool with the institution's business and risk strategies (section 3 (1) of the InstitutsVergV)
- whether the ratio of fixed to variable remuneration has been capped (section 3 (5) of the InstitutsVergV)
- the amount and structure of remuneration granted for 2011 and 2012
- the remuneration systems of the control functions (section 3 (6) of the InstitutsVergV)
- the compliance structures implemented to prevent hedging or countermeasures being taken to mitigate the risk alignment of the remuneration (section 3 (8) of the InstitutsVergV)
- the internal transparency of the applicable remuneration systems for managers and employees (section 3 (9) of the InstitutsVergV)
- whether information is provided to the administrative and supervisory body (section 3 (10) of the InstitutsVergV)
- whether a remuneration committee has been established (section 6 of the InstitutsVergV)
- the remuneration systems in the group (section 9 of the InstitutsVergV)

Use of IRBAs.

As in the previous year, 49 institutions and groups of institutions were using internal securitisation rating systems and assessment approaches (IRBAs) to calculate their capital requirements for counterparty risk at 31 December 2012. Two institutions belong to the cooperative sector and one belongs to the savings bank sector. Within the IRBA, a distinction is made between whether, outside the retail business, an institution must itself estimate only the probability of default (basic approach) or the loss given default and conversion factor as well (advanced approach). Of the 49 IRBA institutions, 17 used the advanced IRBA on a group or individual basis.

Use of AMAs.

At the same date, 16 institutions and groups of institutions used an Advanced Measurement Approach (AMA) for operational risk (previous year: 17). BaFin was responsible for the approval procedures in eight 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 bank sector and one from the credit cooperative

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sector. The decline in the number of authorised AMA institutions from 17 in the previous year to 16 in the year under review is due to a restructuring and a merger. This resulted in two AMA authorisations being returned, a decline that was offset by one new AMA authorisation being granted.

BaFin performed follow-up audits or audits of model revisions at several AMA institutions in the year under review. These audits identified various improvements to procedures and models. Compared with previous years, institutions have done more to address growing legal risks.

Fifty-six institutions and groups of institutions used a standardised approach for operational risk in the year under review. BaFin authorised two institutions to apply an alternative indicator in the standardised approach. The other approximately 1,800 institutions used the Basic Indicator Approach.

Authorisation of internal risk models at credit institutions.

At the end of 2012, BaFin had confirmed to a total of 11 credit institutions that their internal market risk models meet the supervisory requirements for determining capital adequacy (previous year: 12). One institution returned in full its supervisory approval to use an internal market risk model.

The number of backtesting exceptions fell significantly, from 39 in the previous year to just four in 2012. This fall is attributable, among other factors, to a partial decline in market volatility – primarily in the area of interest rate risk – that was supported in particular by the stabilising measures taken by the EU member states and the ECB. Overall, it can be seen that institutions have sharply reduced risk exposures captured by the market risk models, not least of all because of the tighter regulatory own funds requirements imposed by the Second Regulation on the Further Implementation of the Amended Banking Directive and the Amended Capital Adequacy Directive *(CRD-III-Änderungsverordnung).*[56]

According to an evaluation of the quarterly regulatory reports, these new requirements resulted in a 2.5-fold increase on average in the own funds requirements for market risk at the model institutions. At institutions using a comprehensive market risk model (full use), the own funds requirements for market risk captured by the market risk model rose by a factor of 2.8 on average, while the own funds requirements at institutions using a limited market risk model (partial use) rose by a factor of 1.5 on average.

Seven follow-up audits of internal market risk models.

In 2012, Deutsche Bundesbank carried out a total of seven follow-up audits of the internal market risk model. In 2013, supervisory activities will be dominated by three issues: BaFin must continually assess which measures the model institutions are taking to comply with the changing legal requirements. It will also update its administrative practice in light of the guidelines on the supervision of market risk models drawn up by the EBA. And finally, preparatory measures need to be taken to implement CRD IV/the CRR.

[56] See 2011 Annual Report, p. 133.

Table 20

## Risk models and factor ranges

| Year | New applications | Applications withdrawn | Rejections | Number of model banks | Minimum add. factor* | Maximum add. factor* | Median |
|---|---|---|---|---|---|---|---|
| 2002 | 1 | 0 | 0 | 14 | 0.0 | 1.0 | 0.25 |
| 2003 | 0 | 0 | 0 | 15 | 0.0 | 1.8 | 0.20 |
| 2004 | 1 | 1 | 0 | 15 | 0.0 | 1.0 | 0.30 |
| 2005 | 2 | 1 | 0 | 16 | 0.0 | 1.0 | 0.25 |
| 2006 | 0 | 1 | 0 | 15 | 0.0 | 1.0 | 0.2 |
| 2007 | 0 | 0 | 0 | 15 | 0.0 | 1.0 | 0.2 |
| 2008 | 1 | 1 | 0 | 15 | 0.0 | 1.0 | 0.2 |
| 2009 | 0 | 0 | 0 | 14 | 0.0 | 2.5 | 0.3 |
| 2010 | 0 | 0 | 0 | 14 | 0.0 | 2.5 | 0.4 |
| 2011 | 1 | 1 | 0 | 12 | 0.0 | 2.5 | 0.5 |
| 2012 | 0 | 0 | 0 | 11 | 0.0 | 1.2 | 0.2 |

* Including additional factors effective as at 31 December 2012. 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 0.00 and 1.00).

Supervisory law objections and sanctions.

In the year under review, the results of special audits and requests for information in particular resulted in 121 supervisory law objections and sanctions (previous year: 98). The following table shows a breakdown of the objections and sanctions by groups of institutions.

Table 21

## Supervisory law objections and sanctions in 2012

| | | | Group of institutions | | | | |
|---|---|---|---|---|---|---|---|
| Type of sanction | | | Commercial banks | Savings bank sector | Cooperative sector | Other institutions | **Total** |
| Serious violations | | | 46 | 36 | 25 | 0 | 107 |
| 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 | | 0 | 0 | 0 | 0 | 0 |
| Sanctions against supervisory/ administrative board members | Dismissal requests | Formal | 1 | 0 | 0 | 0 | 1 |
| | | Informal | 0 | 0 | 2 | 0 | 2 |
| | | By third party | 0 | 0 | 0 | 0 | 0 |
| | Cautions | | 0 | 0 | 0 | 0 | 0 |
| Administrative fines | | | 0 | 0 | 0 | 0 | 0 |
| Sanctions in accordance with sections 45, 45b and 46 of the KWG* | | | 7 | 1 | 3 | 0 | 11 |
| **Total** | | | **54** | **37** | **30** | **0** | **121** |

* Measures to improve own funds and liquidity (section 45 of the KWG), in the case of organisational deficiencies (section 45b of the KWG) and in the case of specific danger (section 46 of the KWG).

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Liquidity calls and cross-checks.

In 2012, BaFin continued the liquidity surveys – known as "liquidity calls" – introduced in 2008 at institutions subject to substantial liquidity risk. In doing so, it extended the scope of the information gathered on a regular basis and set the frequency of the liquidity calls on an institution-by-institution basis. As well as centrally evaluating the information from the liquidity calls, BaFin regularly conducts more detailed comparative surveys (cross-checks) on specific issues such as funding requirements in US dollars (US$). It also asks some institutions to provide supplementary information, such as additional location- and currency-specific data, and conducts supplementary interviews with the senior management of the bank concerned with responsibility for liquidity management.

**Review of LIBOR and Euribor procedures**

In June 2012, LIBOR (London Interbank Offered Rate) and Euribor (Euro Interbank Offered Rate) came under the spotlight when the UK Financial Services Authority (FSA) and US authorities imposed fines totalling over €300 million on UK bank Barclays plc. LIBOR and Euribor are benchmark interest rates for various maturities and currencies that are calculated daily on the basis of selected banks' submissions regarding their cost of funds in the interbank market. Barclays was accused of making false LIBOR and Euribor submissions between 2005 and 2009, thereby illegally influencing the interest rates. In December 2012, various authorities from the USA, the UK and Switzerland imposed fines totalling around €1.2 billion on Swiss bank UBS AG due to similar misconduct.

Worldwide, supervisory authorities are investigating whether other banks were involved in manipulating LIBOR, Euribor, or similar benchmarks and indices. BaFin, too, asked the German banks that report to the LIBOR or Euribor panels for information on their reporting processes. In some cases, it also ordered special audits, the findings of which are currently being evaluated.

With an eye towards preventive supervision, BaFin is also using the means available to it to uncover and put a stop to any organisational weaknesses in banks' internal control systems.

Various European and international bodies such as the EBA, the European Securities and Markets Authority (ESMA) and the International Organization of Securities Commissions (IOSCO) are currently working on guidelines that enable the processes by which financial benchmarks are calculated and used to be better controlled. The content of the recommendations already published by the EBA on the supervision of panel banks is largely in line with the requirements that BaFin places on the quoting processes of the German institutions involved under the Minimum Requirements for Risk Management (MaRisk). There are as yet no general rules on the supervision of benchmark setters.

In July 2012, the European Commission proposed amendments to the Market Abuse Directive aimed at making the manipulation of benchmarks such as LIBOR a punishable offence under criminal and civil law in future. The Commission also conducted a public

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consultation on the design and use of such benchmarks and the role of regulation. Concrete legislative proposals are expected to be presented in the second quarter of 2013 based on the consultation's findings.

### Supervision of foreign institutions

Foreign banks increasingly trying to attract German deposits.

Foreign banks continue to play an influential role in the German banking system. The majority of these institutions focus their activities on lending. Foreign banks primarily engage in foreign trade financing and the financing of foreign enterprises' investments in Germany. These banks' counterparty credit risk is therefore often concentrated in their own country of origin. Subsidiaries and branches of foreign banks also have significant market share in private banking, investment banking and custodian bank operations. Furthermore, in the more recent past, foreign banks have increasingly been observed trying to attract the bank deposits of German retail clients. Here, competition among the banks in the market has increased significantly, often impacting the terms on offer.

BaFin's supervisory strategy.

This trend is not without risks. BaFin focuses in particular on the subsequent use of the client deposits taken. There is a risk, for example, that the higher interest rates paid to clients will be generated through riskier transactions on the assets side. BaFin's strategy is to conduct independent host supervision within the confines of the options assigned to it. It requires the subsidiaries and the non-European branches to have separate risk management and monitoring processes. In addition, BaFin works closely together with the home supervisor when it comes to integrating the German units into group-wide management processes. Finally, the home supervisor and BaFin also exchange views and information on the strategic focus and business performance of foreign banks.

**Supervisory colleges**

To improve the supervision of cross-border banking groups, Article 131a of the CRD – implemented in section 8e of the KWG – requires supervisory colleges to be set up for all banking groups that have a subsidiary or significant branches in another EU member state. Since the CRD and the amended KWG entered into force at the end of 2010, BaFin and Deutsche Bundesbank have been responsible, in their capacity as home supervisor for 21 banking groups, for setting up and implementing the colleges. The number of host supervisory authorities belonging to the various European supervisory colleges ranges from one to just under 20. In addition, the German supervisory authority is a host supervisor in a steadily growing number of European supervisory colleges. At global level, too, BaFin and Deutsche Bundesbank are active in a large number of colleges in which supervisors from (non-European) third countries are also represented.

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BaFin asks individual foreign banks to provide recovery plans.

Due to the importance of foreign banks for the German market, BaFin for the first time asked some of these institutions to provide recovery plans in the year under review. Institutions affected include both banks that are important for the functioning of the market due to their size and banks that constitute an important part of the market infrastructure. The plans that have been drawn up are intended to enable a swift recovery in the event that one of those institutions experiences serious financial problems, while at the same time minimising the overall impact on financial stability.

**Meeting with the Turkish banking supervisor**

November 2012 saw BaFin make its first official supervisory visit to Turkey following the signing of a memorandum of understanding between BaFin and Turkish banking supervisor Bankacilik Düzenleme ve Denetleme Kurumu (BDDK) back in August 2011. As well as a meeting with the BDDK, the agenda also included talks with the parent companies of the Turkish banks operating in Germany. All meetings were held in Istanbul.

The BDDK was established in 2000, prior to which banking supervision was the joint responsibility of the Turkish central bank and the Turkish treasury department, which reports to the finance ministry. The BDDK has its headquarters in Ankara and maintains a representative office in Istanbul.

Besides a general exchange of information on the Turkish and German prudential supervision system, the BaFin and BDDK representatives participating in the talks also discussed institution-specific issues related to the subsidiaries of Turkish banks operating in Germany. Aside from the four subsidiary banks, there are five EU branches (section 53b of the KWG) of Turkish banks in Germany. Prior to the supervisory visit, a further Turkish institution applied for authorisation to carry on banking business and provide financial services in Germany. This is the first institution engaged in Islamic finance or Islamic banking.

All four banks with which the BaFin representatives held talks during their supervisory visit stressed that Germany is and will remain a key strategic market for them, among other things because of the traditionally strong economic and trade links with Turkey.

## 3.5 Securitisations

Further decline in the securitisation volume of large German banks.

Until mid-2012, 16 institutions were included in the securitisations survey. In the second half of the year, however, WestLB/Portigon were no longer required to report data, as a result of which the number of institutions included in the survey fell to 15 at year-end. The total book value of the securitisation positions held by the banks reporting at the end of 2012 amounted to around €118.1 billion, a decline of approximately 16.5% compared with the prior-year figure (€142 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.

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Conversely, exchange rate changes in the reporting period and the netting of long and short positions increased the total book value. 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.

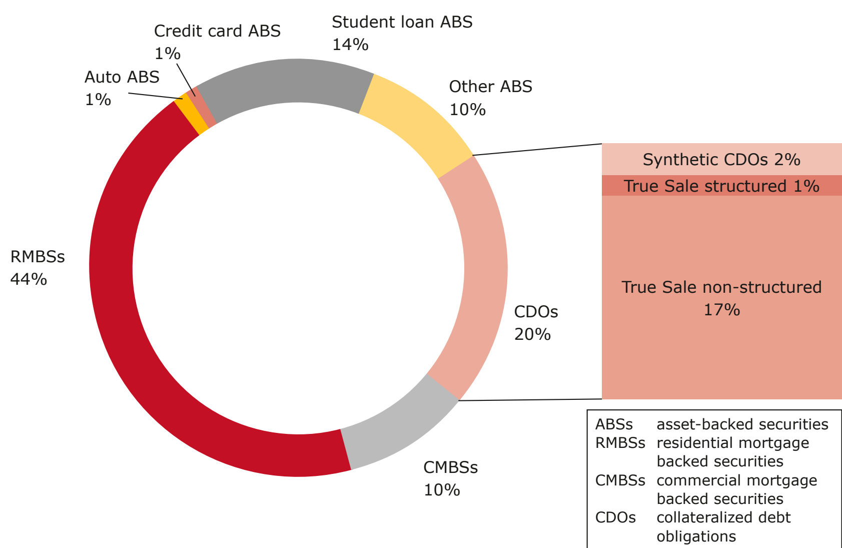
Over half of the securitisation positions held by German banks (54%) comprised residential mortgage-backed securities (RMBSs) and commercial mortgage-backed securities (CMBSs). RMBSs accounted for four-fifths of the mortgage-backed securities, a similar proportion to the previous year; the remaining 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 2012, around 54% (previous year: 61%) of the mortgage-backed securities were rated AAA or AA. The proportion of tranches rated sub-investment grade increased slightly year-on-year and there was therefore a minor deterioration in the rating structure.

Collateralised debt obligations (CDOs) also had a significant weighting, accounting for around a fifth of the total securitisation portfolio of German banks. Most of these were true sale transactions. At around €15.3 billion, collateralised loan obligations (CLOs) formed by far 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 €16.3 billion. By contrast, at €2.2 billion in total, other forms of investment such as auto loan and credit card asset-backed securities played a minor role.

Figure 16

**Securitisation positions by type of collateral**

As at 31 December 2012




Source: Deutsche Bundesbank/BaFin

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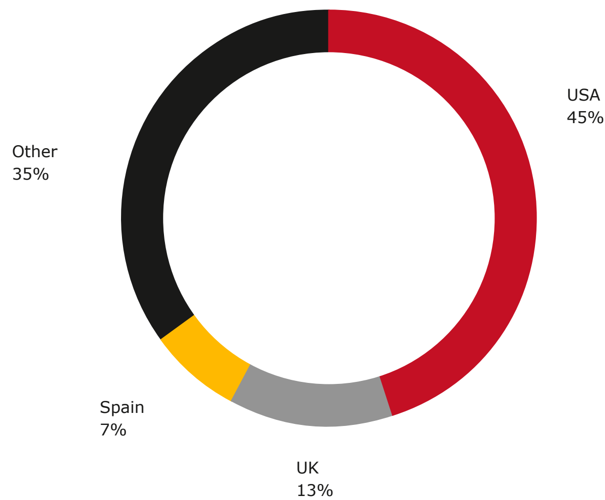
Regional focus of the underlyings in the USA.

Viewed by region, most of the securitised loans again originated from the USA at the end of 2012 (45%). However, the regional breakdown varies considerably from bank to bank depending on their individual investment strategy. The proportion of securitisations backed by US underlyings ranged from just under 80% to 0.3% across the institutions. The regional breakdown by asset class was also heterogeneous.

Figure 17
**Regional breakdown of underlyings**
As at 31 December 2012




Source: Deutsche Bundesbank/BaFin

## 3.6 Financial services institutions

681 authorised financial services institutions.

At the end of 2012, BaFin was supervising 681 financial services institutions (previous year: 680) and 75 German branches of foreign institutions (previous year: 72). A total of 162 financial services institutions were engaged only in investment and contract broking and the provision of investment advice (previous year: 163), while 519 institutions were authorised to conduct portfolio management (previous year: 517). Four financial services providers were authorised to obtain ownership or possession of client money or securities (previous year: two). In 2012, 36 enterprises applied for authorisation to provide financial services (previous year: 42). Fourteen financial services institutions applied to have the scope of their authorisation extended (previous year: 17).

### Tied agents

The number of tied agents fell to around 39,600 in the year under review (previous year: 40,400).

Tied agents not properly integrated.

BaFin revoked the authorisation of one financial services institution due to substantial organisational deficiencies and sustained breaches of the KWG and the WpHG. It did so based on findings it had obtained in 2011 during a special audit at the institution and at

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its tied agents. The tied agents based in the United Kingdom, Spain and Germany had provided cross-border financial services. They mainly offered penny stocks to inexperienced clients in the UK. As the special audit showed, they committed massive breaches of the legal provisions in doing so. For example, they systemically ignored the fact that marketing communications must be honest, clear and not misleading. The financial services institution also made cold calls, i.e. contacted clients by telephone without their prior consent. The financial services institution had not properly integrated the tied agents into its organisational structure. BaFin's investigations also revealed further substantial organisational deficiencies that resulted in numerous breaches of legal provisions in other divisions of the institution as well. The manager of the financial services institution had condoned this and neglected to ensure that the institution was properly managed.

**Integration of tied agents prohibited**

On 16 February 2012, the Administrative Court in Frankfurt am Main confirmed BaFin's decision to prohibit a financial services institution from continuing to use tied agents. The Supervisory Authority had identified numerous serious breaches by the agents and considered these to represent significant organisational and monitoring deficiencies at the financial services provider.

The court also regarded the tied agents' unlawful conduct as an indication of the existence of organisational deficiencies at the liable institution. It said that the obligations incumbent on liable enterprises required preventive and proactive action on the part of the institution and that the burden of proof as regards the fulfilment of those obligations was on the liable enterprise if the agents had already breached the law. The court also stressed that a prohibition in accordance with section 2 (10) sentence 8 of the KWG did not require BaFin to predict the future conduct of the liable enterprise. Rather, it was sufficient that the monitoring obligations had already been breached. Since section 2 (10) sentence 8 of the KWG is also intended to serve as a general deterrent, "probation" – in the sense that one-off breaches are overlooked – was not possible. The court said that fully prohibiting cooperation with tied agents was the only legal remedy in such cases; only prohibiting some tied agents was not a permitted legal consequence and therefore should not be considered by BaFin.

**Supervision of factoring and leasing institutions**

New business stable.

Following the sharp increase in new business in the previous year, the economic slowdown has now also reached the finance leasing and factoring sector. While capital expenditure across the German economy as a whole declined in 2012 as the euro crisis played out, the leasing and factoring institutions – collectively termed the "Group V institutions" – recorded stable new leasing business and stable factoring revenues in the same period. On average, however, there were no noticeable increases in revenue. The financial services

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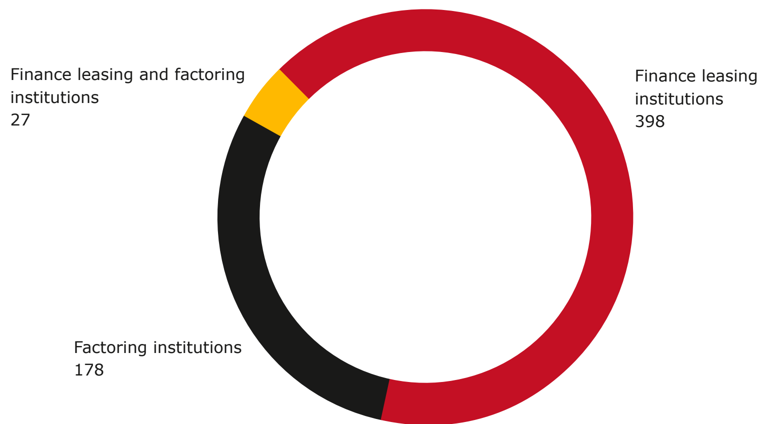
providers saw a further increase in their share of corporate finance compared with other forms of finance.

As at 31 December 2012, 398 finance leasing institutions (previous year: 444), 178 factoring institutions (previous year: 199) and 27 institutions engaged in both finance leasing and factoring (previous year: 31) held authorisations under the ongoing supervision of BaFin.

Figure 18
**Breakdown of Group V institutions**
As at 31 December 2012




Source: Deutsche Bundesbank/BaFin

Process of consolidation continues.

The market shake-up in evidence since supervision of the Group V institutions began continued in 2012, meaning that the finance leasing and factoring sector is continuing to consolidate. The number of returned authorisations once again exceeded the number of applications for new authorisations. In the year under review, BaFin received 34 applications for new authorisations in accordance with section 32 of the KWG. In 22 cases, including several pending authorisation procedures from the previous year, the procedure ended with authorisation being granted. In 12 cases, the applicants withdrew their application prior to the decision-making stage. In one case, BaFin refused to grant authorisation. Conversely, 55 authorisations were returned in the year under review.

Forty-five holder control procedures in accordance with section 2c of the KWG in conjunction with the InhKontrollV were initiated in the year under review. 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 and aims of the potential purchaser of a qualifying holding and to check the existence and origin of the funds to be used to make the purchase. In addition, Group V institutions provided notification of their intention to appoint 174 managers or holders of general commercial power of attorney and 70 supervisory board members. In this case, it is BaFin's responsibility to check whether the persons reported to it are reliable and adequately qualified. In nine cases, BaFin took formal measures against managers.

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Greater supervisory focus on implementation of anti-money laundering requirements.

Due to the implementation of the Second E-Money Directive, additional anti-money laundering obligations have been in force since March 2011. These primarily require institutions to put in place internal safeguards to prevent other punishable offences that may compromise their assets. The transition period agreed with the Federal Ministry of Finance (Bundesfinanzministerium – BMF), during which BaFin refrained from introducing legal supervisory measures if the obligations were inadequately implemented, ended on 31 March 2012.

One supervisory focus in this context are the reports on the audits of the annual financial statements, which continue to exhibit considerable qualitative differences when it comes to the reporting on measures to prevent money laundering, terrorist financing and other punishable offences. BaFin counteracts the varying quality of the reports through targeted letters outlining the deficiencies and discussions with auditing associations.

The 2012 amendments to the MaRisk that entered into force on 1 January 2013 also pose a new challenge for the Group V institutions.[57] In 2013, these institutions will also be required to adequately implement the administrative practice announced with the MaRisk, bearing in mind the proportionality principle.

Action to combat dubious business models.

Once again, BaFin had to sanction enterprises that attracted attention as a result of serious and systematic regulatory failures and in some cases fraudulent business models. Small and medium-sized institutions were particularly affected. In two cases, BaFin revoked their authorisation. If the facts of a case are relevant from a criminal law perspective, BaFin maintains close contact with the criminal prosecution authorities conducting parallel investigations. The aim is to prevent clients and funding banks from suffering damage. In 2013, BaFin will again take vigorous action against dubious institutions, using all the supervisory tools at its disposal.

### Risk-based supervision

The risk classification exercise performed by BaFin covered the 718 authorised financial services institutions (previous year: 680).

Table 22
**Risk classification results**

| Institutions in % | | Quality of the institutions | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Systemic importance | High | | | | | |
| | Medium | 8.77 | 12.53 | 3.48 | 0.14 | 24.93 |
| | Low | 24.09 | 42.2 | 7.10 | 1.67 | 75.07 |
| | Total | 32.86 | 54.73 | 10.58 | 1.81 | 100.00 |

[57] See chapter V 1.4.

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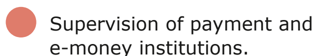
### Audits and measures

In 2012, BaFin participated in 135 audits at financial services institutions (previous year: 89) and conducted 139 supervisory interviews with senior managers or management board members (previous year: 107). Participation in audits and supervisory interviews can concern issues related to both solvency and market supervision. Forty-five authorisations held by financial services institutions ended (previous year: 56), in most cases because they were returned.

Gross violations of client interests.

In one case, an institution had systematically and severely violated client interests. The enterprise had invested its clients' money in forward commodity and exchange transactions. It carried out a large number of financially senseless transactions for its clients for the sole purpose of generating commissions. Thus, clients regularly had to spend a large portion of the assets they had invested on commissions and lost everything. In addition, the institution had repeatedly used misleading graphics in its advertising. These showed potential results that could have been achieved if trading strategies had been used in the past. The gains illustrated by the institution were extremely high. It is prohibited to simulate the past performance of trading strategies in this way. In retrospect, an institution can always make it look as if the trading strategy would have been successful in the past. Furthermore, the enterprise emphasized the advantages of the transactions on offer in its advertising without mentioning the risks and disadvantages. This is also prohibited. Although BaFin had pointed out the shortcomings to the financial services provider on several occasions, the latter continued to use the prohibited advertising. So as not to be discovered, the enterprise even used a second website for advertising after BaFin had formally prohibited it from advertising. In addition, the institution had used tied agents whom it failed to supervise adequately. Many agents had committed massive breaches of supervisory law; some also received criminal convictions. The breaches were so severe that BaFin had prohibited the institution from integrating tied agents into its business activities before the consultation regarding the revocation of its authorisation. As a result of all these breaches, BaFin threatened to revoke the institution's authorisation; following the consultation, the institution returned its authorisation itself.

## 3.7 Payment institutions and e-money institutions


Supervision of payment and e-money institutions.

In the year under review, 36 payment institutions and four e-money institutions were supervised by BaFin in accordance with the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG). Like deposit-taking credit institutions, e-money institutions may provide payment services without requiring special authorisation as a payment institution. In the year under review, most enterprises had to submit an audit report to BaFin for the first time. The business models of the ZAG institutions are heterogeneous and less differentiated than those of deposit-taking credit institutions.

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16 applications for authorisation under the ZAG.

Sixteen authorisation procedures were under way at the end of 2012. The applicants also include providers of payment processes for e-commerce. E-commerce platforms that also offer payment processing frequently provide payment services that require authorisation. The motives platform operators cite for offering payment processing themselves include, for example, saving the merchants transaction costs by bundling payments. In this way, they can also offer fiduciary elements and deduct their own fees from the funds retained. If cross-border services are provided, BaFin also liaises with the home authorities. However, the decision as to whether the services provided in the individual European Economic Area (EEA) member states require authorisation is the responsibility of the supervisory authorities in the member state in question. BaFin and Deutsche Bundesbank received a large number of preliminary enquiries about the obligation to obtain, and preconditions for, authorisation. This contrasts with a comparatively small number of applications for authorisation. This is due, among other things, to the cost of consulting and audits during the authorisation procedure and ongoing supervision as well as the requirements that the ZAG places on institutions and the professional qualifications of managers. Start-up companies especially find it difficult to fulfil these requirements. One issue of particular focus during the authorisation procedure for e-money institutions is the requirements to fulfil the know your customer obligations under section 25i of the KWG.[58]

Provision of cross-border services in Europe.

A total of 179 payment institutions authorised in another EEA member state have provided notification of plans to operate in Germany under the EU passport system. Most of the institutions come from the UK and report payment services taking the form of remittance business. Institutions have a physical presence in Germany through a branch in ten cases and via agents in 19 cases. The number of agents also increased sharply again compared with the previous year. In Germany, branches and agents are subject to anti-money laundering supervision by BaFin.
A total of 27 e-money institutions from the EEA, primarily the United Kingdom, have provided notification that they are using the EU passport in Germany. E-money agents that distribute e-money for these institutions in Germany must fulfil the anti-money laundering obligations.

Supervision of agents and e-money agents.

BaFin carries out anti-money laundering supervision of around 4,600 reported agents, which operate almost exclusively on behalf of foreign payment institutions (payment agents). In 2012, BaFin doubled the number of ordered audits year-on-year to 170 (previous year: 82). The Supervisory Authority was only able to actually carry out 74 of those 170 ordered audits, however. The registers kept by the payment institutions’ home supervisor continue to exhibit considerable shortcomings. For example, 52 planned audits at payment agents could not be carried out because the agents in question were not operating, were no longer operating, or had never operated at the address given despite the entry in the register concerned. The Supervisory Authority was also unable to carry out 43 audits for other reasons (mostly the absence of the payment agent); in one case, a payment agent refused to

[58] See chapter VII 3.2.

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submit to an audit. In this case, BaFin initiated administrative fine proceedings.

Risk-based audit planning.

The payment agents to be audited were selected on the basis of a risk-based approach. It was thus possible to audit eight of the ten payment agents with the highest revenues – with payment orders amounting to over €4 million – to determine whether they comply with anti-money laundering requirements. Five of the audited payment agents were operating on behalf of two payment institutions. However, BaFin takes a critical view of enterprises operating as payment agents for multiple payment institutions, as even separating the amounts received appears problematic. This facilitates smurfing, as splitting one larger amount into two smaller amounts for processing through two payment institutions will not attract the attention of the individual payment institutions. Furthermore, operating on behalf of other payment institutions is usually in contravention of the contracts the agents have signed with the individual payment institutions.

Audits resulted in major objections.

Looking at the audit results, the picture in the year under review is similar to that in the previous year: the vast majority of the audits resulted in significant to substantial objections. In all of these cases, BaFin is examining whether it is necessary to initiate administrative fine proceedings against the individual payment agents. A total of 13 administrative fine proceedings were initiated against payment agents in 2012, three of which have so far been concluded with final and non-appealable decisions.

As in the previous year, BaFin found in individual cases that agents or 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 as specified in the contract with the payment institution. They were therefore engaging in unauthorised remittance business. One reason for this conduct is to conceal the identity of the client. BaFin prohibited these agents from operating as a result of their providing unauthorised payment services. In the year under review, a total of 15 prohibition orders were issued as a result of unauthorised remittance business being conducted, five of them due to previous audits on the basis of section 5 (2) of the ZAG.

Supervision of e-money distribution assistants.

Since 29 December 2011, BaFin has also supervised e-money agents within the meaning of section 1a (6) of the ZAG and obligated parties pursuant to section 2 (1) no. 2c of the Money Laundering Act *(Geldwäschegesetz* – GwG) (2c agents) who distribute and/or redeem e-money on behalf of – mostly foreign – e-money institutions and credit institutions. In 2012, BaFin conducted three audit campaigns comprising a total of 24 audits at these distribution assistants. During these audits, it found that the agents were insufficiently aware of the money-laundering risks associated with the products being distributed and their specific features. Anti-money laundering obligations, particularly the obligation to identify the client and determine beneficial ownership, were not fully fulfilled. Almost all audits led to objections, as a result of which BaFin is examining whether it is necessary to initiate administrative fine proceedings.

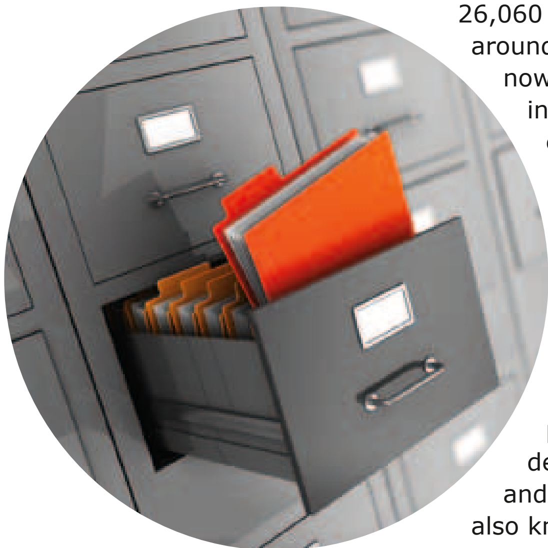
## 3.8 Market supervision of credit and financial services institutions

**Information documents for financial instruments**

The obligation to provide retail clients with a short, easy-to-understand information document before any transaction is executed has been in force since mid-2011. In the second half of 2011, BaFin had already examined 130 information documents and identified shortcomings. The investment services enterprises concerned amended their information documents in the first two months of 2012 or ceased to use them in providing investment advice. Because financial instruments can be structured in a variety of ways, the legal provisions governing the information documents contain a large number of indeterminate legal terms. To clarify these, BaFin has prepared a circular containing anonymised positive and negative examples of wording taken from practice. The draft was released for consultation in autumn 2012, with publication scheduled for the second quarter of 2013; the circular is then to be incorporated into the MaComp.

**Employee and Complaints Register**

At the beginning of November 2012, BaFin went live with the database for the new Employee and Complaints Register. By the end of February 2013, institutions had reported 168,623 advisers, 26,060 sales officers and 2,287 compliance officers. BaFin received around 4,000 complaints. The first clusters of complaints have now emerged. BaFin has taken these up and requested further information on the complaints from the investment services enterprises. If this produces specific indications that the Securities Trading Act has been breached, BaFin will conduct on-site interviews with the investment adviser and the sales officer responsible.



As regards the obligation to only engage employees with sufficient minimum qualifications in the provision of investment advice, BaFin observed in 2012 that the industry was increasingly probing the expertise of the persons concerned. In particular, these must not only demonstrate knowledge of client advisory issues and the legal and technical bases of investment advisory services, but must also know how to apply that knowledge in practice. Some banks, their employees and employee associations were initially critical of the new register. Among other things, they feared that investment advisers could be prematurely sanctioned solely because of a large number of complaints. This prompted BaFin to explain the issue in detail. For example, it conducted a large number of interviews with representatives of the banking industry and employee associations, held presentations for stakeholder groups and answered more than 500 enquiries.

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The findings from the database aside, BaFin has started to carry out more of its own audits at the locations where various institutions provide advice and to conduct interviews with sales managers and investment advisers, thereby building up its own picture locally.

### Investment advice minutes

In early summer 2012, BaFin spoke with 50 selected investment services enterprises and their investment advisers in order to check whether the requirements for investment advice minutes set out in greater detail in 2011 have been implemented. It also checked 1,500 sets of investment advice minutes. In doing so, it found that the quality of the minutes has steadily increased. Many institutions have improved their forms by including free text fields, for example. In addition, many advisers have received training; plus, there are now internal quality controls on the documentation of advice. Despite those controls and contrary requirements in the MaComp, some investment services enterprises continue to use pre-formulated text blocks and too rarely use free text fields. This means that BaFin is often unable to gain an adequate understanding of the actual consultation. It is important, therefore, for investors to read through the minutes carefully and insist that all the content important to them is contained in the minutes.

### Rules of conduct for financial instruments analysis

Research offered by 297 credit institutions and financial services institutions.

In 2012, BaFin supervised 297 credit and financial services institutions that provided their clients with, or publicly disseminated, their own research or third-party reports (previous year: 289). The trend for institutions to buy in research services rather than provide them themselves continued. The large majority of institutions complied with the legal requirements applicable to investment research. Only in a small number of cases were there deficiencies. For example, the data gathered throughout the enterprise regarding conflicts of interest could not always be accessed by the investment research unit in question. The institutions eliminated the deficiencies to which objections were raised in some cases while the annual WpHG audit was still ongoing and at the latest after the audit had ended. Two institutions discontinued the production of investment research; they now purchase investment research from third parties and pass it on.

Recommendations regarding First Quotation Board securities.

BaFin also supervised 159 independent natural or legal persons who had notified BaFin of their activities in accordance with section 34c of the WpHG (previous year: 149). In 2012, the Supervisory Authority examined whether analysts had reported their activities and observed the applicable rules of conduct primarily in the context of the closure of the First Quotation Board, an Open Market segment of the Frankfurt Stock Exchange. Particularly in the weeks prior to the Board’s closure, it searched the Internet for recommendations regarding the financial instruments traded there. BaFin investigated three cases in which recommendations were given in market letters of which BaFin had not previously been notified in accordance with section 34c of the WpHG. The investigations into whether these

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were actually required to be reported or whether they fell under an exemption such as press privilege were ongoing at the end of 2012.

**Cooperation**

Workshop and annual consultation with the IdW.

At the beginning of 2012, BaFin held its annual workshop with the Institute of Public Auditors in Germany (Institut der Wirtschaftsprüfer in Deutschland e.V. – IdW). This focused on the question of how the on-site audit of the investment services business should be performed at branches or tied agents. At the same time, the focal points were decided for the 2012 audit season. As the supervisory focus is mainly on sales management, BaFin expects this area to be presented in detail in the audit reports. The outsourcing of compliance functions is another focal point of auditing.

BaFin itself engages auditors for the 2013 audit season.

In September 2012, the annual consultation took place with the IdW's WpHG working group. This was mainly concerned with BaFin's plans to have the audit of the investment services business at a number of credit and financial services institutions carried out by auditors that it itself engages. In spring 2012, BaFin had investigated how long investment services enterprises have already been examined by the same auditor. In doing so, it found that more than 20 private credit institutions and more than 40 financial services institutions had been audited by the same private auditor for 12 or more consecutive reporting periods. For the 2013 audit season, BaFin will therefore assume responsibility for the regular audit in accordance with section 36 (1) of the WpHG at a random selection of investment services enterprises.

**Credit institutions**

Market survey on sales guidelines.

In a market survey of 84 private credit institutions, 30 savings banks and 81 cooperative banks in spring 2012, BaFin examined how these had organised their sales structures. Institutions must design, implement and monitor their sales guidelines so that client interests are not adversely affected. One finding of the survey was that enterprises do not all interpret the German terms for "sales guidelines" and "sales officer" in the same way. At numerous institutions, the sales officers could not be clearly identified. BaFin consequently explained its interpretation of the terms to the investment services enterprises concerned during supervisory interviews.

Audit focus on outsourcing of compliance functions.

In 2012, the supervisory focus was also on how credit institutions handle the outsourcing of their compliance function. Smaller institutions in particular are keen to outsource the compliance function due to increasing supervisory requirements and the associated cost aspects. BaFin supports this, provided the quality of the compliance processes does not deteriorate as a result. To check this, BaFin obtained a first-hand impression of the contractual bases of the outsourced WpHG compliance function, its ability to function properly and its effectiveness at 26 investment services enterprises. Once the audit findings have been evaluated, BaFin will develop and publish best-practice criteria.

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Integration of the compliance function when issuing certificates and derivatives.

At selected investment services enterprises, BaFin examined whether these adequately and effectively integrate their compliance function into the issuing process for certificates and derivatives. To do this, it told the institutions' auditors on which points of content the audits should focus and accompanied the audits locally. These mainly analysed the institutions' management guidelines and the operational business processes for their own issues. On this basis, BaFin, the auditors and the institutions defined the main compliance-related aspects of the issuing processes and agreed measures to improve the quality of monitoring and thus better protect client interests. BaFin found nothing to indicate that the audited institutions had improperly transferred their own risks in the trading or banking book to retail clients or systematically or deliberately exploited the scope for discretion available to them to the detriment of their clients. In particular, there was no evidence that the institutions speculate against their clients in the course of their issues. Nevertheless, BaFin is working to ensure that the issuers limit the complexity of their certificates and derivatives for retail clients and make the opportunities and risks transparent for investors in the product information documents and other product-related information.

### Financial services institutions

A lack of adequate internal controls.

Numerous complaints alerted BaFin to shortcomings at one financial services institution. The annual audit had also revealed shortcomings with regard to obtaining client details, explaining risks and checking client/product suitability. The enterprise had used an aggressive marketing campaign and the targeted broking of fund-based asset management contracts through intermediaries in accordance with section 34c of the Industrial Code *(Gewerbeordnung* – GewO) to increase the number of retail client mandates it held by a factor of 20 in the first three years after being granted authorisation to provide portfolio management. However, it had not adapted its internal controls, complaints handling and client communications in line with this exorbitant growth. Only after BaFin had cautioned the manager did the enterprise initiate a comprehensive restructuring programme, including a client-oriented advisory concept and an active compliance function. The intermediaries in accordance with section 34c of the GewO may only provide tips; all WpHG-related activities are now consolidated at the financial services institution.

Conflicts of interest.

In 2012, BaFin announced to one financial services institution that it was prohibiting it from buying securities for its asset management clients. The institution had regularly bought illiquid Open Market securities for its clients. In many cases, the asset manager had indirect links to the enterprises whose shares he was buying. This led to considerable conflicts of interest at the institution. Following the consultation by BaFin, the financial services provider refrained from carrying out further transactions.

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## Audit exemptions

62 institutions exempted from annual audit.

BaFin exempted 62 credit and financial services institutions from their annual audit under section 36 of the WpHG (previous year: 68). Twenty-nine exemptions were granted to credit institutions, including 26 cooperative banks and no savings banks, and 33 to financial services institutions. In addition, BaFin exempted 27 credit institutions from a securities custody business audit (previous year: 22).

## Administrative fines

20 administrative fine proceedings related to investment advice minutes.

In 2012, BaFin initiated 20 new proceedings because investment services enterprises had failed to draw up investment advice minutes or to provide them to their clients in a timely manner or at all (previous year: 10). Ten proceedings were still pending from the previous year. BaFin imposed three administrative fines of up to €10,000. All cases concerned a negligent breach of the duty of supervision under section 130 (1) of the Act on Breaches of Administrative Regulations *(Ordnungswidrigkeitengesetz* – OWiG). The owner of the company concerned had not taken sufficient precautions, such as training or appropriate controls, to prevent employees breaching the duty. BaFin can impose fines of up to €12,500 for this. BaFin discontinued three proceedings, one for discretionary reasons. Twenty-three cases were pending at the end of 2012.

Ban on making recommendations and cold calling.

In one case, BaFin also imposed a fine of €20,000 because the company had not obtained all the necessary information from its clients regarding their knowledge, experience, investment objectives and financial circumstances. This is required in order to recommend a suitable financial instrument to clients. In this case, too, the management board member had breached his duty of supervision. In addition, BaFin imposed a fine of €18,000 on a financial services institution because it had violated the ban on cold calling. One further case is still pending.

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# VI Supervision of securities trading and the investment business

Karl-Burkhard Caspari,
Chief Executive Director Securities Supervision/Asset Management

## 1 Bases of supervision

### 1.1 Act Implementing the AIFM Directive

The future Investment Code *(Kapitalanlagegesetzbuch* – KAGB) will create a comprehensive regulatory framework for German investment funds and the distribution of units in domestic and foreign funds in Germany. It is the centrepiece of the draft Act Implementing the Alternative Investment Fund Managers (AIFM) Directive[59], which the Federal Government adopted on 12 December 2012. The new Act will transpose the AIFM Directive into national law effective 22 July 2013 and will bring national law in line with the European Regulation on European Venture Capital Funds and the European Regulation on European Social Entrepreneurship Funds. In addition, as part of this process, the Investment Act *(Investmentgesetz* – InvG) will be repealed and the provisions of the directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS Directive)[60] will be integrated.

Substantive definition of investment fund.

The KAGB covers all funds, regardless of their legal form and regardless of whether they are open-ended or closed-end funds or whether they are intended for institutional or private investors. Every undertaking for collective investment falls under the KAGB's substantive definition of a fund, if it collects capital from investors in order to invest it for their benefit according to a defined investment strategy. These undertakings for collective investment comprise all funds that meet the requirements of the UCITS Directive. All other funds are alternative investment funds (AIFs). These funds are managed by management companies, which require authorisation from BaFin to do so.

Threshold rules.

The draft KAGB provides simplifications for funds managed by the management company, if they remain below certain thresholds. For the management of special AIFs, which may only be distributed to professional and semi-professional investors, the management company is only required to register with and report to BaFin. If the investment volume of the closed-end mutual AIFs under management is below the thresholds, only the depository institution regulations and the product and distribution provisions apply. Finally, compliance is also required with the financial reporting

[59] Directive 2011/61/EU, OJ EU L 174/1, p. 1 ff.
[60] Directive 2009/65/EC, OJ EU L 302, p. 32 ff.

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requirements that had already applied to closed-end funds under the Capital Investment Act *(Vermögensanlagegesetz).*

Amendments applicable to open-ended funds.

Investment funds *(Sondervermögen)* and investment stock corporations *(Investmentaktiengesellschaften)* – fund vehicles already known from the InvG – have been retained in the draft KAGB. In addition, the open-ended investment limited partnership *(Investmentkommanditgesellschaft)* will be introduced, aimed in particular at creating a tax-transparent vehicle for pension asset pooling in Germany. Most types of open-ended mutual AIFs will also be retained from the InvG.

Closed-end funds under ongoing supervision for the first time.

Closed-end funds will now be under ongoing supervision for the first time. According to the draft KAGB, they can choose between two legal forms – investment stock corporations with fixed capital and closed-end investment limited partnerships. To make sure that small investors are protected, both closed-end and open-ended mutual funds will be subject to investment restrictions. For example, closed-end mutual funds will also have to be invested in line with the principle of risk diversification. In addition, under the draft KAGB, investors with a minimum investment volume of €20,000 and confirmed expertise will be allowed to invest in closed-end single-asset mutual funds.

## 1.2 EMIR Implementation Act

The German EMIR Implementation Act *(EMIR-Ausführungsgesetz)* entered into force on 16 February 2013. It brings the German legal framework, such as the Banking Act *(Kreditwesengesetz* – KWG) and the Securities Trading Act *(Wertpapierhandelsgesetz* – WpHG), in line with the European regulation on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR)[61]. EMIR entered into force on 16 August 2012. Technical standards issued by the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) clarify the regulation in greater detail – a precondition for its application to a large extent.

The European regulation is aimed at both financial counterparties (for example banks, insurance undertakings, *Pensionskassen* and asset management companies) and non-financial counterparties (especially companies in the real economy), i.e. counterparties in OTC derivatives transactions. It governs the main requirements for standardised OTC derivatives transactions within the EU.

For example, it introduces a central clearing requirement for OTC derivatives. In the case of central clearing, a central counterparty is interposed between the parties to the contract and becomes the buyer to every seller and the seller to every buyer. Protection from the default risk of one or more parties is provided even in difficult market conditions, because the central counterparty is subject to stringent risk management requirements and demands collateral for the risks assumed. Special risk management and collateralisation requirements will apply to contracts that are not

[61] Regulation (EU) No. 648/2012, OJ EU L 201/1, p. 1 ff.

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subject to the clearing requirement, for example because they cannot be standardised. In addition, the regulation specifies how central counterparties have to organise credit and liquidity risk. It also lays down a uniform procedure involving supervisory colleges for authorising and supervising central counterparties within the EU, and determines in what circumstances central counterparties from third countries can be used.

Trade repositories for derivatives contracts.

To increase transparency, derivatives transactions will in future have to be reported to a trade repository. The reporting requirement will not be limited to OTC derivatives, but will also cover exchange-traded derivatives. The European supervisory authorities will be able to access the data stored.

## 1.3 Regulating short selling

On 1 November 2012, the European Short Selling Regulation[62] entered into force, replacing the previous national regulations on short selling.

Act Implementing the European Short Selling Regulation.

The amendments needed to be made to the German regulations were made by adopting the Act Implementing the European Short Selling Regulation *(EU-Leerverkaufs-Ausführungsgesetz)*[63], which entered into force on 16 November 2012. The provisions no longer required were repealed and section 30h of the WpHG was inserted; this central provision specifies that responsibility for further supervision of short selling lies with BaFin. The Implementing Act also amended the elements of administrative offences.

Regulation on Net Short Positions.

Since 22 December 2012, the Regulation on Net Short Positions *(Netto-Leerverkaufspositionsverordnung* – NLPosV)[64] has specified the form to be taken by reporting and publication systems for short positions and how holders of positions have to identify themselves. The previous provisions have largely been retained and were merely adapted to the new terminology.

## 1.4 Implementation of the revised Prospectus Directive

The Act Implementing the Revised Prospectus Directive *(Umsetzungsgesetz zur geänderten Prospektrichtlinie)*[65], which entered into force on 1 July 2012, led to a large number of amendments to the Securities Prospectus Act *(Wertpapierprospektgesetz* – WpPG) and some consequential amendments to the WpHG. Through the European Prospectus Directive, the WpPG now precisely defines the contents of the summary of securities prospectuses, thus making it easier to compare different securities offerings. In relation to the exemption from the requirement to publish a prospectus, the minimum

[62] Regulation (EU) No. 236/2012, OJ EU L 86, p. 1.
[63] Federal Law Gazette (BGBl.) I 2012, p. 2286.
[64] Federal Law Gazette (BGBl.) I 2012, p. 2699.
[65] Federal Law Gazette (BGBl.) I 2012, p. 1375.

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selling price and the minimum denomination have been increased from €50,000 to €100,000. Moreover, small and medium-sized companies can now offer securities in accordance with simplified legal provisions. No prospectus is required for shares issued under employee share schemes if the issuer's registered office or head office is in a signatory state to the Agreement on the European Economic Area (EEA).

However, investors also benefit from the new prospectus rules: The provision of printed copies of prospectuses is no longer sufficient as the only publication method. Securities prospectuses must now always be published electronically as well. In addition, investors now have an extended right of revocation if the provider has corrected or added to the prospectus in a supplement.

# 2 Monitoring of market transparency and integrity

## 2.1 Monitoring of short selling

**National short selling regulation until the end of October 2012**

11 investigations relating to shares and debt securities.

Until the end of October 2012, 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 were prohibited under national law. BaFin investigated 11 new potential cases of violations (previous year: 68). It discontinued 27 proceedings, for example because the violations were minor (previous year: 40). A total of 19 cases were still pending at the end of 2012 (previous year: 38). In one case, BaFin provided administrative assistance to a foreign supervisory authority investigating naked short sales (previous year: 2).

65 notifications and eight publications on the basis of a general decree.

Under a general decree issued in March 2010, market participants had to notify BaFin until the end of March 2012 if their net short positions in ten selected financial stocks reached, exceeded, or fell below 0.2%. For values of 0.5% or more, BaFin additionally published anonymised information on these net short positions on its website. Until 25 March 2012, BaFin received 65 notifications (previous year as a whole: 240), i.e. an average of one notification per trading day. A total of 20 companies notified BaFin of net short positions (previous year as a whole: 47). Eight notifications were subject to publication requirements (previous year as a whole: 38).

3,128 notifications and 571 publications on the basis of statutory provisions.

For the transition period from the end of March until the end of October 2012, there was a national legal framework. During that period, market participants had to report net short positions for all shares admitted to trading on the regulated market of a German stock exchange if they reached, exceeded, or fell below the 0.2% and subsequently the 0.1% thresholds. The additional publication

in the Federal Gazette for the 0.5% threshold had to be made by the parties subject to the notification requirements. In the period up to 31 October 2012, BaFin received 3,128 notifications from 144 different parties subject to notification requirements; they related to 165 different shares. A total of 571 of these notifications were subject to publication requirements. This corresponds to an average of 20 notifications and four publications per trading day.

80 notifications by market makers and other liquidity providers.

Exemptions to the ban and the transparency requirements existed for market makers and entities performing similar liquidity-providing functions on the financial markets (for example lead brokers, specialists and designated sponsors). They had to notify BaFin quarterly of their activities and the financial instruments concerned. A total of 80 market makers and liquidity providers submitted such notifications to BaFin under the national provisions in 2012 (previous year: 85); 42 of them are domiciled in Germany (previous year: 45) and 38 abroad (previous year: 40).

**European Short Selling Regulation from November 2012**

As from 1 November 2012, the European Short Selling Regulation resulted in another change in the way short selling is regulated. While the main principles of the German short selling regulation were adopted, the European Regulation and the clarifying implementing regulations added numerous detailed provisions. To facilitate practical implementation of the European Regulation, BaFin published a number of FAQs. In addition it participated in the revision of ESMA's FAQs. Moreover, it responded to 226 written enquiries (previous year: 65) and took a large number of calls to a designated telephone hotline.

Bans on short selling.

Like the previous German regulation, the European Regulation contains provisions prohibiting uncovered short sales in shares and sovereign debt as well as uncovered sovereign credit default swaps (CDSs). However, the European bans are stricter in that, for example, the time the transaction is entered into is the relevant time for assessing an uncovered short sale. It is therefore no longer possible to arrange cover by the end of the trading day, as was previously possible under national law (intraday exemption).

Six investigations relating to shares and debt securities.

From November 2012 onwards, BaFin investigated six new potential cases of violations of the ban on short selling under the European Regulation. It discontinued one investigation; the other cases were still pending at the end of 2012.

Notifications of intent received from 47 market makers and 31 primary dealers.

A total of 47 market makers – 42 from Germany and five from a third country – and 31 primary dealers – eight from Germany and 23 from abroad – notified BaFin of their activities. They are exempt from the ban on short selling and transparency requirements for the financial instruments for which they have notified BaFin. A further notification is required if market makers extend their activities to include a new instrument; 34 of the market makers submitted up to 51 additional notifications of intent. In total, market makers submitted 301 and primary dealers submitted 31 notifications of intent to BaFin.

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Table 23

**Notifications by market makers and primary dealers under national and European law**

As at 31 December 2012

| | Market makers | Primary dealers |
|---|---|---|
| **European Short Selling Regulation from 1 Nov. 2012** | | |
| Total number of companies | **47** | **31** |
| of which from Germany | 42 | 23 |
| of which from abroad | 5* | 8** |
| Total number of notifications | **300** | **31** |
| **National regulation until 31 Oct. 2012** | | |
| Total number of companies | **80** | /*** |
| of which from Germany | 42 | /*** |
| of which from abroad | 38 | /*** |
| Total number of notifications | **191** | /*** |

* Non-EU third country.
** Domiciled outside Germany.
*** Primary dealers were not obliged to notify their activities at the time.

Transparency requirements for net short positions.

The European Regulation also includes a two-tier transparency model for shares admitted to trading on a regulated market or multilateral trading facility. If the shares reach or fall below the thresholds of 0.2% and subsequently 0.1%, the party subject to the requirement has to notify the competent national authority of the net short position; if the 0.5% threshold is crossed or reached, the party subject to the notification requirement has to publish the notification in the Federal Gazette.

930 notifications for shares, 331 of them published.

From November to December 2012, 115 parties subject to notification requirements notified BaFin of 930 net short positions in 125 different shares; this corresponds to an average of 24 notifications per trading day. The notifications related not only to shares included in major indices, but also to shares not included in any indices. A total of 331 notifications were subject to publication requirements.

Three notifications relating to sovereign debt.

The single-tier transparency model for net short positions in sovereign debt is new. BaFin must be notified of net short positions in federal government debt securities (initial threshold of 0.5%) and debt securities of the *Länder* (initial threshold of 0.1%). BaFin received three notifications relating to sovereign debt. There is no publication requirement as in the case of shares.

Electronic reporting channel.

Since March 2012, it has been possible to use BaFin's reporting and publication platform to notify net short positions. By the end of 2012, BaFin had received 1,111 applications for authorisation from 528 companies, some of them with several contact persons, and from private individuals. It granted access in the case of 476 applications and rejected 54 applications, while 331 applications were withdrawn. The remaining applications still had preliminary status at the end of 2012, for example because not all the required documents had been submitted. Most parties subject to notification requirements came from the United Kingdom and the USA. Germany accounted for 12%.

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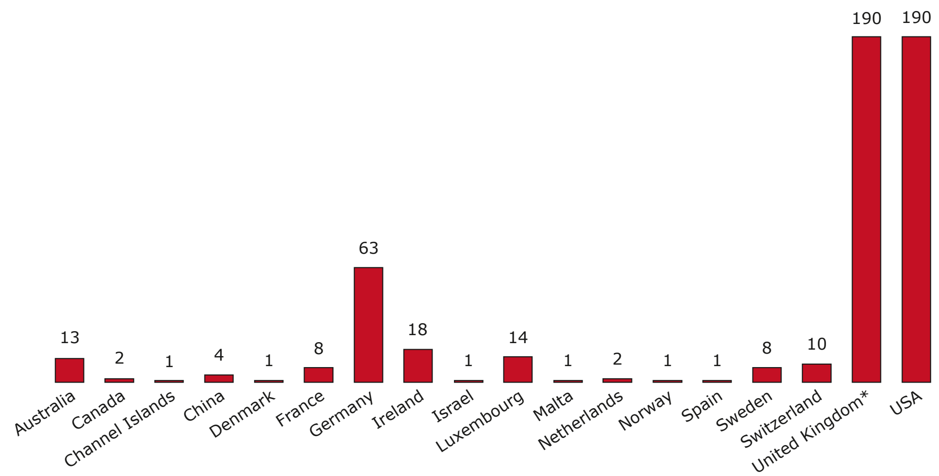
Figure 19
**Parties subject to notification requirements by country of origin**
As at 31 December 2012




* Including overseas territories.

## 2.2 Market analysis

In 2012, BaFin analysed 354 cases of possible market abuse (previous year: 259). In addition, it prepared 18 expert reports for public prosecutors and courts.

Continued focus on market manipulation.

BaFin found initial indications of market abuse and launched further investigations in 100 cases (previous year: 91) of which 24 cases related to accusations of insider trading (previous year: 27). As in previous years, the main focus was on market manipulation, which accounted for 76 cases (previous year: 64).

A total of 43 of these positive market manipulation analyses related to information offences, i.e. incorrect, misleading, or withheld information as well as scalping. Sham activities such as collusive transactions were the subject of investigations in 31 cases, while two cases involved manipulation of the order situation or of reference prices.

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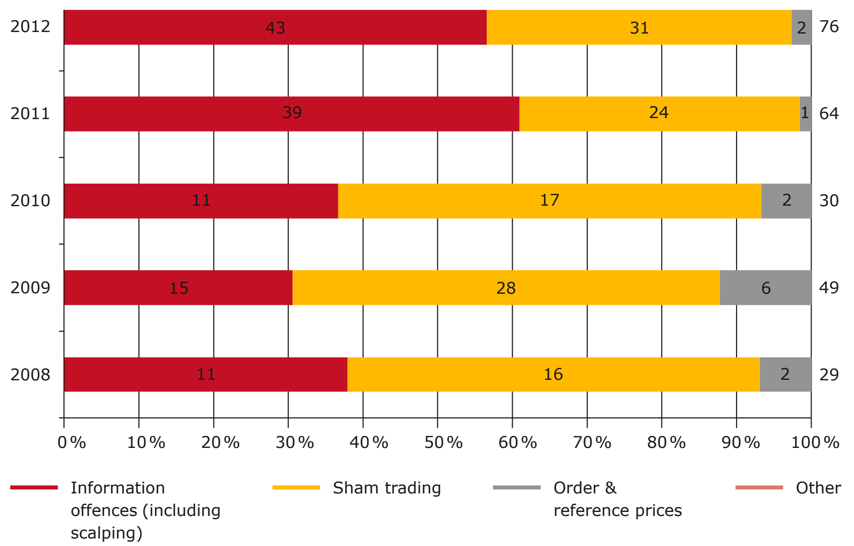
Figure 20
**Positive manipulation analyses by issue**




Latest developments on the regulated unofficial market.

As in the past, manipulation occurred particularly frequently on the regulated unofficial market *(Freiverkehr).* Of the positive analyses, 63 related to this market segment alone (previous year: 58). In only ten cases was the focus on companies from the regulated market (previous year: 6). Three cases involved a number of financial instruments from both segments.

The segment of the regulated unofficial market with the least stringent regulatory requirements, the First Quotation Board, was closed down as from 15 December 2012. Although the requirements had been successively tightened, the incidence of market manipulation had increased there. Issuers that were unable to retrospectively meet the increased transparency requirements of the Open Market, which continues to exist, were delisted. In total, this happened to approximately 700 shares and certificates representing shares.

Preventive warnings.

In 2012, BaFin intensified its preventive measures and issued warnings of possible market manipulation in 12 cases. Manipulation is normally associated with marketing efforts such as unsolicited calls, faxes, or e-mails, which often contain incorrect or misleading information. Frequently their sole purpose is to increase demand for shares, allowing the initiators to sell their own shareholdings at a profit. Prompt publication on BaFin's website has the advantage that all market participants can be alerted at an early stage. In many cases, the warnings prompted the exchanges to suspend or discontinue trading in the shares concerned.

Insider analyses.

Once again, most of the positive insider analyses were attributable to mergers and acquisitions (11) and to companies' earnings figures (5). Unlike the manipulation analyses, the insider analyses primarily related to the regulated market, with 19 cases (previous year: 22); the regulated unofficial market was only affected in four cases

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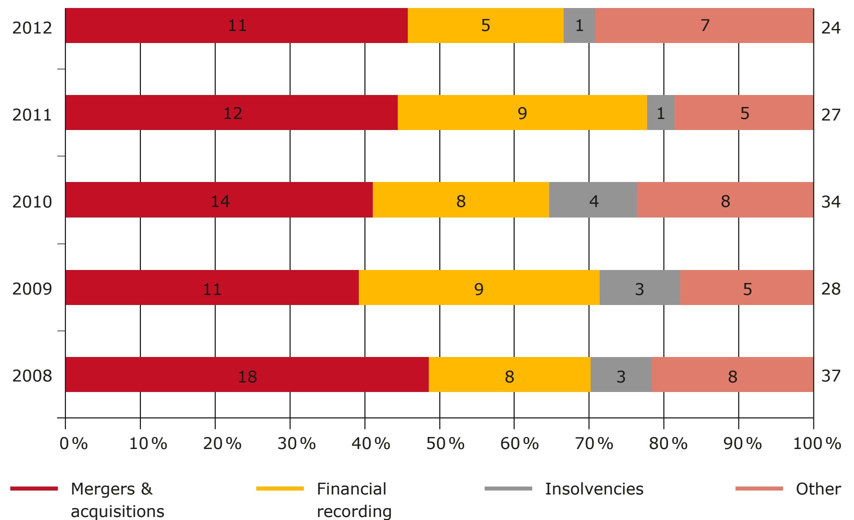
(previous year: 5). In one additional case, financial instruments from both segments were involved.

Figure 21
**Positive insider analyses by issue**




1.3 billion transactions reported.

Reported transaction data is very important for pursuing market abuse. In 2012, BaFin received approximately 689 million transaction data records via the German reporting system (previous year: 910 million) and 606 million data records via the pan-European platform (previous year: 550 million). This corresponds to an average of approximately 5.5 million data records per trading day. BaFin also receives notifications from investment services enterprises transacting on foreign multilateral trading facilities or exchanges based abroad.

**Multilateral trading facilities and foreign market operators**

In 2012, a total of 11 institutions in Germany (previous year: 9) were authorised to operate a multilateral trading facility (MTF). Two of these institutions only had an MTF licence (previous year: 2) and nine companies (previous year: 7) additionally had other licences to provide banking, financial, or investment services.
Four foreign market operators were granted approval to permit German trading participants to conduct exchange trading as remote members (previous year: 4). Foreign operators of markets for financial instruments from non-EU countries require such approval to set up trading screens in Germany if they provide German market participants with direct market access via an electronic system.

Renewed spam campaigns.

BaFin received 547 suspicious transaction reports relating to market manipulation and insider trading in 2012 (previous year: 473). Most of the reports came from savings banks, private credit institutions, foreign supervisory authorities and cooperative banks. The vast majority of the suspicious transaction reports related to shares; bonds, warrants/certificates, and derivatives were only rarely the

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subject of reports. Broken down by type of offence, the majority of the reports related to suspected market manipulation.

## 2.3 Insider trading

Seven convictions for insider trading.

BaFin initiated 26 new insider trading investigations (previous year: 29). Of these, 24 were triggered by BaFin's own analyses; two other cases were triggered by suspicious transaction reports. BaFin referred 11 cases (previous year: 20) involving a total of 25 people (previous year: 52) to the public prosecutor's office. No evidence of insider trading was found in 12 cases (previous year: 14). A total of 34 investigations had not been completed at the end of 2012 (previous year: 29), some of which related to previous years.

Table 24
**Insider trading investigations**

| Period | New investi-gations | Results | | | Pending |
|---|---|---|---|---|---|
| | | Discontinued | Referred to public prosecutors | | |
| | Insiders | Insiders | Cases | Individuals | Total |
| 2010 | 34 | 17 | 10 | 33 | 34 |
| 2011 | 29 | 14 | 20 | 52 | 29 |
| **2012** | **26** | **12** | **11** | **25** | **34** |

German courts convicted a total of seven people of insider trading in 2012 (previous year: 2), four of them in summary proceedings and therefore without a trial (previous year: 1). The public prosecutors discontinued proceedings in 34 cases (previous year: 24), of which six cases (previous year: 4) were part of out-of-court settlements.

Table 25
**Public prosecutors' reports on completed insider trading proceedings**

| Period | Total | Discontinued | Discontinued after out-of-court settlement | Final decisions | | | |
|---|---|---|---|---|---|---|---|
| | | | | Decisions by the court | Convictions following summary proceedings | Convictions following full trial | Acquittals |
| 2010 | 69 | 32 | 26 | 0 | 2 | 9 | 0 |
| 2011 | 31 | 24 | 4 | 0 | 1 | 1 | 1 |
| **2012** | **46** | **34** | **6** | **2** | **2** | **3** | **0** |

BaFin cooperates closely with foreign supervisory authorities when pursuing cases of insider trading. In 2012, it received 27 enquiries from abroad (previous year: 24), with the largest number coming from France and Austria. BaFin itself contacted foreign authorities, and particularly those in Switzerland, the United Kingdom, Austria and Luxembourg, in 31 cases (previous year: 51).

Examples of completed cases are given in the following.

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**aleo solar AG**

On 2 August 2009, Robert Bosch GmbH announced a public takeover offer for aleo solar AG, specifying a takeover price of €9 per share. As a result, the share price rose by approximately 30%.

A secondary insider had bought shares in the target company worth €354,343 in the period between 7 and 31 July 2009 and sold them after the takeover announcement at a profit of €131,985. During its investigation, BaFin established that the person concerned was the mother of an employee in the compliance department of aleo solar AG. A few weeks before the share purchases, she had received bank transfers from her son amounting to €64,200.

The Regional Court in Oldenburg convicted the mother of insider trading on 9 March 2012 and sentenced her to 240 daily units of €40 each, i.e. a total fine of €9,600. The compliance employee was fined €10,800 (90 daily units of €120) for unauthorised communication of inside information. In addition, the court ordered both defendants, who were jointly and severally liable, to forfeit €99,000. The judgement is final.

**IDS Scheer AG**

On 13 July 2009, Software AG announced that it intended to submit a voluntary public takeover offer of €15 per share to the shareholders of IDS Scheer AG. In response, the price of IDS Scheer shares rose from €10.80 to €14.95.

On 6 July 2009, an employee of the target company had bought a total of 700 shares in IDS Scheer AG at a price of €11.48 each and sold them again on 8 September 2009 for €15.00. She made a profit of €2,464. On 13 July 2009, she acquired another 1,400 shares via her mother’s account at a price of €10.72; she sold them on 28 September 2009 for €15.00, thus generating a profit of €5,992.

In addition, a member of the Executive Board of IDS Scheer AG had passed on information about the impending takeover offer in his family circle. A member of the family then bought a total of 19,500 IDS Scheer shares for €210,750 in the period between 7 and 13 July 2009 and sold them on 14 July 2009, generating proceeds of €291,757. On 13 July 2009, another family member acquired 2,725 shares for €29,021.25 and sold them for €40,711.50 on 14 July 2009.

The Regional Court in Saarbrücken discontinued the proceedings against the employee on 4 September 2012 in return for a payment of €17,000 as part of an out-of-court settlement.

By way of summary proceedings, the court fined the Executive Board member €24,000 (60 daily units of €400 each) for unauthorised communication of inside information on 17 December 2012. The Regional Court in Saarbrücken imposed fines of €8,000 and €2,200 respectively (200 daily units of €40 and 40 daily units of €55) on the family members and ordered that €60,315.12 and

€11,690.25 be forfeited as compensation. Moreover, two people were convicted in summary proceedings because they had obtained information about the impending takeover from a primary insider and taken advantage of this information. The convictions are final.

**Ersol Solar Energy AG**

On 2 June 2008, Robert Bosch GmbH published a disclosure indicating its intention to take over Ersol Solar Energy AG at a price of €101 per share. In response, the Ersol share price, which had traded between €50 and €70 in the period from January to May 2008, rose to just over €100.

A few days before the takeover offer was announced, a secondary insider – the former domestic partner of a primary insider – had bought call warrants on Ersol shares worth the equivalent of approximately €85,000 via securities accounts held with various German and foreign banks, using all his assets in the process. He began to sell the call warrants on the day the takeover offer was published, generating a profit of approximately €1 million.

On 13 November 2012, the Regional Court in Wiesbaden sentenced the secondary insider to a suspended jail term of one year and six months and a fine of €5,000. The court discontinued the proceedings against the co-accused primary insider in return for a payment of €20,000 as part of an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure (*Strafprozessordnung* – StPO). The loss of approximately €1 million incurred by the issuer of the warrants as a result of the insider trading was settled by the two defendants during the investigation proceedings. The judgement is final.

**Wilex AG**

On 4 June 2010, dievini Hopp BioTech holding GmbH & Co. KG announced that it had gained control of Wilex AG, a biopharmaceutical company, and that it would submit a mandatory offer to the shareholders of Wilex. As a result, the target company's share price rose by 54%. dievini Hopp BioTech holding GmbH & Co. KG published the mandatory offer on 15 July 2012.

Between 18 and 19 May 2010, the bidder's executive management had decided to acquire shares in Wilex AG in off-exchange transactions and to engage a law firm for this purpose. One of the partners in this law firm was the managing director of dievini Verwaltungsgesellschaft mbH, which in turn managed the business activities of dievini Hopp BioTech holding GmbH & Co. KG. Moreover, as from 21 May 2010, this partner had been appointed to the Supervisory Board of the bidding company.

On 19 May and in the period between 14 and 26 May 2010, the partner sent his brother, who worked for a bank, an SMS telling him to buy Wilex shares. The purchase was also to be made in favour of another brother. The partner gave both brothers another buy recommendation on 30 May 2010.

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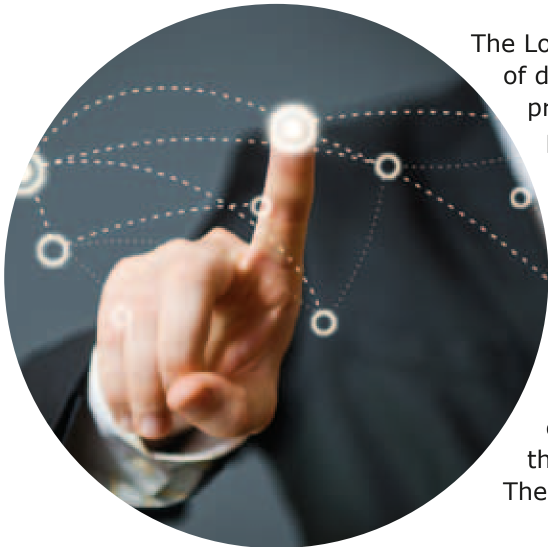
The brother working for the bank subsequently bought a total of 16,439 shares for a total of €70,971.28 via his wife's securities account between 19 and 31 May 2010 and sold them in the period up to 16 July 2010 for €105,056.72. Likewise, between 19 and 26 May 2010, the other brother bought a total of 15,000 shares at a total price of €62,020.84. He sold some of the shares again in the period up to 16 July 2010 for €15,676.50.



The Local Court in Konstanz sentenced the managing director of dievini Verwaltungsgesellschaft mbH, whose law firm had provided advice during the transaction, following summary proceedings to 180 daily units of €500, i.e. a total fine of €90,000. The Court considered it proven that he, as a primary insider, had communicated inside information to his brothers without authorisation to do so. The brother working for the bank was fined €12,000 (120 daily units of €100) for insider trading, also following summary proceedings. In addition, the Court ordered that €34,085 be forfeited as compensation. The Local Court sentenced the third brother following summary proceedings to a total of €9,000, payable in 90 daily units of €100 each. Likewise, the Court ordered that €3,176 be forfeited as compensation. The convictions are final.

**Jagenberg AG**

On 20 December 2002, Rheinmetall Maschinenbau GmbH announced that it intended to submit a voluntary public takeover offer to the shareholders of Jagenberg AG to acquire their shares for a cash payment of €2.20 per share. At the time of the announcement, the bidding company owned 67.5% of the shares in the target company. On 5 December 2002, it had already acquired a block of shares representing 35.8% from another major shareholder of Jagenberg AG, Deutsche Balaton AG, at the same price.

On 7 November 2002, i.e. before the block was sold, two members of the Executive Board and a deputy member of the Supervisory Board of Deutsche Balaton AG had bought 392,769 preferred shares at a price of €1.50 per share. On 3 December 2012, they bought another 453,400 preferred shares at €2.19 each. By selling these shares as part of the block sale on 5 December 2012, they generated a profit of €274,938.30 and €4,534 respectively.

In October 2005, BaFin had already filed a complaint against these primary insiders because of suspected insider trading. On 6 March 2012, the public prosecutor's office in Mannheim discontinued the preliminary investigations against the Deutsche Balaton AG governing body members concerned in return for a payment totalling €147,500 as part of an out-of-court settlement in accordance with section 153a of the StPO. The decision is final.

**Vivacon AG**

On 31 March 2009, the real estate company Vivacon AG published an ad hoc disclosure containing a profit warning. According to

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preliminary, unaudited figures, the company was expecting a consolidated loss of €160 million to €170 million for full-year 2008.

As BaFin established during its analysis, both the Supervisory Board and the Executive Board had been aware already in November 2008 that certain residential property portfolios would have to be liquidated. In January 2009, there were signs of solvency problems at Vivacon AG, which led to the appointment of a new Executive Board.

In the period from December 2008 to February 2009 and again during the week before the ad hoc disclosure, a member of the Executive Board of Vivacon AG sold 364,426 shares worth €945,721.95 in total, thus avoiding a loss totalling €354,409.01. An Executive Board assistant sold another 266,000 shares on behalf of this Executive Board member for a total of €588,026 in February 2009; a loss of €156,417.82 was avoided in this way. In March 2009, shortly before the profit warning, the Executive Board member's wife sold 17,161 and his mother 20,000 Vivacon shares, avoiding losses of €27,845.22 and €6,636.26 respectively. Moreover, the managing director of an investee, whose sole shareholder was a Supervisory Board member of Vivacon AG, sold a total of 353,742 shares from the beginning of January 2009 until shortly before the ad hoc disclosure, thus avoiding a loss of €308,409.08.

The public prosecutor's office in Cologne discontinued the preliminary investigations in accordance with section 153a of the StPO. The Executive Board member had to pay €85,000, the Executive Board assistant €5,000, the wife €3,000 and the mother €6,000 as part of an out-of-court settlement. The decisions are final. The proceedings against the managing director of the investee are still ongoing.

## 2.4 Market manipulation

250 new market manipulation investigations.

In 2012, BaFin investigated 250 cases of suspected market manipulation (previous year: 166). This means that the number of new investigations has more than doubled since 2010 (116). In another 144 cases, public prosecutor's offices or police authorities asked BaFin to provide support in ongoing investigations (previous year: 125).

Important information supplied by trading surveillance units, police and public prosecutor's offices.

More than half of the formal investigations launched – 148 – were based on referrals by the trading surveillance units at the German exchanges. The investigations related to trade-based manipulation activities, such as reference market manipulation, self-dealing, and collusive transactions. A total of 48 investigations were initiated by public prosecutor's offices or police authorities. In many cases, complaints were filed by investors who had followed manipulative recommendations and bought shares. In those cases, the prosecuting authorities then involved asked BaFin to investigate the facts.

In 132 cases, BaFin requested support from foreign supervisory authorities (previous year: 81). Most cases related to customers who had engaged in suspicious trading activities on a German

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exchange via a foreign institution. Foreign authorities made 19 requests to BaFin (previous year: 23).

Market manipulation complaints filed against 229 people.

BaFin found evidence of market manipulation in 121 of the cases it investigated (previous year: 104). It filed complaints against 229 suspects with the public prosecutor's offices (previous year: 211). It discontinued 30 investigations because no evidence of violations was found (previous year: 30). The number of investigations still pending at the end of 2012 was 208 (previous year: 115).

Table 26

## 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 | | |
| 2010 | 116 | 29 | 62 | 109 | 6 | 9 | 68 | 90 |
| 2011 | 166 | 30 | 104 | 211 | 7 | 13 | 111 | 115 |
| **2012** | **250** | **30** | **121** | **229** | **6** | **6** | **127** | **208** |

24 convictions.

In 2012, 24 people were convicted of market manipulation (previous year: 11), 14 of them following a full public trial (previous year: 3) and ten following summary proceedings (previous year: 8). A total of 91 investigations (previous year: 69) were discontinued by the public prosecutors, 19 of them (previous year: 13) as part of out-of-court settlements. BaFin also initiated six new administrative fine proceedings for attempted market manipulation (previous year: 13). In two cases it imposed administrative fines of up to €60,000; six cases were discontinued (previous year: 10). A total of 15 cases were still pending at the end of 2012 (previous year: 17).

Table 27

## 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 |
| 2010 | 73 | 43 | 16 | 0 | 6 | 1 | 1 | 4 | 2 |
| 2011 | 90 | 56 | 13 | 0 | 8 | 3 | 0 | 8 | 2 |
| **2012** | **127** | **74** | **19** | **0** | **10** | **14** | **2** | **6** | **2** |

Information on selected cases is given below.

### Petrohunter Energy Corp. and others

Biggest case of market manipulation and insider trading to date.

In the most comprehensive market manipulation and insider trading proceedings to date, the Munich I Regional Court sentenced a total of four people to jail terms of several years. The convictions were preceded by comprehensive investigations by the Munich I public prosecutor's office and by police headquarters in Munich. The proceedings were triggered by a complaint filed by BaFin in relation to shares in Nascacell AG. BaFin also supported the investigations, for example by providing expert reports and making witness statements during the trial.

On 17 January 2012, the Court initially sentenced the publisher of several market letters to a suspended jail term of two years and a fine of €4,950 for 44 cases of market manipulation. For example, in his market letters, the convicted individual had recommended shares for purchase without disclosing conflicts of interest, which had related to the fact that, among other things, he himself held positions. The court found that he had professionally planned and executed his actions, which had in some cases extended over a long period of time. Extenuating circumstances included his confession and the fact that he had no previous convictions.

On 19 January 2012, the Munich I Regional Court sentenced a former author of the online newsletter of the German Association for the Protection of Investors (Schutzgemeinschaft der Kapitalanleger – SdK) to a suspended jail term of two years and a fine of €9,000 for 92 cases of insider trading. In addition, the Court ordered that €220,000 be forfeited as compensation.

**Forfeiture**

In accordance with section 73 of the German Criminal Code (*Strafgesetzbuch* – StGB), a court can order the forfeiture of assets if the perpetrator has gained an economic benefit as the result of a crime. The benefit is seized in order to eliminate the unlawful enrichment of the perpetrator. If a specific object can no longer be obtained or forfeiture is not possible for some other reason, the perpetrator has to pay compensation (section 73a of the StGB). This is to prevent illegally obtained economic benefits from being sold or consumed to evade forfeiture. The court estimates the scope and value of the compensation (section 73b of the StGB).

The convicted individual had knowledge of non-public information about Nascacell AG. If the information had become public, this could have had a material negative impact on the price of Nascacell's shares. In the knowledge of this inside information, the convicted individual sold shares in Nascacell AG, generating proceeds of approximately €2.5 million.

On 20 March 2012, after court proceedings lasting a total of 17 days, the Munich I Regional Court sentenced two former officers of

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SdK to jail terms of three years and two years and three months respectively for market manipulation. In addition, the Court imposed fines of €27,000 and €36,000 respectively and ordered that €100,000 and €60,000 be forfeited as compensation. The perpetrator whom the court sentenced to a three-year jail term had organised advertising campaigns for shares in various companies and arranged buy recommendations in several market letters. None of the publications alerted the readers clearly and specifically to the fact that the author of the article himself held significant share positions and was acting on behalf of people who likewise held considerable numbers of shares. The Court considered the fact that the convicted individual had provided the original ideas and had managed the operation as exacerbating circumstances. Extenuating circumstances in its view were the convicted individual's full confession and the fact that he had no previous convictions.

The second convicted individual – who was serving on the board of SdK at the time the crimes were committed – had received an anonymous tip-off about a criminal complaint about employees in positions of responsibility at Thielert AG. He subsequently started to speculate on falling Thielert share prices through short selling. On 17 October 2006 and on 7 December 2006, the convicted individual arranged for press releases that advised investors to sell or avoid shares in Thielert AG. In neither publication did he disclose his own positions. In determining the extent of the penalty, the Court specifically took into account that the convicted individual had also misused the platform offered by SdK for his personal ends and had thus helped damage its reputation. His full confession and the fact that the publications did not contain any incorrect information about Thielert AG were regarded as extenuating circumstances by the Court. The judgements of the Munich I Regional Court are final. The investigations against ten other defendants have not yet been completed.

**DB Real Estate AG and others**

In a case that has already gone through several rounds of appeals, a banking professional working for a Landesbank issued offsetting buy and sell orders for his own securities account and that of his domestic partner. The orders led to transactions in shares in DB Real Estate AG, Maternus AG and Westgrund AG between 22 May and 10 December 2008. In all instances, the shares were first sold by one securities account to the other. These sales were then followed immediately by the offsetting transaction; the shares were transferred back to the original securities account via the stock exchange. On 28 April 2009, BaFin reported its suspicion of trading-based market manipulation to the public prosecutors in Stuttgart. Following the end of the preliminary investigations, the Local Court in Stuttgart on 4 December 2009 sentenced the two defendants in summary proceedings to a fine of €49,000 each. In addition, it ordered that €101,498.41 be forfeited by each defendant.

After the defendants had appealed, the Court imposed a fine of €20,000 on 28 October 2012 – this time for a deliberately perpetrated administrative offence in three cases, stating that criminal conviction was not possible because the actual impact of

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the transactions on share prices could not be determined beyond reasonable doubt.

**Market manipulation as an administrative offence**

Violations of the ban on market manipulation are initially an administrative offence (section 39 (1) nos. 1 and 2 of the WpHG and section 39 (2) no. 11 of the WpHG). As the competent administrative authority, BaFin can sanction such violations by imposing fines of up to €1 million. However, if the act constituting the offence has an actual impact on the market price of the financial instrument concerned, the conduct is not merely an administrative offence, but a criminal one (section 38 (2) of the WpHG). It is punishable by a jail term or a criminal fine. The jail term can be up to five years, and there is no maximum in principle to the criminal fine.

The Local Court in Stuttgart acquitted the banking professional's domestic partner. The Court was convinced that the banking professional had issued all buy and sell orders himself and that the domestic partner had been unaware of the transactions. The Court also refrained from ordering any forfeiture; the act had not led to any gains.

Both the convicted banking professional and the public prosecutors in Stuttgart appealed against this judgement to the Higher Regional Court in Stuttgart. This sided with the public prosecutors and referred the case back to the Local Court in Stuttgart. The banking professional's appeal was, however, rejected as unfounded. The opinion of the Local Court in Stuttgart, according to which there had been no impact on prices, contained errors of law. In particular, an actual impact on prices did not require the act constituting the offence to have had an impact on the subsequent development of the price of the financial instrument concerned.

On 28 March 2012, after a new trial, the Local Court in Stuttgart sentenced the banking professional to a fine of €25,200 and ordered €101,498 to be forfeited. The Court upheld that there had been an actual impact on prices, because the offsetting executable orders had directly led to a new determination of the price. The judgement is not yet final.

**Significance of the judgement of the Higher Regional Court in Stuttgart**

The judgement delivered by the Higher Regional Court in Stuttgart fully confirmed BaFin's legal interpretation regarding the actual impact on prices. The Court shares BaFin's opinion that the existence of an actual impact on prices does not depend on the price changing as a result of being caused by the act constituting the offence. Likewise, it is not necessary for the subsequent price development to be influenced by the act constituting the offence. It matters only that the perpetrator's manipulative act is a cause of

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the price in question of the financial instrument. For this to apply, it is sufficient that an influence is exerted on any of the prices determined during ongoing trading. This does not necessarily have to be the closing price of a financial instrument.

In the case of trading-based manipulation, it is therefore sufficient when assuming an actual impact on prices if a price determination is triggered by the orders at issue. The consequence is that collusive transactions with which securities are transferred from the securities account of one market participant to that of another market participant via the stock exchange are not merely administrative offences, but criminal ones. The same applies to constellations in which a market participant performs self-trading by acting on both the buying and the selling side and thus triggers a price determination.

**De Beira Goldfields Inc.**

In February 2006, the shares of De Beira Goldfields Inc. were admitted to the Open Market of Deutsche Börse AG. There was hardly any turnover at first. In May and June 2006, the price was manipulated significantly upwards in a very short period of time. In a total of 62 publications – including market letters, a weekly news magazine as well as advertisements in major national dailies in Germany and abroad – the shares were recommended for purchase on a massive scale. The perpetrators of this concerted push campaign did not disclose that they themselves held considerable amounts of the shares. These publications demonstrably influenced the share price, which climbed from an initial price of €1.90 in the middle of May 2006 to a high of €18.50 in the middle of June 2006. At the same time, the trading volume increased significantly. From the middle of 2006 onwards, both turnover and share price declined again, until the shares were left without any significant trading volume and the share price trended towards zero. The manipulation generated gross proceeds totalling approximately €38.4 million.

BaFin examined the case, made comprehensive requests for assistance to foreign supervisory authorities and uncovered the perpetrators' positions and sales, which had been concealed across various companies. Moreover, BaFin employees gave evidence as witnesses or experts at the trial.

On 12 October 2012, the Regional Court in Stuttgart sentenced a Canadian national to a jail term of three years and two months, a market letter publisher with a similar previous conviction to a suspended jail term of one year and ten months and the former editor of a news magazine to a suspended jail term of one year and nine months for collusive market manipulation. In addition, the market letter publisher and the former editor have to pay €350,000 and €200,000 respectively to charitable organisations as conditions of their probation. Another suspected principal perpetrator, who is an Austrian resident, had also been charged. However, since market manipulation is not considered a criminal office in Austria, the accused was not extradited to Germany and could not be tried. The judgement is not yet final.

**Alcatel-Lucent bearer bond**

In July 2012, the defendant – a trader employed by a securities trading bank – issued sell orders in two cases on the Frankfurt and Stuttgart Stock Exchanges that were merely designed to execute offsetting orders on the Tradegate Exchange.

By placing the phantom orders on the Frankfurt and Stuttgart Stock Exchanges, the trader succeeded in manipulating the prices quoted on the Tradegate Exchange in his favour and thus acquiring securities at a lower price. The Tradegate Exchange ultimately cancelled the securities transactions.

In September 2012, BaFin reported the case to the public prosecutor's office in Frankfurt am Main, which discontinued the proceedings on 4 January 2013 in return for a payment of €5,450 as part of an out-of-court settlement in accordance with section 153a of the StPO.

**HSBC T+B 09/10 DBK reverse convertible bond**

In his capacity as senior asset manager, a Landesbank employee had power of disposal over 12 customer securities accounts. This meant that he could execute transactions for his customers independently and without specific instructions. On 22, 28 and 30 December 2009, the asset manager issued 17 coordinated offsetting buy and sell orders for these customer securities accounts in relation to the HSBC T+B 09/10 DBK reverse convertible bond. To ensure the offsetting execution of the orders, he issued the orders in quick succession and specified trading limits and notional amounts that could immediately be executed against each other. As a result, prices were determined on the Baden-Württemberg Stock Exchange in eight cases that would not have been determined if the offsetting orders had not been issued.

The trading surveillance office of the Baden-Württemberg Stock Exchange informed BaFin of the asset manager's unusual trading behaviour. BaFin filed a complaint with the public prosecutors in Stuttgart. On 30 May 2012, the Local Court in Stuttgart sentenced the defendant by way of summary proceedings to a fine of €14,400. The decision is not yet final.

**Resprop Immobilien AG**

The trading surveillance office of the Frankfurt Stock Exchange informed BaFin in February 2009 of unusual transactions in shares in Resprop Immobilien AG. During the investigation launched in response, BaFin identified a large number of corresponding offsetting buy and sell orders for the period from August 2008 to September 2009. These were aimed at generating exchange transactions in the otherwise illiquid financial instrument on the Frankfurt and Stuttgart Stock Exchanges and hence at influencing price formation. The numbers, order limits and system entry times

of the buy and sell orders had been coordinated in such a way that they could be executed against each other immediately. This allowed the perpetrators to generate turnover by performing a total of 335 manipulative exchange transactions. To conceal their activities, they traded both via their own securities accounts at different banks and as authorised agents for various companies they managed or with which they had business relations. At the same time, the perpetrators had close personnel connections at the level of the Executive Board, Supervisory Board and major shareholders of Resprop Immobilien AG.

The perpetrators' aim with the manipulative transactions was to maximise the market value and increase the liquidity of Resprop shares. Almost the entire trading volume in the period under investigation was attributable to the group of perpetrators.

On 7 May 2012, the Regional Court in Düsseldorf sentenced the perpetrators to fines of €9,900, €5,400, €4,500, €6,600 and €1,100. The court discontinued the proceedings against one defendant belonging to the group of perpetrators in return for a payment of €500 as part of an out-of-court settlement. In addition, it acquitted one other defendant because it was not possible to prove his involvement in the acts. The decisions are final.

## 2.5 Ad hoc disclosures and directors' dealings

**Ad hoc disclosures**

1,818 ad hoc disclosures.

In 2012, listed companies published a total of 1,818 ad hoc disclosures (previous year: 2,002). BaFin examined whether these had been published in time and whether their content was consistent. In the process, it established whether the disclosures had notified the financial market fully and accurately of the inside information. BaFin launched 86 investigations and discontinued 89 cases, some of them relating to previous years. It pursued 23 investigations in administrative fine proceedings.

Companies made increasing use of the option to seek exemption from publication requirements (244, previous year: 212).

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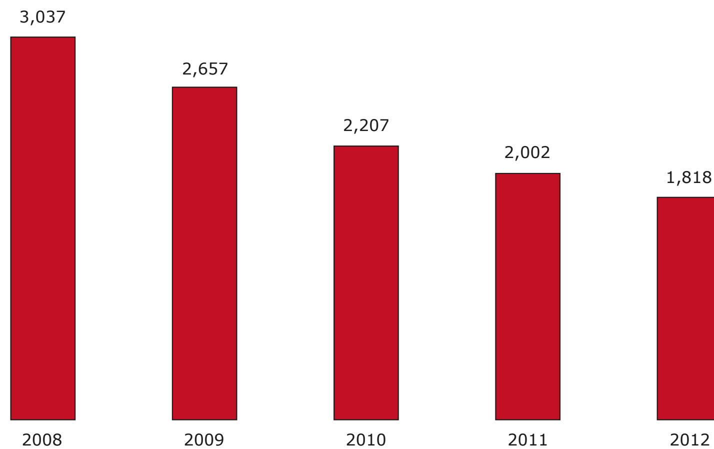
Figure 22
**Ad hoc disclosures**




Continued problems distinguishing ad hoc from regular disclosures.

In 2012, BaFin focused on investigating the publication of press releases instead of ad hoc disclosures. Inside information must always be published as an ad hoc disclosure; its publication in a press release amounts to failure to publish an ad hoc disclosure. BaFin launched an investigation in 19 cases. It discontinued seven cases; two investigations are still ongoing. BaFin is pursuing ten cases further as administrative fine proceedings.

In addition, BaFin observed in 2012 that companies are continuing to publish ad hoc disclosures containing their financial results immediately before the stock exchange opens and announcing at the same time that their annual report is available online for downloading. In doing so, they disregard the immediacy rule that applies to the publication of inside information. In the cases that BaFin investigated it did not find sufficient evidence of misconduct. In 2013, BaFin will therefore focus its checks on the frequent early-morning publications made before the stock exchange opens and will write to the companies concerned.

**ECJ ruling on multi-stage decision processes**

On 28 June 2012, the European Court of Justice (ECJ) ruled that the intermediate steps of a decision process may already constitute inside information,[66] confirming BaFin's interpretation of the law.

The litigation before the Federal Court of Justice (Bundesgerichtshof – BGH) that had led to the ruling dealt with the question of whether Daimler AG had delayed disclosure of information about the early departure of its CEO, Jürgen Schrempp. The latter had already discussed his intention with the Chairman of the Supervisory Board on 17 May 2005; after that meeting, other members of the Supervisory and Management Boards were informed. However, the company only published the Supervisory Board's decision on 28 July 2005. The BGH had to clarify whether Daimler AG would have had to publish Jürgen Schrempp's

[66] Case ref.: C-19/11.

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declaration of intent as an intermediate step towards his actual departure.

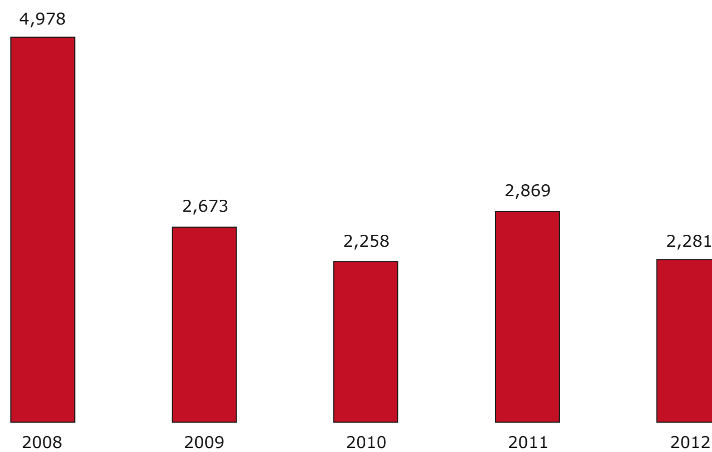
Following submission by the BGH, the ECJ examined whether individual intermediate steps in a protracted process may also be "precise information" and therefore subject to publication requirements. Moreover, it was not clear whether "sufficient likelihood" can be measured in terms of the expected effect on the share price. In the opinion of the ECJ, the individual intermediate steps connected with the occurrence of an event may already be "precise information". The relevant criterion for "sufficient likelihood" is that the underlying event exists or has occurred or may be expected to do so. In this context, whether inside information exists is not to be determined solely on the basis of the (expected) effect on the share price. The ECJ referred the case back to the BGH for a final ruling.

## Directors' dealings

Significant decline in directors' dealings.

The members of executive and supervisory boards of listed companies and their related parties reported a total of 2,282 securities transactions for their own account in 2012 (previous year: 2,869). The number of reported transactions had almost halved between 2008 and 2009, and this trend continued.

Figure 23
**Directors' dealings**



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## 2.6 Voting rights and duties to provide information to security holders

### Voting rights

Significant rise in number of notifications relating to financial instruments.

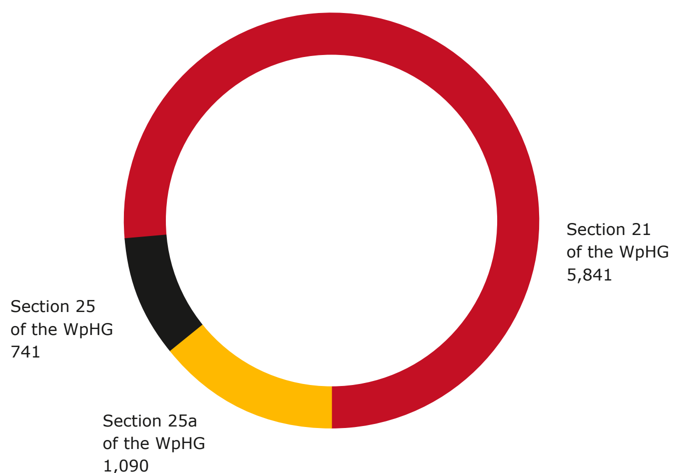
In 2012, BaFin received 5,841 voting rights notifications (previous year: 5,929). The number of notifications relating to financial instruments in accordance with section 25 of the WpHG increased fivefold to 741 (previous year: 135). These can include repurchase agreements or call options with physical settlement, for example. The pronounced increase is due to the extended reporting requirements that have been in force since 1 February 2012. For example, rights of redemption under securities loans are now also included.

Also new since February 2012 is the reporting requirement under section 25a of the WpHG for financial and other instruments that allow their holders or a third party to acquire shares that carry voting rights and have already been issued. BaFin received 1,090 such notifications and 302 notifications of existing holdings.

Since 30 June 2012, a requirement has also been in force in accordance with section 2b of the WpHG to report the choice of home country for existing holdings of voting rights. The choice of home country is now made exclusively by publishing the choice and recording it in the company register. The annual document under section 10 of the WpPG is no longer relevant; this provision has been repealed. BaFin received 11 notifications of the choice of home country for existing holdings of voting rights.

BaFin received a total of around 8,000 notifications in accordance with sections 21, 25, 25a and 30c of the WpHG and monitored all publications.

Figure 24
**Voting rights notifications**



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795 authorised issuers.

The number of companies admitted to trading on the regulated market declined to 795 (previous year: 859).

**Duties to provide information to security holders**

In 2012, issuers of listed securities reported a total of 300 planned changes in the legal basis of their activities (previous year: 355). When convening their annual general meeting, issuers also have to publish for example the attendance rights, the agenda and the total number of shares and voting rights. Moreover, a large number of resolutions and events in connection with the annual general meeting are subject to publication requirements. Issuers notified BaFin of changes in rights attached to securities admitted to trading, bond issuance and the publication of material information in third countries in 2,614 cases (previous year: 2,983).

# 3 Prospectuses

## 3.1 Securities prospectuses

Number of approvals similar to previous year.

In 2012, BaFin approved 3,043 securities prospectuses, registration documents and supplements. It refused to grant approval in four cases. The number of cases was thus similar to the previous year (3,039). Because of the amendments to securities prospectus legislation as from 1 July 2012, an especially large number of issuers submitted their prospectuses to BaFin in May and June.

Table 28
**Number of approvals in 2012 and 2011**

| Product | 2012 | 2011 |
|---|---|---|
| Equities/IPOs/capital increases | 75 | 69 |
| Derivatives | 150 | 140 |
| Bonds | 187 | 214 |
| Registration documents | 28 | 31 |
| Supplements | 2,603 | 2,585 |
| **Total** | **3,043** | **3,039** |

The number of prospectuses approved for debt securities declined to 187 (previous year: 214); by contrast, it increased slightly for derivative products, rising from 140 to 150. The number of prospectuses for initial public offerings, admissions to the regulated market and capital increases was relatively stable at 75 (previous year: 69). A total of 2,603 supplements were approved; this number was also only slightly higher than in the previous year (2,585), remaining flat at a high level. A total of 28 issuers used the option of submitting a separate registration document (previous year: 31).

Issues at a new high.

The number of issues rose again in 2012, reaching a new high of 1,945,201 prospectuses, final terms and supplements based on the

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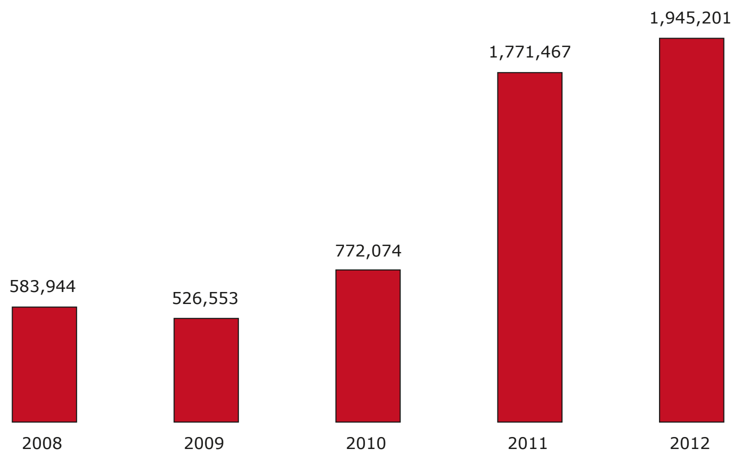
old legislation (previous year: 1,771,467). The renewed increase is attributable to the continued growth in the number of final terms, with issuers submitting 1,945,068 (previous year: 1,771,315). By contrast, the number of supplements governed by the old Sales Prospectus Act *(Verkaufsprospektgesetz)* declined continuously to four until it was repealed on 1 June 2012 (previous year: eight).

Figure 25
**Total issue volume**




European passport still popular with issuers.

The number of prospectuses and supplements notified for EU countries outside Germany rose to 5,065 in 2012 (previous year: 4,602). Most of the notifications were again for Austria (2,030) and Luxembourg (1,195). Issuers from EU member states obtained notifications for the German market for 1,504 prospectuses and supplements (previous year: 1,747). Over half (778) of the notifications came from Luxembourg.

Table 29
**Notifications issued and received**

| | Notifications issued | Notifications received |
|---|---|---|
| Austria | 2,030 | 72 |
| Belgium | 116 | 9 |
| Denmark | 76 | 1 |
| Finland | 137 | - |
| France | 215 | 61 |
| Ireland | 34 | 57 |
| Italy | 239 | 12 |
| Liechtenstein | 151 | - |
| Luxembourg | 1,195 | 778 |
| Netherlands | 151 | 181 |
| Norway | 144 | - |
| Poland | 66 | - |
| Spain | 114 | - |
| Sweden | 172 | 2 |
| United Kingdom | 141 | 331 |
| Other | 84 | - |
| **Total** | **5,065** | **1,504** |

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## 3.2 Non-securities investment prospectuses

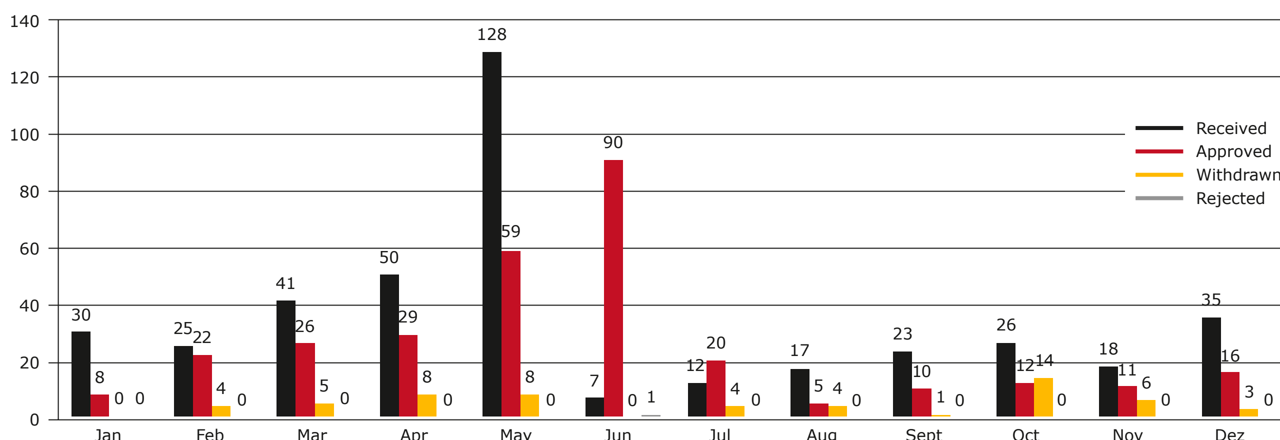
Consistency checks extended to non-securities investments.

Since 1 June 2012, BaFin has also examined non-securities investment prospectuses for consistency. The Capital Investment Act *(Vermögensanlagengesetz)* extended the consistency check, which had previously only applied to securities prospectuses. In addition, sales prospectuses have to contain a large number of new minimum disclosures, for example on previous convictions of the persons involved and information on each level in the case of multi-level target investments. The Key Investor Information Document *(Vermögensanlagen-Informationsblatt* – VIB) now also provides a kind of package insert, the aim of which is to make it easier for investors to compare individual non-securities investments.

Slight decline in non-securities investments.

Demand for non-securities investments declined slightly. A total of 412 sales prospectuses for non-securities investments were submitted to BaFin in 2012 (previous year: 456). BaFin approved publication in 308 cases (previous year: 342) and rejected one offering (previous year: one). Providers withdrew their applications in 57 cases (previous year: 62). As a result of the introduction of the Capital Investment Act, which raised the benchmark for checking, many prospectuses were submitted on the basis of the old legislation, especially in May 2012, when 128 prospectuses were received (previous year: 39).

Figure 26
**Prospectuses received, approved, withdrawn and rejected**




Real estate and renewable energies still in demand.

There was renewed particularly high demand for real estate funds, which accounted for 31% of target investments in 2012 (previous year: 26%). 26% of the funds invested in domestic properties (previous year: 22%) and 5% in foreign properties (previous year: 4%). Renewable energy funds also continued to enjoy popularity, accounting for approximately 25% (previous year: 24%). This figure includes wind power (16%, previous year: 10%) and solar power plants (8%, previous year: 12%). The proportion accounted for by ship funds declined further to 4% (previous year: 8%). Conversely, mixed funds were on the rise, accounting for a share of 10% (2011: 5%).

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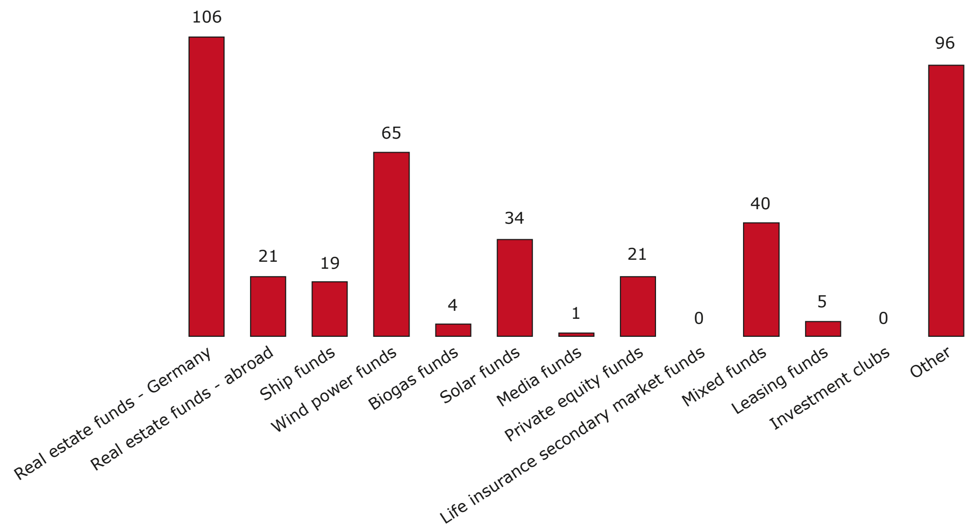
Figure 27
**Prospectuses by target investment**




Supplements on the rise again.

The number of supplements started to rise again, reaching 420 after 362 in the previous year. The increase is primarily due to longer placement periods and the higher proportion of blind pools. Blind pools are funds whose target investments are not yet certain at the time the prospectus is compiled. Four supplements were submitted under the Capital Investment Act.

# 4 Corporate takeovers

Takeover Directive: no major reform, but guidelines for acting in concert.

In June 2012, the European Commission published its report[67] on the Takeover Directive. The report draws on a study on the application of the Takeover Directive conducted on behalf of the Commission. In the report, the Commission comes to the conclusion that, on the whole, the Takeover Directive is working satisfactorily. It singled out only a few points of detail that required improvement, for example the concept of acting in concert, i.e. coordinated shareholder action in exercising voting rights. The rules in this regard play a role in calculating shareholders' percentages of voting rights and impact the determination of whether a shareholder has reached the control threshold for shares in a target company. In Germany, section 30 (2) of the German Securities Acquisition and Takeover Act *(Wertpapiererwerbs- und Übernahmegesetz* – WpÜG) determines the point at which voting rights are attributed. Since the rules for acting in concert differ significantly in the individual member states of the European Union, the Commission believes there is a risk that it will not be sufficiently clear to international investors which rules have to be applied. These investors could opt not to coordinate how they exercise their voting rights for fear

[67] COM 2012/0347.

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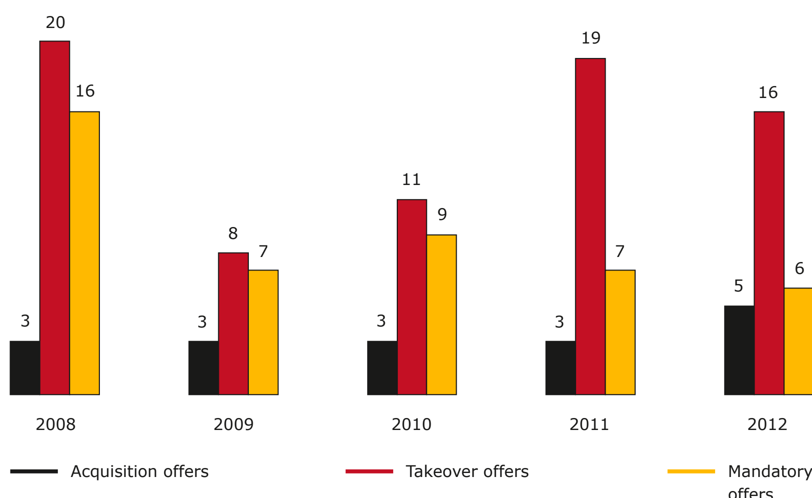
of inadvertently triggering a mandatory bid. This could prevent them from actively exercising their rights as shareholders. The Commission is planning to issue guidelines as an incentive not to exercise such caution. The Takeover Bids Network (TBN) has established a working group to this end. The TBN, which operates under the umbrella of ESMA, is a network of institutions responsible for ensuring compliance with the Takeover Directive in the respective member states. The working group is tasked with identifying behaviours with which shareholders can coordinate the way they exercise their rights vis-à-vis a target company without triggering an obligation to launch a mandatory bid.

### Offer procedures

In 2012, BaFin examined a total of 29 offer documents and approved their publication in 27 cases (previous year: 29). It rejected two offerings.

Figure 28
**Offer procedures**




Acquisitions in the public spotlight.

The takeover offers made by FPS Beteiligungs AG to RHÖN-KLINIKUM Aktiengesellschaft's shareholders and by Andrem Power S.C.A. to 3W Power S.A.'s shareholders met with particularly keen public interest in 2012.

### Takeover offer by FPS Beteiligungs AG to RHÖN-KLINIKUM Aktiengesellschaft's shareholders

A particular focus of attention was on the takeover offer made by FPS Beteiligungs AG to the shareholders of RHÖN-KLINIKUM Aktiengesellschaft (RHÖN-KLINIKUM), which had a transaction volume of more than €3 billion.

The bidder, a company of the Fresenius Group, published its decision to submit the offer on 26 April 2012. The decision was based on plans by the bidder and the Fresenius Group to merge

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RHÖN-KLINIKUM with the Group's own hospital company, Fresenius Helios, within the Fresenius Group.

The Chairman of the Supervisory Board of RHÖN-KLINIKUM, Eugen Münch, and his wife, Ingeborg Münch, had given an undertaking to the bidder that, during the acceptance period, they would accept the offer in relation to the approximately 12.45% of the shares and voting rights that they held in RHÖN-KLINIKUM. The offer was subject to the condition of a minimum acceptance threshold of 90% plus one RHÖN-KLINIKUM share. This condition was due to the (rare) constellation that the Articles of Association of RHÖN-KLINIKUM do not require, as is usual, a simple majority of the votes for passing resolutions at annual general meetings, but a majority of 90% of the share capital represented at the time the resolution is passed. Although section 133 (1) of the German Stock Corporation Act *(Aktiengesetz* – AktG) specifies the principle of a simple majority of the votes, it also allows larger majorities or other requirements to be provided for in the articles of association, for example. The acceptance period was set for the period from 18 May to 27 June 2012.

Apart from the agreement with Mr and Mrs Münch, there were no other tender agreements. This meant that a high acceptance ratio was needed to achieve the approximately 77.55% outstanding. To this end, the bidder offered a premium of €7.81 (approximately 53.2%) over and above the statutory minimum price of €14.69, but declared that it would not exceed the consideration of €22.50 it was offering.

At the end of the acceptance period, on 27 June 2012, RHÖN-KLINIKUM published a voting rights notification from Asklepios Kliniken Verwaltungsgesellschaft mbH. According to this notification, this company belonging to the Asklepios Group, which also operates in the hospital sector, had built up a share of 5.01% of the voting rights in RHÖN-KLINIKUM.

The additional purchases made by a company belonging to the Fresenius Group shortly before the acceptance period expired did not prevent the failure of the takeover. According to the final notification, the acceptance ratio was only approximately 84.32%, thus falling short of the minimum acceptance threshold. Preventing a takeover by building up an interest cannot be objected to under takeover law.

### Takeover offer by Andrem Power S.C.A. to 3W Power S.A.'s shareholders

On 22 February 2012, Andrem Power S.C.A. published its decision to submit an offer to 3W Power S.A.'s shareholders. Although the target company is domiciled in Luxembourg, BaFin was responsible for examining the offer document, because the shares in 3W Power S.A. are only admitted to trading in Germany.

BaFin prohibited the publication of the offer document on 5 April 2012, primarily because the offer contained conditions that were inadmissible.

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**Offer conditions**

In principle, bidders can make their offers contingent on certain conditions being fulfilled or not being fulfilled (lack of fulfilment), i.e. on unknown future events. Depending on the nature of the offer document, the offer becomes invalid if the condition is fulfilled or not fulfilled. However, conditions whose fulfilment or lack of fulfilment can only be brought about by the bidder itself or by certain persons or enterprises associated with it are inadmissible (section 18 of the WpÜG). The condition that a resolution of the bidder's meeting of shareholders be obtained is not covered by this prohibition (section 25 of the WpÜG).

Andrem Power S.C.A.'s offer conditions could have caused the offer to become invalid even before the offer document was published. BaFin cannot allow these types of conditions, which could lead to the publication of a factually incorrect offer document, because once non-fulfilment of a condition has occurred, the offer lapses and the shareholders can no longer accept it. If the offer document were to be published nevertheless, it would contain the false information that the shareholders of the target company could accept the offer. Another factor is that the bidder would otherwise have the impermissible opportunity to evade its obligations under takeover law without the offer having been prohibited. It would merely have to include in the offer a condition whose non-fulfilment had already occurred even before the offer document was published. It is immaterial in this context whether the bidder is aware of the condition having been fulfilled or not been fulfilled.

**Exemption procedures**

In 2012, BaFin received 152 applications for exemption or non-consideration (previous year: 56). In 92 cases, holders of voting rights requested that voting rights should not be considered in accordance with section 36 of the WpÜG (previous year: 17), while 60 applications for exemption were made in accordance with section 37 of the WpÜG (previous year: 39). BaFin approved 89 applications. Nineteen applications were withdrawn and 44 were still being processed at the end of 2012.

# 5 Financial reporting enforcement

## 5.1 Monitoring of financial reporting

825 companies subject to financial reporting enforcement.

As at 1 July 2012, 825 companies from 20 countries (previous year: 873 companies from 22 countries) were subject to the two-

Table 30
**Companies subject to financial reporting enforcement by country**
As at 1 July 2012

| Country | Number |
|---|---|
| Germany | 689 |
| Jersey, Channel Islands | 27 |
| United States of America | 21 |
| Netherlands | 20 |
| Austria | 16 |
| Luxembourg | 10 |
| United Kingdom | 9 |
| Switzerland | 7 |
| Ireland | 6 |
| Israel | 4 |
| France | 3 |
| Japan | 3 |
| Italy | 2 |
| Spain | 2 |
| Cayman Islands | 1 |
| Finland | 1 |
| Guernsey, Channel Islands | 1 |
| Isle of Man | 1 |
| Canada | 1 |
| Sweden | 1 |
| **Total** | **825** |

tier enforcement procedure performed by BaFin and the Financial Reporting Enforcement Panel (FREP).

The FREP completed a total of 113 examinations in 2012 (previous year: 110), of which 110 were sampling examinations. BaFin itself completed 28 financial reporting enforcement procedures (previous year: 32), with an error publication order being issued in 23 cases.

The following table gives an overview of the cases completed since the Financial Reporting Enforcement Act *(Bilanzkontrollgesetz)* entered into force in 2005.

Table 31
**BaFin enforcement procedures from July 2005 to December 2012**

| | Error findings: yes | Error findings: no | Error publication: yes | Error publication: no |
|---|---|---|---|---|
| Company accepts FREP's findings | 145 | | 142 | 3 |
| | (14) | | (14) | (0) |
| Company does not accept FREP's findings | 34 | 7 | 32 | 2 |
| | (7) | (1) | (7) | (0) |
| Company refuses to cooperate with FREP | 4 | 10 | 4 | 0 |
| | (2) | (4) | (2) | (0) |
| BaFin has considerable doubts as to the accuracy of the FREP examination findings/ procedure | 3 | 0 | 2 | 1 |
| | (0) | (0) | (0) | (0) |
| BaFin takes over the examination (banks, insurance undertakings) | 0 | 0 | 0 | 0 |
| | (0) | (0) | (0) | (0) |
| **Total** | **186** | **17** | **180** | **6** |
| | **(23)** | **(5)** | **(23)** | **(0)** |

In brackets: procedures in 2012.

The FREP had previously identified errors in consultation with the relevant companies in 14 of the 28 cases. The remaining 14 cases were based on error identification procedures performed by BaFin, nine of which concluded with errors being identified. The 14 error identification procedures performed by BaFin were based on eight procedures performed by the FREP in which the companies concerned had not accepted the errors identified by the FREP. BaFin identified errors at the end of seven of these procedures. In one case the examination was unnecessary because there was no public interest given the company's pending delisting. BaFin closed two of the six other procedures in which the companies concerned had refused to cooperate with the FREP with errors being identified. It completed the remaining four procedures without finding any errors. BaFin ordered the errors identified in completed procedures to be published in all cases. The procedures performed by BaFin related to a wide range of accounting issues, from questions of measurement (equity investments, receivables, inventories) through notes disclosures and management board remuneration down to risk reporting in the management report. Three cases were still pending at BaFin at the end of 2012.

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**Court rulings on the disclosure of management board remuneration**

The Higher Regional Court in Frankfurt am Main ruled on 31 May 2012[68] that the total management board remuneration has to be disclosed in the annual and consolidated financial statements even if the board only has one member. On 14 February 2012, BaFin found that the financial reports of a company were incorrect in this respect and ordered the error to be published. The company objected to both the finding and the order and applied to the Higher Regional Court for an order of suspensive effect. In the summary proceedings, the company reported that the exchange listing had meanwhile been revoked as from 31 May 2012. BaFin rejected both objections as unfounded.

The Court confirmed this interpretation of the law and also rejected the applications for an order of suspensive effect as unfounded. It ruled that the total remuneration of a sole management board member has to be disclosed in the notes to the annual and consolidated financial statements even if a resolution has been passed in accordance with section 286 (5) of the Commercial Code *(Handelsgesetzbuch* – HGB). Such a resolution only makes it possible not to publish separately the remuneration of the individual management board members. The disclosure of the total remuneration cannot be omitted even in accordance with section 286 (4) of the HGB. The exemption from having to publish the total remuneration if the remuneration of a member of a governing body can be determined on the basis of the total remuneration of a governing body specifically only applies to companies that are not listed on a stock exchange. Moreover, delisting after an error has been identified and publication has been ordered does not lead to the termination of the enforcement procedure and does not render unlawful the administrative acts already performed. Even if a company were to delist before the FREP's or BaFin's examination procedure was completed, the continuation of the procedure could be considered in exceptional circumstances, for example if the procedure is at an advanced stage and the capital market continues to have an interest in the information. Equally, public interest in the publication of the error does not cease to exist as a result of the financial statements objected to being given a qualified audit opinion precisely because the information was not disclosed. The audit opinion only permits the conclusion that the management and supervisory boards on the one hand and the auditors on the other do not agree about the legality of the financial reporting. Only the publication of the error identified makes it clear for the capital market that there had in fact been an error in the financial reporting. The company has since met its obligations.

## 5.2 Publication of financial reports

Positive interim assessment of financial reporting.

The rules on financial reporting have now been in place for over six years, and BaFin can draw a positive conclusion to date.

[68] Case ref.: WpÜG 2/12 and 3/12.

Initially, BaFin had identified a high proportion of issuers that had consistently failed to meet their obligations. It has performed over 100 administrative procedures since the new rules entered into force in order to ensure the financial reports were published. In addition, it initiated over 200 administrative offence procedures to sanction violations and to warn issuers of their obligations. Companies now normally meet their publication requirements.

Audit focus on Internet publication.

Issuers have to make their annual and half-yearly financial reports as well as interim management statements available online. In 2012, BaFin examined in approximately 2,200 cases whether the financial reports were published within the statutory periods (previous year: 2,400). In 45 cases, BaFin did not find any financial report on the company's website (previous year: 53 cases) and initiated administrative fine proceedings. In some cases, no website with any financial information could be identified at all. In addition, BaFin launched eight administrative procedures in 2012 to enforce the financial reporting requirements (previous year: six). Twelve cases were still pending from 2011. BaFin closed 11 administrative procedures (previous year: 14) after the issuers subsequently met their obligations. In three cases it had to threaten coercive fines; these were ultimately imposed in two cases. In one of these cases, the issuer then met its obligations. In the other case, the issuer paid the imposed coercive fines, but without meeting its obligations. BaFin therefore threatened further coercive fines of €28,500, after which the issuer met its financial reporting requirements. Nine administrative procedures were still pending at the end of 2012.

# 6 Supervision of the investment business

Although the continuing financial crisis continued to impact the German investment market in 2012, market participants managed to stabilise or slightly improve their financial results. Although turnover recovered slightly, it remained flat year-on-year overall.

Six-monthly trend scouting an additional supervisory tool.

In 2012, BaFin performed 54 supervisory visits and annual interviews on site (previous year: 48). In addition, it accompanied 25 audits; for the first time these included not only special audits, but also statutory audits at companies and custodian banks. BaFin also launched trend scouting activities in 2012 as part of its investment business supervision. This entails surveying the companies it supervises every six months on trends that they believe could have a major impact on the fund sector in the near future. The aim is to detect risks, for example from investment strategies, as early as possible. Based on the initial results, BaFin will increase its focus in 2013 on investments by mutual funds and special funds in emerging markets.

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## 6.1 Asset management companies and custodian banks

In 2012, BaFin granted three German asset management companies (previous year: 5) licences for the first time to manage investment funds. Two asset management companies returned their licences. This meant that, at the end of the year, 78 asset management companies were licensed in accordance with the InvG (previous year: 77). Three asset management companies applied for the scope of their licences to be extended. A total of 17 companies established a branch in another EU member state or offered cross-border services. At the same time, 15 companies from other EU countries notified BaFin that they had established a branch or started providing cross-border services in Germany.

2,168 mutual funds and 3,901 special funds.

At the end of 2012, asset management companies managed a total of 6,069 funds (previous year: 5,892) comprising assets worth €1,309 billion (previous year: €1,139 billion). Of this figure, 2,168 (previous year: 2,147) were mutual funds with assets of €333.9 billion (previous year: €314.9 billion) and 3,901 (previous year: 3,745) were special funds with assets of €974.7 billion (previous year: €823.8 billion). Of the mutual funds, 262 were organised as funds of funds (previous year: 260), while there were 72 funds of funds among the special funds (previous year: 70).

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 €89.9 billion (previous year: €45.2 billion). (Gross) cash inflows totalled €280.3 billion (previous year: €231.3 billion), of which €84.6 billion was attributable to mutual funds (previous year: €101.4 billion) and €195.7 billion to special funds (previous year: €129.9 billion).

In addition to mutual funds and special funds, there were 22 investment stock corporations with variable capital (previous year: 16), which had launched a total of 105 sub-pools of assets *(Teilgesellschaftsvermögen)*. Total assets under management at these investment stock corporations and sub-pools of assets amounted to approximately €22.9 billion (previous year: €15 billion).

### Risk-based supervision

Table 32
**Risk classification of asset management companies**

| Asset management companies | | Quality | | | | |
|---|---|---|---|---|---|---|
| | | A | B | C | D | Total |
| Impact | High | 29 | 4 | 1 | 0 | 34 |
| | Medium | 13 | 4 | 0 | 0 | 17 |
| | Low | 14 | 9 | 0 | 0 | 23 |
| | Total | 56 | 17 | 1 | 0 | 74 |

Three asset management companies only received licenses in 2012 and no classification has yet been performed. Final classification is still pending for a further company.

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Table 33
**Risk classification of custodian banks**

| Custodian banks | | Quality | | | | |
|---|---|---|---|---|---|---|
| | | A | B | C | D | Total |
| Impact | High | 9 | 4 | 2 | 0 | 15 |
| | Medium | 7 | 5 | 5 | 0 | 17 |
| | Low | 8 | 2 | 1 | 0 | 11 |
| | Total | 24 | 11 | 8 | 0 | 43 |

Classifications for another six institutions are still pending, because their financial year differs from the calendar year and the reports to be analysed were not yet available.

## 6.2 Investment funds

Increase in the number of new approvals.

BaFin approved 132 new mutual funds. Although this suggests that the market as a whole seems to have stabilised somewhat (previous year: 88), it failed to attain the levels of earlier years (2010: 153, 2009: 147). A total of 56 mutual funds were merged. The management rights for 16 mutual funds were transferred to other asset management companies. In 50 cases, companies terminated their management of mutual funds and liquidated the funds in question.

Focus on portfolio structure and liquidity situation of funds of funds.

In 2012, BaFin predominantly requested information on the portfolio structure and liquidity situation of funds of funds holding units in real estate funds as target funds. BaFin's supervision of funds of funds continued to focus heavily on the ongoing crisis at open-ended real estate funds, which was (one of) the reason(s) for the closure in 2011 of three funds of funds with an investment focus on real estate funds. Some of the funds of funds closed in the previous year are currently being liquidated; at one of the funds, unit redemption is still suspended. In 2012, another eight funds of funds had to suspend the redemption of their units. This was due to the continuing strained financial situation at the funds, because many assets, especially units in suspended open-ended real estate funds, cannot be liquidated.

Large variations in results of operations persist.

Most asset management companies reported higher net fee and commission income and therefore improved results of operations in 2012. Thus 37 asset management companies achieved an increase in net fee and commission income, seven of them by more than 20%. By contrast, net fee and commission income declined at 34 companies; in nine cases the losses exceeded 20% in some areas.

## 6.3 Real estate funds

More mutual and special real estate funds, ...

In 2012, the number of open-ended mutual real estate funds *(Immobilien-Publikumsfonds)* increased to 55 (previous year: 48); the aggregate fund volume was €84 billion at the end of the year (previous year: €86 billion). The funds were managed by 21 asset management companies. BaFin approved 11 mutual real estate funds, ten of which were actually launched. Three open-ended

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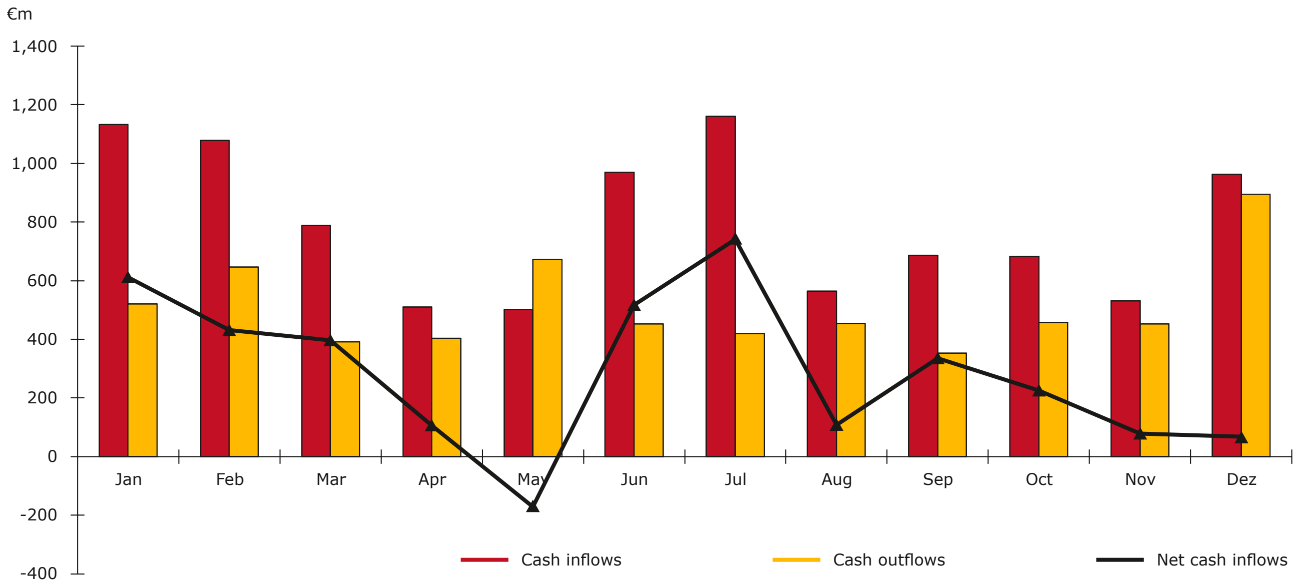
mutual real estate funds were reorganised as special real estate funds.

The number of special real estate funds *(Immobilien-Spezialfonds)* launched also increased. The asset management companies managed 358 special real estate funds with an aggregate net asset value of €36.6 billion (previous year: 176 funds with €32.8 billion).

Figure 29

**Fund flows at mutual real estate funds**




In the year under review, BaFin granted three authorisations to conduct the real estate fund business in three cases (previous year: 4). The trend towards establishing new asset management companies and focusing their business strategies on institutional investors continued in 2012. One licence was returned.

… but also more suspensions and terminations.

In 2012, some asset management companies again had to initially temporarily suspend unit redemptions for their open-ended mutual real estate funds. Following notice of termination, further mutual real estate funds are now being liquidated. Thus another seven funds were unable to reopen permanently within the maximum statutory period of two years. This means that, at the end of 2012, 14 funds with an aggregate fund volume of approximately €20 billion were being liquidated (previous year: 7). The asset management companies terminated their management of the mutual real estate funds, giving notice periods of three and in individual cases five years. Unit redemptions were temporarily suspended at another four mutual real estate funds with an aggregate fund volume of approximately €1.7 billion. This means that, at the end of 2012, 18 out of a total of 55 open-ended real estate funds had suspended unit redemptions or were being liquidated (previous year: 14). In total, over 25% of the money invested could therefore not be accessed by unit holders.

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## 6.4 Hedge funds

Number of German hedge funds declines again.

At the end of 2012, there were a total of 27 single hedge funds (previous year: 28), including seven special funds, and four funds of hedge funds (previous year: 8). This meant that the decline in the number of hedge funds licensed under German law continued. Seven single hedge funds were liquidated (previous year: 9) and six new funds were authorised (previous year: 3).

BaFin performed routine supervisory visits and annual interviews at companies authorised to establish single hedge funds and funds of hedge funds. Their focus was mainly on investment strategies and the implementation of suitable risk measurement systems.

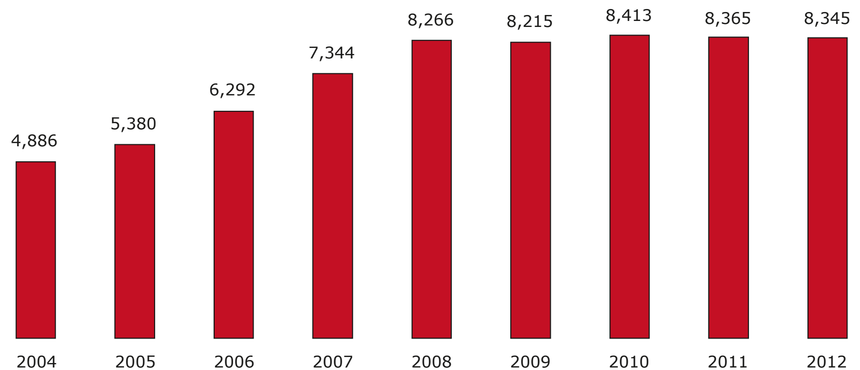
## 6.5 Foreign investment funds

### UCITS funds

Most distribution notices again from Luxembourg and Ireland.

In 2012, BaFin received 906 new distribution notices for UCITS funds (previous year: 752). More than half of the new distribution notices came from Luxembourg-based companies, while Irish funds were also strongly represented, as in the past. Austria, France and Liechtenstein were other key originating countries. The total number of UCITS funds declined slightly. At the end of 2012, 8,345 foreign UCITS funds were authorised for distribution in Germany (previous year: 8,365).

Figure 30
**UCITS funds**




### Foreign non-UCITS funds

At the end of 2012, 117 foreign non-UCITS funds, including one hedge fund of funds, were authorised for public distribution in Germany (previous year: 115). A large majority of these funds are also domiciled in Luxembourg, although some of them are domiciled in Switzerland, the United States, or Austria.

A total of ten new funds notified BaFin of their intention to distribute their units. Six funds were authorised to commence distribution.

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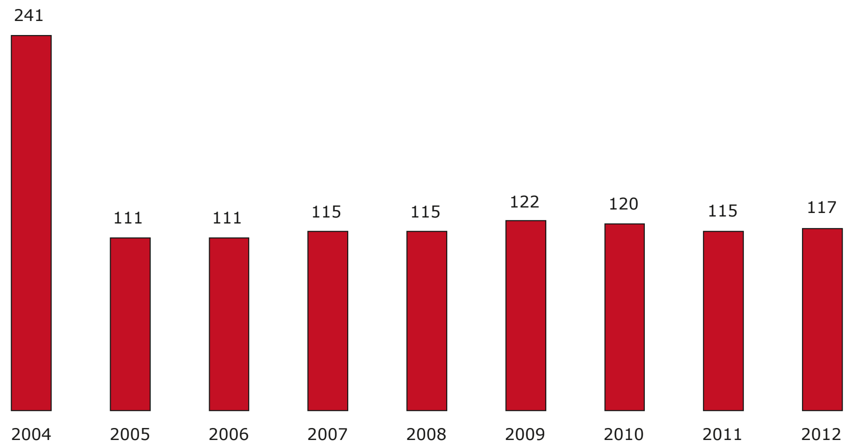
BaFin prohibited two funds from doing so, because they had distributed their units to the public during the notification procedure without authorisation having been obtained. Four funds discontinued distribution, including two funds of hedge funds.

Figure 31
**Non-UCITS funds**



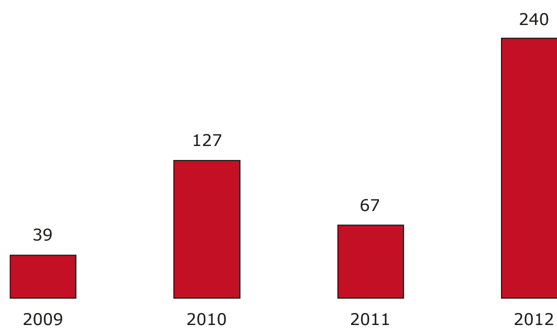

From 2006 onwards, the statistics also contain foreign funds of hedge funds that have been authorised for distribution.

# 7 Administrative fines

Administrative fines totalling €3.6 million imposed.

BaFin initiated 534 administrative fine proceedings relating to potential violations of securities supervision provisions (previous year: 360). Administrative fines were imposed at the end of 240 proceedings (previous year: 67), totalling approximately €3.6 million.

Figure 32
**Proceedings closed by imposing administrative fines**



BaFin discontinued 265 proceedings, 202 for discretionary reasons. A total of 851 cases were still pending at the end of 2012 (previous year: 823).

Table 34

**Administrative fines**

| | Number of cases pending at the beginning of 2012 | Number of new cases in 2012 | Administrative fines* | Highest administrative fine imposed (€) | Discontinued for factual or legal reasons | Discontinued for discretionary reasons | Number of cases pending at the end of 2012 |
|---|---|---|---|---|---|---|---|
| **Reporting requirements (section 9 of the WpHG)** | 6 | 2 | 1 | 5,500 | 1 | 1 | 5 |
| **Ad hoc disclosures (section 15 of the WpHG)** | 57 | 20 | 3 | 87,500 | 2 | 12 | 60 |
| **Directors' dealings (section 15a of the WpHG)** | 4 | 7 | 2 | 35,000 | 0 | 1 | 8 |
| **Market manipulation (section 20a of the WpHG)** | 17 | 7 | 2 | 60,000 | 3** | 2 | 16 |
| **Notification and publication requirements (sections 21 ff. of the WpHG)** | 503 | 347 | 186 | 230,000 | 16 | 144 | 504 |
| **Duties to provide information to security holders (sections 30a ff. of the WpHG)** | 71 | 78 | 13 | 14,000 | 30 | 7 | 99 |
| **Short selling (section 30h of the WpHG)** | 3 | 2 | 1 | 12,000 | 0 | 1 | 3 |
| **Financial reporting requirements (sections 37v ff. of the WpHG)** | 103 | 52 | 27 | 100,000 | 6 | 22 | 100 |
| **Securities Prospectus Act** | 16 | 4 | 2 | 10,000 | 5 | 2 | 11 |
| **Capital Investment Act/Sales Prospectus Act** | 4 | 10 | 1 | 5,600 | 0 | 1 | 12 |
| **Takeovers (WpÜG)** | 36 | 5 | 3 | 10,000 | 0 | 9 | 30 |

* Proceedings closed by imposing an administrative fine.

** The public prosecutors discontinued another case referred to them because the violation was an immaterial ancillary offence compared with the other offences committed by the defendant.

Information on selected completed proceedings is given in the following.

### Voting rights notification and publication requirements

BaFin imposed an administrative fine of €160,000 on a foreign company. The company was obliged to submit voting rights notifications for itself and on behalf of seven other companies. In 2007 and from 2009 to 2011, their holdings of voting rights in companies with Germany as their home country reached or crossed a large number of thresholds subject to notification requirements. BaFin accused the management body of the company of not having taken the necessary supervisory measures to ensure the notifications were submitted in good time.

BaFin imposed administrative fines totalling €230,000 on another company and the management board member responsible. The company had published ten voting rights notifications only after a delay of approximately two years. The company was a domestic issuer domiciled abroad. Although its holders of voting rights are subject to the foreign country's notification thresholds, publication is based on German law.

### Financial reporting requirements

BaFin imposed administrative fines totalling €88,000 on a company that had failed in 2009 to publish a half-yearly financial report and interim management statements. The 2010 half-yearly financial report was not published either, even though the company was obliged to do so. Although the management board was aware of its obligation, it decided not to meet it, thus acting with intent. In addition, BaFin imposed further fines totalling €180,000 on the company for intentionally failing to publish the 2011 and 2012 half-yearly financial reports.

### Administrative fine proceedings

BaFin can conduct administrative fine proceedings against both natural and legal persons. Action can be taken against legal persons if a responsible manager has violated legal requirements. In such cases, BaFin can impose the fine either in a single set of proceedings against the natural person and the company concerned, or in independent proceedings exclusively against the company concerned.

Administrative fine proceedings are initiated by determining that legal provisions have objectively been violated. BaFin examines in preliminary proceedings whether there is a prima facie case to answer. The preliminary proceedings serve to establish the facts, secure evidence and determine decision-relevant assessment criteria for the amount of a possible administrative fine. The party concerned can comment on the accusations.

BaFin subsequently examines the information provided by the party concerned and the evidence at hand. It decides whether to discontinue the proceedings or to order the imposition of an administrative fine. BaFin can also start by threatening the fine. If the imposition of an administrative fine is ordered, the party concerned can object to it within two weeks of the order having been served.

If an objection is filed, BaFin reviews its decision, taking into account any reasons on which it is based. It can discontinue the proceedings, modify the decision about the fine, or uphold the decision. If BaFin upholds its original decision, it refers the case to the competent court via the public prosecutors.

BaFin takes part in the court case relating to the administrative fine proceedings and regularly submits comments. The court rules on the case either by issuing an order or by passing judgement following a full trial. The court's ruling replaces BaFin's administrative fine decision.

If the ruling is final, the party concerned is obliged to pay the amount imposed. Payment may also be enforced through judicial enforcement proceedings.

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# VII Cross-sectoral issues

## 1 Deposit protection, investor compensation and guarantee schemes

Gabriele Hahn
Chief Executive Director
Regulatory Services/Human Resources[69]

BaFin supervises the statutory compensation schemes and bank guarantee schemes governing the banking and securities trading sector, as well as the statutory guarantee schemes for life and substitutive health insurance. Where compensation and guarantee schemes issue administrative acts, such as notices of contributions, BaFin also rules on any objections by member institutions of these schemes.

**Supervision of the Compensatory Fund of Securities Trading Companies**

Most of the claims submitted by the injured parties in the Phoenix Kapitaldienst GmbH compensation event were settled in 2012. By the end of 2012, the Compensatory Fund of Securities Trading Companies *(Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW) had made more than 71,000 decisions amounting to a total of approximately €260 million. A total of 25,500 of the decisions relate to the year 2012 alone; in those cases, new rulings were required on the basis of the judgements of the Federal Court of Justice *(Bundesgerichtshof)*[70] relating to decisions already made. In the case of about 150 pending claims, the investors are required to provide input to the resolution. The payment process in the Phoenix compensation event has therefore been largely completed.

Legality of the special payments.

The focus is now on the repayment of the loans by the EdW. The Federal Ministry of Finance and the EdW have entered into three loan agreements for credit lines of €128 million (December 2008), €141 million (April 2011) and €28.5 million (March 2012) to finance compensation payments to eligible claimants in the Phoenix Kapitaldienst GmbH compensation event; the EdW has not drawn the full amounts available under these credit lines. The loan amounts drawn will have to be repaid from the annual contributions, the allocation under the current insolvency proceedings of Phoenix AG and special annual payments to be made by the EdW's member institutions. Many institutions sought protection of their legal rights through the courts against the imposition of special payments. In its judgement dated 11 May 2012, the Administrative Court in Berlin confirmed in principal proceedings for the first time the legality of

[69] Gabriele Hahn was Chief Executive Director for Insurance Supervision up until June 2012.
[70] Case ref.: IX ZR 434/10, 435/10 and 436/10; XI ZR 67/11; see 2011 Annual Report, p. 243.

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the 2010 special payment order in dispute.[71] The decision is not yet final. No court rulings are as yet available on the 2011 and 2012 special payment orders.

FXdirekt Bank AG compensation event.

In the year under review, another institution, FXdirekt Bank AG, triggered a compensation event for the EdW.[72] BaFin confirmed the compensation event on 22 January 2013. The EdW, which is the competent compensation scheme, is in discussions with the insolvency administrator and has already made contact with all the creditors of the respective transactions in Germany and abroad.

FXdirekt Bank AG, a securities trading bank, offered on its trading platforms margin-based – i.e. collateralised – foreign exchange and precious metal trades, contracts for differences (CFDs) on shares, exchange-traded funds (ETFs) and futures, primarily to private clients in Germany and abroad.

In autumn last year, the financial press published critical reports about the institution. FXdirekt was accused of dubious business practices and it was alleged that the trading system was susceptible to manipulation. This was followed by liquidity problems, which led to BaFin being notified of imminent insolvency on 20 December 2012. In response, BaFin issued a moratorium on 21 December 2012 and applied to the Local Court in Duisburg on 3 January 2013 to have insolvency proceedings opened. The proceedings were opened on 9 January 2013.

# 2 Authorisation requirements and prosecution 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 option to ask BaFin to examine whether their planned business models require authorisation under the Banking Act *(Kreditwesengesetz* – KWG), the Insurance Supervision Act *(Versicherungsaufsichtsgesetz* – VAG), or the Payment Services Supervision Act *(Zahlungsdiensteaufsichtgesetz* – ZAG). Activities that require authorisation may only be commenced once written authorisation has been given by BaFin. BaFin may prohibit providers operating without such authorisation from carrying on the business and force it to be unwound. In addition, business activities carried

[71] Case ref.: 4 K 309.11.
[72] See chapter V 3.2.

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on without the necessary authorisation from BaFin are punishable by law.

723 enquiries about authorisation requirements.

In the year under review, BaFin received 723 requests to examine whether an authorisation was required for planned business ventures (previous year: 716).

Guidance notices on financial instruments and prohibited business.

Since the middle of 2012, financial investments have been included in the definition of financial instruments, as required under the Investment Intermediaries Act *(Finanzanlagenvermittlergesetz*[73]) of 6 December 2011. Accordingly, BaFin has updated its guidance notice on selected financial instruments published in 2011 by adding notes on financial investments. In another guidance notice, BaFin provides a summary of the different types of derivatives and their features. This means that BaFin has now explained in guidance notices all financial instruments within the meaning of section 1 (11) of the KWG.

BaFin also published a guidance notice on business prohibited under section 3 of the KWG. It deals in particular with the prohibition on company savings banks *(Werksparkassen)* and special-purpose savings enterprises *(Zwecksparunternehmen).* For 2013, BaFin is planning a guidance notice on the Act Implementing the European Market Infrastructure Regulation (EMIR) *(Ausführungsgesetz zur Verordnung über die europäische Marktinfrastruktur).*

Exemption for secondary market funds and funds of funds.

The extension by the Investment Intermediaries Act of the definition of financial instruments to include financial investments within the meaning of the Capital Investment Act *(Vermögensanlagengesetz)* also brought, among other products, closed-end funds that invest in units in other closed-end funds into the scope of the KWG. The exemption set out in section 2 (6) sentence 1 no. 20 of the KWG applies to all companies that do not provide any financial services other than portfolio and investment management, but only if the provision of portfolio and investment management is strictly limited to financial investments. This issue will also be the subject of the implementation of the Directive on Alternative Investment Fund Managers (AIFM Directive), which is planned for the middle of 2013.

Secondary market trading platforms require authorisation.

Some fund houses also operate secondary market trading platforms for existing limited partner investments. Normally the contract between the buyer and the seller of the investments is not entered into within the system, so that the operation of a multilateral trading system, i.e. the provision of a financial service, does not apply. However, since the parties' declarations of intent are forwarded by the platform operator, the operator provides a financial service within the meaning of the KWG by brokering the investment. The platform operator cannot invoke the exemption under section 2 (6) sentence 1 no. 8 (e) of the KWG because this provision does not cover brokerage on the secondary market. It applies only to primary market brokers, i.e. those companies that provide financial services to third parties only in the form of investment advice and investment and contract broking between customers and providers or issuers of financial investments within the meaning of the Capital Investment Act.

[73] Federal Law Gazette (BGBl.) I 2011, p. 2481.

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## 2.2 Exemptions

331 institutions exempted.

BaFin may exempt a company from the authorisation requirement if the nature of its business makes supervision unnecessary. This normally relates to transactions conducted in connection with principal business activities that do not need authorisation. By comparison, these transactions are merely regarded as low-level auxiliary or ancillary transactions. BaFin exempted 43 companies in 2012. This means that a total of 331 institutions were exempt from the authorisation requirement at the end of the year.

The exemption option is also available to companies from third countries outside the European Union that want to commence cross-border activities in Germany. However, a condition is that they are subject to equivalent supervision in their home country. In the past year, BaFin exempted six companies from third countries.

## 2.3 Illegal investment schemes

Nobody may provide banking, investment, insurance, financial, or payment services in Germany unless they have provided evidence as part of a statutory authorisation procedure that they meet the personal, technical and financial requirements for carrying on such business and their business is continually supervised by BaFin on the basis of an authorisation. Without rigorously enforcing the right to insist on authorisation, the supervisory process would be largely futile. For this reason, BaFin has comprehensive powers of investigation and intervention to clear up and act against unauthorised business activities. For example, it can search the business premises of suspect companies, confiscate documents, prohibit business activities, order the business to be unwound, issue instructions and impose coercive fines. In addition, the operator of an unauthorised business faces criminal prosecution.

Purchase of second-hand life insurance policies.

In 2012 BaFin again took action against individual providers whose business model is to “purchase” second-hand life insurance policies and financial investments. BaFin is seeking a court’s clarification in principle of the authorisation requirement of the individual cases.

BaFin believes that the purchase of life insurance contracts and other financial investments may in some cases amount to deposit business and therefore banking business within the meaning of the KWG. This may be the case if the purchase price is to be paid out only at a later date and the purchase contract is presented as an investment offer.

Facts that qualify the business as deposit business subject to authorisation are:

- The life insurance contract/financial investment is cancelled or otherwise terminated and the buyer opts not to have all or any of the surrender value or consideration paid out.
- The purchase price is calculated on the basis of the surrender value (for example double the amount after eight years).

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- The buyer advertises the offering by claiming that in this way a higher return could be generated than through the financial investment itself.

Meanwhile some providers try to circumvent the authorisation requirement by subjecting the investors' claims to qualified subordination. If effective under civil law, qualified subordination is in principle suitable for preventing the transaction from amounting to deposit business. Under such an arrangement, the subordination of the claim in relation to the other claims of other creditors is agreed, and the subordination is qualified in that the claim to repayment is excluded for as long as and to the extent that the repayment would trigger a reason for opening insolvency proceedings. If, based on the design and positioning of the investment offering, the investors (purchasers) therefore have to assume that they are accepting financing responsibility for the provider (seller), the conditions for deposit business are not met. BaFin takes into account all the circumstances of the specific case in question and assumes that the product is addressed to an average informed person.

Consumer loans require authorisation.

The granting of cash loans to consumers within the meaning of section 1 (1) sentence 2 no. 1 of the KWG, including those with subordination clauses, always requires authorisation. BaFin has recently taken action against loan offerings addressed in particular to consumers. They relate to small short-term loans that attract not inconsiderable costs for interest, processing, or credit checks and can be applied for via the Internet. The loan agreements contain different kinds of subordination clauses. In corporate financing, subject to certain conditions, the granting of a loan may not require authorisation if a qualified subordination clause is agreed. The subordination clause specifies firstly that the lender's repayment claim is subordinate to the claims of other creditors. Moreover, the loan claim cannot be asserted if this would lead to the insolvency of the borrower. In this way, the lender assumes financing responsibility. However, assuming financing responsibility as a sort of investment in a business is only possible in the context of financing business activities. The privileged status of these types of loans cannot therefore be extended to consumer loans.

Successful intervention against an ekonomisk förening.

In the year under review, BaFin prevented Credit Efficiency United Ekonomisk Förening (CEU EF), Sweden, from carrying on unauthorised business. The legal form of the ekonomisk förening had been used in other cases in the past to carry on unauthorised banking business in Germany. The organisers behind CEU EF advertised fixed-term deposits via tvest Hamburg financial planning GmbH (TVEST), which has since become insolvent. The cash deposits were accepted through Spanish accounts of Credit Efficiency United Sociedad Limitada. From there, transfers were made to the organisers behind the scheme, TVEST and the Panama-based Financial Planning Services Sociedad Anónima. BaFin searched business and residential premises, received valuable support from the Spanish, Liechtenstein and Swiss supervisory authorities, and cooperated closely with the Hamburg State Criminal Police Office (Landeskriminalamt). Insolvency proceedings have since been opened against the assets of the organisers. Preliminary

investigations by the public prosecutor against the organisers are also pending.

Cash dispensing in adult gaming centres requires authorisation.

In the year under review, BaFin prohibited a large number of adult gaming centre operators from carrying on cash-dispensing business. The adult gaming centre operators dispensed cash on their premises in (ec) card-based transactions and thus carried on payment services in the form of cash-dispensing business, which requires authorisation.

Anyone wishing to provide payment services as a payment institution in Germany commercially or on a scale which requires a commercially organised business undertaking needs written authorisation from BaFin in accordance with the ZAG. The term "cash-dispensing business" refers to payment services that can be used to make cash payments from a payment account. The cash-dispensing business accordingly comprises any service that allows the user to turn book money into cash and therefore also covers the option provided in adult gaming centres to make (ec) card-based cash withdrawals. The exemption under section 1 (10) no. 4 of the ZAG under which cash dispensing in connection with the purchase of goods or services – referred to as cashback – does not require authorisation was not applicable in the cases concerned: BaFin does not believe that the conditions of the exemption rule are met if cashless purchases of goods or services are clearly only made for the purpose of making cash withdrawals in order to be able to use the cash-operated gaming machines.

Acquirers implicated in unauthorised cash-dispensing business.

Service providers that win merchants for accepting credit cards for payment (merchant acquisition) and technical service providers that settle or authorise cash dispensing by adult gaming centres are implicated in the unauthorised business carried on by the adult gaming centres. BaFin therefore requested the payment institutions it supervises to stop facilitating cash-dispensing services provided by adult gaming centres without authorisation.

### Supervisory and investigative measures

641 new investigations.

In 2012, BaFin initiated 641 new investigations (previous year: 689). As part of the investigations, BaFin issued formal requests for information and the submission of documents to suspicious companies in 73 cases (previous year: 55) and imposed coercive fines in 19 cases (previous year: 22).

21 searches of premises and on-site inspections.

As part of its investigations into unauthorised business operations, BaFin carried out 21 searches of premises and on-site inspections in the year under review (previous year: eight). This figure also includes administrative assistance provided to public prosecutors and the police, who asked BaFin to participate because of its specialist expertise. BaFin also cooperates closely with foreign supervisory authorities. For example, in spring 2012 it searched five properties in Germany and inspected one property in Austria together with the Austrian Financial Market Authority (FMA). The two supervisory authorities will intensify their cooperation in 2013.

More prohibition orders and liquidation orders.

In the year under review, BaFin issued 19 prohibition orders (previous year: 12) and 26 liquidation orders (previous year: 19) against companies that were not prepared to discontinue unauthorised business operations voluntarily. BaFin had to use a liquidator in four cases (previous year: two). Twenty-one companies discontinued their unauthorised business operations voluntarily.

Legal remedies against BaFin measures.

In the year under review, BaFin received 39 objections from individuals or companies that were subject to formal measures (previous year: 33). BaFin completed 28 objection procedures (previous year: 24), 15 of them on the basis of objection notices (previous year: 11). Some affected parties took legal action against supervisory measures. In 2012, the courts across all levels ruled in a total of 14 cases (previous year: 16), handing down 12 judgements or orders in favour of BaFin (previous year: 14). In two cases the courts ruled in favour of the affected parties (previous year: two).

# 3 Money laundering prevention

## 3.1 International anti-money laundering activities and national implementation measures

Act Supplementing the Money Laundering Act.

On 14 December 2012, the Bundesrat approved the Act Supplementing the Money Laundering Act *(Gesetz zur Ergänzung des Geldwäschegesetzes)* passed by the Bundestag on 8 November 2012. In order to effectively address the money-laundering risks arising from the gambling industry, the Supplementing Act is aimed in particular at ensuring that online gambling is covered by the provisions of the Money Laundering Act *(Geldwäschegesetz –* GwG). To this end, the range of entities subject to the GwG has been expanded by including Internet-based gambling organisers and brokers; they will in future be required in particular to identify the players and establish segregated player accounts. In addition, credit and payment institutions will in future have to meet special due diligence requirements in settling and supervising cash flows relating to online gambling activities. The extension of the range of obligations of these institutions also extends the supervisory spectrum of BaFin, which is the competent supervisory authority.

Revised interpretation and application guidelines in the financial sector.

The joint working group of BaFin, the Federal Ministry of Finance and the associations of banks belonging to the German Banking Industry Committee *(Die Deutsche Kreditwirtschaft* – DK) agreed in August 2012 to further revise the interpretation and application guidance on money-laundering prevention. The revisions take into account some of the changes to the anti-money laundering requirements implemented by the Act on Optimising the Prevention of Money Laundering *(Gesetz zur Optimierung der*

*Geldwäscheprävention* – GwOptG) of 28 December 2011. Among other things, the published guidance addresses certain issues relating to the new customer due diligence and ways of testing the reliability of employees. BaFin issued a circular[74] to inform the affected parties subject to these requirements, including those that are not members of the associations belonging to the DK, about the guidance. In addition, the circular defines BaFin's administrative practice with regard to cash payments into third-party accounts of €1,000 or more: this stipulates that the customer due diligence requirements must be met at all times, including in such cases.

In cooperation with the relevant sector associations, the interpretation and application guidelines for the insurance undertakings, leasing and factoring institutions subject to the GwG were also revised and published in the year under review.

Recommendations for risk-based supervision.

A working group of the Sub-Committee on Anti-Money Laundering (AMLC) is developing recommendations for risk-based supervision. The AMLC is a sub-committee of the Joint Committee of the European Supervisory Authorities, i.e. the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). At an AMLC workshop, BaFin presented its approach to the risk-based supervision of institutions in relation to money-laundering prevention. The ambitious time schedule envisages the completion of a good practice paper by July 2013.

Another joint press conference of BaFin and the BKA.

According to the annual report of the Financial Intelligence Unit (FIU) at the Federal Criminal Police Office (Bundeskriminalamt – BKA), which the BKA presented at a joint press conference with BaFin in Wiesbaden on 29 October 2012, over 90% of the suspicious transaction reports received in 2011 came from credit institutions. The FIU received a total of 12,868 suspicious transaction reports in 2011, 17% more than in the previous year. BaFin emphasised the importance of critical and accurate audit reporting.

## 3.2 Anti-money laundering activities at banks, insurers, financial services institutions, payment institutions and agents

Establishment of a central office was the subject of special audits.

In 30 special audits (previous year: 32), BaFin examined the implementation of measures to prevent money laundering and other punishable offences at credit institutions. During these audits, BaFin paid special attention to the establishment of a central office within the meaning of section 25c (9) sentence 1 of the KWG. Under this provision, the function of the anti-money laundering officer and the obligations to prevent other punishable offences at institutions must be performed by a single office. On 30 March 2012, the period expired during which BaFin did not object to the absence of such an office. Meanwhile, virtually all the institutions have established a central office.

[74] Circular 4/2012 GW, www.bafin.de/dok/3223922.

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Measures to prevent punishable offences require improvement.

As a large number of reports on financial statements have revealed, the institutions will in particular have to improve their measures to prevent other punishable offences in order to ensure successful prevention. Given the generally worded legal requirements, BaFin and auditors still have a lot of persuading to do and need to resolve issues of detail with the institutions in relation to this matter.

Audit focus on dealing with foreign PEPs.

One focus of the audits of the annual financial statements of 30 banks with international operations was on dealings with foreign politically exposed persons (PEPs), especially those who come from countries with dictatorial regimes. The institutions have to meet stricter due diligence requirements for PEPs. The auditors identified a few minor non-compliance cases, which BaFin has discussed with the banks and they have remedied. Overall, the institutions maintained suitable organisational systems and met their stricter due diligence requirements.

Special audit of international embargo requirements.

BaFin examined how some banks implement and comply with international embargo requirements, investigating allegations made by parties in the USA that German banks were facilitating payments in contravention of US financial sanctions; the main focus was on payments in relation to Iran. Some of the payment transactions in question go back as far as ten years. BaFin believes transactions effected before sanctions were imposed by the United Nations (UN) and the European Union did not amount to violations of the law. The UN has imposed various sanctions against Iran since 2006 and the EU has done so since 2007.[75] The results of the special audits are still outstanding.

Audit campaign to assess the quality of audit reports.

In 2011, the auditors from the territories covered by savings bank and cooperative bank associations had in most cases not found any cases of non-compliance with money-laundering prevention. To obtain an overview of the informational value of the audit reports of the auditors of the annual financial statements, BaFin launched an audit campaign in the fourth quarter that involved examining 12 focal points of prevention at 78 institutions from all territories covered by savings bank and cooperative bank associations. The results will subsequently be compared with the findings of the audit reports from the associations and possible conclusions will be discussed with the associations. Since the Audit Report Regulation *(Prüfungsberichtsverordnung* – PrüfbV) was amended in 2011, the associations' auditors have been required – like all other auditors of annual financial statements – to provide an assessment on 48 points relating to money-laundering prevention in the annual audit report.

Prevention of money laundering at insurance undertakings.

As in the previous year, BaFin audit teams conducted eight special audits in 2012 at insurance undertakings it supervises. Overall, the preventive work of these undertakings has improved significantly in the past few years. However, especially in the case of single-premium insurance contracts, the insurance undertakings will have to research the origin of the payment in greater detail to counter possible money-laundering activities. The auditors also repeatedly criticised insurers that failed to identify beneficiaries, in breach of

[75] UN: http://www.un.org/en/sc/documents/resolutions/; EU: most recently Regulation (EU) No. 264/2012 of 23 March 2012.

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the legal requirement, and made the insurance benefit payment into a nominated account without asking any further questions.

Special obligations in the e-money business.

On 29 December 2011, through the GwOptG, the German lawmakers defined special due diligence and organisational requirements for business involving electronic money (e-money) in the newly introduced section 25i of the KWG. The background is that issuing e-money entails an increased risk of money laundering because it can often be acquired anonymously.

However, by including an exemption in section 25i (2) of the KWG, the lawmakers also defined indicators of low risk. If they apply, the law allows simplified due diligence. For e-money products that are not covered by this exemption, BaFin can, on application, allow an institution that issues e-money to meet simplified due diligence requirements or exempt it from meeting further obligations (section 25i (5) of the KWG). Eight institutions applied for exemption in the year under review; one application was approved. In April 2012, BaFin additionally published a guidance notice on the interpretation of the legal provisions.[76]

# 4 Account information access procedure

Number of information requests stable.

Most requests for account information were again attributable to public prosecutor's offices and police authorities of the federal government and the *Länder.* The fact that there was virtually no change in the number of times account information was accessed shows that it is still a proven tool for clarifying issues, especially in preliminary criminal investigations as well as in supervisory administrative procedures.

Table 35
**Requests for account information in 2012**

| Account information recipients | 2012 | | 2011 | |
|---|---|---|---|---|
| | absolute | in % | absolute | in % |
| **BaFin** | 992 | 0.9 | 757 | 0.6 |
| **Tax authorities*** | 13,286 | 11.6 | 13,122 | 11.2 |
| **Police authorities** | 68,066 | 59.5 | 69,330 | 59.3 |
| **Public prosecutors** | 24,629 | 21.5 | 25,997 | 22.2 |
| **Customs authorities*** | 7,207 | 6.3 | 7,316 | 6.3 |
| **Other** | 184 | 0.2 | 386 | 0.3 |
| **Total** | **114,364** | **100** | **116,908** | **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.

Data quality improved.

In the case of ten credit institutions (previous year: eight), BaFin examined on site the quality of the processes for identifying bank customers and beneficial owners within the meaning of section

[76] www.bafin.de/dok/2828516.

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1 (6) of the GwG. The particular purpose of the local audits in these cases was also to ascertain whether the collected account master data was accurate and complete. Overall, the evidence suggested that in principle the banks' work instructions and working processes provided for sufficient identification and authentication checks. Any weaknesses identified in the practical implementation mostly related to the fact that institutions had not captured the complete first names of account holders and authorised users. In addition, the information on the company names of legal persons and partnerships did not always exactly match the commercial register entry. It was evident, however, that the audited institutions generally try to make lasting improvements to data quality by training and monitoring their employees – and, if necessary, they also perform comprehensive checks of their data resources. BaFin will continue to ensure that these efforts are successful.

# 5 Consumer complaints and enquiries

The Act on the Strengthening of German Financial Supervision *(Gesetz zur Stärkung der deutschen Finanzaufsicht),* significant parts of which entered into force on 1 January 2013, aims to enable BaFin to improve the way it incorporates insights obtained from consumers into its supervisory work. To this end, the Act stipulates the standardisation of the complaints procedure. Accordingly, BaFin now has a legal obligation to comment on complaints within a reasonable period of time. It may request comments from the company concerned if necessary.

In the event of a violation of supervisory law, BaFin issues a warning to the institution or company and requires it to take measures to prevent future deficiencies. If there are organisational deficiencies, it works to ensure organisational changes and subsequently monitors their implementation. However, the complaints procedure is not used to enforce individual legal rights.

The number of clients of insurers, credit institutions and financial services institutions who contacted BaFin with complaints, enquiries, or information in 2012 was 17,831 (previous year: 21,547).

## 5.1 Complaints about credit and financial services institutions

In 2012, BaFin processed a total of 5,134 submissions relating to credit and financial services institutions (previous year: 6,660), of which 4,773 were complaints and 361 general enquiries. The figure includes 27 cases where BaFin issued statements to the Petitions

Committee of the Bundestag. In addition, BaFin received 82 information requests about former banks, and especially their legal successors. The complaints were upheld in 831 cases (including five petitions).

Table 36
**Complaints by group of institutions**

| Group of institutions | Total number of submissions |
|---|---|
| Private commercial banks | 2,715 |
| Savings banks | 646 |
| Public-sector banks | 119 |
| Cooperative banks | 624 |
| Mortgage banks | 20 |
| Building and loan associations | 224 |
| Financial services providers. leasing and factoring companies | 278 |
| Foreign banks | 147 |
| **Total** | **4,773** |

## Selected cases

Handling charges for consumer loans.

A large number of consumers contacted BaFin following reports in the media about a new ruling by the Higher Regional Court (Oberlandesgericht) in Dresden of 29 September 2011[77] that handling charges for consumer loans are inadmissible.

Although several higher regional courts have in the past few years ruled that such charges are invalid and therefore non-binding in accordance with section 307 (1) sentence 1 and (2) no. 1 of the of the German Civil Code *(Bürgerliches Gesetzbuch* – BGB)[78], the Higher Regional Court in Celle issued a mixed ruling on legal issues relating to these types of handling charges.[79] Since there is no ruling on this matter from the highest instance, BaFin cannot urge, let alone require, the credit institutions subject to its supervision to refund any handling charges levied or not to specify such charges in loan agreements in the future. Each customer has to judge for themselves whether in their particular case they wish to make a claim for a possible refund against their bank through litigation; BaFin is unable to assess the prospects for success of such litigation.

Notification fees for returned direct debits.

As a result of the introduction of the Single Euro Payments Area (SEPA), the institutions have amended their terms and conditions for payment transactions; it is now possible to charge fees that were previously rejected as inadmissible by court rulings. According to the Federal Court of Justice (Bundesgerichtshof – BGH), there is sufficient legal basis in the provisions of SEPA for charging notification fees for returned direct debits.[80] The BGH's opinion as well as amendments to the banking industry's general terms and conditions of business to bring them in line with the SEPA provisions

[77] Case ref.: 8 U 562/11.
[78] OLG Bamberg, judgement dated 4 August 2010, case ref.: 3 U 78/10 and OLG Karlsruhe, judgement dated 3 May 2011, case ref.: 1 U 192/10.
[79] OLG Celle, judgement dated 2 February 2010, case ref.: 3 W 109/09 and judgement dated 13 October 2011, case ref.: 3 W 86/11.
[80] Judgement dated 20 July 2010 case ref.: XI ZR 236/07, BGHZ 186, p. 269.

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as at 9 July 2012 ended years of uncertainty about the effectiveness of such fees.

In addition to authorising the payment recipient to collect the amount receivable, the direct debit mandate also includes an instruction to the debited bank to honour the respective direct debit. In the BGH's opinion[81], this constitutes a legal basis for notification in case the direct debit is not honoured. The BGH clarified at the same time that the previous provisions in the general terms and conditions had not met the requirements and the fees charged had been inadmissible. The credit institutions concerned have generally refunded the fees.

Turnaround times for credit transfers.

Transposing the European Payment Services Directive into German law has revised the provisions on execution deadlines for credit transfers in the BGB among other things: as from 1 January 2012, credit transfers must arrive at the recipient's credit institution on the next business day; for paper-based transfers, the deadline can be extended by one business day (section 675 (1) of the BGB).

Many consumers complained that their payment orders had not been executed in time because the amount transferred did not arrive at the recipient on the next calendar day; however, in almost all cases, the complaints were not justified. The consumers had not taken into account that the turnaround time is calculated not on the basis of calendar days, but business days. Business days are those days on which all parties involved in executing a credit transfer maintain the business operations necessary to do so (section 675n of the BGB). Saturdays, Sundays and public holidays, as well as days on which banks do not open for business (such as Christmas Eve and New Year's Eve), are not business days. Especially for payment orders made at a weekend – possibly in combination with a public holiday – it is therefore possible that even an amount credited after several calendar days was executed on the next business day and therefore in time.

Garnishment protection account.

The number of consumers who contacted BaFin to complain about issues relating to the garnishment protection account *(Pfändungsschutzkonto* – P account) increased compared with previous years. Many customers complained about problems with opening such an account or the limited range of services on offer and the level of account management fees: following conversion into a P account, some institutions charged a separate or higher fee than for managing a normal account. In two judgements of 13 November 2012[82], the BGH has since ruled that clauses introduced by credit institutions that stipulate a higher fee for managing a P account than for managing a normal current account are invalid.

[81] Judgement dated 22 May 2012, case ref.: XI ZR 290/11, BGHZ 193, p. 238.
[82] Case ref.: XI ZR 500/11 and XI ZR 145/12.

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**Consumer hotline**

In 2012, BaFin's consumer hotline provided information on financial market topics to 22,064 (previous year: 27,313) callers. 39% of the calls related to the insurance sector and 43% to the banking sector. 8% of the enquiries were about securities supervision.

The enquiries reflect all consumer-related topics affecting BaFin. One focal point was handling charges for loans. A large number of consumers contacted BaFin in response to media reports about a new ruling by the Higher Regional Court (Oberlandesgericht) in Dresden that handling charges on consumer loans are inadmissible. Since a ruling on this matter at the highest instance is still outstanding and there were also Higher Regional Court rulings to the contrary, BaFin could only inform callers that it was currently not in a position to press for the charges to be refunded.

Another frequent topic was the latest ruling of the Federal Court of Justice on the ineffectiveness of clauses in life and pension insurance contracts. In most instances, customers wanted to make additional claims. As this can only be examined by comparing the terms and conditions of each case, BaFin asked the callers to make written submissions. The hotline staff also answered queries, especially at the beginning of the year, about open-ended real estate funds and – as an after-effect of the financial crisis – about deposit protection. Consumers also called to get information about the basic complaints procedure and the status of their ongoing complaints.

## 5.2 Complaints about insurance undertakings

**Number of complaints**

In 2012, BaFin processed fewer submissions year-on-year, finalising 10,954 compared with 13,616 in the previous year. The figure declined primarily because a special factor[83] involving approximately 2,000 cases relating to liability insurance did not recur. The submissions received comprised 8,730 complaints, 642 general enquiries not based on a complaint and 103 petitions that BaFin received via the Bundestag or the Federal Ministry of Finance. In addition, it received 1,479 written submissions that did not fall within its remit.

In relation to the total number of submissions, the complainants were successful in 26.5% of the proceedings (previous year: 24.8%), while 60.0% of the submissions were unfounded and, in 13.5% of the cases, BaFin was not the competent authority. If only the proceedings for which BaFin is the competent authority are taken into account, the success ratio is 30.6%.

[83] See 2011 Annual Report, p. 258.

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Table 37

## Submissions received by insurance class (since 2008)

| Year | Life | Motor | Health | Accident | Liability | Legal expenses | Building/ house-hold | Other classes | Other com-plaints* |
|---|---|---|---|---|---|---|---|---|---|
| 2012 | 2,794 | 1,312 | 2,360 | 383 | 601 | 683 | 766 | 442 | 1,612 |
| 2011 | 3,230 | 1,390 | 2,218 | 459 | 674 | 741 | 898 | 400 | 1,615 |
| 2010 | 3,512 | 1,640 | 2,326 | 606 | 755 | 763 | 1,118 | 413 | 2,125 |
| 2009 | 4,490 | 1,431 | 2,259 | 726 | 907 | 913 | 1,372 | 568 | 1,608 |
| 2008 | 4,941 | 1,600 | 2,157 | 870 | 949 | 1,004 | 1,387 | 569 | 1,634 |

* Wrong address. brokers. etc.

At 31.47%, the most common complaint by consumers related to claims administration or the adjustment of life insurance benefits (previous year: 39.02%). These were followed by complaints on contract handling (24.03%; previous year: 20.48%), contract termination (12.87%; previous year: 12.17%) and contract negotiation (8.9%; previous year: 7.26%). Within these general categories, the following reasons were the most commonly given.

Table 38

## Reasons for complaints

| Reason | Number |
|---|---|
| Claims handling/delays | 1,155 |
| Coverage issues | 1,136 |
| Termination | 1,047 |
| Amount of insurance payment | 1,025 |
| Advertising/advice/application processing | 700 |
| Changes and adjustments to premiums | 637 |
| Policy alterations and extensions | 580 |
| Tariff issues/no-claims classes | 525 |
| Processing quality or duration of complaints processing | 436 |
| Contributions. dunning | 341 |

### Selected cases

Calculation of premium supplement in the basic tariff.

In view of the introduction of the general compulsory health insurance as from 1 January 2009, persons without insurance cover were required to obtain insurance cover from that date at the latest. Nevertheless, one complainant only applied at a later date to be admitted to the basic tariff. For this reason, the insurer charged a one-time premium supplement for the uninsured period in accordance with section 193 (4) of the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG), which could not be objected to in principle from a supervisory perspective.

However, the amount determined for the premium supplement proved to be incorrect. In accordance with section 193 (4) of the VVG, the supplement amount is based on the monthly premium. This means, for example, that for the period from the second up to and including the fifth month, a supplement amounting to one month's premium is payable, and from the sixth month onwards, one-sixth of one month's premium is payable for each additional month or part of a month of non-insurance. The insurer had calculated this supplement on the basis of the full uncapped monthly premium, although the complainant was in fact only

paying a monthly premium limited to the maximum amount of the statutory health insurance system. BaFin believes that the "monthly premium" within the meaning of section 193 (4) section 4 of the VVG specifies the amount a policyholder actually pays for his or her insurance. For this reason, the amount on which the calculation of the premium supplement is to be based cannot exceed the current maximum premium for the basic tariff of the statutory health insurance system; if the insured person is claiming welfare benefits, the limit is only half the maximum premium.

When BaFin intervened, the insurer changed its procedure. In this specific complaint, the amount the complainant had to pay retrospectively was reduced by approximately €4,000.

Information on option to switch to standard tariff must be included.

The Regulation on Information Obligations for Insurance Contracts *(Verordnung über Informationspflichten bei Versicherungsverträgen* – VVG-InfoV) requires insurers to inform policyholders who have reached the age of 60 that they have the option to switch to the standard or basic tariff. At the time of announcing planned premium increases, the insurer had, however, only notified its existing customers of the option to switch to the basic tariff, not of the option to switch to the standard tariff. This contravenes the intention of section 6 (2) of the VVG-InfoV, according to which the policyholder must be allowed to switch to a tariff with a reduced premium. Because of the way premiums are calculated in the basic tariff, basic tariff premiums for policyholders of the same age are normally higher than standard tariff premiums and therefore less attractive for older holders of existing policies who want to switch. When BaFin intervened, the insurer announced that it would also inform its existing customers about the standard tariff in future.

Incorrect application form for Riester pension insurance.

A complainant cancelled his Riester pension insurance contract, which had been in place since 2005, effective 1 October 2010. In his submission, he expressed doubts about the accuracy of the refund determined by the insurer. An examination by BaFin found that the undertaking had shown a lower total cost burden of the premium and the supplement (12.5%) in the insurance application than was in fact required in terms of the tariff (16.5%). The incorrect application forms were used in about 12,000 cases in total. Following BaFin's intervention, the insurer compiled a plan for settling the 12,000 cases, most of which has by now been implemented.

BGH rulings on the effectiveness of general terms and conditions of life insurance.

In its judgements against four life insurance undertakings in the second half of 2012[84], the BGH ruled that certain clauses in the general terms and conditions for endowment insurance contracts and for deferred and unit-linked pension insurance contracts used after 2001 are also ineffective. The rulings primarily relate to provisions on the surrender value and cancellation fee as well as on acquisition cost loadings. Additional payments arise for the contracts concerned if they have been converted into paid-up policies or cancelled.

[84] For the first time in a judgement dated 25 July 2012, case ref.: IV ZR 201/10.

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In the case of one complaint, the refund of the cancellation penalty resulted in an additional payment of €1,200; in another case about €2,000 and in a third case almost €3,200 was refunded. Since the contracts had existed for a relatively long time before they were cancelled, in all three cases the minimum surrender value of half the non-zillmerised net premium reserve had already been exceeded, which meant that no further additional payments were forthcoming.

General terms and conditions not aligned with new VVG.

An examination of several complaint processes revealed that various insurance undertakings had not effectively adapted their general terms and conditions to the new 2008 version of the VVG when the VVG was reformed. At the time, the insurers did not notify existing customers of the amended insurance terms and conditions – with the amended text highlighted – even though this is a requirement under section 1 (3) of the Act Introducing the VVG *(Einführungsgesetz zum VVG).* A judgement of the BGH dated 12 October 2011[85] specifies that, since the insurers have not amended their general terms and conditions, they cannot claim a right to reducing benefits because contractual obligations have been breached through gross negligence.

Opt-in and opt-out procedures for travel insurance.

Some complainants complained to BaFin about the unintended Internet purchase of travel insurance with a contract term of one year. The contract was entered into when booking travel via the travel portal of an Internet services provider using an opt-out procedure. Under this procedure, chargeable ancillary services are pre-installed in the system and users have to deselect them explicitly if they do not want them. As a result of correspondence with BaFin, the insurer compelled the Internet services provider to convert its flight portals to the opt-in procedure. Moreover, the use of the opt-out procedure led to duplicated insurance purchases in 1,200 cases, all of which the insurer has since reversed.

In accordance with Article 23 (1) of the Regulation on common rules for the operation of air services in the Community[86], optional price supplements may only be agreed on an opt-in basis. This means that consumers must explicitly accept such offers. According to a ruling of the European Court of Justice (ECJ)[87], the costs of travel cancellation insurance are to be considered optional price supplements within the meaning of Article 23 (1) sentence 4 of the Regulation if the insurance is not provided by the airline and the agent has charged the costs of this trip as an all-in price together with the airfare.

## 5.3 Complaints relating to securities transactions

Each year, BaFin receives a large number of complaints relating to securities transactions. In 2012, BaFin received 666 complaints about credit and financial services institutions (previous year: 917) and 780 written enquiries by investors (previous year: 332).

[85] Case ref.: IV ZR 199/10.
[86] Regulation No 1008/2008.
[87] Judgement dated 19 July 2012, case ref.: C-112/11.

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In addition, it received 14 written complaints about investment research (previous year: 22). BaFin responded to 65 written enquiries related to the interpretation of section 34b of the Securities Trading Act *(Wertpapierhandelsgesetz* – WpHG) (previous year: 35), the relevant provision applicable to the analysis of financial instruments. In many cases, the enquiries were about the supervisory classification of business models. One focal point in 2012 was the assessment of computer-generated trading signals.

Losses on swap contracts.

Complaints relating to securities transactions may provide indications of violations of the provisions of the Securities Trading Act. In 2012, for example, a complaint pointed to systematic misconduct by an investment services enterprise. The complainant criticised above all that the bank had debited her account for receivables arising from a swap contract entered into between her and the bank. However, the complaint also raised the question of whether the sale of the swap contract was compliant with the rules of good conduct of sections 31 ff. of the WpHG because it was not a conventional interest rate or currency swap. Instead, the reciprocal payment obligations depended on the performance of a specially constructed index that was intended to track the development of a particular investment strategy. This strategy swap was also marketed to retail clients.

In response, BaFin launched comprehensive investigations. On the basis of samples, further business transactions were examined in detail. This led to various findings that suggested that some clients had not been given any information, or had not been given the correct information. In addition, there were indications that the product was not suitable for every client who purchased it. Following BaFin's investigations, the investment services enterprise subjected the other transactions to a comprehensive review and reached agreement with the clients. It also took measures to prevent future violations of the provisions of the Securities Trading Act.

Further decline in number of complaints.

In 2012, BaFin received a total of 102 complaints in relation to the investment sector (previous year: 130). They related primarily to the performance of specific funds compared with the market as a whole. BaFin received 34 complaints about the ongoing suspension of unit redemption and the liquidation at the open-ended real estate funds concerned (previous year: 41).

**Meeting of ombudspersons of the German financial sector**

Representatives of all 15 ombudsperson's offices of the German financial sector held their first meeting in Berlin in September 2012 to share experiences and exchange views. The meeting was organised by BaFin, which itself operates an arbitration board under the Investment Act *(Investmentgesetz* – InvG).

Because of the increasing importance of out-of-court dispute resolution, the European Commission had drafted a regulation and a directive, which were discussed at length at the meeting. For all disputes between consumers and companies, the EU wants entities to be available for out-of-court dispute resolution. The Alternative

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Dispute Resolution (ADR) Directive is designed to guarantee comprehensive and consistent minimum standards in dispute resolution. It will also apply to financial services and its transposition may lead to the creation of additional dispute resolution entities. The Online Dispute Resolution (ODR) Directive is intended to improve out-of-court dispute resolution for contracts entered into online for the sale of goods or the provision of services. A European platform for online dispute resolution is to be established for this purpose. The platform will be developed as a website and will help consumers to identify an out-of-court dispute resolution entity for cross-border cases. The interactive website will also be used to forward consumer complaints to the appropriate competent national entity. The actual dispute resolution will be conducted there in compliance with the ADR Directive.

The participants discussed selected aspects of dispute resolution. The differences between dispute resolution systems were highlighted especially as regards the conditions for authorisation, the rules of procedure for suspending the limitation period and the way the adoption or rejection of a dispute resolution proposal is dealt with in the case of unresolved legal issues of fundamental significance. This was reflected in the participants' desire to share experiences and exchange views and had already been highlighted at BaFin's consumer protection forum in October 2011, where the ombudspersons had voiced keen interest in sharing their thoughts on a range of topics. Given the growing importance of out-of-court dispute resolution, BaFin will organise further meetings.

## 5.4 Enquiries under the Freedom of Information Act

Legal uncertainty continues.

BaFin's hopes for a clarifying and final landmark ruling in principal proceedings by the Higher Administrative Court (Verwaltungsgerichtshof – VGH) in Hesse were again not fulfilled in 2012. In 2011, in its orders to take evidence, the court specifically recognised BaFin's obligation of confidentiality under supervisory law. However, the question remains unanswered as to how to interweave the procedural reasons for secrecy under the Rules of the Administrative Courts *(Verwaltungsgerichtsordnung* – VwGO) with the substantive reasons for rejecting an application for access to information under the Freedom of Information Act *(Informationsfreiheitsgesetz* – IFG).

In 2012, the Federal Administrative Court (Bundesverwaltungsgericht – BVerwG) again had to deal with appeals against orders of the VGH in Hesse in order to issue final rulings on the submission of documents or files in the court proceedings. In in camera proceedings, it confirmed existing rulings that, among other things, section 9 of the KWG and section 8 of the WpHG are not laws within the meaning of section 99 of the VwGO on the basis of which the submission of files and documents in the

court proceedings may be refused subject to certain conditions. A blocking order can therefore not be justified on the basis of these provisions. The conduct of such interim proceedings in the form of in camera proceedings has therefore proved unsuitable for BaFin in IFG-related cases and leads to a break with the principal proceedings in many areas. This is firstly because the reasons for secrecy recognised by a judge in procedural interim proceedings are stricter than those of the (substance of the) IFG, because they do not cover the full range of authority-specific obligations of confidentiality. Secondly, in camera proceedings provide powers of discretion at a purely procedural level that counteract substantive obligations of confidentiality and the threat of punishment based on them under the German Criminal Code *(Strafgesetzbuch* – StGB). In its ruling of 27 August 2012[88], the BVerwG clarified for the first time that, although BaFin's fears that the information protected under section 9 of the KWG might not be protected to the full extent by in camera proceedings could trigger a legislative initiative, the break between principal proceedings and in camera proceedings would have to be accepted in the prevailing legal situation.

IFG: evaluation of the legislation on behalf of the Bundestag.

In 2012, BaFin again contributed the experience it had gathered in dealing with the IFG to an evaluation commissioned by the Committee on Internal Affairs of the Bundestag and highlighted problem areas at the same time. The report of 22 May 2012 presented by the Institute of Regulatory Impact Assessment and Evaluation[89] contains a large number of proposed amendments to the law that could eliminate in particular the structural protection deficits of in camera proceedings. BaFin especially welcomes the equal treatment proposed in the evaluation report of procedural reasons for secrecy and of substantive reasons for rejecting an application for access to information.

Mass actions cause sharp rise in number of new applications.

The number of new applications rose to a multiple of the already high number of new applications recorded in 2011. This was again due to mass actions. In 1,490 cases, one law firm applied for information from and access to company files held by BaFin relating to three banks and financial services institutions wound up in 2003, 2005 and 2006. As in previous years, BaFin had to reject most of these applications for access to information in 2012, both in the application and in the objection procedures, since there were grounds for exclusion. In particular these mass actions led to more than 400 proceedings pending with BaFin alone.

In addition to the 1,490 new applications to be processed by BaFin, over 1,000 identical applications were submitted to the Compensatory Fund of Securities Trading Companies *(Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW) and the Compensation Scheme of German Banks *(Entschädigungseinrichtung deutscher Banken* – EdB). They, too, had to be rejected by the EdW and the EdB for reasons of secrecy. BaFin largely rejected the objections raised to the decisions on grounds of substance.

[88] Case ref.: 20 F 3.12.
[89] Committee printed paper 17 (A) 522 A.

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Outlook: 2013 promises to be an exciting year.

BaFin expects up to 1,000 further proceedings in the first half of 2013. In addition, various rulings are pending: on the one hand, BaFin hopes to get clarification of how to deal with mass actions, which clearly constitute an abuse of the legal process, and on the other, BaFin expects landmark rulings by the BVerwG that will provide a more detailed definition of the scope of reasons for secrecy if there is a potential threat to investigations by the public prosecutor.

It will also be interesting to observe the impact of the new section 4c of the Act Establishing the Federal Financial Supervisory Authority *(Finanzdienstleistungsaufsichtsgesetz* – FinDAG), which entered into force on 1 January 2013, and according to which BaFin will in future have to issue blocking orders at its own discretion in accordance with section 99 of the VwGO. These arrangements will not only for the first time grant BaFin procedural powers of discretion to submit files in the course of a contentious administrative matter if the court requests files held by BaFin as evidence in IFG court proceedings. The new arrangements will also lead to considerable administrative effort for BaFin in processing these company files, because in addition to requiring extensive coordination with the companies affected, the preparation of tables of contents and the classification and identification of business and trade secrets will be very labour-intensive.

Table 39

**Enquiries under the IFG in 2012**

| Supervisory areas | Number | Application withdrawn | Access to information granted | Access to information partially granted | Access to information denied | In process | Objection filed* | Appeal lodged |
|---|---|---|---|---|---|---|---|---|
| **Banking supervision** | 2,042 | 0 | 0 | 1,432 | 107 | 503 | 1,606 | 432 |
| **Insurance supervision** | 11 | 0 | 1 | 0 | 0 | 9 | 5 | 1 |
| **Securities supervision** | 70 | 7 | 30 | 16 | 13 | 4 | 20 | 11 |
| **Other** | 3 | 0 | 0 | 0 | 3 | 0 | 1,512 | 123 |
| **Total** | **2,126** | **7** | **31** | **1,448** | **123** | **516** | **3,143** | **567** |

* BaFin also rules on objections to rulings of the EdW/EdB, although it is not responsible for the applications for access they receive.

# VIII About BaFin

## 1 Human resources

As at 31 December 2012, BaFin had 2,336 employees (previous year: 2,151) divided between its offices in Bonn (1,735) and Frankfurt am Main (601). Approximately 66% (1,541) are civil servants *(Beamte)* and approximately 34% (795) are public service employees covered by collective wage agreements *(Tarifbeschäftigte).*

Women make up almost half of BaFin's workforce (1,097) and are also represented in senior management. Around 25% of all management positions are held by women. Twenty-three BaFin employees are on long-term assignment to international institutions and supervisory authorities.

Table 40
**Personnel**
As at 31 December 2012

| Career level | Employees | | | Civil servants | Public service employees |
|---|---|---|---|---|---|
| | Total | Female | Male | Total | Total |
| **Higher Civil Service** | 971 | 372 | 599 | 851 | 120 |
| **Upper Civil Service** | 792 | 356 | 436 | 619 | 173 |
| **Middle/ Basic Civil Service** | 573 | 369 | 204 | 71 | 502 |
| **Total** | **2,336** | **1,097** | **1,239** | **1,541** | **795** |

Total of 262 new staff recruited.

To manage its steadily growing workload, BaFin recruited a total of 262 new members of staff in 2012 (previous year: 249). 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 41
**Recruitment in 2012**

| Career level | | | | Qualifikationen | | | |
|---|---|---|---|---|---|---|---|
| | Total | Female | Male | Fully qualified lawyers | Economists | Mathematicians/ statisticians | Other |
| **Higher Civil Service** | 105 | 47 | 58 | 55 | 38 | 8 | 4 |
| | | | | **Business lawyers** | **Economists** | **IT specialists** | **Other** |
| **Upper Civil Service** | 101 | 37 | 64 | 19 | 52 | 11 | 19 |
| **Middle/Basic Civil Service** | 37 | 23 | 14 | | | | |
| **Candidates for entry to the Upper Civil Service/ Vocational trainees** | 19 | 12 | 7 | | | | |
| **Total** | **262** | **119** | **143** | | | | |

Vocational training at BaFin.

Nineteen people started vocational training or preparation for the Civil Service with BaFin in 2012 (previous year: 24). In collaboration with Deutsche Bundesbank, BaFin is preparing

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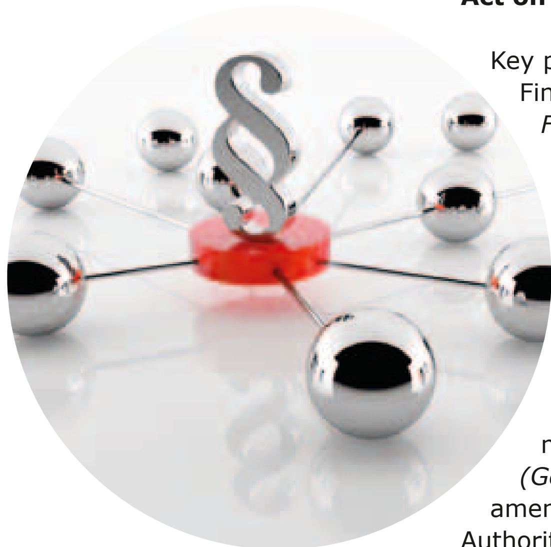
31 candidates for entry to the Upper Civil Service for their future responsibilities. BaFin currently also provides vocational training in two careers: office communication specialists (29), and media and information services specialists (1). At the end of 2012, BaFin thus had a total of 61 vocational trainees and candidates (previous year: 71).

Staff appointment scheme.

BaFin's Administrative Council approved a total of 30 additional staff positions (Planstellen) and posts (Stellen) as part of the 2012 budget to perform new statutory tasks and cope with a rise in the number of cases handled.[90] BaFin was able to fill most of these by the end of the year.

# 2 Organisation

**Act on the Strengthening of German Financial Supervision**



Key parts of the Act on the Strengthening of German Financial Supervision *(Gesetz zur Stärkung der deutschen Finanzaufsicht)* entered into force on 1 January 2013. The Act is based on the agreement reached by the governing coalition at the end of 2010 to reform financial supervision in Germany and to bring it into line with the changes in requirements since the financial crisis. The division of responsibilities between Deutsche Bundesbank and BaFin is, however, to be retained. With this aim in mind, the coalition agreed on ten key points to be implemented with the amending act that was adopted by the Bundestag on 25 October 2012. Among other measures, lawmakers created a new Financial Stability Act *(Gesetz zur Überwachung der Finanzstabilität* – FinStabG) and amended the Act Establishing the Federal Financial Supervisory Authority *(Finanzdienstleistungsaufsichtsgesetz* – FinDAG) as well as the Regulation on the Imposition of Fees and Allocation of Costs Pursuant to the FinDAG *(Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem FinDAG* – FinDAGKostV).

Financial Stability Commission established.

The ten key points for reforming financial supervision in Germany identified a need to clearly regulate and expand macro-prudential oversight. A Financial Stability Commission modelled on the European Systemic Risk Board (ESRB) was therefore established in accordance with section 2 of the FinStabG. The Commission supersedes the Standing Committee on Financial Market Stability.

The newly formed Financial Stability Commission comprises representatives from Deutsche Bundesbank, the Federal Ministry of

[90] The term 'positions' *(Planstellen)* 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' *(Stellen)* refers to posts for public service employees covered by collective wage agreements in the staff appointment scheme, broken down by pay grade.

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Finance (Bundesministerium der Finanzen – BMF), BaFin and one non-voting representative from the Federal Agency for Financial Market Stabilisation (Bundesanstalt für Finanzmarktstabilisierung – FMSA). In accordance with section 1 of the FinStabG, Deutsche Bundesbank is obliged to help safeguard financial stability by virtue of its macro-economic and financial market expertise. In particular, it is to analyse issues material to financial stability on an ongoing basis to identify threats and, where necessary, propose appropriate warnings to the Financial Stability Commission and develop recommendations for measures to combat these threats. This enables the Commission, which meets quarterly, to issue warnings and recommend countermeasures to the Federal Government, BaFin, or another German public-sector entity in the event of threats to financial stability (section 3 of the FinStabG).

In accordance with section 5 of the FinStabG, BaFin and Deutsche Bundesbank are obliged to provide each other with the information required to perform their respective functions.

Furthermore, Deutsche Bundesbank has a right to demand information from financial corporations insofar as it cannot obtain the information required to perform its functions from BaFin or other authorities (section 6 of the FinStabG). Section 7 sets out the obligation of confidentiality applicable to the members of the Financial Stability Commission.

The Commission ensures structured and transparent dialogue on financial stability issues between the key authorities responsible for the supervision and regulation of the German financial sector. Important information and findings on financial stability are bundled and can be factored into decisions.

FinDAG amended.

The amendments to the FinDAG are likewise designed to strengthen financial supervision in Germany. It should first be noted that, in accordance with section 4 of the FinDAG, BaFin remains responsible for micro-prudential supervision of banking, insurance and securities trading services. The amendments to the FinDAG relate more to the composition of BaFin's Administrative Council, among other things (section 7 of the FinDAG). Moreover, supervision should take consumer issues better into account. In addition to the provisions of the FinStabG governing cooperation between BaFin and Deutsche Bundesbank, section 4a of the FinDAG sets out a(n escalation) mechanism to ensure that both authorities adopt a uniform approach at all times, including in relation to difficult supervisory issues arising in the course of ongoing supervisory activities.

Composition of Administrative Council amended.

The number of members of BaFin's Administrative Council was reduced from 21 to 17. Instead of ten representatives from the financial industry, six persons with particular knowledge of the financial and insurance industry will now be represented on the Administrative Council. Table 42 shows the composition of the Administrative Council since 1 March 2013.

Table 42
### Composition of BaFin's Administrative Council

| FinDAG, old version | FinDAG, new version |
|---|---|
| Four representatives of the Federal Ministry of Finance (BMF) | Three representatives of the BMF |
| One representative of the Federal Ministry of Economics and Technology (BMWi) | One representative of the BMWi |
| One representative of the Federal Ministry of Justice (BMJ) | One representative of the BMJ |
| | One representative of the Federal Ministry of Food, Agriculture and Consumer Protection (BMELV) |
| Five members of the Bundestag | Five members of the Bundestag |
| Five representatives of credit institutions | Six persons with professional experience in or particular knowledge of banking, financial services, payment services, investment, venture capital, insurance, securities, or accounting, who are not employed by BaFin |
| Four representatives of insurance undertakings | |
| One representative of asset management companies | |

The interests of the supervised companies, which finance BaFin through fees and a cost allocation system, are taken into account by granting the relevant industry associations a right to be consulted before these persons are appointed. They can also submit proposals for three of the six experts. Further details are set out in BaFin's Articles of Association.[91]

Consumer Consultative Panel.

The financial crisis has highlighted the need for greater consumer protection. The complaints procedure for consumers and other customers of supervised companies, as well as for consumer protection organisations has therefore been set out for the first time in section 4b of the FinDAG.[92] In addition, a Consumer Consultative Panel is being set up at BaFin in accordance with section 8a of the FinDAG to better incorporate findings from consumers and consumer protection organisations in supervisory activities. The Consumer Consultative Panel is responsible for advising BaFin in its supervisory functions. To this end, the Consumer Consultative Panel may track and analyse consumer trends and report these to the Executive Board. However, it does not have a right to be consulted. The twelve members of the panel are appointed by the BMF and are to be drawn from the fields of academia, consumer or investor protection organisations, out-of-court dispute resolution entities, trade unions, as well as the Federal Ministry of Food, Agriculture and Consumer Protection.

#### Developments in supervisory activities

BaFin regularly reviews ways of making its supervisory activities more efficient, risk-based and forward-looking. Since the recent past has shown that crises are not limited to individual sectors, BaFin will focus even more strongly on the interrelationships between financial market participants. To be able to address the new challenges appropriately, BaFin restructured the "Risk and Financial Markets Analysis" department, renamed it "Analysis and Strategy" and allocated it to the President's areas of responsibility. Among other things, the Analysis and Strategy department will

[91] www.bafin.de/dok/2684006.
[92] See chapter VII 5.

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prepare for the Financial Stability Commission's meetings from BaFin's perspective and in doing so contribute to improving the links between macro-prudential and micro-prudential supervision. BaFin has established a section within the department whose tasks include advising and supporting the Executive Board in updating BaFin's strategic management and the associated resources planning.

Cross-Sectoral Risk Committee and Committee on Regulation and International Policy established.

BaFin established the new Cross-Sectoral Risk Committee, which also aims to bring together macro-prudential and micro-prudential issues, as well as the new Committee on Regulation and International Policy with effect from 1 January 2013. Both committees aim to help further strengthen the integrated financial supervision approach since they also address sector-specific topics on a cross-sector basis. They are responsible for developing proposals for decisions by BaFin's Executive Board and recommending courses of action to the individual areas. The focus is on issues of key strategic importance, which the committees evaluate and classify depending on their importance for BaFin.

**Cross-Sectoral Risk Committee**

The Cross-Sectoral Risk Committee aims to help further strengthen BaFin's forward-looking and risk-based supervisory activities. It identifies and documents those risks that are primarily relevant to BaFin's solvency supervision and market supervision. It assesses these risks and reports on them to the Executive Board. The Committee's work is based on internal and external analyses, as well as cross-enterprise comparisons conducted by BaFin or the Bundesbank. On the basis of this information, the Risk Committee draws up proposals for decisions by the Executive Board and recommends courses of action to the individual supervisory areas, allowing them to address these risks in their ongoing supervisory work.

At the same time, the Committee aims to ensure that macro-prudential supervision is even more closely integrated with micro-prudential supervision in future. The Risk Committee represents the interface between the Bundesbank's macro-prudential supervision and the newly established Financial Stability Commission.

The Cross-Sectoral Risk Committee succeeds BaFin's old area-specific risk committees. It comprises representatives from all BaFin areas, as well as representatives of the Bundesbank. The Committee is chaired by the head of BaFin's Analysis and Strategy department.

**Committee on Regulation and International Policy**

BaFin established the Committee on Regulation and International Policy to represent core German positions more effectively on international regulatory bodies. The Committee develops proposals for BaFin's Executive Board on how BaFin should position itself with regard to sector-specific issues (such as Solvency II) and cross-

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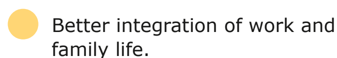
sector issues (such as the regulatory treatment of systematically important institutions and the shadow banking sector) and how it should assert this position at an international level. The Executive Board is ultimately responsible for agreeing BaFin's international objectives and strategies. The Committee coordinates and monitors the implementation of the Executive Board's decisions at BaFin and the extent to which targets are met.

Together with BaFin's International Policy/Affairs department, it also examines how BaFin implements global and European requirements. In particular, these include the Financial Sector Assessment Programs (FSAPs) developed by the International Monetary Fund and the World Bank, the peer reviews by the European Supervisory Authorities (ESAs) and the Financial Stability Board (FSB), guidelines and recommendations from the ESAs and warnings issued by the European Systemic Risk Board (ESRB).

The Committee is chaired by the head of BaFin's International Policy/Affairs department. The permanent members of the Committee consist of two heads of departments from each of BaFin's directorates. The President and the other members of BaFin's Executive Board are entitled to participate in meetings but are not permanent members.

### In-house day care centre in Frankfurt am Main

The new day care centre at BaFin's Frankfurt am Main office opened its doors on 1 October 2012. The centre can accommodate up to 25 children and has a baby and toddler group for children aged one to three years and a mixed-aged group for children aged one to six years. It is operated by a private provider and receives public subsidies.




By setting up the Frankfurt day care centre, BaFin is helping its employees to better integrate work and family life.

### Continuing professional development (CPD)

In 2012, 1,506 BaFin employees took part in at least one of a total of 575 CPD sessions offered (previous year: 1,409 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 5.38 days of training (previous year: 5.12 days).

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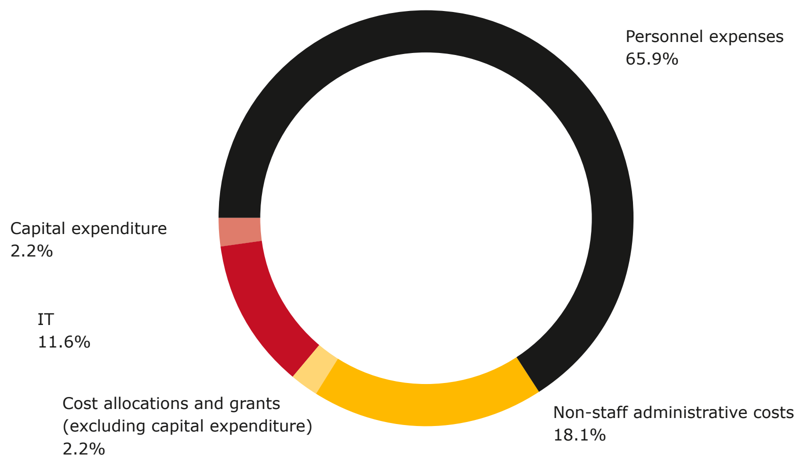
# 3 Budget

2012 budget: €170.3 million.

BaFin's Administrative Council approved a budget of €170.3 million for 2012 (previous year: €160.57 million). Personnel expenses accounted for around 65.9% of the projected expenditure (€112.3 million; previous year: €107.7 million) and non-staff costs for around 18.1% (€30.8 million; previous year: €28.5 million); 11.6% was allocated for IT expenses (previous year: 10.6%), while capital expenditure and cost allocations and grants each represented 2.2% of the budget (previous year: capital expenditure 2.6%, cost allocations and grants 2.0%).

Figure 33
**2012 budget expenditure**




BaFin is independent of the federal budget and is fully self-financed from its own income. Of this, over three-quarters is attributable to cost allocations levied on the supervised companies, a special levy with a financing function (projected figure for 2012: €150.9 million; previous year: €141.6 million). BaFin also finances itself from administrative income such as fees and interest (projected figure for 2012: €19.4 million; previous year: €18.9 million). The Federal Constitutional Court *(Bundesverfassungsgericht)* has confirmed that the cost allocations are compatible with higher law and are thus constitutional.[93]

[93] Federal Constitutional Court Karlsruhe, decision dated 16 September 2009 (case ref.: 2 BvR 852/07).

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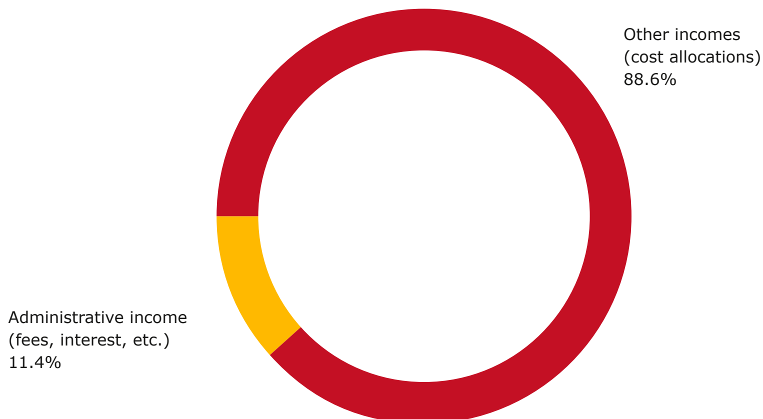
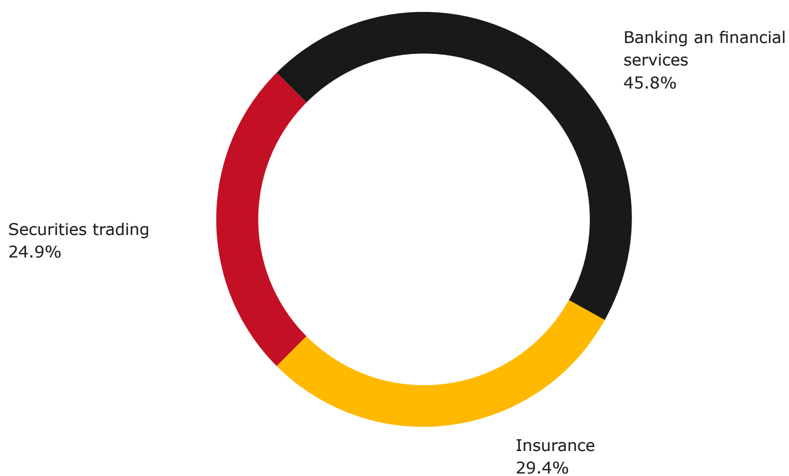
Figure 34
## 2012 budget income




The final cost allocation for 2011 was performed in 2012. The banking industry contributed 45.8% of the total income from cost allocations. The insurance sector financed 29.4% and the securities trading sector 24.9%. The final cost allocation for 2012 will be performed in the course of 2013.

Figure 35
## Cost allocations by supervisory area in 2011




**Securities trading – new cost allocation rules for BaFin**

The Act on the Strengthening of German Financial Supervision also brought with it changes to cost allocation at BaFin, effective 1 January 2013. Since then, all the rules governing cost allocation have been laid down in the FinDAG. The previous requirements set out in the FinDAGKostV have been incorporated into the FinDAG and therefore now have the full force of statute law.

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Lawmakers also broke down the cost allocation provisions more clearly by the individual supervisory areas in the Act. The provisions are now worded more understandably so as to aid transparency. BaFin has allocated its personnel expenses and non-staff costs to its three supervisory areas – Banking Supervision, Insurance Supervision and Securities Trading – ever since it was established in 2002. The cost allocation requirements and the assessment bases used in Banking Supervision and Insurance Supervision remain unchanged in terms of content. The same applies to the provisions governing minimum cost allocation amounts, as these have proven successful in the past. Only the wording of the provisions was modified.

The main content-related changes affect the cost allocations for the supervision of securities trading, where the provisions governing cost allocation, the entities liable to pay the cost allocation and the assessment base have changed. These cost allocation parameters for the Securities Trading supervisory area are set out in the amended sections 16i and 16j of the FinDAG. The first final cost allocation under the new law is expected to be performed in autumn 2014 for allocation year 2013.

The number of allocation groups in the Securities Trading supervisory area declined from four to two as at 1 January 2013. The issuer group remained unchanged; the only other group is now investment services enterprises. The old credit institutions, listed trading participants and financial services institutions allocation groups were rolled into the new group.

The amended cost allocation provisions in the Securities Trading supervisory area reflect the changed market conditions. The number of exchange participants admitted to trading has declined considerably, and securities trading supervision has also evolved since its inception. In particular, lawmakers have given BaFin additional responsibilities, such as enforcing the ban on short selling. The breakdown of costs across these two allocation groups is now more appropriate in terms of origin and use than in the past.

In addition, the provisions governing the time limit on cost allocation receivables were revised and brought into line with the planned Federal Fees Act (*Bundesgebührengesetz* – BGebG), for which a draft has already been published.[94]

Expenditure of €165.3 million, income of €166.4 million.

BaFin's actual expenditure in 2012 was approximately €165.3 million (previous year: €155.1 million). Its income amounted to approximately €166.4 million (previous year: €162.6 million). The Administrative Council still has to approve the annual financial statements.

Separate enforcement budget.

BaFin drew up a separate enforcement budget of €7.83 million (previous year: €7.8 million). This included an allocation to the German Financial Reporting Enforcement Panel (Deutsche Prüfstelle für Rechnungslegung) at the prior-year level (€6 million).

[94] Bundestag printed paper 17/10422.

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Actual expenditure amounted to around €7.5 million (previous year: €7.4 million), while income (including advance cost allocation payments for 2013) stood at approximately €15.2 million (previous year: €15.1 million).

# 4 Press and Public Relations

Results of the EBA recapitalisation survey.

BaFin answered a total of 3,416 press enquiries in 2012. One important banking supervision topic for the press was the results of the EU-wide recapitalisation survey conducted by the European Banking Authority (EBA). Bank restructuring plans, on which BaFin published a consultation circular containing minimum requirements in November 2012, also generated considerable media attention. A press conference on this issue was held in Bonn with the Executive Director of Banking Supervision. BaFin also received a large number of enquiries about the planned common European banking supervisor and about its cooperation with the European Central Bank (ECB) in future. Another important topic was the suspected manipulation of LIBOR and EURIBOR interest rates and BaFin's response to this. 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 Capital Requirements Directive IV (CRD IV) package, also generated a large number of press enquiries in 2012.

New adviser register met with great media interest.

BaFin also received a large number of press enquiries relating to securities supervision in 2012, in particular on the new Employee and Complaints Register that was launched on 1 November 2012. The Register is maintained by BaFin and is designed to better protect investors against wrongful advice by compiling information such as customer complaints about investment advisers. In addition, many media representatives were interested in market manipulation issues, particularly spam faxes or cold calls with buy recommendations for shares. Another media focus was the implementation of the Alternative Investment Fund Managers Directive (AIFM Directive). High-frequency trading on stock exchanges, which is to be subject to supervision in future, also attracted considerable media attention.

Enquiries about the situation in the insurance sector.

Insurance supervision-related enquiries in 2012 mainly concerned the situation in the German insurance sector. Media representatives were primarily interested in how the low interest rate phase is affecting the industry, the associated risks for companies and how they can address the problem. Journalists sought information on the *Zinszusatzreserve* (an additional provision to the premium reserve introduced in response to the lower interest rate environment), which life insurers were required to establish for the first time as from financial year 2011, the maximum technical interest rate for life and private health insurance, as well as alternative investment options that promise companies higher yields in times of lower interest rates. BaFin also received a large number of press enquiries about the transposition into German law of the European Court

of Justice's unisex ruling, as well as about the ban on passing on commissions and the latter's future. At a European level, important topics were the implementation of the Solvency II framework and the revision of the Directive on the activities and supervision of institutions for occupational retirement provision (IORP Directive).

Authorisation required for consumer credit.

In the past year, press representatives also wanted to know about illegal investment schemes – for example, a large number of enquiries were received about the purchase of second-hand life insurance policies and financial investments. BaFin had ruled that individual business models required authorisation and had prohibited them. The prohibition on small loans to consumers also received media coverage.

Cooperation with the Federal Criminal Police Office.

BaFin held its fourth joint press conference with the Federal Criminal Police Office (Bundeskriminalamt – BKA) at the end of October 2012. The BKA presented the annual report of the Financial Intelligence Unit (FIU) Germany, the central office for suspicious transaction reports. BaFin and the BKA also reported on their work to combat money laundering and terrorist financing and warned against the threat posed by electronic money (e-money) laundering.

Forum on White-collar Crime and the Capital Market.

BaFin hosted its ninth two-day Forum on White-collar Crime and the Capital Markets at the German National Library in Frankfurt am Main in September 2012. The event was attended by nearly 450 participants, including a large number of judges, public prosecutors and economic advisers, as well as representatives from police forces, 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 combatting insider trading and market manipulation.

Information for investors and other interested parties.

BaFin again took part in the "Invest" fair for investors held in Stuttgart in April 2012, as well as in stock exchange days in Dresden, Munich, Berlin and Hamburg, and the Federal Ministry of Finance's open day last year. BaFin primarily uses these events to disseminate information about its work and powers. It also uses the opportunity to inform investors of unfair market practices such as illegal financial transactions or cases of market manipulation.

BaFin published two new consumer publications in 2012. The flyer "Anlageberatung – Was Sie als Kunde beachten sollten" ("Investment advisory services – what consumers need to know" – only available in German) explains the consultation procedure with investment advisers at a bank or financial services provider to consumers. The second brochure provides information on the new Arbitration Board under the Investment Act, which was set up by BaFin in 2011. BaFin also reissued its "Wertpapiere – Was Sie als Anleger beachten sollten" brochure ("Securities – what investors need to know" – only available in German). This explains to retail investors what they should look out for before investing in securities.

# Appendix

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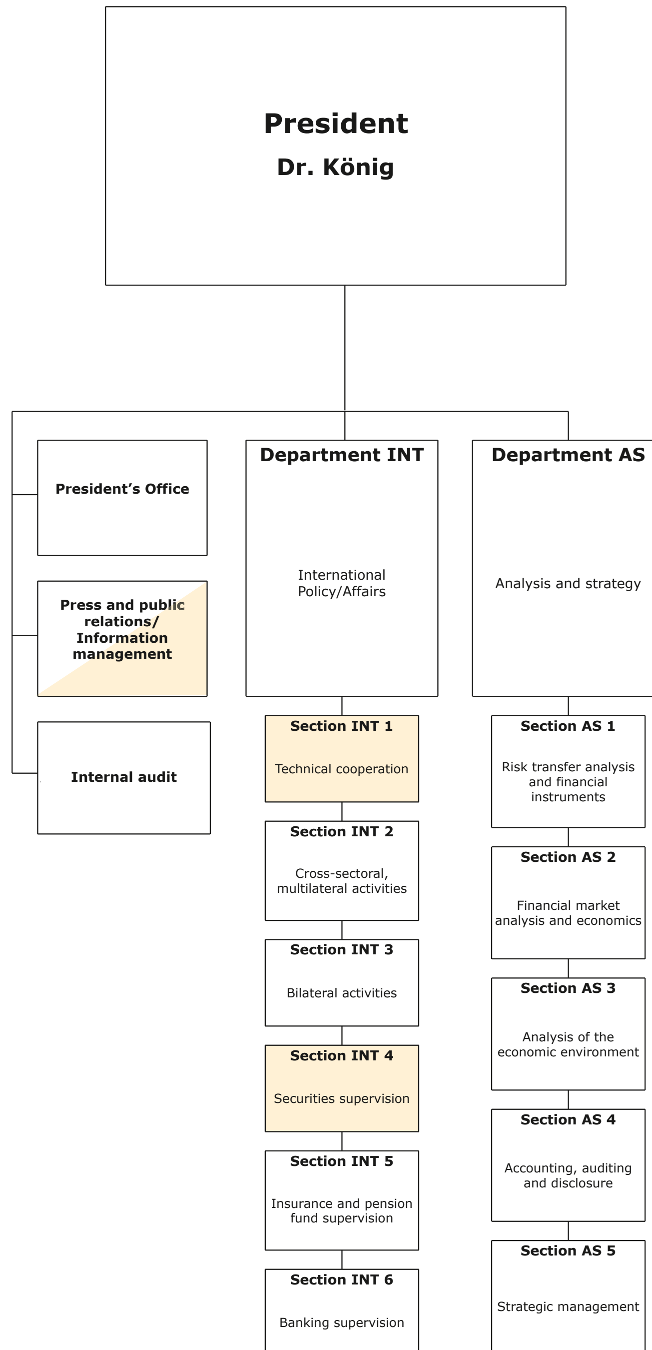
# Organisation chart




**Notes:**

Bonn office

Frankfurt office

Offices in Bonn and Frankfurt

As at March 2013

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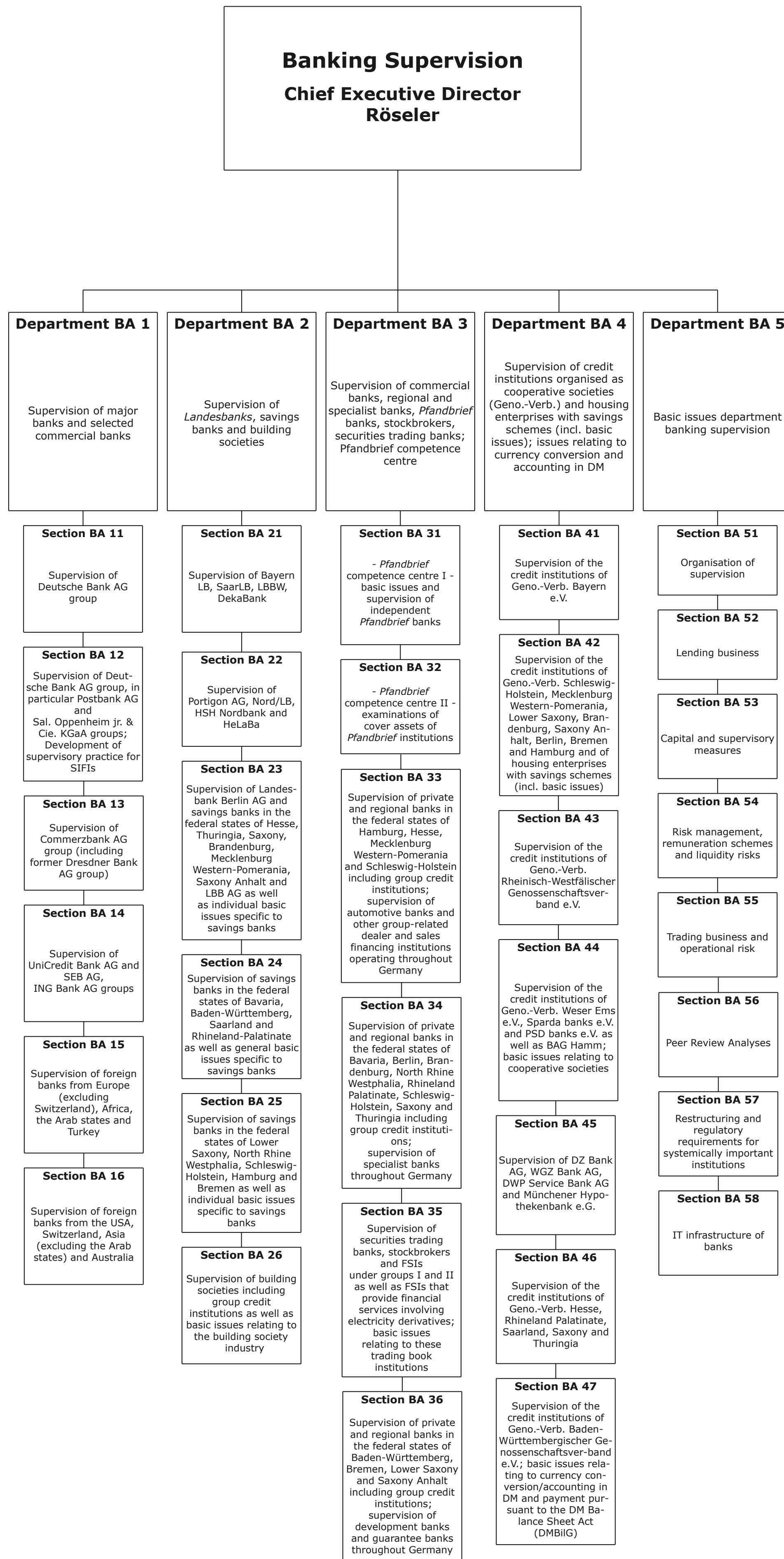

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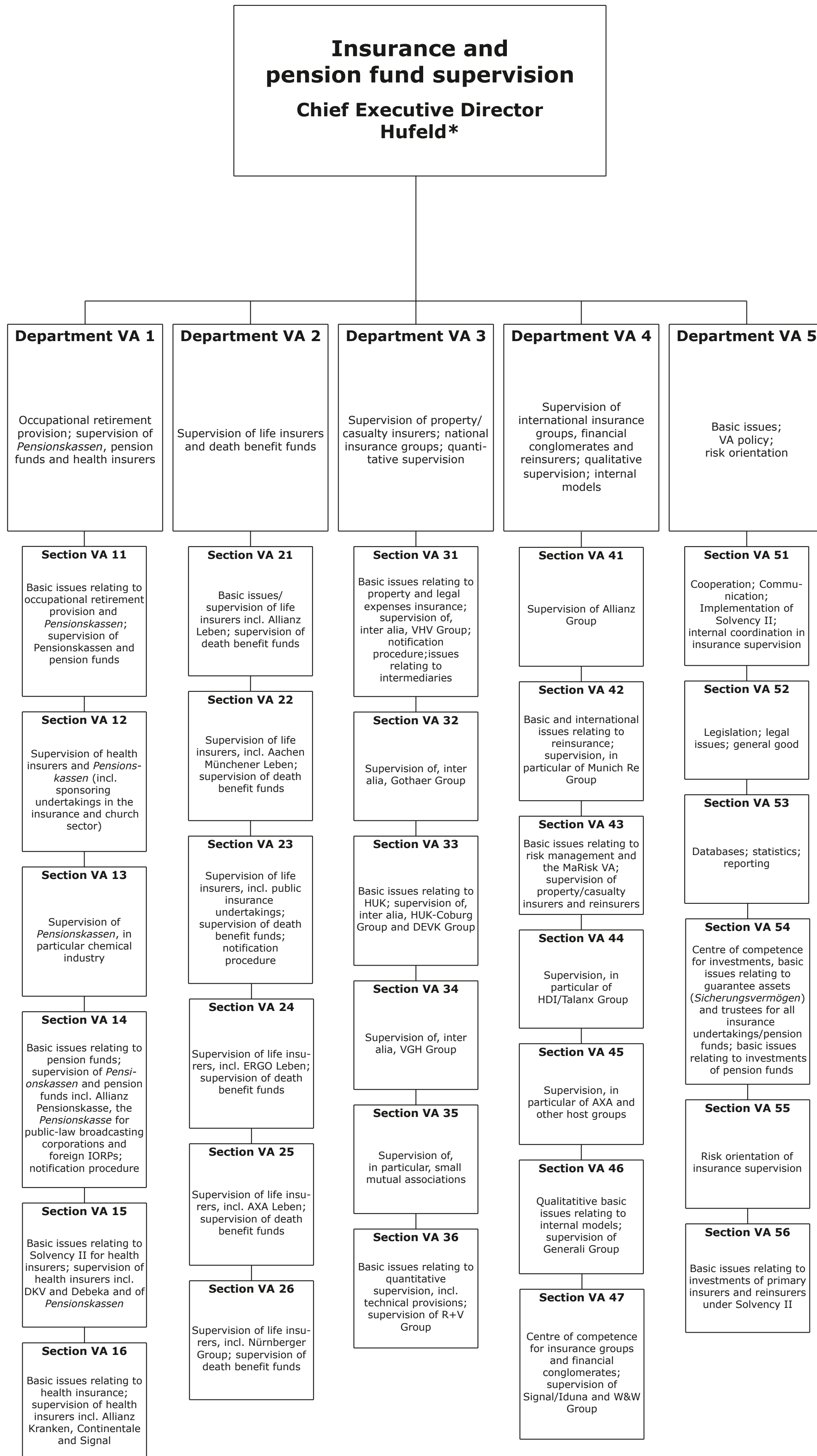


* Chief Executive Director since January 2013.

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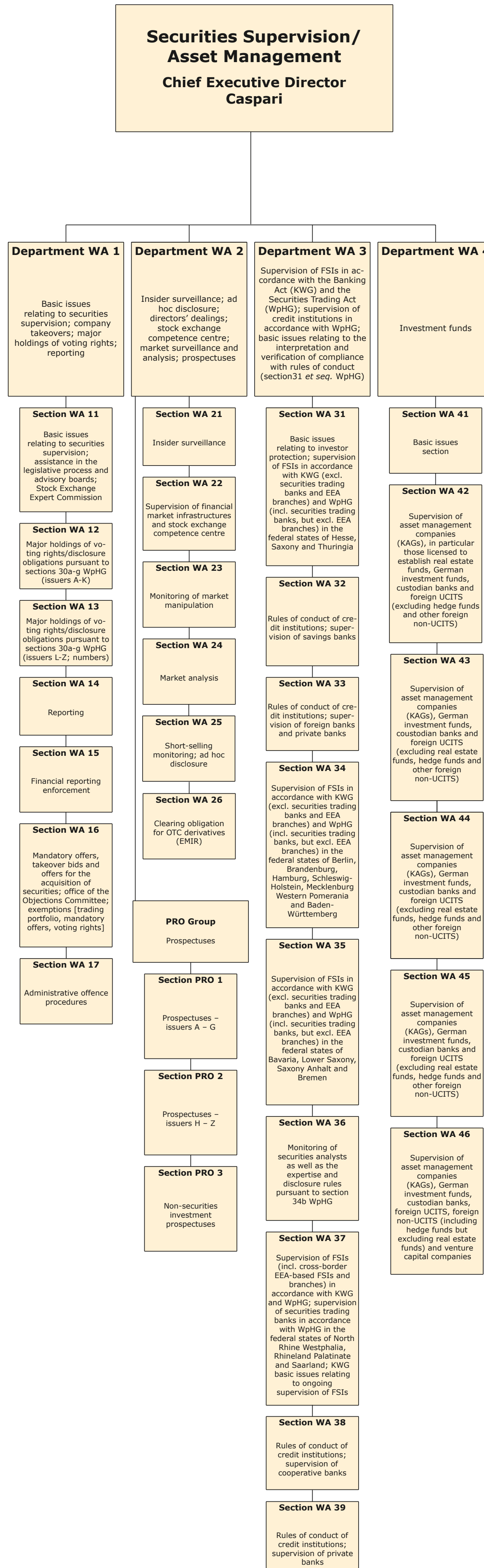

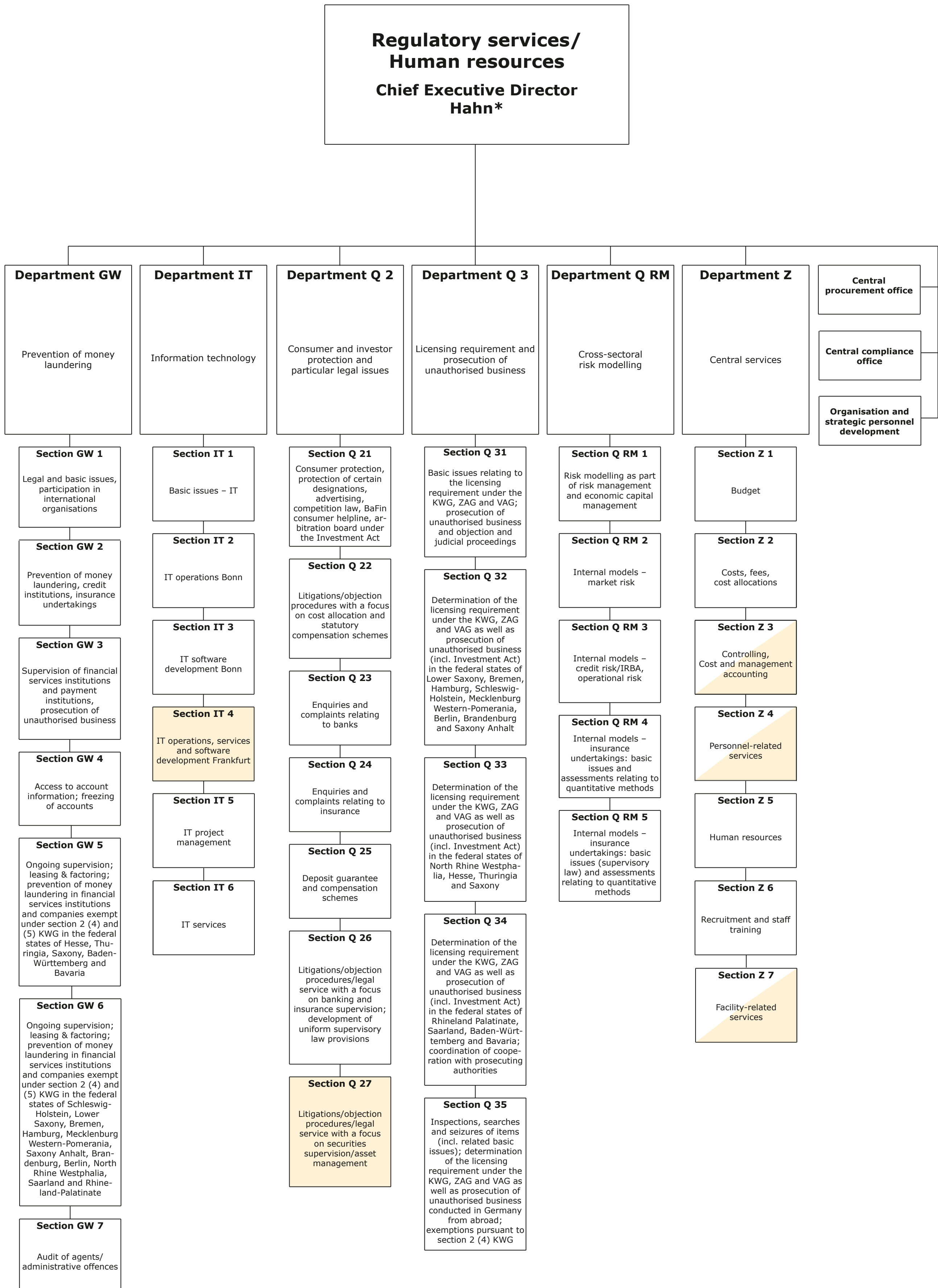


* Chief Executive Director of Regulatory Services/Human Resources, Gabriele Hahn, was Chief Executive Director of Insurance and Pension Fund Supervision until June 2012.

# BaFin bodies

## 2.1 Members of the Administrative Council

**Representing Federal Ministries**
Dr Thomas Steffen (Chairman – BMF)
Dr Levin Holle (Deputy chairman – BMF)
Corinna Westermann (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
Georg Fahrenschon
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 December 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
Dr Hartwig Hamm

**Representing insurance undertakings**
Dr Wolfgang Weiler
Dr Jörg Schneider
Dr Maximilian Zimmerer
Dr Jörg Freiherr Frank von Fürstenwerth

**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. Andreas Richter
Prof. Isabel Schnabel (Deputy chairman)

**Representing the Working Party on Occupational Retirement Provision**
Heribert Karch

**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**
Ralf Frank (DVFA)

**Representing the trade unions**
Beate Mensch (ver.di)

**Representing industry**
Folkhart Olschowy (Wacker Chemie AG)

As at December 2012

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## 2.3 Members of the Insurance Advisory Council

Dr Helmut Aden

Prof. Dr Christian Armbrüster

Dr Alexander Barthel

Lars Gatschke

Ira Gloe-Semler

Norbert Heinen

Michael H. Heinz

Werner Hölzl

Sabine Krummenerl

Uwe Laue

Katharina Lawrence

Dr Ursula Lipowsky

Adelheid Marscheider

Dr Torsten Oletzky

Prof. Dr Catherine Pallenberg

Prof. Dr Petra Pohlmann

Holger R. Rohde

Prof. Dr Heinrich R. Schradin

Reinhold Schulte

Ilona Stumm

Prof. Dr Manfred Wandt

Michael Wortberg

Dr Maximilian Zimmerer

Prof. Dr Jochen Zimmermann

As at March 2013

## 2.4 Members of the Securities Council

Baden-Württemberg 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, Labour and Ports

Free and Hanseatic City of Hamburg
Office of Economic Affairs, Transport and Innovation,
Commerce and Services

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 March 2013

# Complaints statistics for individual undertakings

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3.2 Life insurance
3.3 Health insurance
3.4 Motor vehicle insurance
3.5 General liability insurance
3.6 Accident insurance
3.7 Household contents insurance
3.8 Residential building insurance
3.9 Legal expenses insurance
3.10 Insurers based in the EEA

## 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 the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen – BAV), one of BaFin's predecessors, 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 2012 is compared with the number of policies in the respective insurance class as at 31 December 2011. 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 information on property and casualty insurance figures relates 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 2011

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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 (EEA) 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 2011 | Complaints |
|---|---|---|---|
| 1001 | AACHENMüNCHENER LEB. | 5,372,064 | 83 |
| 1006 | ALLIANZ LEBEN | 10,344,206 | 191 |
| 1007 | ALTE LEIPZIGER LEBEN | 1,124,935 | 28 |
| 1035 | ARAG LEBEN | 340,964 | 11 |
| 1303 | ASSTEL LEBEN | 316,091 | 23 |
| 1020 | AXA LEBEN | 1,721,239 | 61 |
| 1011 | BARMENIA LEBEN | 237,485 | 7 |
| 1028 | BASLER LEBEN | 776,039 | 23 |
| 1012 | BASLER LEBEN (CH) | 148,177 | 2 |
| 1013 | BAYER. BEAMTEN LEBEN | 283,500 | 6 |
| 1015 | BAYERN-VERS. | 1,774,764 | 21 |
| 1122 | CONCORDIA LEBEN | 141,368 | 4 |
| 1021 | CONDOR LEBEN | 210,734 | 2 |
| 1335 | CONTINENTALE LV AG | 633,567 | 16 |
| 1022 | COSMOS LEBEN | 1,379,780 | 34 |
| 1146 | DBV DEUTSCHE BEAMTEN | 1,708,465 | 28 |
| 1023 | DEBEKA LEBEN | 3,439,980 | 33 |
| 1017 | DELTA LLOYD LEBEN | 471,574 | 20 |
| 1136 | DEVK ALLG. LEBEN | 784,946 | 11 |
| 1025 | DEVK DT. EISENBAHN LV | 700,176 | 1 |
| 1110 | DIREKTE LEBEN | 132,604 | 1 |
| 1180 | DT. ÄRZTEVERSICHERUNG | 199,960 | 8 |
| 1148 | DT. LEBENSVERS. | 386,890 | 9 |
| 1130 | ERGO DIREKT LEBEN AG | 1,214,088 | 23 |
| 1184 | ERGO LEBEN AG | 5,702,749 | 129 |
| 1107 | EUROPA LEBEN | 456,901 | 3 |
| 1310 | FAMILIENFüRSORGE LV | 273,058 | 10 |
| 1139 | GENERALI LEBEN AG | 4,942,957 | 123 |
| 1108 | GOTHAER LEBEN AG | 1,150,770 | 34 |
| 1040 | HAMB. LEBEN | 23,401 | 3 |
| 1312 | HANNOVERSCHE LV AG | 870,342 | 22 |
| 1114 | HANSEMERKUR LEBEN | 210,520 | 5 |
| 1192 | HANSEMERKUR24 LV AG | 6,314 | 1 |
| 1033 | HDI LEBEN AG | 2,593,787 | 100 |
| 1158 | HEIDELBERGER LV | 442,564 | 26 |
| 1137 | HELVETIA LEBEN | 140,631 | 4 |
| 1055 | HUK-COBURG LEBEN | 705,202 | 8 |
| 1047 | IDEAL LEBEN | 547,603 | 6 |
| 1048 | IDUNA VEREINIGTE LV | 1,938,525 | 53 |
| 1330 | INTER LEBENSVERS. AG | 156,028 | 2 |
| 1045 | KARLSRUHER LV AG | 110,075 | 2 |
| 1062 | LEBENSVERS. VON 1871 | 710,296 | 18 |
| 1112 | LVM LEBEN | 783,049 | 7 |
| 1198 | MAMAX LEBEN | 16,111 | 1 |
| 1109 | MECKLENBURG. LEBEN | 166,170 | 2 |
| 1064 | MÜNCHEN. VEREIN LEBEN | 148,234 | 5 |
| 1134 | NEUE BAYER. BEAMTEN | 94,882 | 3 |
| 1164 | NEUE LEBEN LEBENSVERS | 876,439 | 9 |

| Reg. no. | Name of insurance undertaking | Number of life insurance policies 2011 | Complaints |
|---|---|---|---|
| 1131 | NÜRNBERGER BEAMTEN LV | 35,671 | 2 |
| 1147 | NÜRNBG. LEBEN | 2,938,932 | 136 |
| 1177 | OECO CAPITAL LEBEN | 32,424 | 3 |
| 1056 | OEFF. LEBEN BERLIN | 215,871 | 2 |
| 1194 | PB LEBENSVERSICHERUNG | 1,221,241 | 39 |
| 1123 | PLUS LEBEN | 111,100 | 1 |
| 1309 | PROTEKTOR LV AG | 143,818 | 10 |
| 1081 | PROV. LEBEN HANNOVER | 849,213 | 7 |
| 1083 | PROV.NORDWEST LEBEN | 1,797,441 | 24 |
| 1082 | PROV.RHEINLAND LEBEN | 1,361,287 | 20 |
| 1018 | RHEINLAND LEBEN | 282,884 | 5 |
| 1085 | R+V LEBEN | 64,521 | 6 |
| 1141 | R+V LEBENSVERS. AG | 4,127,219 | 47 |
| 1150 | SAARLAND LEBEN | 150,866 | 1 |
| 1157 | SKANDIA LEBEN | 352,472 | 29 |
| 1153 | SPARK.-VERS.SACHS.LEB | 497,480 | 6 |
| 1104 | STUTTGARTER LEBEN | 422,197 | 15 |
| 1091 | SV SPARKASSENVERS. | 1,739,072 | 11 |
| 1090 | SWISS LIFE AG (CH) | 876,061 | 37 |
| 1132 | TARGO LEBEN AG | 1,567,352 | 20 |
| 1092 | UNIVERSA LEBEN | 193,431 | 1 |
| 1093 | VER.POSTVERS. | 23 | 3 |
| 1140 | VICTORIA LEBEN | 1,519,379 | 63 |
| 1099 | VOLKSWOHL-BUND LEBEN | 1,344,512 | 26 |
| 1151 | VORSORGE LEBEN | 149,504 | 10 |
| 1160 | VPV LEBEN | 978,326 | 22 |
| 1005 | WÜRTT. LEBEN | 2,540,709 | 39 |
| 1103 | WWK LEBEN | 960,250 | 35 |
| 1138 | ZURICH DTSCH. HEROLD | 3,746,685 | 108 |

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## 3.3 Health insurance

| Reg. no. | Name of insurance undertaking | Number of persons insured as at 31. Dec. 2011 | Complaints |
|---|---|---|---|
| 4034 | ALLIANZ PRIV.KV AG | 2,456,612 | 158 |
| 4010 | ALTE OLDENBG. KRANKEN | 99,804 | 1 |
| 4142 | ALTE OLDENBURGER | 151,461 | 1 |
| 4112 | ARAG KRANKEN | 497,030 | 28 |
| 4095 | AXA KRANKEN | 1,488,680 | 154 |
| 4042 | BARMENIA KRANKEN | 1,251,336 | 44 |
| 4134 | BAYERISCHE BEAMTEN K | 1,050,684 | 59 |
| 4004 | CENTRAL KRANKEN | 1,851,290 | 343 |
| 4118 | CONCORDIA KRANKEN | 85,516 | 4 |
| 4001 | CONTINENTALE KRANKEN | 1,304,911 | 66 |
| 4028 | DEBEKA KRANKEN | 3,774,546 | 96 |
| 4131 | DEVK KRANKENVERS.-AG | 312,157 | 5 |
| 4044 | DKV AG | 4,424,312 | 198 |
| 4013 | DT. RING KRANKEN | 657,617 | 22 |
| 4121 | ENVIVAS KRANKEN | 348,166 | 3 |
| 4126 | ERGO DIREKT KRANKEN | 1,317,009 | 32 |
| 4053 | FREIE ARZTKASSE | 29,390 | 1 |
| 4119 | GOTHAER KV AG | 569,300 | 100 |
| 4043 | HALLESCHE KRANKEN | 629,561 | 55 |
| 4144 | HANSEMERKUR KRANKEN_V | 1,327,239 | 60 |
| 4122 | HANSEMERKUR S.KRANKEN | 4,775,678 | 1 |
| 4117 | HUK-COBURG KRANKEN | 925,720 | 37 |
| 4031 | INTER KRANKEN | 375,065 | 35 |
| 4011 | LANDESKRANKENHILFE | 398,027 | 21 |
| 4109 | LVM KRANKEN | 304,012 | 6 |
| 4123 | MANNHEIMER KRANKEN | 77,759 | 11 |
| 4037 | MÜNCHEN.VEREIN KV | 251,627 | 36 |
| 4125 | NÜRNBG. KRANKEN | 238,286 | 11 |
| 4080 | OPEL AKTIV PLUS | 94,654 | 1 |
| 4116 | R+V KRANKEN | 552,843 | 7 |
| 4002 | SIGNAL KRANKEN | 1,983,192 | 55 |
| 4039 | SÜDDEUTSCHE KRANKEN | 599,203 | 5 |
| 4108 | UNION KRANKENVERS. | 1,059,330 | 32 |
| 4045 | UNIVERSA KRANKEN | 360,945 | 20 |
| 4139 | WÜRTT. KRANKEN | 192,658 | 5 |

## 3.4 Motor vehicle insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 1,959,148 | 12 |
| 5135 | ADAC AUTOVERSICHERUNG | 965,301 | 14 |
| 5581 | ADLER VERSICHERUNG AG | n.a. | 2 |
| 5312 | ALLIANZ VERS. | 13,645,631 | 136 |
| 5441 | ALLSECUR DEUTSCHLAND | 582,647 | 20 |
| 5405 | ALTE LEIPZIGER VERS. | 398,131 | 2 |
| 5455 | ARAG ALLG. VERS. | n.a. | 2 |
| 5397 | ASSTEL SACH | 190,271 | 8 |
| 5155 | AXA EASY | n.a. | 2 |
| 5515 | AXA VERS. | 4,946,817 | 52 |
| 5593 | BAD. ALLG. VERS. | 188,795 | 3 |
| 5317 | BARMENIA ALLG. VERS. | 135,265 | 1 |
| 5633 | BASLER SECURITAS | 439,695 | 3 |
| 5310 | BAYER. BEAMTEN VERS. | 254,520 | 2 |
| 5324 | BAYER.VERS.VERB.AG | 1,972,955 | 9 |
| 5146 | BGV-VERSICHERUNG AG | 426,767 | 1 |
| 5098 | BRUDERHILFE SACH.AG | 391,563 | 3 |
| 5338 | CONCORDIA VERS. | 1,353,678 | 10 |
| 5339 | CONDOR ALLG. VERS. | 95,007 | 2 |
| 5340 | CONTINENTALE SACHVERS | 474,170 | 12 |
| 5552 | COSMOS VERS. | 618,362 | 9 |
| 5343 | DA DEUTSCHE ALLG.VER. | 1,450,834 | 48 |
| 5311 | DBV DT. BEAMTEN-VERS. | 677,166 | 1 |
| 5549 | DEBEKA ALLGEMEINE | 747,246 | 5 |
| 5084 | DTSCH. INTERNET | n.a. | 7 |
| 5513 | DEVK ALLG. VERS. | 3,570,166 | 36 |
| 5344 | DEVK DT. EISENB. SACH | 998,648 | 1 |
| 5055 | DIRECT LINE | 788,165 | 16 |
| 5562 | ERGO DIREKT | n.a. | 1 |
| 5472 | ERGO VERSICHERUNG | 2,491,542 | 37 |
| 5508 | EUROPA VERSICHERUNG | 446,415 | 10 |
| 5470 | FAHRLEHRERVERS. | 307,402 | 1 |
| 5024 | FEUERSOZIETÄT | 175,537 | 4 |
| 5505 | GARANTA VERS. | 741,842 | 9 |
| 5473 | GENERALI VERSICHERUNG | 2,584,376 | 22 |
| 5858 | GOTHAER ALLGEMEINE AG | 1,219,009 | 4 |
| 5469 | GVV-KOMMUNALVERS. | 145,228 | 2 |
| 5585 | GVV-PRIVATVERSICH. | 246,104 | 2 |
| 5131 | HANNOVERSCHE DIREKT | n.a. | 3 |
| 5501 | HANSEMERKUR ALLG. | n.a. | 3 |
| 5085 | HDI VERSICHERUNG | 2,684,151 | 42 |
| 5512 | HDI-GERLING FIRMEN | 1,139,107 | 33 |
| 5096 | HDI-GERLING INDUSTRIE | 958,264 | 2 |
| 5044 | HDNA VVAG | n.a. | 1 |
| 5384 | HELVETIA VERS. (CH) | 299,488 | 4 |
| 5375 | HUK-COBURG | 6,961,533 | 36 |
| 5521 | HUK-COBURG ALLG. VERS | 6,420,299 | 39 |

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5086 | HUK24 AG | 2,337,201 | 36 |
| 5401 | ITZEHOER VERSICHERUNG | 923,862 | 14 |
| 5078 | JANITOS VERSICHERUNG | 234,534 | 2 |
| 5058 | KRAVAG-ALLGEMEINE | 1,428,647 | 17 |
| 5080 | KRAVAG-LOGISTIC | 889,334 | 15 |
| 5402 | LVM SACH | 5,117,356 | 33 |
| 5061 | MANNHEIMER VERS. | 219,872 | 6 |
| 5412 | MECKLENBURG. VERS. | 797,562 | 4 |
| 5414 | MÜNCHEN. VEREIN ALLG | n.a. | 1 |
| 5426 | NÜRNBG. ALLG. | 163,688 | 1 |
| 5686 | NÜRNBG. BEAMTEN ALLG. | 224,654 | 2 |
| 5519 | OPTIMA VERS. | 133,616 | 5 |
| 5787 | OVAG – OSTDT. VERS. | n.a. | 17 |
| 5446 | PROV.NORD BRANDKASSE | 747,575 | 3 |
| 5095 | PROV.RHEINLAND VERS. | 1,268,375 | 6 |
| 5798 | RHEINLAND VERS. AG | 225,064 | 1 |
| 5438 | R+V ALLGEMEINE VERS. | 3,937,584 | 26 |
| 5137 | R+V DIREKTVERSICHER. | 154,821 | 13 |
| 5051 | S DIREKTVERSICHERUNG | 201,923 | 3 |
| 5690 | SCHWARZMEER U. OSTSEE | n.a. | 5 |
| 5448 | SCHWEIZER NATION.VERS. | n.a. | 1 |
| 5125 | SIGNAL IDUNA ALLG. | 1,077,568 | 8 |
| 5781 | SPARK.-VERS.SACHS.ALL | 193,527 | 2 |
| 5036 | SV SPARK.VERSICHER. | 824,745 | 5 |
| 5463 | UNIVERSA ALLG. VERS. | n.a. | 1 |
| 5042 | VERSICHERUNGSK.BAYERN | 158,475 | 2 |
| 5400 | VGH LAND.BRAND.HAN. | 1,895,141 | 11 |
| 5862 | VHV ALLGEMEINE VERS. | 3,999,054 | 37 |
| 5484 | VOLKSWOHL-BUND SACH | n.a. | 1 |
| 5093 | WESTF.PROV.VERS.AG | 1,379,836 | 1 |
| 5525 | WGV-VERSICHERUNG | 964,258 | 14 |
| 5479 | WÜRTT. GEMEINDE-VERS. | 976,632 | 3 |
| 5783 | WÜRTT. VERS. | 2,552,304 | 29 |
| 5476 | WWK ALLGEMEINE VERS. | 283,337 | 4 |

## 3.5 General liability insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 1,240,472 | 6 |
| 5312 | ALLIANZ VERS. | 4,481,656 | 50 |
| 5405 | ALTE LEIPZIGER VERS. | 217,839 | 3 |
| 5455 | ARAG ALLG. VERS. | 21,193,516 | 4 |
| 5397 | ASSTEL SACH | n.a. | 5 |
| 5515 | AXA VERS. | 3,137,026 | 38 |
| 5792 | BADEN-BADENER VERS. | n.a. | 1 |
| 5593 | BAD. ALLG. VERS. | n.a. | 1 |
| 5316 | BAD. GEMEINDE-VERS. | 2,733 | 1 |
| 5633 | BASLER SECURITAS | 258,966 | 2 |
| 5319 | BAYER. HAUSBESITZER | n.a. | 1 |
| 5324 | BAYER.VERS.VERB.AG | 1,056,828 | 6 |
| 5146 | BGV-VERSICHERUNG AG | 117,328 | 1 |
| 5098 | BRUDERHILFE SACH.AG | 218,331 | 1 |
| 5338 | CONCORDIA VERS. | 344,481 | 4 |
| 5340 | CONTINENTALE SACHVERS | 351,326 | 2 |
| 5552 | COSMOS VERS. | 315,417 | 3 |
| 5311 | DBV DT. BEAMTEN-VERS. | 551,173 | 2 |
| 5549 | DEBEKA ALLGEMEINE | 1,240,094 | 5 |
| 5513 | DEVK ALLG. VERS. | 1,114,255 | 8 |
| 5343 | DA DEUTSCHE ALLG.VER. | n.a. | 2 |
| 5129 | DFV DEUTSCHE FAM. VERS. | n.a. | 1 |
| 5328 | DOCURA VVAG | n.a. | 2 |
| 5472 | ERGO VERSICHERUNG | 1,797,231 | 40 |
| 5024 | FEUERSOZIETÄT | 153,830 | 1 |
| 5473 | GENERALI VERSICHERUNG | 1,870,953 | 31 |
| 5858 | GOTHAER ALLGEMEINE AG | 1,333,463 | 18 |
| 5469 | GVV-KOMMUNALVERS. | 2,865 | 1 |
| 5585 | GVV-PRIVATVERSICH. | n.a. | 2 |
| 5374 | HAFTPFLICHTK.DARMST. | 925,895 | 10 |
| 5501 | HANSEMERKUR ALLG. | n.a. | 2 |
| 5085 | HDI VERSICHERUNG | 675,488 | 4 |
| 5512 | HDI-GERLING FIRMEN | 686,789 | 4 |
| 5096 | HDI-GERLING INDUSTRIE | 15,232 | 4 |
| 5375 | HUK-COBURG | 1,927,341 | 13 |
| 5521 | HUK-COBURG ALLG. VERS | 1,165,966 | 8 |
| 5086 | HUK24 AG | 330,362 | 2 |
| 5546 | INTER ALLG. VERS. | 138,925 | 4 |
| 5057 | INTERLLOYD VERS.AG | n.a. | 1 |
| 5393 | ISSELHORSTER VERS | n.a. | 1 |
| 5401 | ITZEHOER VERSICHERUNG | 165,491 | 2 |
| 5078 | JANITOS VERSICHERUNG | 199,166 | 4 |
| 5058 | KRAVAG-ALLGEMEINE | n.a. | 2 |
| 5402 | LVM SACH | 1,188,718 | 3 |
| 5412 | MECKLENBURG. VERS. | 273,916 | 6 |
| 5334 | MEDIENVES.KARLSRUHE | n.a. | 2 |

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| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5426 | NÜRNBG. ALLG. | 320,605 | 9 |
| 5787 | OVAG – OSTDT. VERS. | n.a. | 2 |
| 5446 | PROV.NORD BRANDKASSE | 391,822 | 3 |
| 5095 | PROV.RHEINLAND VERS. | 834,015 | 6 |
| 5583 | PVAG | n.a. | 1 |
| 5798 | RHEINLAND VERS. AG | 95,093 | 2 |
| 5438 | R+V ALLGEMEINE VERS. | 1,723,476 | 25 |
| 5008 | SHB ALLGEMEINE | n.a. | 1 |
| 5125 | SIGNAL IDUNA ALLG. | 678,214 | 11 |
| 5781 | SPARK.-VERS.SACHS.ALL | 115,918 | 1 |
| 5036 | SV SPARK.VERSICHER. | 907,688 | 3 |
| 5459 | UELZENER ALLG. VERS. | 177,704 | 1 |
| 5042 | VERSICHERUNGSK.BAYERN | 16,263 | 1 |
| 5400 | VGH LAND.BRAND.HAN. | 723,612 | 2 |
| 5862 | VHV ALLGEMEINE VERS. | 996,363 | 15 |
| 5484 | VOLKSWOHL-BUND SACH | 130,556 | 1 |
| 5461 | VPV ALLGEMEINE VERS. | n.a. | 1 |
| 5093 | WESTF.PROV.VERS.AG | 804,971 | 5 |
| 5525 | WGV-VERSICHERUNG | 330,668 | 4 |
| 5783 | WÜRTT. VERS. | 1,178,490 | 18 |
| 5476 | WWK ALLGEMEINE VERS. | 143,487 | 4 |

## 3.6 Accident insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 1,633,682 | 11 |
| 5498 | ADAC – SCHUTZBRIEF VERS. | 3,598,107 | 4 |
| 5312 | ALLIANZ VERS. | 4,553,907 | 38 |
| 5068 | AMMELÄNDER VERS. | n.a. | 1 |
| 5455 | ARAG ALLG. VERS. | 21,040,634 | 2 |
| 5515 | AXA VERS. | 809,576 | 16 |
| 5792 | BADEN-BADENER VERS. | 276,274 | 6 |
| 5317 | BARMENIA ALLG. VERS. | 132,847 | 2 |
| 5633 | BASLER SECURITAS | 131,672 | 2 |
| 5310 | BAYER. BEAMTEN VERS. | 170,779 | 1 |
| 5324 | BAYER.VERS.VERB.AG | 683,407 | 3 |
| 5338 | CONCORDIA VERS. | 323,360 | 2 |
| 5340 | CONTINENTALE SACHVERS | 655,862 | 9 |
| 5343 | DA DEUTSCHE ALLG.VER. | n.a. | 1 |
| 5311 | DBV DT. BEAMTEN-VERS. | 216,551 | 3 |
| 5549 | DEBEKA ALLGEMEINE | 1,841,488 | 12 |
| 5513 | DEVK ALLG. VERS. | 854,117 | 4 |
| 5350 | DT. RING SACHVERS. | 345,259 | 5 |
| 5129 | DFV DEUTSCHE FAM.VERS. | n.a. | 2 |
| 5562 | ERGO DIREKT | 285,597 | 4 |
| 5472 | ERGO VERSICHERUNG | 2,618,616 | 56 |
| 5473 | GENERALI VERSICHERUNG | 3,632,354 | 15 |
| 5858 | GOTHAER ALLGEMEINE AG | 721,373 | 7 |
| 5501 | HANSEMERKUR ALLG. | 78,725 | 1 |
| 5085 | HDI VERSICHERUNG | 167,741 | 1 |
| 5512 | HDI-GERLING FIRMEN | 355,186 | 6 |
| 5096 | HDI-GERLING INDUSTRIE | 42,503 | 1 |
| 5384 | HELVETIA VERS. (CH) | 125,287 | 3 |
| 5375 | HUK-COBURG | 993,287 | 2 |
| 5521 | HUK-COBURG ALLG. VERS | 526,364 | 1 |
| 5573 | IDEAL VERS. | n.a. | 2 |
| 5546 | INTER ALLG. VERS. | 131,766 | 3 |
| 5780 | INTERRISK VERS. | 392,852 | 2 |
| 5393 | ISSELHORSTER VERS. | n.a. | 1 |
| 5401 | ITZEHOER VERSICHERUNG | n.a. | 1 |
| 5078 | JANITOS VERSICHERUNG | 153,222 | 3 |
| 5402 | LVM SACH | 875,018 | 5 |
| 5061 | MANNHEIMER VERS. | 72,972 | 1 |
| 5412 | MECKLENBURG. VERS. | 137,971 | 4 |
| 5070 | NECKERMANN VERS. | n.a. | 3 |
| 5426 | NÜRNBG. ALLG. | 575,347 | 29 |
| 5015 | NV-VERSICHERUNGEN | n.a. | 4 |
| 5017 | OSTANGLER BRANDGILDE | n.a. | 1 |
| 5074 | PB VERSICHERUNG | n.a. | 2 |
| 5446 | PROV.NORD BRANDKASSE | 342,827 | 2 |
| 5095 | PROV.RHEINLAND VERS. | 936,109 | 1 |

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5583 | PVAG POLIZEIVERS. | 318,266 | 3 |
| 5438 | R+V ALLGEMEINE VERS. | 1,527,748 | 3 |
| 5125 | SIGNAL IDUNA ALLG. | 1,743,969 | 11 |
| 5586 | STUTTGARTER VERS. | 437,527 | 5 |
| 5790 | TARGO VERSICHERUNG | 125,912 | 2 |
| 5463 | UNIVERSA ALLG. VERS. | n.a. | 3 |
| 5400 | VGH LAND.BRAND.HAN. | 5,504,264 | 2 |
| 5862 | VHV ALLGEMEINE VERS. | 311,997 | 3 |
| 5484 | VOLKSWOHL-BUND SACH | 177,764 | 1 |
| 5093 | WESTF.PROV.VERS.AG | 963,937 | 1 |
| 5783 | WÜRTT. VERS. | 715,218 | 7 |
| 5476 | WWK ALLGEMEINE VERS. | 240,539 | 4 |
| 5461 | VPV ALLGEMEINE VERS. | n.a. | 1 |
| 5590 | WÜRZBURGER VERSICHER. | n.a. | 1 |

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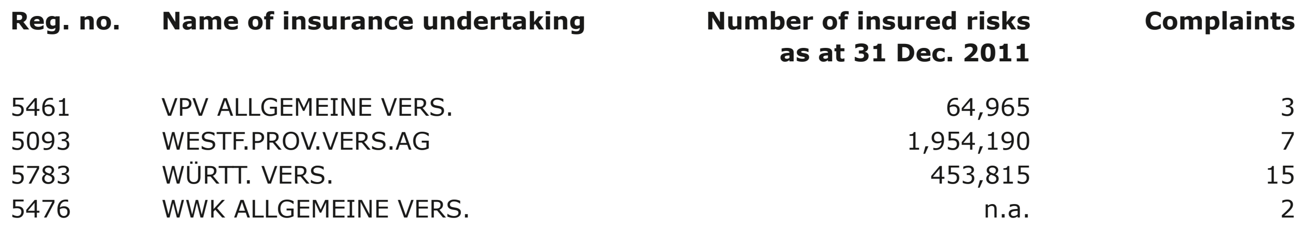
## 3.7 Household contents insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 884,307 | 9 |
| 5312 | ALLIANZ VERS. | 2,543,961 | 44 |
| 5405 | ALTE LEIPZIGER VERS. | 140,676 | 2 |
| 5068 | AMMERLÄNDER VERS. | n.a. | 9 |
| 5455 | ARAG ALLG. VERS. | 363,645 | 4 |
| 5397 | ASSTEL SACH | n.a. | 6 |
| 5515 | AXA VERS. | 1,182,427 | 11 |
| 5317 | BARMENIA ALLG. VERS. | n.a. | 1 |
| 5633 | BASLER SECURITAS | 204,552 | 3 |
| 5324 | BAYER.VERS.VERB.AG | 540,652 | 3 |
| 5146 | BGV-VERSICHERUNG AG | n.a. | 1 |
| 5098 | BRUDERHILFE SACH.AG | 188,725 | 2 |
| 5338 | CONCORDIA VERS. | 221,674 | 1 |
| 5311 | DBV DT. BEAMTEN-VERS. | 287,559 | 6 |
| 5549 | DEBEKA ALLGEMEINE | 742,166 | 5 |
| 5513 | DEVK ALLG. VERS. | 955,418 | 8 |
| 5344 | DEVK DT. EISENB. SACH | 484,812 | 3 |
| 5350 | DT. RING SACHVERS. | 172,861 | 2 |
| 5129 | DFV DEUTSCHE FAM.VERS | n.a. | 1 |
| 5328 | DOCURA VVAG | n.a. | 1 |
| 5562 | ERGO DIREKT | n.a. | 3 |
| 5472 | ERGO VERSICHERUNG | 1,154,456 | 27 |
| 5473 | GENERALI VERSICHERUNG | 1,392,616 | 13 |
| 5858 | GOTHAER ALLGEMEINE AG | 727,793 | 8 |
| 5372 | GOTHAER VERS.BANK | n.a. | 1 |
| 5485 | GRUNDEIGENTÜMER-VERS. | 1 | 1 |
| 5365 | GVO GEGNSEITIGKEIT | n.a. | 1 |
| 5374 | HAFTPFLICHTK.DARMST. | n.a. | 1 |
| 5085 | HDI VERSICHERUNG | 349,285 | 1 |
| 5512 | HDI-GERLING FIRMEN | 307,261 | 1 |
| 5375 | HUK-COBURG | 1,351,236 | 7 |
| 5521 | HUK-COBURG ALLG. VERS | 698,902 | 9 |
| 5086 | HUK24 AG | 174,287 | 1 |
| 5546 | INTER ALLG. VERS. | n.a. | 1 |
| 5780 | INTERRISK VERS. | 135,531 | 1 |
| 5401 | ITZEHOER VERSICHERUNGEN | n.a. | 2 |
| 5078 | JANITOS VERSICHERUNG | n.a. | 2 |
| 5404 | LBN | n.a. | 1 |
| 5402 | LVM SACH | 715,918 | 3 |
| 5061 | MANNHEIMER VERS. | 77,676 | 1 |
| 5412 | MECKLENBURG. VERS. | 173,361 | 1 |
| 5426 | NÜRNBG. ALLG. | 157,649 | 4 |
| 5015 | NV VERSICHERUNGEN | n.a. | 1 |
| 5787 | OVAG – OSTDT. VERS. | n.a. | 1 |
| 5446 | PROV.NORD BRANDKASSE | 291,908 | 1 |
| 5095 | PROV.RHEINLAND VERS. | 519,351 | 9 |
| 5798 | RHEINLAND VERS. AG | n.a. | 2 |

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5438 | R+V ALLGEMEINE VERS. | 926,368 | 5 |
| 5125 | SIGNAL IDUNA ALLG. | 331,961 | 3 |
| 5036 | SV SPARK.VERSICHER. | 447,521 | 1 |
| 5400 | VGH LAND.BRAND.HAN. | 477,858 | 2 |
| 5862 | VHV ALLGEMEINE VERS. | 315,942 | 2 |
| 5484 | VOLKSWOHL-BUND SACH | n.a. | 1 |
| 5461 | VPV ALLGEMEINE VERS. | 171,162 | 3 |
| 5093 | WESTF.PROV.VERS.AG | 2,358,279 | 1 |
| 5525 | WGV-VERSICHERUNG | 142,099 | 1 |
| 5783 | WÜRTT. VERS. | 764,197 | 8 |
| 5476 | WWK ALLGEMEINE VERS. | n.a. | 4 |

## 3.8 Residential building insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 350,547 | 7 |
| 5312 | ALLIANZ VERS. | 2,005,963 | 59 |
| 5405 | ALTE LEIPZIGER VERS. | 132,570 | 5 |
| 5455 | ARAG ALLG. VERS. | n.a. | 2 |
| 5515 | AXA VERS. | 686,702 | 24 |
| 5633 | BASLER SECURITAS | 159,969 | 7 |
| 5310 | BAYER. BEAMTEN VERS. | n.a. | 3 |
| 5319 | BAYER. HAUSBESITZER | 21,850 | 2 |
| 5043 | BAYER.L-BRAND.VERS.AG | 2,293,604 | 17 |
| 5324 | BAYER.VERS.VERB.AG | 654,900 | 11 |
| 5338 | CONCORDIA VERS. | 186,394 | 5 |
| 5339 | CONDOR ALLG. VERS. | 50,692 | 4 |
| 5340 | CONTINENTALE SACHVERS | 95,639 | 3 |
| 5311 | DBV DT. BEAMTEN-VERS. | 156,159 | 4 |
| 5549 | DEBEKA ALLGEMEINE | 230,735 | 1 |
| 5513 | DEVK ALLG. VERS. | 430,757 | 7 |
| 5350 | DT. RING SACHVERS. | 43,522 | 1 |
| 5522 | DOLLERUP.FREIE BRANDG | n.a. | 1 |
| 5472 | ERGO VERSICHERUNG | 540,269 | 19 |
| 5024 | FEUERSOZIETÄT | 87,778 | 1 |
| 5473 | GENERALI VERSICHERUNG | 586,064 | 14 |
| 5858 | GOTHAER ALLGEMEINE AG | 300,534 | 6 |
| 5485 | GRUNDEIGENTÜMER-VERS. | 70,344 | 1 |
| 5085 | HDI VERSICHERUNG | 145,243 | 3 |
| 5384 | HELVETIA VERS. (CH) | 174,662 | 2 |
| 5126 | HÜBENER VERSICHERUNG | n.a. | 3 |
| 5375 | HUK-COBURG | 600,565 | 3 |
| 5521 | HUK-COBURG ALLG. VERS | 201,909 | 3 |
| 5401 | ITZEHOER VERSICHERUNG | 46,437 | 2 |
| 5078 | JANITOS VERSICHERUNG | n.a. | 2 |
| 5402 | LVM SACH | 522,105 | 7 |
| 5061 | MANNHEIMER VERS. | 57,975 | 6 |
| 5412 | MECKLENBURG. VERS. | 101,032 | 3 |
| 5426 | NÜRNBG. ALLG. | 72,618 | 5 |
| 5446 | PROV.NORD BRANDKASSE | 317,098 | 3 |
| 5095 | PROV.RHEINLAND VERS. | 567,690 | 16 |
| 5798 | RHEINLAND VERS. AG | n.a. | 3 |
| 5121 | RHION VERSICHERUNG | n.a. | 1 |
| 5438 | R+V ALLGEMEINE VERS. | 962,530 | 14 |
| 5773 | SAARLAND FEUERVERS. | 76,361 | 2 |
| 5491 | SCHLESWIGER VERS.V. | n.a. | 1 |
| 5125 | SIGNAL IDUNA ALLG. | 149,424 | 8 |
| 5036 | SV SPARK.VERSICHER. | 2,047,888 | 24 |
| 5459 | UELZENER ALLG. VERS. | n.a. | 1 |
| 5042 | VERSICHERUNGSK.BAYERN | n.a. | 3 |
| 5400 | VGH LAND.BRAND.HAN. | 471,612 | 5 |
| 5862 | VHV ALLGEMEINE VERS. | 106,475 | 6 |



| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5461 | VPV ALLGEMEINE VERS. | 64,965 | 3 |
| 5093 | WESTF.PROV.VERS.AG | 1,954,190 | 7 |
| 5783 | WÜRTT. VERS. | 453,815 | 15 |
| 5476 | WWK ALLGEMEINE VERS. | n.a. | 2 |

## 3.9 Legal expenses insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2011 | Complaints |
|---|---|---|---|
| 5826 | ADAC-RECHTSSCHUTZ | 2,554,834 | 5 |
| 5809 | ADVO CARD RS | 1,506,211 | 35 |
| 5312 | ALLIANZ VERS. | 2,391,455 | 48 |
| 5405 | ALTE LEIPZIGER VERS. | 416,413 | 95 |
| 5455 | ARAG ALLG. VERS. | n.a. | 3 |
| 5800 | ARAG SE | 1,336,284 | 63 |
| 5801 | AUXILIA RS | 520,885 | 11 |
| 5838 | BADISCHE RECHTSSCHUTZ | 165,481 | 2 |
| 5310 | BAYER. BEAMTEN VERS. | n.a. | 13 |
| 5098 | BRUDERHILFE SACH.AG | 98,606 | 4 |
| 5831 | CONCORDIA RS | 410,815 | 11 |
| 5340 | CONTINENTALE SACHVERS | 93,701 | 2 |
| 5343 | DA DEUTSCHE ALLG.VER. | n.a. | 1 |
| 5802 | D.A.S. ALLG. RS | 2,742,198 | 77 |
| 5549 | DEBEKA ALLGEMEINE | 366,054 | 9 |
| 5803 | DEURAG DT. RS | 1,158,732 | 25 |
| 5829 | DEVK RECHTSSCHUTZ | 1,051,592 | 10 |
| 5129 | DFV DEUTSCHE FAM.VERS | n.a. | 3 |
| 5055 | DIRECT LINE | n.a. | 2 |
| 5834 | DMB RECHTSSCHUTZ | 816,822 | 31 |
| 5365 | GVO GEGENSEITIGKEIT | n.a. | 2 |
| 5501 | HANSEMERKUR ALLG. | n.a. | 1 |
| 5512 | HDI-GERLING FIRMEN | n.a. | 1 |
| 5096 | HDI-GERLING INDUSTRIE | 5,170 | 1 |
| 5827 | HDI-GERLING RECHT. | 475,973 | 14 |
| 5818 | HUK-COBURG RS | 1,561,992 | 19 |
| 5086 | HUK24 AG | 90,452 | 1 |
| 5573 | IDEAL VERS. | n.a. | 1 |
| 5401 | ITZEHOER VERSICHERUNG | n.a. | 4 |
| 5812 | JURPARTNER RECHTSSCH. | n.a. | 1 |
| 5815 | LVM RECHTSSCHUTZ | 726,916 | 6 |
| 5402 | LVM SACH | n.a. | 4 |
| 5412 | MECKLENBURG. VERS. | 141,870 | 5 |
| 5805 | NEUE RECHTSSCHUTZ | 403,991 | 9 |
| 5426 | NÜRNBERG: ALLG | n.a. | 2 |
| 5813 | OERAG RECHTSSCHUTZ | 1,417,525 | 19 |
| 5807 | ROLAND RECHTSSCHUTZ | 1,289,658 | 32 |
| 5438 | R+V ALLGEMEINE VERS. | 699,621 | 10 |
| 5459 | UELZENER ALLG. VERS. | n.a. | 1 |
| 5400 | VGH LAND.BRAND.HAN. | 182,299 | 3 |
| 5525 | WGV-VERSICHERUNG | 425,754 | 8 |
| 5479 | WÜRTT. GEMEINDE-VERS. | n.a. | 1 |
| 5783 | WÜRTT. VERS. | 651,994 | 10 |

## 3.10 Insurers based in the EEA

| Reg. no. | Abbreviated name of insurance undertaking | Complaints |
|---|---|---|
| 5902 | ACE EUROPEAN (GB) | 9 |
| 9053 | ADMIRAL INSURANCE(GB) | 4 |
| 5636 | AGA INTERNATION. (F) | 20 |
| 5029 | AIOI NISSAY (GB) | 3 |
| 1306 | ALICO LIFE INT. (IRL) | 1 |
| 7698 | ALICO LIFE INT. (IRL) | 3 |
| 7671 | ASPECTA ASSUR. (L) | 5 |
| 5119 | ASSURANT ALLG. (GB) | 1 |
| 7203 | ATLANTICLUX (L) | 14 |
| 1324 | ATLANTICLUX LEBEN (L) | 9 |
| 5064 | ATRADIUS KREDIT (NL) | 3 |
| 5090 | AXA CORPORATE S. (F) | 1 |
| 1319 | AXA LIFE EUR.LTD(IRL) | 10 |
| 7382 | BANK AUSTRIA (AT) | 1 |
| 5145 | BTA INSURANCE (LV) | 3 |
| 7811 | CACI LIFE LIM. (IRL) | 2 |
| 7807 | CACI NON-LIFE (IRL) | 1 |
| 1300 | CANADA LIFE (IRL) | 12 |
| 7786 | CANADA LIFE (IRL) | 2 |
| 1182 | CARDIF LEBEN (F) | 1 |
| 5056 | CARDIF VERS. (F) | 9 |
| 5595 | CHARTIS EUROPE (F) | 7 |
| 5142 | CHUBB INSUR. (GB) | 2 |
| 7690 | CIGNA LIFE INS. (B) | 2 |
| 7453 | CLERICAL MED.INV.(GB) | 23 |
| 7724 | CREDIT LIFE INT. (NL) | 20 |
| 7985 | CSS VERSICHERUNG (FL) | 29 |
| 7281 | DKV BELGIUM (B) | 2 |
| 5048 | DOMESTIC AND GEN.(GB) | 5 |
| 7256 | EAGLE STAR EUROP (RL) | 1 |
| 1161 | EQUITABLE LIFE (GB) | 1 |
| 5115 | EUROMAF SA (F) | 1 |
| 5053 | FINANCIAL INSUR.(GB) | 3 |
| 7410 | FOYER INTERNAT. (L) | 1 |
| 7814 | FRIENDS PROVID. (GB) | 5 |
| 7268 | GENERALI VERS. AG (A) | 1 |
| 7776 | GENWORTH FINANC. (GB) | 1 |
| 7270 | HANSARD EUROPE (IRL) | 1 |
| 5788 | INTER PARTNER ASS.(B) | 5 |
| 7587 | INTERN.INSU.COR.(NL) | 1 |
| 9031 | LIBERTY EURO.(IRL/E) | 5 |
| 9301 | LIBERTY SEGUROS (ES) | 2 |
| 7007 | LLOYD‘S OF LONDON(GB) | 3 |
| 5592 | LLOYD‘S VERS. (GB) | 5 |
| 5054 | LONDON GENERALI I. (GB) | 1 |
| 5130 | MAPFRE ASISTENC.(E) | 1 |
| 7828 | MASSMUTUAL (L) | 1 |

| Reg. no. | Abbreviated name of insurance undertaking | Complaints |
|---|---|---|
| 1323 | MONUTA VERS. (NL) | 1 |
| 7579 | NEMIAN LIFE & P. (L) | 1 |
| 7897 | NUCLEUS LIFE AG (FL) | 1 |
| 7723 | PRISMALIFE AG (FL) | 22 |
| 7455 | PROBUS INSURANCE(IRL) | 2 |
| 9062 | PRUDENTIAL ASS. (GB) | 1 |
| 7894 | QUANTUM LEBEN AG(FL) | 2 |
| 1317 | R+V LUXEMB. LV (L) | 4 |
| 7415 | R+V LUXEMBOURG L (L) | 6 |
| 9158 | RCI INSURANCE (M) | 2 |
| 9159 | RCI INSURANCE (MT) | 1 |
| 7730 | RIMAXX (NL) | 9 |
| 5127 | SOGECAP RISQUES (F) | 1 |
| 5128 | SOGECAP DNL (F) | 1 |
| 1320 | STANDARD LIFE (GB) | 7 |
| 7763 | STONEBRIDGE (GB) | 4 |
| 7878 | SWISS LIFE (FL) | 1 |
| 9000 | SWISSLIFE ASS. (F) | 17 |
| 5157 | TELEFONICA INSURANCE (L) | 4 |
| 7883 | TELEFONICA INSURANCE (LU) | 1 |
| 9241 | UK GENERAL INS. (IRL) | 1 |
| 1311 | VDV LEBEN INT. (GR) | 7 |
| 7456 | VDV LEBEN INTERN.(GR) | 39 |
| 7643 | VIENNA-LIFE (FL) | 3 |
| 7483 | VORSORGE LUXEMB. (L) | 4 |
| 9085 | WEALTH-ASSURANCE (FL) | 1 |
| 5151 | ZURICH INSURANCE(IRL) | 95 |

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# Abbreviations

| | | |
|---|---|---|
| A | **ABS** | asset-backed security |
| | **ACP** | Autorité de Contrôle Prudentiel |
| | **ADR** | Alternative Dispute Resolution |
| | **AfW** | *Bundesverband Finanzdienstleistung e.V.* (Federal Financial Services Association) |
| | **AG** | *Aktiengesellschaft* (German stock corporation) |
| | **AGB** | General Terms and Conditions |
| | **AIF** | Alternative Investment Fund |
| | **AIFM** | Alternative Investment Fund Manager |
| | **AKIM** | *Arbeitskreis Interne Modelle* (Internal Models Working Group) |
| | **AktG** | *Aktiengesetz* (Stock Corporation Act) |
| | **AMA** | Advanced Measurement Approach |
| | **AMLC** | Sub-Committee on Anti-Money Laundering |
| | **AnlV** | Anlageverordnung (Investment Regulation) |
| | **AS** | Analysis and strategy |
| | **ASC** | Advisory Scientific Committee |
| | **ATC** | Advisory Technical Committee |
| B | **BA** | *Bankenaufsicht* (Banking Supervision) |
| | **BaFin** | *Bundesanstalt für Finanzdienstleistungsaufsicht* (Federal Financial Supervisory Authority) |
| | **BAV** | *Bundesaufsichtsamt für das Versicherungswesen* (Federal Insurance Supervisory Office) |
| | **BayernLB** | Bayerische Landesbank |
| | **BCBS** | Basel Committee on Banking Supervision |
| | **BDDK** | Bankacilik Düzenleme ve Denetleme Kurumu |
| | **BGB** | *Bürgerliches Gesetzbuch* (Civil Code) |
| | **BGBl.** | *Bundesgesetzblatt* (Federal Law Gazette) |
| | **BGebG** | *Bundesgebührengesetz* (Federal Fees Act) |
| | **BGH** | *Bundesgerichtshof* (Federal Court of Justice) |
| | **BGHZ** | *Entscheidungssammlung des BGH in Zivilsachen* (Decisions of the BGH in civil matters) |
| | **BI** | Banca d'Italia |
| | **BIS** | Bank for International Settlements |
| | **BKA** | *Bundeskriminalamt* (Federal Criminal Police Office) |
| | **BMELV** | *Bundesministerium für Ernährung, Landwirtschaft und Verbraucherschutz* (Federal Ministry of Food, Agriculture and Consumer Protection) |
| | **BMF** | *Bundesministerium der Finanzen* (Federal Ministry of Finance) |
| | **BMI** | *Bundesministerium des Innern* (Federal Ministry of the Interior) |
| | **BMJ** | *Bundesministerium der Justiz* (Federal Ministry of Justice) |
| | **BMWi** | *Bundesministerium für Wirtschaft und Technologie* (Federal Ministry of Economics and Technology) |
| | **BO** | branch office business |
| | **BoE** | Bank of England |
| | **BoS** | Board of Supervisors |
| | **BSC** | Banking Supervision Committee |

| | | |
|---|---|---|
| | **BVerwG** | *Bundesverwaltungsgericht* (Federal Administrative Court) |
| **C** | **CBS** | cross-border provision of services |
| | **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 |
| | **CEU EF** | Credit Efficiency United Ekonomisk Förening |
| | **CFD** | contract for difference |
| | **CFTC** | US Commodity Futures Trading Commission |
| | **CH** | Confoederatio Helvetica (Switzerland) |
| | **CIRC** | China Insurance Regulatory Commission |
| | **CLN** | credit-linked note |
| | **CLO** | collateralised loan obligation |
| | **CMA** | Capital Market Authority |
| | **CMBS** | commercial mortgage backed security |
| | **CMG** | Crisis Management Group |
| | **CNAV** | constant net asset value |
| | **Co.** | Compagnie |
| | **CO2** | carbon dioxide |
| | **COM** | commission |
| | **Corp.** | corporation |
| | **CPD** | continuing professional development |
| | **CPSS** | Committee on Payment and Securities Settlement Systems |
| | **CRA** | credit rating agency |
| | **CRD** | Capital Requirements Directive |
| | **CRR** | Capital Requirements Regulation |
| | **CSRC** | China Securities Regulatory Commission |
| | **CSSF** | Commission de Surveillance du Secteur Financier |
| **D** | **DAX** | *Deutscher Aktienindex* |
| | **DK** | *Deutsche Kreditwirtschaft* (German Banking Industry Committee) |
| | **DM** | *Deutsche Mark* |
| | **DMBilG** | *D-Marktbilanzgesetz* (DM Balance Sheet Act) |
| | **DSGV** | *Deutscher Sparkassen- und Giroverband* (German Savings Banks Association) |
| | **D-SIBs** | domestic systemically important banks |
| | **DVFA** | *Deutsche Vereinigung für Finanzanalyse und Asset Management* (Society of Investment Professionals in Germany) |
| **E** | **e.G.** | *eingetragene Genossenschaft* (registered cooperative society) |
| | **e.V.** | *eingetragener Verein* (registered association) |
| | **EAA** | *Erste Abwicklungsanstalt* |
| | **EBA** | European Banking Authority |
| | **EC** | European Community/electronic cash |
| | **ECB** | European Central Bank |
| | **ECJ** | European Court of Justice |
| | **EdB** | *Entschädigungseinrichtung deutscher Banken* (Compensation Scheme of German Banks) |

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| | |
|---|---|
| **EdW** | *Entschädigungseinrichtung der Wertpapierhandelsunternehmen* (Compensatory Fund of Securities Trading Companies) |
| **EEA** | European Economic Area |
| **EEX** | European Energy Exchange |
| **EFSF** | European Financial Stability Facility |
| **EG** | *Einführungsgesetz* (Introductory Act) |
| **EIOPA** | European Insurance and Occupational Pensions Authority |
| **EMIR** | European Market Infrastructure Regulation |
| **e-money** | electronic money |
| **ESA** | European Supervisory Authority |
| **ESFS** | European System of Financial Supervision |
| **ESM** | European Stability Mechanism |
| **ESMA** | European Securities and Markets Authority |
| **ESRB** | European Systemic Risk Board |
| **ETF** | exchange-traded fund |
| **EU** | European Union |
| **EURIBOR** | European Interbank Offered Rate |

## F

| | |
|---|---|
| **f., ff.** | and the following |
| **FAQ** | frequently asked questions |
| **FATF** | Financial Action Task Force on Money Laundering |
| **FinaV** | *Finanzinformationenverordnung* (Financial Information Regulation) |
| **FinDAG** | *Finanzdienstleistungsaufsichtsgesetz* (Act Establishing the Federal Financial Supervisory Authority) |
| **FinDAGKostV** | *Verordnung über die Erhebung von Gebühren und die Umlegung von Kosten nach dem Finanzdienstleistungsaufsichtsgesetz* (Regulation on the Imposition of Fees and Allocation of Costs Pursuant to the FinDAG) |
| **FINMA** | Swiss Financial Market Supervisory Authority |
| **FINREP** | Financial Reporting |
| **FinStabG** | *Gesetz zur Überwachung der Finanzstabilität* (Financial Stability Act) |
| **FIU** | Financial Intelligence Unit |
| **FMA** | Financial Market Authority (Austria, Liechtenstein) |
| **FMSA** | *Bundesanstalt für Finanzmarktstabilisierung* (Federal Agency for Financial Market Stabilisation) |
| **FROB** | Fondo de Reestructuración Ordenada Bancaria |
| **FREP** | Financial Reporting Enforcement Panel *(Deutsche Prüfstelle für Rechnungslegung)* |
| **FSA** | Financial Services Authority |
| **FSAP** | Financial Sector Assessment Program |
| **FSB** | Financial Stability Board |
| **FSF** | Financial Stability Forum |
| **FSI** | Financial Stability Institute/ financial services institution |
| **FSS** | Financial Supervisory Service |

## G

| | |
|---|---|
| **G20** | The Group of Twenty |
| **GADOI** | Georgia Department of Insurance |
| **GBP** | pound sterling |
| **GDP** | gross domestic product |

| | | |
|---|---|---|
| | **GDV** | *Gesamtverband der Deutschen Versicherungswirtschaft e.V.* (German Insurance Association) |
| | **GewO** | *Gewerbeordnung* (Industrial Code) |
| | **GHoS** | Governors and Heads of Supervision |
| | **GIIPS** | Greece, Ireland, Italy, Portugal and Spain |
| | **GIZ** | *Gesellschaft für Internationale Zusammenarbeit* (Agency for International Cooperation) |
| | **GmbH** | *Gesellschaft mit beschränkter Haftung* (German private limited company) |
| | **GPC** | General Policy Conditions |
| | **GroMiKV** | *Großkredit- und Millionenkreditverordnung* (Regulation Governing Large Exposures and Loans of €1.5 million or More) |
| | **G-SIBs** | global systemically important banks |
| | **G-SIIs** | global systemically important insurers |
| | **GW** | *Geldwäsche* (money laundering) |
| | **GwG** | *Geldwäschegesetz* (Money Laundering Act) |
| | **GwOptG** | *Gesetz zur Optimierung der Geldwäscheprävention* (Act on Optimising the Prevention of Money Laundering) |
| **H** | **HeLaBa** | Landesbank Hessen-Thüringen Girozentrale |
| | **HGB** | *Handelsgesetzbuch* (Commercial Code) |
| | **HVB** | HypoVereinsbank |
| **I** | **IAASB** | International Auditing and Assurance Standards Board |
| | **IADI** | International Association of Deposit Insurers |
| | **IAIS** | International Association of Insurance Supervisors |
| | **IAS** | International Accounting Standards |
| | **IASB** | International Accounting Standards Board |
| | **IdW** | *Institut der Wirtschaftsprüfer in Deutschland e.V.* (Institute of Public Auditors in Germany) |
| | **IFG** | *Informationsfreiheitsgesetz* (Freedom of Information Act) |
| | **IFRS** | International Financial Reporting Standard |
| | **IMD** | Insurance Mediation Directive |
| | **IMG** | Internal Monitoring Group |
| | **IMF** | International Monetary Fund |
| | **Inc.** | incorporated company |
| | **InstitutsVergV** | *Institutsvergütungsverordnung* (Remuneration Ordinance for Institutions) |
| | **INT** | International Policy/Affairs |
| | **InvG** | *Investmentgesetz* (Investment Act) |
| | **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 |
| | **IT** | information technology |
| | **IU** | insurance undertaking |
| **J** | **JC** | Joint Committee |
| | **JCFC** | Joint Committee on Financial Conglomerates |
| | **JF** | Joint Forum |

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| | | |
|---|---|---|
| | **JFSC** | Jersey Financial Services Commission |
| | **JPY** | Japanese yen |
| **K** | **KAG** | *Kapitalanlagegesellschaft* (asset management company) |
| | **KAGB** | *Kapitalanlagegesetzbuch* (Investment Code) |
| | **KG** | *Kommanditgesellschaft* (German limited partnership) |
| | **KGaA** | *Kommanditgesellschaft auf Aktien* (German partnership limited by shares) |
| | **KID** | key information document |
| | **KNF** | Komisja Nadzoru Finansowego |
| | **KWG** | *Kreditwesengesetz* (Banking Act) |
| **L** | **LB** | *Landesbank* |
| | **LBB** | Landesbank Berlin Holding AG |
| | **LBBW** | Landesbank Baden-Württemberg |
| | **LG** | *Landgericht* (Regional Court) |
| | **LI** | life insurance |
| | **LIBOR** | London Interbank Offered Rate |
| **M** | **MaComp** | *Mindestanforderungen an die Compliance* (Minimum Requirements for the Compliance Function) |
| | **MaRisk** | *Mindestanforderungen an das Risikomanagement* (Minimum Requirements for Risk Management) |
| | **MAS** | Monetary Authority of Singapore |
| | **MaSan** | *Mindestanforderungen an die Ausgestaltung von Sanierungsplänen* (Minimum Requirements for the Design of Recovery Plans) |
| | **MiFID** | Markets in Financial Instruments Directive |
| | **MMF** | money market fund |
| | **MoU** | memorandum of understanding |
| | **MTF** | multilateral trading facility |
| **N** | **n.a.** | not applicable |
| | **NPL** | non-performing loan |
| | **no.** | number |
| | **NYSBD** | New York State Banking Department |
| | **OCC** | Office of the Comptroller of the Currency |
| | **ODR** | online dispute resolution |
| | **OECD** | Organisation for Economic Co-operation and Development |
| | **OIS** | overnight index swap |
| | **OJ** | Official Journal |
| | **OLG** | *Oberlandesgericht* (Higher Regional Court) |
| | **OMT** | Outright Monetary Transaction |
| | **ORSA** | Own Risk and Solvency Assessment |
| | **OTC** | over-the-counter |
| | **OTF** | organised trading facility |
| | **OTS** | Office of Thrift Supervision |
| | **OVG** | *Oberverwaltungsgericht* (Higher Administrative Court) |
| | **OWiG** | *Ordnungswidrigkeitengesetz* (Act on Breaches of Administrative Regulations) |
| **P** | **P account** | *Pfändungsschutzkonto* (garnishment protection account) |

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| | | |
|---|---|---|
| | **p.** | page |
| | **PEP** | politically exposed person |
| | **PF** | pension fund |
| | **PfandBG** | *Pfandbriefgesetz* (Pfandbrief Act) |
| | **PLC** | public limited company |
| | **PRIP** | packaged retail investment product |
| | **PRO** | Prospectuses |
| | **Prof.** | Professor |
| | **PrüfbV** | *Prüfungsberichtsverordnung* (Audit Report Regulation) |
| | **PSI** | private sector involvement |
| **Q** | **Q** | quarter/Regulatory services |
| | **QIS** | quantitative impact study |
| **R** | **RC** | Risk Committee |
| | **RechVersV** | *Verordnung über die Rechnungslegung von Versicherungsunternehmen* (Regulation on Insurance Accounting) |
| | **REIT** | real estate investment trust |
| | **repo** | repurchase agreement |
| | **RfB** | *Rückstellung für Beitragsrückerstattung* (provision for bonuses and rebates) |
| | **RMBS** | residential mortgage backed security |
| | **RS** | *Rechtsschutz* (legal protection) |
| **S** | **S&P** | Standard & Poor's |
| | **S.A.** | Société Anonyme |
| | **SBV** | State Bank of Vietnam |
| | **S.C.A.** | Société en Commandite par Actions |
| | **SCR** | Solvency Capital Requirement |
| | **SdK** | *Schutzgemeinschaft der Kapitalanleger e.V.* (German Association for the Protection of Investors) |
| | **SE** | Societas Europaea |
| | **SEC** | Securities and Exchange Commission |
| | **SEPA** | Single Euro Payments Area |
| | **SIB** | systemically important bank |
| | **SIE** | Supervisory Intensity and Effectiveness group |
| | **SIFI** | systemically important financial institution |
| | **SIG** | Standards Implementation Group |
| | **SMP** | Securities Markets Programme |
| | **SMS** | short message service |
| | **SoFFin** | *Sonderfonds* Finanzmarktstabilisierung (Financial Market Stabilisation Fund) |
| | **SolvV** | *Solvabilitätsverordnung* (Solvency Regulation) |
| | **SPE** | special purpose entity |
| | **SPV** | special purpose vehicle |
| | **SREP** | Supervisory Review and Evaluation Process |
| | **SROs** | self-regulatory organisations |
| | **SSC** | State Securities Commission |
| | **SSG** | Senior Supervisors Group |
| | **SSM** | Single Supervisory Mechanism |
| | **StGB** | *Strafgesetzbuch* (Criminal Code) |
| | **StPO** | *Strafprozessordnung* (Code of Criminal Procedure) |

**T**

| | |
|---|---|
| **TBN** | Takeover Bids Network |
| **TEHG** | *Treibhausgas-Emissionshandelsgesetz* (Greenhouse Gas Emissions Trading Act) |
| **TFCM** | Task Force on Crisis Management |
| **TVEST** | tvest Hamburg financial planning GmbH |

**U**

| | |
|---|---|
| **UCITS** | Undertakings for Collective Investment in Transferable Securities |
| **UK** | United Kingdom |
| **UN** | United Nations |
| **US** | United States |
| **USA** | United States of America |
| **US$** | US dollar |

**V**

| | |
|---|---|
| **VA** | *Versicherungsaufsicht* (Insurance Supervision) |
| **VAG** | *Versicherungsaufsichtsgesetz* (Insurance Supervision Act) |
| **VAG-E** | *Entwurf zum Versicherungsaufsichtsgesetz* (draft Insurance Supervision Act) |
| **ver.di** | *Vereinte Dienstleistungsgewerkschaft* |
| **VERS.** | *Versicherung* (insurance) |
| **VG** | *Verwaltungsgericht* (Administrative Court) |
| **VGH** | *Verwaltungsgerichtshof* (Higher Administrative Court) |
| **VIB** | *Vermögensanlagen-Informationsblatt* (Key Investor Information Document) |
| **VO** | *Verordnung* (Regulation) |
| **VVaG** | *Versicherungsverein auf Gegenseitigkeit* (mutual insurance association) |
| **VVG** | *Versicherungsvertragsgesetz* (Insurance Contract Act) |
| **VVG-InfoV** | *Verordnung über Informationspflichten bei Versicherungsverträgen* (Regulation on Information Obligations for Insurance Contracts) |
| **VwGO** | *Verwaltungsgerichtsordnung* (Rules of the Administrative Courts) |

**W**

| | |
|---|---|
| **WA** | *Wertpapieraufsicht* (Securities Supervision) |
| **WpDVerOV** | *Wertpapierdienstleistungs- Verhaltens- und Organisationsverordnung* (Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises) |
| **WpHG** | *Wertpapierhandelsgesetz* (Securities Trading Act) |
| **WpPG** | *Wertpapierprospektgesetz* (Securities Prospectus Act) |
| **WpÜG** | *Wertpapiererwerbs- und Übernahmegesetz* (Securities Acquisition and Takeover Act) |

**Z**

| | |
|---|---|
| **Z** | Central services |
| **ZAG** | *Zahlungsdiensteaufsichtsgesetz* (Payment Services Supervision Act) |

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