BaFin

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

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Texts marked with this symbol contain information on investor and consumer protection.

Interview with BaFin's President

Dr Elke König takes a stand

Six years after the outbreak of the crisis, what conclusions would you draw?

▶ Highly positive ones. The banks are more robust now, and we as supervisors can take preventive action in many issues earlier on. We have implemented more tightly knit structures in Germany and Europe, and new bodies are monitoring the financial market as a whole. We've also made significant progress at the global level.

Would bank supervisors have the right tools at their disposal if there were to be a new crisis?

▶ Well, we can't foresee what the future will bring, but we have a different awareness today for the fact that things might go wrong – and international cooperation has changed, too. If German banks get into difficulties, BaFin can now demand that they divest businesses that are preventing resolution, to give just one example. Resolution planning has also reached an advanced stage at the European level, too. However, we still need to find a global solution to the problem of how to resolve global banks. Going it alone at the national level is no help. Another positive example is the new European banking supervision, which will become operational in 2014.

What do you expect it to achieve?

▶ That it fully meets the expectations that have rightly been placed in it: the goal is to increase safety and for confidence in the market to be restored. Banks today operate on a cross-border basis. A purely national approach to supervision has not been enough for some time now. However, that doesn't mean that national supervisory authorities will become obsolete. On the contrary: the European Central Bank and the national supervisors will have to cooperate.

What are the most burning issues that need to be tackled apart from European banking supervision?

▶ To start with, there's obviously the implementation of the EU Capital Requirements Regulation and Capital Requirements Directive. We also have to address the implementation of bank restructuring and resolution, especially as regards bail-ins and the Single Resolution Mechanism. In addition, the European Commission has published its proposals for separating commercial and investment banking. And last but not least, we have to deal with the fallout from the manipulation of a number of different benchmarks.

The German government's Coalition Agreement proposes to significantly extend BaFin's role in the area of consumer protection. Is this the right thing to do?

▶ To be precise: the aim is to further strengthen our existing consumer protection role. Collective consumer protection and public-interest activities have always been part of our mandate, even though a different impression is often given in the media. Solvency supervision and consumer protection are not necessarily mutually incompatible. In fact, efficient solvency supervision is one of our most effective consumer protection weapons. We also have a number of other efficient consumer protection tools at our disposal, such as in the areas of securities and insurance supervision. Nevertheless, it is true that we need to look closely at more than whether and how we wish to regulate the unregulated capital market. We need to ask ourselves at a fundamental level if and how we want to introduce additional regulations governing product development, the suitability of certain products for certain investors, and how financial investments are marketed. We will contribute to this debate – both here in Germany and in the relevant European bodies.

Life insurers are continuing to suffer from the prolonged period of low interest rates. Are they going to have to look for new business models?

▶ Low interest rates are a problem for all institutions with long-term investments, including life insurers. The *Zinszusatzreserve* – the additional provision to the premium reserve introduced in response to the lower interest rate environment – imposes a burden on undertakings, but it is a necessary and important one. It is the only way that insurers will be able to meet their obligations in the long term. Our stress tests and forecasts show that they will be able to do this in the medium term. Nevertheless, the sector must redesign its products and develop a more diversified product range. And in fact it has already started doing so. In addition, a critical review of cost structures and naturally also of the investments involved is required. Investments in real estate, infrastructure and corporate bonds are interesting topics. However, care must be taken to ensure that the undertakings have the necessary expertise for this. In addition, the rules governing participation in the valuation reserves should be changed, which would benefit policyholders as a group.

Solvency II is now on the home straight. Good things come to those who wait – does this proverb apply to insurers and supervisors in this case?

▶ Yes it does. Everyone involved now has the planning certainty that was so urgently needed. The preparatory phase in the period up to 2016 will not be easy. But it will be worth it in the end. If each and every insurer is individually responsible for transparently assessing its risk situation in future, this will help improve risk management in difficult market situations in particular. Consequently, BaFin will implement all guidelines issued by EIOPA in preparation for the new Solvency II supervisory regime. We expect undertakings to forecast their expected solvency position under Solvency II in a timely manner.

Securities supervision is having to handle two major sets of European regulations simultaneously. What effect will the AIFM Directive and EMIR have?

▶ They are triggering a minor revolution. The Act Implementing the AIFM Directive (*Gesetz zur Umsetzung der AIFM-Richtlinie*), which is aimed at managers of alternative investment funds, introduced the Investment Code (*Kapitalanlagegesetzbuch*) and hence put the supervision of German investment funds on a new footing. And it is not just the terminology that has changed. The Code sets out comprehensive rules detailing the management and custody requirements for all investment funds, including closed-ended funds. EMIR – the European Regulation on OTC derivatives, central counterparties and trade repositories – will make the derivatives markets more transparent and reduce the danger of contagion. The work on implementing EMIR is now focusing on setting up the comprehensive reporting of derivatives transactions to the trade repository.

I Highlights

1 Low interest rates

Low key interest rates, extensive liquidity support, government bond purchases: central banks around the world have calmed the financial markets by taking measures whose side effects – historically low interest rates – are now causing serious problems for some players.

1.1 Insurers and pension funds under pressure

Life insurers and – to an even greater extent – *Pensionskassen* are among those affected. They will be able to meet their benefit obligations in the short and medium term. However, as long as interest rates remain at such a low level, income from investments will decline faster than the guaranteed interest in the portfolio. For this reason, a number of measures will have to be implemented to equip life insurers and *Pensionskassen* for the future.

Lawmakers have already taken one decisive step in this direction: for three years now, life insurers have had to establish a *Zinszusatzreserve* (an additional provision to the premium reserve) to offset the fall in investment income. Initially, establishing the *Zinszusatzreserve* is a heavy burden on the sector, which spent a good €6 billion on this in 2013 alone. Nevertheless, the *Zinszusatzreserve* is the right tool for equipping insurers for periods of persistently low interest rates.

Another step, which is very important for policyholders collectively, should follow: the current arrangements for policyholder participation in the valuation reserves funded by fixed-income securities have an unpleasant side effect. Insurers are forced to pay out very high amounts to their few outgoing customers precisely in an environment of declining and low interest rates. This siphons off funds from the much larger group of remaining customers. An arrangement should therefore be found which fairly balances the interests of outgoing customers with those of policyholders as a whole.

Acting with foresight

Further steps will have to follow – especially on the part of the insurance undertakings. They

need to act cautiously and with foresight and be prudent when setting the annual discretionary bonuses paid to policyholders, as well as any dividend payments. In addition, of course, they have to regularly subject their investments and cost structures to critical analysis. *Pensionskassen* should discuss the need for any additional funds with their sponsoring companies in good time.

New approaches to designing products

No matter how important the existing portfolio, the way forward lies above all in product design. The objective is to develop differentiated and balanced offerings that are positioned between traditional guarantee products and purely unit-linked policies, with which investors may theoretically suffer the total loss of their investments. There are three deciding factors for customers: their risks should be limited, their retirement provision should be calculable and the product should be as transparent and understandable as possible. Initial steps in this direction can already be observed, and BaFin encourages undertakings to continue on this path.

1.2 Credit institutions in the low interest rate environment

The low interest rates also pose a problem for building societies – one which can only be solved if appropriate countermeasures are taken. The institutions concerned identified this problem years ago and adjusted the interest rates underlying their tariffs. However, if market interest rates remain at their current low levels for the long term, several of them will have to consider a further reduction of the interest rates for new tariffs.

Risks for banks

The low interest rates also have disadvantages for the many credit institutions that grant long-term loans and refinance themselves on a short-term basis, for example through customer deposits. Nobody can seriously predict how interest rates will develop. This makes it all the more important for the institutions to have sufficient capital to meet all eventualities. There are no own funds requirements (yet) for the interest rate risk in the banking book. For this reason, BaFin had already tightened the requirements for calculating the effects of interest rate shocks back in 2011. The interest rate risk in the banking book currently falls under Pillar 2 of the Basel regulatory framework, which deals with risk management. The institutions must have adequate risk management and be able to manage their interest rate risk, as well as being ready to respond to the various interest rate scenarios with appropriate courses of action. The central question each bank has to face is where and how it can generate, now and in future, the income it needs for long-term survival in the market. The key criterion is that the institution pursues a sustainable business strategy. This has been a requirement under BaFin's Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk) since 2009, when it included this issue in response to the financial crisis. Since the beginning of this year, banks have also been required by law to "define a business strategy aimed at ensuring the sustainable development of the institution". If a business strategy is not sustainable, BaFin can take formal measures.

2 Collective consumer protection

Consumer protection has always been one of BaFin's core responsibilities. Solvency supervision is among its most effective weapons in this area. However, BaFin also has efficient instruments in other branches of supervision that it can use to ensure consumers are protected. The key elements of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG), for example, include rules designed to protect investors, and these have

repeatedly been tightened, especially in recent years. This means that Securities Supervision is able to enforce standards of behaviour that ensure transparency and fairness in the financial markets.

In recent years, BaFin's role has been extended to include numerous new investor and consumer protection functions – investment advice minutes (*Beratungsprotokoll*) and the Employee and Complaints Register (*Mitarbeiter- und Beschwerderegister*) are only two examples of many. There are solid reasons for both, even though the financial sector has repeatedly cast doubt on them in public. BaFin is not opposed to justified criticism. However, it is beyond dispute that investment advice can only serve its purpose if clients can trust their advisers. This was not always the case in the past.

Collective consumer protection is continuing to gain importance for BaFin. Since summer 2013, a Consumer Advisory Council (*Verbraucherbeirat*) has advised it on issues relating to consumer protection. A number of regulatory changes are being worked on in Brussels, and the issue also has a prominent place in the coalition agreement between Germany's governing parties.

For example, we need to ask ourselves whether and to what extent the unregulated capital market should be supervised. This is where providers conduct business that does not require authorisation from BaFin and that is not supervised by BaFin. It is not feasible for BaFin to supervise each and every company, as it does for good reason in the case of banks and insurers. Nor can it be expected to examine the returns promised by all companies. This would turn the state into the judge of every commercial activity. For this reason, BaFin focuses its attention, for example, on the transparency of product information and the question as to which products may in future be distributed to whom and through what channels.

It is true, though, that consumers have to protect themselves and that they therefore have to act on their own responsibility – for example by gathering sufficient information and developing a healthy measure of scepticism. Nobody should invest in a product that they do not understand, and all investors should know that there is a link between the promised return on an investment and its risk.

3 Manipulation of reference rates

The accusations that key reference rates had been manipulated continued to cause uproar in 2013. Initially the main focus was on LIBOR and Euribor. Then suspicions arose of irregularities in determining reference rates for the foreign exchange and precious metal markets. These accusations are particularly serious since – unlike LIBOR and Euribor – these reference rates are typically not based on bank estimates, but on actual transactions in liquid markets.

Reform projects do not go far enough

The accusations of manipulation have damaged confidence in the processes for creating and using all types of reference rates above and beyond individual sectors. Comprehensive regulation and effective supervision are intended to help restore trust. The first regulatory steps at European and global level have already been taken, and others are being prepared. In Brussels, amendments to the Market Abuse Directive are about to be finalised, for example, which will make the manipulation of benchmarks a criminal offence. In September 2013, the European Commission presented a proposal for regulating reference rates, which includes comprehensive rules for creating and using reference rates, along with extended supervisory powers. From BaFin's point of view, the draft regulation falls into the same category as all previous reform projects: they are headed in the right direction, but do not go far enough.

Trading on state-supervised venues

The draft addresses one key aspect in particular: reference rates should, wherever possible, be based on data from real transactions in future. Expert assessments will continue to be permissible, but only if they can be documented and verified. Although this would represent progress, the Commission's proposal is largely based on self-regulation. The data used in determining reference rates is to be fully documented in future. However, it is to be analysed and examined by an independent, but private supervisory body.

This prompts two questions: who will check whether these private supervisory bodies are really independent? And can these bodies verify whether reference interest rates have been honestly determined? This is doubtful.

The markets for money market transactions, foreign exchange and precious metals are decentralised. A large proportion of trading is bilateral and not conducted on exchanges or similar platforms. Private supervisory bodies can therefore observe and supervise only a relatively small section of market activity.

For this reason, the reforms need to go one step further: market transparency and market supervision are only possible if the countless data flows on the markets concerned are centralised. Trading in these markets should be moved as far as possible to transparent trading venues that are directly or indirectly state-supervised – something that is planned for OTC derivatives with the reform of the Markets in Financial Instruments Directive (MiFID).

4 Supervisory reform

Banking, insurance and securities supervision are currently undergoing radical change. Large-scale reforms – some of them resulting from the lessons learned during the financial crisis – have been adopted or are in the pipeline.

4.1 New banking regulations

In June 2013, the European Commission published the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR). Significant components of this enormous legislative package, which among other things implements Basel III in Europe, have applied since the beginning of January. The Directive has been implemented in Germany by way of the CRD IV Implementation Act (*CRD-IV-Umsetzungsgesetz*), whereas the Regulation is directly applicable in all member states.

In the recent past, fundamental criticism has repeatedly been voiced of the risk sensitivity of the Basel regulatory framework. BaFin does see the need for improvement in this respect. Change is required, for example, in the treatment of government bonds, which is sometimes indiscriminate and is not risk sensitive. It encourages banks to invest in government bonds to an extent that is excessive – including from a risk perspective – and that leads to increased interdependencies between governments and banks. However, a move away from risk sensitivity and a return to Basel I, which sowed the seeds for the subprime crisis, would be a mistake in BaFin's opinion.

4.2 Systemically important institutions

One of the most urgent regulatory tasks following the outbreak of the financial crisis was and still is to rid governments of the obligation to save systemically important banks in an emergency. These institutions will in future be required to maintain particularly large amounts of capital and will be subject to particularly close supervision. If they nevertheless experience distress, their recovery or resolution must be possible – across national borders and

without impacting the general public. This would not be possible without a globally standardised and effective cross-border recovery and resolution regime. Although such a regime does not exist as yet, the main building blocks are expected to be in place by the time the G20 summit takes place in autumn 2014. In autumn 2011, the Financial Stability Board (FSB) had published a blueprint for this purpose, the "Key Attributes of Effective Resolution Regimes for Financial Institutions".

The European Union is making good progress in this area. The Council, Commission and Parliament have reached agreement at technical level on a directive establishing a framework for the recovery and resolution of credit institutions and investment firms. Progress has also been made with the Single Resolution Mechanism (SRM) Regulation, which will be part of the European banking union: the Council reached consensus on a general approach in the run-up to Christmas 2013 and the trialogue negotiations are expected to be completed before the end of the European Parliament's legislative period. Next, the Commission will submit its proposals for separating commercial and investment banking.

Germany – a pioneer and shaper

The Restructuring Act (*Restrukturierungsgesetz*) of 2011 and the Ringfencing Act (*Risikoabschirmungsgesetz*), which entered into force in August 2013, make Germany a pioneer in these areas and have secured the country a significant role in shaping developments in Brussels. For example, Germany successfully negotiated a clear sequence of liability as part of the Recovery and Resolution Directive: owners and creditors will be called on first. They are liable for any losses incurred by their bank and have to ensure it is recapitalised before the resolution fund, for example, and – as a very last resort – the taxpayers have to bear the costs. In other words: more bail-in and less bail-out.

The Single Resolution Mechanism must have legal certainty. The decision processes should be clearly defined and efficient, because resolutions cannot be delayed. The decision as to whether and how a bank is to be resolved will in future be taken by the board of a central resolution authority – a sensible approach. Initially, the Commission only wanted to give the board the right to make proposals and to reserve the right to amend these for itself. Germany, however, prefers the Council's opinion that the board's resolutions should enter into effect, unless the Commission and the Council together insist on an amendment. If the board wants to take resources for a resolution from the fund or – as a last resort – government resources have to be used, Germany believes that the representatives of the Council should also be involved in the decision.

4.3 European banking supervision

Another component of the banking union is also nearing completion: the Single Supervisory Mechanism (SSM) for all eurozone banks, in which the European Central Bank (ECB) will play a leading role. The corresponding Regulation entered into force on 4 November 2013 and the ECB is to start its supervisory work one year later, on 4 November 2014.

As an integrated European banking supervisor, with real powers of intervention, the SSM aims to provide greater stability and security than the sum of all national authorities. The ECB and national supervisors will in future perform supervision together, with the ECB focusing on significant institutions and groups of institutions. The national supervisory authorities will support it in these tasks, for example in the joint supervisory teams. Institutions of lesser significance will in principle continue to fall under the responsibility of the national supervisory authorities. The new European supervisor should in any event make use of their comprehensive expertise – especially during, but also beyond the initial phase. It is important to ensure a strict separation between supervision and monetary policy. In BaFin's view, separating the two tasks by creating a supervisory body that is independent of the ECB would have been a better solution. However, the EU Treaties would have had to be amended to achieve that.

Before entering the new era of supervision, the banks expected to fall under the direct supervision of the ECB will have to undergo a comprehensive assessment, which will be conducted in several stages. This detailed assessment, which will require a lot of effort from all parties involved, is indispensible to setting up the future banking supervision.

4.4 The road to Solvency II

The Solvency II reform project will bring about radical change for insurance supervision in Germany – to a certain extent even before it officially comes into force on 1 January 2016. This is because BaFin will implement all the guidelines the European Insurance and Occupational Pensions Authority (EIOPA) has published on preparing for the new supervisory regime.

BaFin's answer to the question as to whether now is the right time to require the sector, which is already going through tough times, to switch to a complex regulatory framework such as Solvency II is a resounding "yes". It is precisely because the situation is so difficult that both sides – the supervisor and the undertakings – have to be able to identify risks at an early enough stage. The risk-sensitive approach adopted in Solvency II is designed to enable just that, and there is no reason not to benefit from it wherever possible, even before it enters into force. Although market-based measurement will make risk measurement under Solvency II rather more volatile than under Solvency I and may pose a problem for the long-term guarantees business, the instruments and transitional arrangements contained in the Long-Term Guarantee Package agreed by the Council, Commission and Parliament in the context of the Omnibus II Directive will make it easier for undertakings to implement the new requirements. Nevertheless, some providers of long-term guarantees are expected to have to increase their own funds in the coming years.

4.5 Systemically important insurers

The FSB published a list of global systemically important insurers (G-SIIs) for the first time on 18 July 2013. The list also includes Allianz, the German insurance group. At the same time, the International Association of Insurance Supervisors (IAIS) published a framework for the supervisory treatment of G-SIIs.

Supervision of G-SIIs

Under this framework, the group supervisor of a G-SII is to be obliged – in a similar manner as for banks – to set up a crisis management group (CMG). Each G-SII should also draw up a recovery plan. The group supervisors responsible for the recovery of the insurance group are to play a lead role in developing a resolution plan and finalising this in consultation with the crisis management group. The IAIS paper also envisages expanded group-wide supervision for G-SIIs. In addition, increased capital requirements are to apply from January 2019 onwards to boost the loss absorption capacity of G-SIIs. This will require uniform global basic capital requirements, which the IAIS is in the process of developing.

Although insurers are systemically important in a different way than banks, for example because insurers do not trade among each other, the identification of global systemically important insurers and the supervision requirements established for them by the IAIS are crucial in helping BaFin to maintain financial stability and protect policyholders. BaFin is currently also examining whether there are insurers that are systemically important for Germany, in addition to those on the FSB's list. There are no reinsurers on the FSB's list, which was published in 2013. The IAIS will conduct a further analysis of these by mid-2014 and the FSB is then expected to decide about the systemic importance of these undertakings.

4.6 The new Investment Code

Since summer 2013, there has been a new legal basis for supervision of German investment funds and their management companies:

the Investment Act (*Investmentgesetz* – InvG) was repealed after roughly a decade by the Act Implementing the Alternative Investment Fund Managers (AIFM) Directive. It has been replaced by the Investment Code (*Kapitalanlagegesetzbuch* – KAGB), which has resulted in fundamental changes, not only to the terminology. It also provides comprehensive rules detailing the management and custody requirements for all investment funds. They include undertakings for collective investment in transferable securities (UCITS) in accordance with the UCITS Directive, referred to in the Investment Act as "*richtlinienkonforme Sondervermögen*" (common funds complying with the UCITS Directive), as well as alternative investment funds (AIFs), i.e. all non-UCITS.

The KAGB hinges on the new definition of investment fund (*Investment-vermögen*) because it is this which determines whether the KAGB applies. A fund is any collective investment undertaking which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which is not an operating company outside the financial sector. The KAGB covers all investment funds, regardless of their legal form and of whether they are open-ended or closed-ended funds. This means that many investments in Germany's unregulated capital market are for the first time also subject to an authorisation requirement and ongoing supervision. This applies both to the products and to the management companies.

4.7 European Market Infrastructure Regulation

In 2013, BaFin's securities supervision dealt in detail with interpretation issues relating to the European Regulation on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR). It coordinated its approach to these issues with other national supervisory authorities and the European Securities and Markets Authority (ESMA). The results of this coordination have been summarised in a Questions and Answers document, which is regularly updated and can be accessed on ESMA's website.

In response to a demand from the G20, the European Regulation had in August 2012 introduced the requirement to clear standardised OTC derivatives via a central counterparty (CCP). CCPs require prior authorisation by the respective national supervisory authority. Since the clearing activities for the financial markets of the EU member states are closely interwoven, a supervisory college decides on the authorisation. Central counterparties from third countries can be recognised by ESMA and may operate in the European Union, if they meet the EMIR requirements. The groups of derivatives that will require clearing in the EU in future will be determined by the European Commission on the recommendation of ESMA, as soon as the first central counterparty has been authorised.

Clearing is not mandatory for non-standardised OTC derivatives, but the counterparties to these types of contracts have to meet special requirements for managing the risks associated with these transactions.

The EMIR requirements apply both to financial counterparties already subject to ongoing supervision, such as credit institutions or insurers, and to non-financial counterparties, such as small and medium-sized enterprises. In December 2013, the European Commission specified how entities such as local authorities and sole traders are to be classified. The key criterion is whether the entity engages in any business activity.

The second key requirement under EMIR is that, as from 12 February 2014, all derivatives contracts entered into, modified, or terminated prematurely have to be communicated to the trade repository within one trading day. This reporting requirement applies not only to transactions that are cleared centrally, but also to transactions that are entered into bilaterally between two parties and that are not subject to the clearing obligation.

5 Shadow banks

Further progress has been made in regulating the shadow banking system – at both global and European level.

5.1 Regulation at global level

At their September 2013 summit in St. Petersburg, the G20 heads of state and government adopted further significant FSB recommendations on the regulation of the shadow banking system. In addition to the framework for money market funds, there is now also one for "other shadow banking entities" such as investment funds, financial intermediaries, finance companies, securitisation vehicles and credit insurers. The other shadow banking entities differ widely in terms of their business models, the risks they enter into and the legal requirements to which they are subject. The national regulators are therefore to be allowed to select the appropriate measures from the framework.

In addition, the FSB has finalised some of its recommendations for regulating the securities lending and repo markets. These are aimed above all at providing greater transparency for market participants and supervisory authorities. The FSB is also calling for limits on collateral reuse and cash collateral reinvestment. During the financial crisis, these practices had contributed to heightening risk and increasing leverage in the financial system. The FSB is expected to develop further recommendations for regulating the securities lending and repo markets by autumn 2014 – relating in particular to the issue of minimum haircuts.

There has also been progress in the area of indirect regulation, which relates to the regulation of the links between the banking and the shadow banking sector. Among other things, the Basel Committee on Banking Supervision has revised the large exposure rules to take account of typical shadow banking risks.

As most of the FSB's regulatory proposals have now been adopted, the focus is shifting to implementation. The federal government made a significant contribution to the inclusion of a detailed implementation schedule (roadmap) in the Annexes to the St. Petersburg G20 Leaders' Declaration.

5.2 Regulation at European level

In February 2013, the European Systemic Risk Board (ESRB) published a set of recommendations on the regulation of money market funds. According to the recommendations, these types of funds should be required to switch to a variable net asset value (VNAV) model, as this would reinforce their investment characteristics and reduce their deposit-like features. The ESRB also recommends the introduction of minimum ratios for daily and weekly liquid assets, in addition to the existing liquidity requirements. Furthermore, the marketing material for money market funds should draw the attention of investors to the absence of a capital guarantee and the possibility of principal loss. The ESRB also dealt with the issue of sponsor support. It recommends, for example, that all cases of sponsor support should be reported to the relevant national supervisory authorities. Sponsor support is defined as support for a money market fund provided by a bank granting a line of liquidity, for example.

Draft regulation of the European Commission

In September 2013, the European Commission submitted a draft regulation aimed at further regulating money market funds without limiting their financing role, which is vital for the economy. The focus is above all on the liquidity profile and stability of European money market funds. For example, uniform rules should ensure that the liquid assets have certain daily and weekly minimum levels and money market funds invest in high-quality, well-diversified assets with a high credit quality. With the regulation, the Commission aims to ensure that the funds have sufficient liquidity to meet investors' redemption requests.

Financial crisis and regulation: timeline of important events in 2013

January	▸ The **Japanese** government approves an economic stimulus package worth the equivalent of €175 billion. At the same time, the Bank of Japan announces that it will buy bonds for an indefinite period.
February	▸ The ailing Spanish lender **Bankia** reports a record loss of €19.2 billion for 2012.
March	▸ The **German Financial Stability Commission** (*Ausschuss für Finanzstabilität* – AFS) starts its work. The AFS aims to strengthen macroprudential supervision in Germany and integrate it more closely with microprudential supervision. ▸ As a supplement to the European Market Infrastructure Regulation (**EMIR**), European regulations enter into force which contain key risk management as well as reporting and organisational requirements for trading OTC derivatives. ▸ The European Union and the International Monetary Fund approve an aid programme of up to €10 billion for **Cyprus**. The Cypriot banking system is restructured. For the first time, bank customers with deposits in excess of €100,000 have to contribute to the bailout. The banks remain closed for several days and are subject to restrictions on capital and payment transactions after reopening. ▸ **Ireland** places ten-year government bonds in the primary market for the first time since accepting funds from the rescue scheme.
April	▸ **BaFin** publishes a guidance notice on reviewing the professional qualifications and reliability of managers of credit institutions. ▸ In **Portugal**, the Constitutional Court rejects some of the country's austerity measures.
May	▸ The High-frequency Trading Act (*Hochfrequenzhandelsgesetz*) enters into force, introducing mandatory authorisation and special organisational requirements for all German **high-frequency traders**, to apply no later than the end of the transition period on 15 February 2014. ▸ The federal government's Financial Market Stabilisation Fund (*Sonderfonds Finanzmarktstabilisierung des Bundes* – **SoFFin**) reports a profit (€580 million) for 2012 – the first since it was established. ▸ The ECB reduces the **key interest rate** on main refinancing operations by 25 basis points to 0.5%. ▸ **Portugal** succeeds in placing a ten-year bond in the primary market for the first time since accepting funds from the assistance package. The government introduces another €4.8 billion austerity package.
June	▸ The European Commission publishes the Capital Requirements Regulation (**CRR**) and the Capital Requirements Directive (**CRD IV**), which implement Basel III throughout Europe, among other things. ▸ In Europe, **CRA III** – the third regulation governing credit rating agencies – enters into force. Core elements are increased liability for rating agencies issuing incorrect credit ratings, mandatory rotation and prior announcement of country ratings. ▸ EIOPA publishes a report on the findings of the quantitative impact study on the long-term guarantees assessment (**LTGA**). It confirms that, under Solvency II, the insurance business with long-term guarantees can in principle be modelled using the instruments contained in the Long-Term Guarantee Package, which is part of the Omnibus II Directive.

July	▸ The Financial Stability Board (FSB) publishes a list of global systemically important insurers (**G-SIIs**). The supervisory measures that will apply to G-SIIs in future include resolution and recovery plans. ▸ The Investment Code (*Kapitalanlagegesetzbuch* – **KAGB**) enters into force. It implements the European Alternative Investment Fund Managers Directive (AIFM Directive) in Germany and replaces the Investment Act (*Investmentgesetz* – InvG). As a result, key requirements for managers of open-ended and closed-ended investment funds will in future be governed by a single piece of legislation. ▸ **Portugal's** finance minister resigns, triggering a government crisis. The financial markets react nervously.
August	▸ The **Ringfencing Act** (*Risikoabschirmungsgesetz*) enters into force. It contains provisions on recovery and resolution planning for credit institutions, on keeping proprietary trading activities and other risky banking transactions separate from the customer business and on criminal liability for senior managers in the area of risk management.
September	▸ Michel Barnier, European Commissioner for Internal Market and Services, presents plans to regulate **shadow banks**.
October	▸ The Council of the European Union adopts the Single Supervisory Mechanism (**SSM**) Regulation. The eurozone's larger banks will be subject to direct supervision by the ECB. ▸ The ECB sets out initial details for the **comprehensive assessment** of 124 banking groups in the eurozone, including 24 German institutions. The goal is to complete the assessment, which consists of a risk assessment, balance sheet assessment and stress test, before the SSM is launched in November 2014. ▸ The International Association of Insurance Supervisors (IAIS) starts the public consultation process for the Common Framework (**ComFrame**). This is a set of global, principle-based requirements for large internationally active insurance groups and their supervision.
November	▸ The trialogue parties (Council of the European Union, European Commission, European Parliament) reach agreement on the **Omnibus II Directive**, which amends the Solvency II Directive. The effective date for Solvency II will be 1 January 2016. ▸ The ECB reduces the **key interest rate** on main refinancing operations by another 25 basis points to 0.25%. ▸ The **Portuguese parliament** passes a new austerity budget with cuts amounting to € 3.9 billion. Portugal aims to exit the financial assistance programme.
December	▸ The European Commission imposes a record fine on several large banks in connection with the **manipulation of reference interest rates**. ▸ The EU finance ministers reach agreement on key points of a common **bank resolution** system with bail-in elements and on the structure of a resolution fund (Single Resolution Mechanism – **SRM**). ▸ Following the scheduled expiry of the financial assistance programme, **Ireland** exits the European Financial Stability Facility (EFSF). **Spain** also declares that it will not request further financial assistance from the European Stability Mechanism (ESM) for the recovery of the banking sector.

II Integrated financial services supervision

1 Macroeconomic environment

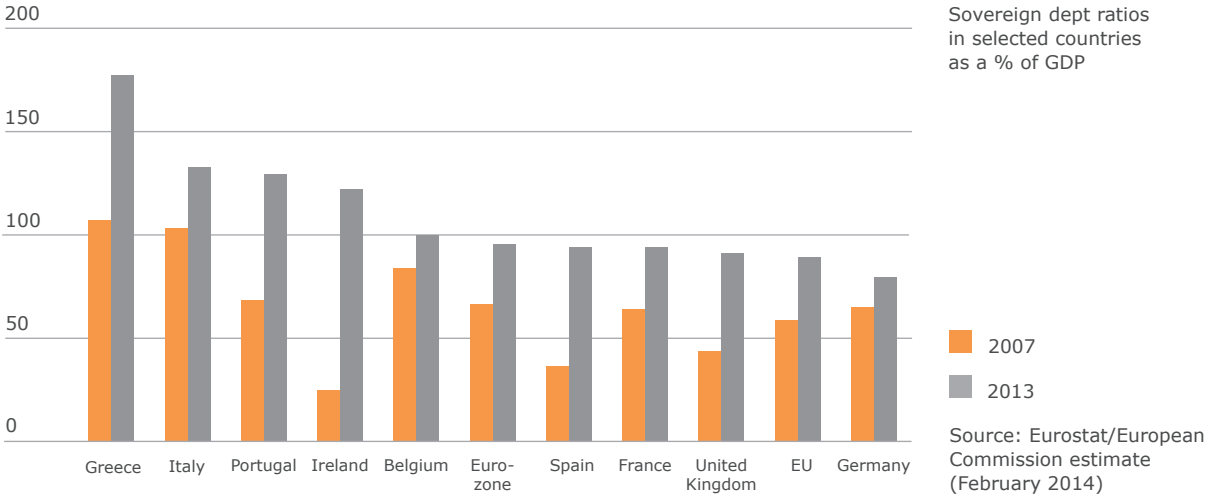
1.1 Sovereign debt crisis

Financial market uncertainty about how the European sovereign debt crisis would develop eased further over the course of 2013. The spreads on government bonds of crisis-hit countries recorded a downward trend. The fact that the European Central Bank (ECB) is able if necessary to purchase government bonds to assist countries with financing problems under its Outright Monetary Transactions (OMT) programme, which was announced in 2012, also significantly reduced tension in 2013. However, the programme did not have to be used during the year. In addition, the affected eurozone countries managed to improve their competitiveness, make progress with budget consolidation and initiate economic reform.

Despite the clear progress, there were still major weaknesses in the struggling eurozone countries. The necessary banking sector restructuring was ongoing and the reduction in non-performing loans (NPLs) progressed sluggishly, if at all. The hesitant economic stabilisation and the in some cases extremely high unemployment levels also prevented a rapid recovery in public finances. In 2013, the ratio of sovereign debt to economic output increased in all eurozone countries with the exception of Germany and Latvia. The interdependencies between governments and the domestic banking sector even increased significantly in some countries.

Following the haircut in Greece, the banking sector in Cyprus became distressed in 2012 due to the close ties between the countries. The government was unable to implement the necessary support measures using its own resources and applied for financial assistance from the European Union and the International Monetary Fund (IMF). A bailout package of up to € 10 billion was ultimately granted via the European Stability Mechanism (ESM) in spring 2013. A precondition for and core element of this package was the radical restructuring of the oversized banking system. In addition to shareholders and bondholders, who suffered the total loss of their investments, major depositors with the banks concerned also had to make a significant contribution for the first time. However, deposits of up to € 100,000,

Figure 1 Sovereign debt ratios in Europe



which are covered by European deposit protection mechanisms, ultimately remained untouched.

In contrast, encouraging signs came from Ireland, which had been the first country to accept help from the European Financial Stability Facility (EFSF) in November 2010. After three years, at the end of 2013, the loan assistance expired as scheduled. In total, Ireland received international assistance of €67.5 billion. The Irish government's aim is to refinance itself in full via the capital markets once more.

Before the end of the year, Spain also declared that it will not apply for further financial aid from Europe. A bailout package of up to €100 billion had been granted in spring 2012 in order to recapitalise and restructure the Spanish banking sector. The country has since received €41.3 billion from the ESM. However, despite several successes, the reorganisation of the banking system could not be completed in 2013, as in Ireland, due to a downward trend in credit quality.

1.2 Low interest rates

Central banks all over the world introduced extensive support measures during the financial and sovereign debt crisis. They reduced key interest rates, provided substantial amounts of liquidity, and purchased government bonds and other securities. The accompanying historically low interest rates are posing more and more of a challenge for financial intermediaries the longer they last, and could facilitate the formation of asset bubbles.

If interest rates remain low, it will become increasingly difficult for life insurers to meet the commitments made in the past through investment income. This is clearly demonstrated by comparing the average technical interest rate (guaranteed return) of 3.2% at the end of 2013 with the ten-year Bund yield of 1.9%. The low interest rates have also led to high valuation reserves for fixed-income securities, half of which must be paid out to policyholders when their policies mature. Institutions for occupational retirement provision, *Pensionskassen* and pension funds will also find it more difficult to meet their pension commitments the longer the low interest rates last.

The low level of interest rates initially had a positive impact on banks' net interest result, as they were able to refinance themselves at favourable terms but still had relatively high-interest legacy business on the assets side of their balance sheets. However, this legacy business has now largely been replaced by low-interest new business. Both income and interest margins have declined as a result and will decline further if interest rates remain low.

A sharp rise in short-term interest rates would further exacerbate this problem.[1]

Low interest rates could prompt market participants to take more risks to increase their investment income and generate higher returns. This could lead to overvaluations in some submarkets, meaning that asset valuations would no longer reflect their economically justified value and the likelihood of sudden price corrections would increase.

2 Financial stability

2.1 Macroprudential supervision

2.1.1 Financial Stability Commission

The ten key points for reforming financial supervision in Germany, which were resolved by the federal government in response to the financial crisis, include the task of expanding macroprudential oversight and integrating it more closely with microprudential supervision. Consequently, the German Financial Stability Commission (*Ausschuss für Finanzstabilität* – AFS), which was modelled on the European Systemic Risk Board (ESRB), was established under the Financial Stability Act (*Gesetz zur Überwachung der Finanzstabilität* – FinStabG). The AFS provides a framework for the cooperation between BaFin, the Deutsche Bundesbank and the federal government. The AFS began its work at the start of 2013, superseding the Standing Committee on Financial Market Stability (*Ständiger Ausschuss für Finanzmarktstabilität*). Since then, it has met on a quarterly basis.

The AFS comprises representatives from the *Deutsche Bundesbank*, the Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF) and BaFin, along with one non-voting representative from the Federal Agency for Financial Market Stabilisation (*Bundesanstalt für Finanzmarktstabilisierung* – FMSA). BaFin's President and Chief Executive Directors for banking and insurance supervision regularly participate in the meetings.

The AFS discusses matters of importance to financial stability. If necessary, it can issue public or confidential warnings and recommendations to counter potential threats to financial stability. These can be addressed to BaFin, the federal government or other public bodies in Germany. The AFS also provides advice on how to deal with warnings and recommendations issued by the ESRB.

In addition, it aims to improve cooperation between the institutions represented in it in the event of a financial crisis. It provides a report on its work to the *Bundestag* each year. The AFS bases its work on the experience gained by the *Deutsche Bundesbank* in its macroprudential supervision of the financial system. If the *Bundesbank* sees a threat to financial stability, it can propose that the AFS issue corresponding warnings and recommend measures to avoid the danger.

2.1.2 Cooperation with the *Deutsche Bundesbank* in the area of insurance supervision

The *Bundesbank* has also been working with BaFin in the area of macroprudential insurance supervision since the start of 2013. Their contact on this subject had previously been restricted to individual cases. The aim of the cooperation, which is also based on the FinStabG, is to strengthen financial market supervision in Germany.

BaFin and the *Bundesbank* had already worked closely together on banking supervision and in international committees, such as the ESRB and the Financial Stability Board (FSB).

1 See chapter III 4.2 and 4.3.

BaFin remains solely responsible for supervising undertakings in the insurance sector. However, under the FinStabG, the *Deutsche Bundesbank* is now required to include insurers in its macroprudential supervision of the German financial system. In this context, it analyses issues that are significant for financial stability and identifies potential threats.

To ensure optimal performance of their respective micro- and macroprudential insurance supervision duties, BaFin and the *Deutsche Bundesbank* have kept each other informed of their observations, findings and assessments since the start of 2013. This exchange of information also includes extensive data interchange, which is governed by a joint administrative agreement. BaFin and the *Deutsche Bundesbank* also share knowledge about specific issues and organise joint training programmes.

The insurance undertakings benefit from these increased efforts to ensure financial market stability. However, they are not burdened by additional reporting requirements, as BaFin transfers the supervisory data to the *Deutsche Bundesbank*. Confidentiality of the data is guaranteed, since both institutions are subject to a duty of confidentiality.

2.1.3 Cross-Sectoral Risk Committee

BaFin's Cross-Sectoral Risk Committee (RC) has acted as the interface to macroprudential supervision by the *Bundesbank* and the AFS since January 2013. The RC aims to ensure that macroprudential supervision is even more effectively integrated with microprudential supervision in the future, and to strengthen forward-looking and risk-based integrated financial supervision.

The RC identifies and records risks at the supervised institutions that are relevant to BaFin as a whole, or which have cross-sector significance. It assesses these risks and draws up proposals for resolutions by the Executive Board, and recommends courses of action to the individual supervisory areas. The RC's work is based on internal and external analyses, as well as cross-enterprise comparisons conducted by BaFin.

The Risk Committee comprises representatives from all directorates of BaFin as well as representatives of the *Bundesbank*, who do not have voting rights. The Committee is chaired by the head of BaFin's Analysis and Strategy department and meets once per quarter.

In addition to the RC, BaFin also established the Committee on Regulation and International Policy in January 2013. This Committee also aims to strengthen integrated financial supervision within BaFin.[2]

2.2 Systemically important financial institutions

2.2.1 Determination of systemically important financial institutions

A key lesson from the financial crisis was that global systemically important financial institutions (G-SIFIs) not only need to be subject to greater and particularly close supervision, but also to assume responsibility for their actions. Financial institutions that are too big, too complex, or too interconnected with other market participants cannot smoothly exit the market in the event of their insolvency. Such institutions' expectations of state support if insolvency threatens lead to a further problem: moral hazard. Institutions that pose a potential systemic risk could be tempted to take significant risks in order to benefit from the resulting profits, without the fear of insolvency were they to incur losses. To counter this effect, BaFin will in future apply particularly stringent requirements for systemically important financial institutions to increase their loss-bearing capacity. It is also important to ensure that these institutions can be resolved without damaging the financial system.[3] Both of these goals require systemically important institutions to be identified at both global and national level.

2 See chapter II 3.

3 See chapter III 1.5.

Global systemically important banks

The Financial Stability Board (FSB) produces a list of global systemically important banks (G-SIBs) each year. When the list was updated in November 2013, the Industrial and Commercial Bank of China Limited was added, bringing the total to 29 banks. Classification was based on the data as at year-end 2012 and the modified assessment methodology published by the Basel Committee on Banking Supervision (BCBS) in July 2013. The assessment methodology also incorporated the lessons learned by the BCBS from its data collection exercises in 2009 to 2011.

The BCBS uses a global reference system to identify G-SIBs. Banks that would cause global turbulence were they to become distressed are identified by the BCBS in close cooperation with national supervisory authorities using an indicator-based measurement approach. One indicator of systemic risk is a bank's size, for example. The aim of the approach is to minimise the probability of G-SIBs defaulting by imposing higher capital requirements.[4] The BCBS allocates the banks to five different categories (buckets), according to the level of systemic risk they represent. Depending on their classification, they must currently meet an additional capital requirement that initially ranges between 1.0% and 2.5% of their risk-weighted assets (RWAs). No banks have so far been allocated to the highest bucket, which imposes an additional capital requirement of 3.5%. However, banks that represent a higher level of systemic risk could still be allocated to the highest bucket in future.

Systemically important banks in Germany

In addition to globally important banks, there are a number of banks that are highly significant to the financial market and economy in Germany. Although it would not threaten the stability of the global financial system if these banks were to become distressed, it would have a massive negative impact in Germany. These banks are therefore also subject to special regulation.

BaFin, in cooperation with the *Deutsche Bundesbank*, uses quantitative and qualitative measures to identify such banks. For the quantitative assessment, it applies a uniform indicator approach to uncover the impact chains that are relevant for systemic risk. However, since a purely quantitative approach is not able to identify all key impact chains, qualitative factors are also taken into account. Consequently, determining whether or not a bank is systemically important always also involves a judgement being made by BaFin and the *Deutsche Bundesbank*.

What is more, systemic importance is not a black and white affair. Since there are different degrees of systemic importance and of the associated negative effects, BaFin differentiates between two groups of banks:

- Systemically important banks (Group I): threats to these banks' viability as a going concern always have a negative impact on financial market stability.
- Other banks that pose a potential systemic risk (Group II): such banks pose a lower level of systemic risk than the banks in Group I. If their viability as a going concern is threatened, the negative impact on financial market stability needs to be assessed alongside other factors, such as the current market situation.

In Germany, banks classified as belonging to Group I and Group II must prepare recovery plans. The aim is to ensure that they are aware well in advance of how they can overcome future crises. Recovery plans set out the organisational and business policy measures, for example, that banks could implement now to overcome a future crisis as quickly and effectively as possible using their own resources. BaFin also prepares resolution plans for those banks that pose a potential systemic risk, so that they can be resolved without endangering the financial system or using public funds. Under the CRD IV Implementation Act of January 2014, BaFin can also classify institutions as "other systemically important institutions" and impose an additional capital

4 See chapter III 1.1.

buffer of up to 2.0% of their total risk exposure amount.

Systemically important insurers

In addition to systemically important banks, the supervisory authorities are also increasingly focusing on systemically important insurers. The FSB published a list of global systemically important insurers in July 2013.[5] In addition, at the FSB's request, the International Association of Insurance Supervisors (IAIS) is developing proposals to improve the loss-bearing capacity of internationally active insurance undertakings.[6]

2.2.2 Resolution of systemically important financial institutions

The Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes), which were adopted by the FSB in 2011, must be transposed into national law by 2015. They provide for a series of institution-specific requirements to ensure that systemically important financial institutions can be reorganised or resolved if they become distressed, without sending shock waves through the financial system. The requirements include preparing recovery and resolution plans, establishing crisis management groups, ensuring the effective exchange of information between the authorities involved, discussing the resolvability of systemically important institutions and eliminating any barriers to resolution.

Implementation in FSB member countries

The FSB established the Resolvability Assessment Process (RAP) to ensure that the individual measures are implemented consistently and in line with the risks involved in all FSB member countries. Building on the crisis management groups' work on the resolvability of G-SIFIs, high-ranking representatives from the home and host supervisory authorities have been asked to reach joint assessments on the extent to which G-SIFIs are resolvable. To do so, they assess whether the resolution strategy is credible and practicable. They estimate the extent to which the institution's preferred resolution strategy is viable from an operational, financial and legal perspective. In addition, they discuss whether the selected resolution strategy makes it possible to maintain critical functions. The RAP also requires the national supervisory authorities to discuss measures that would further improve resolvability.

The results of these discussions are reported to the FSB Chairman in writing, so the FSB can in turn evaluate the resolvability of all G-SIFIs. The RAP thus makes it possible to address specific cases where resolvability appears to be uncertain or incomplete. In addition, the RAP is a valuable tool for identifying regulatory deficits. Whether it meets the expectations of the FSB members, or whether an even more institutionalised process is required will be assessed once the first RAP cycle is completed in autumn 2014.

Resolution of non-bank financial institutions

The FSB has developed a number of sector-specific guidelines on the application of the Key Attributes, which take the form of Annexes. Where necessary, these adapt the Key Attributes, which were primarily prepared for the banking sector, to the specific needs of non-bank financial institutions, making them practicable for these institutions. In August 2013, the FSB launched a public consultation on the Annexes and will adopt the final versions in 2014.

In the event of the resolution of insurance undertakings, the guidelines provide for the resolution authority to restructure or limit liabilities, including insurance and reinsurance liabilities. In addition, the guidelines provide for the rights of policyholders and reinsurers to be temporarily suspended. The guidelines also cover the resolution of financial market infrastructures (FMIs) to ensure that their specific requirements are met and to prevent the resolution of an FMI participant threatening the FMI itself. Finally, the guidelines deal with firms that hold and manage client assets. This

5 See chapter IV 1.3.1.

6 See chapter IV 1.4.

section addresses how to ensure that assets are immediately available and that there are no negative consequences for clients when such firms are resolved.

Cross-border resolution

The FSB began a peer review on the cross-border resolution of financial institutions in 2012. The final report was approved by the FSB Plenary and published in April 2013. The status of implementation of the Key Attributes in all financial services sectors of the FSB member countries – banking, insurance, securities and financial market infrastructures – was investigated.

The peer review found that the most progress in implementing the Key Attributes had been made in the area of banking supervision. However, there is still a need for clarification in this area, too. This relates in particular to the extent of the available resolution powers and the distinction between resolution powers, supervisory powers and standard insolvency procedures. Further problems arose from insufficient powers in relation to the resolution of financial groups and conglomerates, the sharing of information in cases of cross-border resolution and the suspension of early termination rights.

The peer review recommendations are aimed in the first instance at the FSB members, which should take action to ensure that the Key Attributes are fully implemented. In addition, it is recommended that the FSB provide clarification with regard to the assessment methodology and unresolved issues, and that it monitors the implementation of the Key Attributes.

2.3 Shadow banks

2.3.1 Regulation at global level

Additional framework for the regulation of shadow banks

At their September 2013 summit in St. Petersburg, the G20 heads of state and government adopted further significant FSB recommendations on the regulation of the shadow banking system. Following the G20's approval of a framework for money market funds at the end of 2012, a further framework now exists for the remaining shadow banking companies, which the Financial Stability Board (FSB) refers to as "other shadow banking entities". These include investment funds, financial intermediaries, finance companies, securitisation vehicles and credit insurers, among others. However, the entities covered by the new framework differ extremely widely in terms of their business models, the risks they enter into and the legal requirements to which they are subject. The FSB therefore decided to develop a classification system based on their economic function, rather than company type. The framework describes five economic functions, for each of which the FSB has developed a series of specific regulatory measures. However, implementation of these measures at national level is not mandatory. Instead, they are to be viewed as building blocks from which the national regulators can select the individual measures best suited to the company types, local market conditions and stability risks. To ensure uniform application of the measures by all FSB member countries, the FSB is to develop a mechanism for sharing information that will, in turn, serve as the basis for a peer review.

Regulation of securities lending and repo markets

In addition to the frameworks for regulating shadow banking entities, the FSB has also already adopted some of the recommendations for regulating the securities lending and repo markets. One of the recommendations' key aims is to improve transparency for market participants and supervisory authorities. For example, building on the work of the G20 Data Gaps Initiative, the FSB recommends that supervisory authorities gather meaningful data on the securities lending and repo positions held by large international institutions. The FSB also recommends regularly reviewing the overall extent of repo and securities lending market activity using existing infrastructures, such as central securities depositaries or trade

repositories. This would allow the FSB to then aggregate the available data to obtain a global overview of the growth of and risks associated with the securities lending and repo markets.

During the financial crisis, the practice of collateral reuse and cash collateral reinvestment generally contributed to heightening risk and increasing leverage in the financial system. The FSB is therefore calling for these activities to be restricted.

By the autumn of 2014, the FSB will develop further recommendations that are also aimed at reducing procyclical behaviour in the securities lending and repo markets. Minimum standards for haircut calculation methods are one of the initiatives planned. Specific minimum supervisory requirements for haircut amounts are also being considered. The FSB has implemented consultations on corresponding proposals with market participants and conducted impact studies.

Indirect regulation of the shadow banking system

In addition to the direct regulation described above, significant progress was made with regard to the indirect regulation of the shadow banking system. Indirect regulation means the regulation of the links between the banking sector and the shadow banking sector. Among other things, the Basel Committee on Banking Supervision (BCBS) revised the large exposure rules to take account of typical shadow banking risks, which arise due to the interconnectedness of the entities in this sector and the latter's opacity.

Since most of the proposed regulations have now been adopted, the future focus will shift to monitoring their implementation. The federal government made a significant contribution to the inclusion of a detailed implementation schedule – the Shadow Banking Roadmap – in the Annexes to the Leaders' Declaration for the G20 summit in St. Petersburg. Under this roadmap, the G20 aims to review all regulatory recommendations again in 2015 and then decide whether further regulatory steps are required.

2.3.2 Regulation of money market funds in the EU

Money market funds are an important source of short-term finance for financial institutions, companies and governments alike. Due to the systemic links between money market funds and the banking sector, as well as between money market funds and corporate and government finance, the international work on shadow banks centres on the activity of money market funds.

ESRB recommendations

In February 2013, the European Systemic Risk Board (ESRB) published a set of recommendations on the regulation of money market funds. These cover four areas:

- The ESRB recommends a mandatory change to a variable net asset value (VNAV). Money market funds should be required to switch to a VNAV model, as this would reinforce their investment characteristics and reduce their deposit-like features.
- The ESRB further recommends that existing liquidity requirements be enhanced by imposing explicit minimum amounts of daily and weekly liquid assets that money market funds must hold.
- With regard to disclosures, the ESRB calls for the marketing material for money market funds to draw the attention of investors to the absence of a capital guarantee and the possibility of principal loss. In the ESRB's view, public information should only mention sponsor support or capacity for such support if this support represents a firm commitment on the part of the sponsor.
- Finally, the ESRB recommends that all instances of sponsor support should be reported to the national supervisory authorities.

Draft regulation of the European Commission

To preserve the integrity and stability of Europe's internal market for money market funds, the European Commission published a draft regulation in September 2013. This aims to further regulate money market funds, without limiting their financing role, which is

vital for the economy. The new rules focus mainly on the liquidity profile and stability of European money market funds. The introduction of uniform rules to ensure that a minimum amount of liquid assets are available on a daily and weekly basis is proposed. Standardised principles would allow fund managers to better understand their investor base. In addition, common rules would ensure that money market funds invest in high-quality, well-diversified assets with a high credit quality. With these measures, the Commission aims to ensure that the funds have sufficient liquidity to meet investors' redemption requests.

2.4 Financial conglomerates

The Supervision of Financial Conglomerates Act (*Finanzkonglomerate-Aufsichtsgesetz* – FKAG), which entered into force on 4 July 2013, transposed the Financial Conglomerates Directive I (FiCoD I)[7] into German law. In addition to the Financial Conglomerates Directive of 2005 (see info box "Financial Conglomerates Directive"), the Directive amends the Insurance Groups Directive[8], the Solvency II Framework Directive[9] and the Banking Directive.[10]

Common supervisory standards

The FKAG groups together the rules on the supplementary supervision of financial entities in a financial conglomerate that were previously included in the KWG and VAG. Individual supervisory standards were previously included either only in the KWG or only in the VAG and were therefore only applicable to bank- and insurance-led financial conglomerates respectively. Under the FKAG, these regulations are now applicable across the board. The supervisory authorities are now also able to require stress tests for financial conglomerates.

7 Directive 2011/89/EU, OJ EU L 326, p. 113ff.

8 Directive 98/78/EC, OJ EU L 330, p. 1ff.

9 Directive 2009/138/EC, OJ EU L 335, p. 1ff.

10 Directive 2006/48/EC, OJ EU L 177, p. 1ff.

Financial Conglomerates Directive

The transposition of the Financial Conglomerates Directive[11] of 2005 embedded the supplementary supervision of the credit institutions, insurance undertakings and investment firms in a financial conglomerate in the Banking Act (*Kreditwesengesetz* – KWG) and the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG).

Numerous regulations were amended in addition to the KWG and VAG, with the aim of expanding the scope of consolidated supervision to include "mixed financial holding companies". For example, if a group's superordinated enterprise is a mixed financial holding company, rather than an insurance holding company, an adjusted solvency calculation must be performed. Consequently, the content of the Solvency Adjustment Regulation (*Solvabilitätsbereinigungs-Verordnung* – SolBerV) and the Solvency Regulation (*Solvabilitätsverordnung* – SolvV) also had to be amended. The Financial Conglomerates Solvency Regulation (*Finanzkonglomerate-Solvabilitäts-Verordnung* – FkSolV) was reissued as the previous legal basis no longer applied. The other regulations that were amended included the Remuneration Regulation for the Insurance Companies (*Versicherungs-Vergütungsverordnung*), the Holder Control Regulation (*Inhaberkontrollverordnung*), the Reporting Regulation concerning the Payment Services Supervision Act (*ZAG-Anzeigenverordnung*), the Audit Report Regulation (*Prüfungsberichtsverordnung*) and the Audit Report Regulation concerning Payment Institutions (*Zahlungsinstituts-Prüfungsberichtsverordnung*).

Aims of the new legislation

Bundling the relevant regulations into a single act is consistent with the cross-sector significance of the issue and is in line

11 Directive 2002/87/EC, OJ EU L 35, p. 1ff.

Financial conglomerates

A financial conglomerate is a (sub-)group whose entities are active in the banking, securities services, or insurance sector. The specific requirements set out in the FKAG must be met for supplementary supervision under this Act to apply. Section 1 (2) of the FKAG provides a detailed definition of a financial conglomerate. At present, eight financial conglomerates have been identified. Two are subject to banking supervision and six to insurance supervision, based on the supervisory area that covers their respective superordinated enterprises.

with the format of European directives. The previous supervisory standard for financial conglomerates is maintained by the FKAG. The Act implements the main objectives of FiCoD I:

- to make supplementary supervision more effective,
- to strengthen financial conglomerates' risk management,
- to avoid the opportunities for regulatory arbitrage,
- to limit the expense required to comply with the regulations and
- to promote cooperation between supervisory authorities.

FiCoD I also brings the Financial Conglomerates Directive into line with the new European supervisory structure.

Identification of financial conglomerates

Identification of a group as a financial conglomerate is more flexible and risk-based under the FKAG than previously. Asset management companies and alternative investment fund managers (AIFMs) as defined in the AIFM Directive are now included in the identification of financial conglomerates. Companies in third countries which belong to a conglomerate must be included in the threshold calculations if the company has moved from a country in the European Economic Area (EEA) to the third country in order to avoid supervision in the EEA. Equity interests may be excluded from threshold calculations if they are in sectors that are less strongly represented within the financial conglomerate and are less significant from a supervisory perspective. Groups may also be released or exempted from the rules on risk concentrations, intra-conglomerate transactions and special organisational duties even if they have reached a certain relative threshold, but their total assets in the least represented sector do not exceed the absolute limit of €6 billion. BaFin conducts an annual review to establish whether this limit has been exceeded.

More supervised entities

The FKAG expands the group of supervised entities to include reinsurance undertakings, insurance SPVs and alternative investment fund managers. It also adds new information requirements for companies and disclosure requirements for financial conglomerates regarding their legal, governance and organisational structures in each case.

Mixed financial holding companies are now included in sectoral group supervision. It was previously a problem if a financial holding company or an insurance holding company became a mixed financial holding company, for example by purchasing a company from the other sector. The inclusion of mixed financial holding companies in sectoral group supervision means that the two supervisory regimes are now applicable in parallel. The VAG and KWG now include a waiver provision intended to avoid identical requirements being duplicated.

2.5 Rating agencies

2.5.1 Supervision by ESMA

Since 2011, the European Securities and Markets Authority (ESMA) has been solely responsible for supervising rating agencies. As part of its delegation of supervisory tasks – based on the relevant provision of the EU Credit Rating Agencies Regulation – ESMA asked BaFin to provide assistance with several on-

site inspections of German rating agencies in summer 2013. Employees from BaFin and ESMA together inspected the six German rating agencies in August and September 2013. They conducted extensive individual interviews with the companies' key personnel and the independent members of supervisory bodies, who must be appointed by rating agencies under the Credit Rating Agencies Regulation and who do not participate in rating activities. The companies' premises were also inspected. The costs incurred by BaFin in the performance of the delegated tasks were fully reimbursed by ESMA in accordance with the provisions of European law.

2.5.2 New Credit Rating Agencies Regulation

One of the key events in 2013 was the entry into force of the new Credit Rating Agencies Regulation (CRA III) on 20 June 2013. This imposed numerous requirements on ESMA and the national supervisory authorities, particularly in relation to the following:

- Reducing references to ratings in European and national laws and regulations
- Development of binding regulatory technical standards on the publication of information on structured financial products (including the establishment of a corresponding website by ESMA)
- Development of binding regulatory technical standards on the fees charges by credit rating agencies.

2.5.3 Reducing references to external ratings

The three European supervisory authorities (ESMA, EIOPA and EBA) have reviewed the references to ratings in their own regulations and replaced them as necessary. A need for modifications was identified in the ESMA guidelines on money market funds, in particular. The report on reducing these references to ratings was exposed for consultation until December 2013 and published by the authorities' supervisory bodies in February 2014. Corresponding changes are to be made by national supervisory authorities by the end of 2014.

In addition to the European supervisors, the FSB is also focusing on reducing references to ratings. It began a peer review in spring 2013, with the aim of identifying the degree to which its members have met the requirement to remove as many references to external credit ratings as possible from their laws and regulations. It is also looking at whether members are doing enough to help ensure that market participants do not solely rely on external ratings when assessing credit risk, but also conduct their own credit risk assessments. This requirement is based on the corresponding principle decisions by the G20 and a supplementary FSB roadmap. Governments should develop action plans outlining how they intend to ensure through the administrative practice of the supervisory authorities that market participants also assess credit risk by means other than credit ratings, and that references to ratings is further reduced in private contracts as well. The German action plan was developed by BaFin in consultation with the *Deutsche Bundesbank* and the Federal Ministry of Finance (*Bundesministerium der Finanzen* – BMF).

2.6 High-frequency trading

The High-frequency Trading Act (*Hochfrequenzhandelsgesetz*)[12] entered into force on 15 May 2013 and contains new rules for high-frequency and algorithmic trading. The new provisions cover both trading participants and trading venues. They are intended to close supervisory gaps and mitigate potential risks, such as trading systems becoming overloaded by a large number of order entries, changes, or cancellations (see info box "Authorisation requirements for high-frequency trading", page 35). The new legislation is the lawmakers' response to the increasing speed and complexity of trading due to the greater use of algorithms. It has implemented in advance several rules on algorithmic trading and high-frequency trading that are also planned at

12 Federal Law Gazette (BGBl.) I 2013, p. 1162.

European level as part of the revision of the Markets in Financial Instruments Directive (MiFID)[13]. However, the European rules will probably not apply before the end of 2016.

High-frequency trading defined as a financial service requiring authorisation

Before the new rules were introduced, high-frequency traders were not subject to any authorisation requirement if they only traded financial instruments for their own account and did not provide any other financial services or conduct banking business. Under section 1 (1a) sentence 2 no. 4d of the KWG, high-frequency trading now requires authorisation. Entities requiring authorisation must meet risk management and capital adequacy requirements, among other things, as well as obligations to report to the supervisor.

Under the new section 33 (1a) of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG), supervised investment services enterprises that engage in algorithmic trading must also have implemented appropriate system and risk controls in their trading systems. In addition, they must maintain effective business continuity arrangements to deal with unforeseen trading systems failures. BaFin monitors these new requirements as part of its annual audit under section 36 of the WpHG.

Authorisation requirements for high-frequency trading

High-frequency trading is a type of algorithmic trading in which buy and sell orders are entered, modified and cancelled using computer-based systems. High-frequency trading is often characterised by a large number of order entries, modifications and cancellations within a very short period (microseconds). Traders try to position themselves as closely as possible to the trading venue's server to obtain a speed advantage by shortening the distance the signal has to travel. The High-frequency Trading Act takes account of these characteristics. It introduces an authorisation requirement for trading participants who trade financial instruments for their own account using high-frequency algorithmic trading technology. According to the legislation, high-frequency algorithmic trading technology is defined by

- the use of infrastructures that aim to minimise latency,
- the system deciding on when to introduce, create, transmit, or execute orders without human intervention and
- a high message intra-day rate.

3 International supervision

3.1 European System of Financial Supervision

The three European supervisory authorities (ESAs) became operational at the start of 2011: the European Banking Authority (EBA), its insurance industry counterpart the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). The European Systemic Risk Board (ESRB) started work shortly before, at the end of 2010.

The ESAs and the ESRB together form the European System of Financial Supervision (ESFS). The ESFS aims to promote regulatory and supervisory centralisation in Europe and strengthen the coordination between macroprudential analysis and microprudential supervision.[14]

13 Directive 2004/39/EC, OJ EU L 145, p. 1ff.

14 See chapter III 2.1 for further information on the future of European banking supervision.

3.1.1 Review of the ESFS

In 2013, the European Commission, the Council and the European Parliament reviewed whether the ESFS had achieved this aim in its first two years of existence, as was provided for in the regulations establishing the ESAs and the ESRB. The purpose of the review was to identify whether and in what areas the ESFS must be improved. BaFin views the work of the ESAs and the ESRB very positively, although too little time has passed to fully and finally evaluate the effectiveness and efficiency of the ESFS. This applies in particular to the ESAs, as significant directives have not yet been adopted and important frameworks for action have therefore not been established. Despite a few initial difficulties, including with the EBA's stress test in 2011 and its recapitalisation exercise in 2012, the three authorities and the ESRB deserve respect for what they have managed to achieve from a standing start in the first two years, initially with relatively few staff.

However, they need to learn to prioritise their work correctly and efficiently manage their human resources. There also seems to be room for improvement in the cooperation between these bodies and with the European Central Bank (ECB). Work was unnecessarily duplicated in the past, which could have been avoided.

Another key point is that the ESAs should in future be fully funded from the Commission's budget. At present, the authorities of the member states finance part of the costs, without having adequate input on how the budget is allocated. In addition, the staffing of the EBA, ESMA and EIOPA should be commensurate with the work they perform, with more personnel being approved only if new tasks are assigned to the authorities.

BaFin also views the calls for the European supervisory authorities to have greater independence from the member states' authorities, for example, by creating executive boards with their own decision-making powers, as problematic. Ensuring that those with supervisory expertise can play a decisive role in discussions guarantees the quality of the three European supervisory authorities' work.

Committee on Regulation and International Policy

Financial market regulation is increasingly the product of European legislation and global initiatives. It is therefore all the more important to ensure Germany's position is effectively represented in the bodies where the important decisions are made. This requires central coordination. For this reason, BaFin established the Committee on Regulation and International Policy (KomRI). It keeps track of BaFin's participation in all European and global committees, prepares proposals for decisions by BaFin's Executive Board and draws up recommendations for courses of action to the individual directorates. Its work focuses on topics of major strategic significance for Germany. In certain circumstance, if mandated to do so by the Executive Board, the Committee can also make decisions in its own right. It also identifies cross-sectoral issues, with the aim of implementing tried and tested regulatory approaches in other supervisory areas where appropriate. In 2013, the Committee made decisions relating to the implementation of the Financial Stability Board's "Key Attributes of Effective Resolution Regimes for Financial Institutions" and on how to handle applications made to the ESAs to access documents. The Committee also conducted a comparative analysis of Basel III and Solvency II.

3.1.2 ESA peer reviews

The Review Panels of the European Supervisory Authorities conduct peer reviews of individual aspects of the national supervisory authorities' work, with the aim of standardising supervisory practices. A team of experts, comprising Review Panel members and experts from the national authorities, perform the reviews and for example, identify good practices.

EBA stress testing guidelines

In November 2013, the EBA published the results of a peer review to determine whether the national supervisory authorities had appropriately and fully implemented its stress testing guidelines. The guidelines specify how credit institutions should structure and perform stress tests as part of their risk management activities. The report confirms that all 30 supervisory authorities reviewed (including BaFin) from the 27 EU member states and the three observer states (Iceland, Liechtenstein and Norway) have largely applied the guidelines. On average, the assessment fell into the second highest of four rating categories. Some supervisory practices were considered to be best practices. The peer review, which was conducted between October 2012 and September 2013, was the first review conducted under the EBA's responsibility. The national supervisory authorities were required to complete a standardised self-assessment questionnaire. The EBA Review Panel then assessed the consistency of the supervisory authorities' responses. On-site inspections were carried out at six supervisory authorities.

EIOPA peer reviews

In 2013, EIOPA completed three peer reviews that it had started in the previous year. It has so far published two reports. In addition to identified best practices, the reports also outline a number of recommendations addressed to the national supervisory authorities and EIOPA. One of the peer reviews assessed internal model pre-application in preparation for the future Solvency II framework and recommended consistent communication with the industry and within colleges of supervisors. In addition, supervisors and risk experts should be equally involved in the pre-application process.
The peer review confirmed that BaFin has a convincing and well-organised pre-application process involving various departments. It found that consistency is ensured through guidance and regular meetings. The peer review recommended immediate follow-up peer reviews in three areas: ensuring a consistent approach to reviews, developing a consistent interpretation of requirements and improving the functioning of the colleges. These reviews began at the end of 2013.

ESMA conduct of business rules on consumer information

In a peer review of the conduct of business rules designed to ensure that consumers are provided with information that is fair and not misleading, which began in 2012, ESMA investigated whether various supervisory practices in the areas of internal organisation, supervisory approaches, monitoring of available information and market communication are consistent with the Markets in Financial Instruments Directive (MiFID). ESMA largely completed this peer review in 2013. BaFin was found to be fully compliant with all supervisory requirements. In connection with the peer review, on-site visits were carried out at four participating authorities, including BaFin in January 2014. These visits make it possible to document individual supervisory practices at close range and improve the understanding of these practices between the authorities.

In 2014, ESMA will continue its work on two further peer reviews that it began in 2013. One relates to the implementation of the ESMA guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities. The other peer review concerns the MiFID requirements on supervisory practices and the quality of execution of client orders. At the beginning of 2013, further good practices were determined for ESMA's peer review on the supervision of market abuse, which was conducted in 2012.

3.2 Comparison of Germany with its global peers

3.2.1 Financial Stability Board peer review

Germany last underwent a voluntary Financial Stability Board (FSB) country peer review in 2013 (see info box "Country peer reviews", page 38). The review was completed at the end of March 2014. One focal point of the peer review was the microprudential supervision

Country peer reviews

The FSB's country peer reviews investigate how the national supervisory authorities implement the guidance and supervisory standards agreed by the FSB. The reviews are based on the Financial Sector Assessment Program (FSAP) launched by the International Monetary Fund (IMF) and the World Bank. The FSB's peer reviews for individual countries can also focus on regulatory, supervisory, or other policy issues in the financial sector that are not covered by the FSAP. Unlike the FSAP, the FSB's country peer reviews do not comprehensively analyse the structure or policies of the financial system or compliance with international financial standards. The FSB member countries have agreed to undergo assessment in accordance with the FSAP every five years. In addition to this, an FSB peer review is carried out every two to three years following the most recent FSAP assessment. Countries complete a questionnaire for the peer review.

of banks and insurance undertakings. For example, on-site inspections were conducted at BaFin to review the reporting requirements regime and the enforcement of supervisory measures. Another focus was on the macroprudential framework. This covered BaFin's institutional structure, the processes related to the macroprudential structure, macroprudential strategy, instruments and measures, the elimination of systemic and cross-border risks and cooperation with the ESRB.

3.2.2 Assessment by the International Monetary Fund

In addition to the FSB peer review, a consultation under Article IV of the Articles of Agreement of the International Monetary Fund (IMF) was carried out in Germany in May and June 2013. According to this provision, the IMF has to conduct a consultation with each member country on their economic situation once a year. The IMF held discussions with representatives of BaFin, the Federal Ministry of Finance, the Federal Ministry for Economic Affairs, the *Bundesbank*, the Federal Agency for Financial Market Stabilisation (FMSA) and various private firms. The discussion with BaFin focused on the situation on the German financial market, challenges in the banking sector, the preparations for the Single Supervisory Mechanism (SSM), the management of the eurozone crisis and the implementation of the recommendations of the FSAP, which was conducted in Germany in 2011 (see info box "Country peer reviews"). As usual, the IMF published the results of the Article IV Consultation on its website.

As part of the consultation, the IMF positively assessed the macroprudential framework introduced in Germany and praised the improved stability of the German banking system, as well as the progress made in implementing the FSAP recommendations. However, the IMF sees a need for improvement in German banks' capital buffers and with regard to the issue of how to structure the financial system more profitably and efficiently. The progress made by German banks so far to strengthen their capital buffers was highlighted by the IMF, but it stressed that it expects further steps to be taken to improve capitalisation. In addition, further efforts need to be made in relation to the supervision of large, internationally active banks, and coordination with the supervisory authorities of major financial centres should be improved.

3.3 Recognition and equivalence of provisions

The high level of cross-border activity in the financial sector means regulatory authorities worldwide need to better coordinate their national supervisory requirements to avoid unnecessary double regulation and undesirable

regulatory arbitrage. In light of this, initiatives to establish comparable and equivalent supervisory requirements have been underway for several years. Since a large number of states, unions of states and international organisations have continued to develop their supervisory requirements without adequate international coordination in advance, a system of mutual recognition is also needed.

In 2009, the heads of state and government at the G20 summit in Pittsburgh decided that all standardised over-the-counter (OTC) derivatives must be traded on stock exchanges or electronic trading platforms and cleared through central counterparties by the end of 2012 at the latest. It was also decided that OTC derivatives contracts should be reported to trade repositories. The USA and Europe implemented the G20 requirements through national supervisory requirements that were not adequately coordinated internationally, necessitating their mutual recognition. To achieve this, the U.S. Commodity Futures Trading Commission (CFTC) and the European Commission agreed on a Common Path Forward on 11 July 2013. The extent of the mutual recognition will depend on the outcome of the detailed discussions currently underway.

3.3.1 Dodd Frank Act and Volcker Rule

In 2012 and 2013, BaFin and the *Bundesbank* used the comment periods provided by the US authorities to express doubts regarding the planned regulation of foreign banking organizations (FBOs) and the Volcker Rule. In their comments, BaFin and the *Bundesbank* focused on the unreasonable extraterritorial scope of the planned regulations, the unequal treatment of identical risks, the departure from the concept of globally harmonised regulation and the associated cooperation, and non-compliance with internationally adopted principles. The Federal Reserve published the final version of the Volcker Rule in mid-December 2013. This version takes account of BaFin's comments, which had urged appropriate consideration of government bonds. In February 2014, the Federal Reserve published the final version of the rules governing FBO. In them, the USA emphatically distances itself from the provisions of Basel III, even though the US supervisory authorities participated in its development. Equally, the USA has therefore also turned its back on the decisions made by the G20 in Pittsburgh. The intermediate holding company to be introduced under the new rules further fragments international regulation and promotes national protectionism. The mandatory establishment of new structures in the USA and tying up liquidity in a single jurisdiction contradicts the approach of consolidated supervision and is not an adequate means of dealing with the increasingly complex risks. Repercussions for competition and international cooperation appear inevitable.

Together with the German associations and banks, BaFin followed up on another aspect of the Dodd-Frank Act with cross-border implications. Exemptions still apply for non-US swap dealers, mostly on a time-limited basis, although the CFTC in particular has issued extensive provisions since the second half of 2013 specifying the extent to which European derivative rules can be recognised instead of US requirements (substituted compliance). It appears that the US rules are also impacting the areas of responsibility of European regulators. BaFin is therefore working at both European and bilateral level to help ensure adherence to the declaration of joint understanding issued by the USA and EU – the Common Path Forward on Derivatives of July 2013. According to this, only the closest possible alignment of the two regimes (outcome-based approach) can avoid the costs and contradictions caused by double regulation and regulatory arbitrage. At the same time, BaFin is pushing for more transparency from the OTC Derivatives Regulators Group, which is leading the equivalence debate. Europe is only represented in this group by the Commission, supported by ESMA.

3.3.2 Recognition as a qualified jurisdiction

In June 2013, the National Association of Insurance Commissioners (NAIC) published

a consultation paper proposing that the supervisors of the US federal states apply reduced collateral requirements for reinsurers from countries with good ratings, which would then be known as qualified jurisdictions. It was proposed that Bermuda, the United Kingdom, Switzerland and Germany should be offered the opportunity to be the first countries included in the list of qualified jurisdictions by means of a fast-track procedure. EIOPA requested that the NAIC in principle treat undertakings of the EU member states equally. EIOPA also criticised the fact that, once the assessment is completed, the US federal states still have discretion to decide whether they recognise the findings of the assessment. The NAIC then opened up the opportunity for countries other than the four previously selected jurisdictions to participate in the fast-track procedure. It continued the initial procedure with the four jurisdictions and recognised Germany, Switzerland and the United Kingdom as conditional qualified jurisdictions. Bermuda was awarded this status with restrictions. In 2014, the NAIC will continue its assessment of the four conditional qualified jurisdictions, with the aim of recognising them as qualified jurisdictions.

3.4 International cooperation

3.4.1 Memoranda of Understanding

BaFin agrees memoranda of understanding (MoUs) with other supervisory authorities to put the cooperation between the authorities and their exchange of information on cross-border credit institutions, investment firms and insurers on a formal basis (see table 1 "Memoranda of Understanding (MoUs) in 2013", page 41). This year, BaFin entered into an MoU on banking supervision with the Reserve Bank of India. Among other things, the supervisors agreed on the procedure for on-site inspections. The supervisory agreements usually specify that the supervisory authority that intends to conduct the inspection will notify the other supervisory authority of the timing and subject matter of the planned inspection in advance, and will either invite it to attend the inspection or propose a wrap-up meeting once the inspection has been conducted. Issues to be inspected include how subsidiaries integrate their risk management systems with that of their parent company and the appropriateness of valuation processes.

Cooperation arrangements are also entered into with authorities outside of the European Union on the basis of the European Alternative Investment Fund Managers (AIFM) Directive. The Directive also includes rules governing the international coordination of AIFM supervision. For example, cooperation between BaFin and the competent supervisory authorities of the relevant third countries must be ensured. This is particularly relevant if risk or portfolio management is outsourced to third countries in accordance with section 36 (1) no. 4 of the Investment Code (*Kapitalanlagegesetzbuch* – KAGB). The AIFM Directive also requires cooperation arrangements to be entered into if the national supervisory authority in the third-country regime provided for in the Directive is to be called on. As specified in the AIFM Directive, ESMA has developed minimum requirements for the content of such cooperation arrangements.

Since the AIFM Directive entered into force on 22 July 2013, BaFin has entered into such cooperation arrangements with supervisory authorities in Australia, Bermuda, Canada, the Cayman Islands, Guernsey, Hong Kong, India, Jersey, Switzerland, Singapore and the USA.

3.4.2 Technical cooperation

BaFin also met with numerous foreign supervisory authorities in 2013, including those from India, Russia, Turkey and South Korea. Representatives from the Chinese supervisory authorities visited BaFin again, further strengthening the cooperation on a number of levels.

In Hanoi, BaFin provided technical support for two workshops conducted by the State Securities Commission of Vietnam and the State Bank of Vietnam. BaFin employees provided on-site training to Vietnamese colleagues in the areas of market abuse

Table 1 Memoranda of Understanding (MoUs) in 2013

Banking supervision	
Albania	2012
Argentina	2001
Armenia	2011
Australia	2005
Austria	2000
Belgium	1993
Brazil	2006
Canada	2004
China	2004
Croatia	2008
Czech Republic	2003
Denmark	1993
Dubai	2006
El Salvador	2011
Estonia	2002
Finland	1995
France	1992
Georgia	2011
Greece	1993
Guernsey	2011
Hong Kong	2004
Hungary	2000
India	**2013**
Ireland	1993
Italy (BI)	1993
Italy (BI-Unicredit)	2005
Jersey	2012
Jersey	2000
Korea	2006
Kosovo	2011
Latvia	2000
Lithuania	2001
Luxembourg	1993
Macedonia	2011
Malta	2004
Mexico	2010
Netherlands	1993
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 (FDIC)	2006
USA (FedBoard/OCC)	2003
USA (NYSBD)	2002
USA (OCC)	2000
USA (OTS)	2005
USA (SEC)	2007
Vietnam	2010

Securities supervision	
Argentina	1998
Australia	1998
Brazil	1999
Canada	2003
China	1998
Croatia	2008
Cyprus	2003
Czech Republic	1998
Dubai	2006
Estonia	2002
France	1996
Guernsey	2011
Hong Kong	1997
Hungary	1998
Italy	1997
Jersey	2012
Jersey	2001
Korea	2010
Luxembourg (w/Clearstream)	2004
Monaco	2009
Poland	1999
Portugal	1998
Qatar	2008
Russia	2001
Russia	2009
Singapore	2000
Slovakia	2004
South Africa	2001
Spain	1997
Switzerland	1998
Taiwan	1997
Turkey	2000
United Arab Emirates	2008
USA (CFTC)	1997
USA (SEC)	1997
USA (SEC)	2007

Insurance supervision	
Australia	2005
California (USA)	2007
Canada	2004
China	2001
Connecticut (USA)	2011
Croatia	2008
Czech Republic	2002
Dubai	2006
Egypt	2010
Estonia	2002
Florida (USA)	2009
Georgia (USA)	2012
Guernsey	2011
Hong Kong	2008
Hungary	2002
Jersey	2012
Korea	2006
Latvia	2001
Lithuania	2003
Malta	2004
Maryland (USA)	2009
Minnesota (USA)	2009
Nebraska (USA)	2007
New Jersey (USA)	2009
New York (USA)	2008
Qatar	2008
Romania	2004
Singapore	2009
Slovakia	2001
Thailand	2010
USA (OTS)	2005

and the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk) for banks. This cooperation stems from the State Bank of Vietnam's desire to introduce requirements for the Vietnamese market that are comparable to the MaRisk. In addition, BaFin employees provided advice to the securities supervisory authority in Azerbaijan as part of a European Commission twinning project. Over a period of several days, they provided on-site training to employees in workshops and seminars on the subjects of market abuse, minimum capital requirements for banks and financial services providers, and issues relating to MiFID.

Together with the Securities and Exchange Board of India (SEBI) and Germany's Agency for International Cooperation (*Gesellschaft für Internationale Zusammenarbeit* – GIZ), BaFin also organised and hosted a regional conference in Mumbai lasting several days. Speakers from BaFin discussed investor protection and capital market regulation.

4 Management compliance

4.1 Professional qualifications and reliability

On 20 February 2013, BaFin published a Guidance Notice for assessing the Professional Qualifications and Reliability of Managers in accordance with the Insurance Supervision Act, the Banking Act, the Payment Services Supervision Act and the Investment Act (*Merkblatt für die Prüfung der fachlichen Eignung und Zuverlässigkeit der Geschäftsleiter gemäß Versicherungsaufsichtsgesetz (VAG), Kreditwesengesetz (KWG), Zahlungsdienste-aufsichtsgesetz (ZAG) und Investmentgesetz (InvG)*), which was replaced by the Investment Code (*Kapitalanlagegesetzbuch* – KAGB) on 22 July 2013. It explains which documents entities need to provide when notifying their intention to appoint managers and on the managers' appointment to allow BaFin to assess their professional qualifications and reliability. The guidance notice was first released for public consultation and then entered into force on 1 April 2013.

It creates a uniform working basis for all of BaFin's supervisory areas, but differentiates as required. For entities covered by the KWG (*Kreditwesengesetz* – KWG), ZAG (*Zahlungsdiensteaufsichtsgesetz* – ZAG) and KAGB, it only presents the formal requirements, as a supplement to the Reports Regulation (*Anzeigenverordnung* – AnzV) and the Reporting Regulation concerning the Payment Services Supervision Act (*ZAG-Anzeigenverordnung* – ZAGAnzV). No such regulation exists for insurance supervision. Circular 6/97 issued by the former Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen* – BAV) dealt with the formal and material considerations when appointing managers. BaFin revoked this circular with the entry into force of the guidance notice.

The guidance notice amends the "*Straffreiheitserklärung*" (a statement that the person concerned has no prior or pending charges or convictions), which was previously used when notifying the intention to appoint managers. The self-declarations managers are required to make in the "Disclosures relating to the reliability of designated managers" ("*Angaben zur Zuverlässigkeit*") form are now consistent with those required to be submitted by members of management and supervisory bodies to BaFin and the relevant *Deutsche Bundesbank* head office.[15] To assist the reporting entities, the guidance notice

15 See the Guidance Notice on Vetting Members of Administrative and Supervisory Bodies in accordance with the Banking Act and the Insurance Supervision Act (*Merkblatt zur Kontrolle der Mitglieder von Verwaltungs- und Aufsichtsorganen gemäß KWG und VAG*) of 3 December 2012.

§

Ruling

In its ruling of 22 May 2013, the Higher Administrative Court (*Verwaltungsgerichtshof* – VGH) in Hesse clarified several basic issues regarding warnings (case ref.: 6 A 2016/11). In practice, warnings are a relatively frequently used supervisory tool. They are designed to call on a regulated entity's manager or managers to remedy organisational defects or other breaches of supervisory regulations. If the manager fails to do so, BaFin can demand his or her removal. The VGH in Hesse has now clarified that litigation regarding a warning is not resolved if the manager retires. The reason advanced by the court was that the manager concerned could seek a new appointment as the manager of a different institution or as a member of a management or supervisory board. The VGH in Hesse also clarified that the facts and legal situation at the time the objection notice is issued are decisive. A warning is therefore not comparable with a disciplinary measure. Lastly, the court clarified that subsequent good business conduct will not necessarily lead to a warning being lifted. It will merely prevent the manager being the subject of a dismissal request, which is based on the manager continuing the misconduct despite receiving a warning.

includes a checklist that summarises the relevant documents on one page. These include a criminal record check for submission to an authority and an excerpt from the Federal Business Record Register.

Since the Act Implementing the European Capital Requirements Directive IV (CRD IV) (*Umsetzungsgesetz zur europäischen Eigenmittelrichtlinie CRD IV*) of 1 January 2014 has introduced changes for managers that are covered by the KWG, the guidance notice is currently being revised.

4.2 Irregularities in the business organisation

The responsibilities of managers of institutions, insurance undertakings and pension funds regarding proper business organisation have been set out in greater detail by the lawmakers. Articles 3 and 4 of the Ringfencing Act (*Trennbankengesetz*[16]) include provisions amending the KWG and VAG that entered into force on 2 January 2014.

These two articles specify the obligations to be met by managers of banks and insurance undertakings under the KWG, VAG and the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk) to establish and maintain a proper business organisation, including appropriate risk management. The new provisions set out in section 25c (4a) and (4b) of the KWG and section 64a (7) of the VAG contain requirements regarding strategies, processes, procedures, functions and concepts, with which managers must ensure compliance. The business organisation requirements differ depending on the entity and the risk exposure associated with the business conducted. The principle of proportionality applies.

If managers breach these duties, BaFin can order the entity to take appropriate measures to remedy the deficiencies. The Ringfencing Act has also introduced criminal penalties for such cases (section 54a of the KWG and section 142 of the VAG). Managers of an institution or entity can now be held liable under criminal law if the entity experiences financial distress due to mismanagement and the fact that the manager fails to implement the measures ordered by BaFin. This is because such misconduct may not only threaten the stability of the individual institution or insurance undertaking, but also that of the financial system as a whole.

16 Federal Law Gazette (BGBl.) I 2013, p. 3090.

5 Consumer protection

5.1 Consumer Advisory Council (*Verbraucherbeirat*)

BaFin's Consumer Advisory Council (*Verbraucherbeirat*) met for the first time on 20 June 2013. It was established in accordance with section 8a of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz* – FinDAG), which was added to the FinDAG by the Act on the Strengthening of German Financial Supervision (*Gesetz zur Stärkung der deutschen Finanzaufsicht*)[17]. The Consumer Advisory Council advises BaFin on its collective consumer protection work. To do so, it identifies and analyses consumer trends and reports its findings to BaFin's Executive Board. The panel is entitled to submit fundamental opinions on the procedures by which BaFin issues regulations and administrative provisions, where these are relevant to consumer protection. It can also advise BaFin on the opinions the latter submits during the legislative process. The twelve members of the panel are appointed by the Federal Ministry of Finance (*Bundesfinanzministerium* – BMF) and represent 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 (*Bundesministerium für Ernährung, Landwirtschaft und Verbraucherschutz*).[18] The Consumer Protection Panel is chaired by Dorothea Mohn of the Federation of German Consumer Organisations (*Bundesverband Verbraucherzentrale e. V.*).

5.2 Deposit guarantee schemes and investor compensation

BaFin supervises the statutory compensation schemes and bank guarantee schemes of the banking and securities trading sector, as well as the statutory guarantee schemes for life and substitutive health insurance.[19] 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.

5.2.1 Current compensation procedures

The compensation procedure relating to Phoenix Kapitaldienst GmbH, which began in March 2005, was finally concluded in January 2013. Around 71,000 decisions were made during the procedure, while total compensation amounted to €261 million. To repay the federal loan taken out to cover this compensation, the Compensatory Fund of Securities Trading Companies (*Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW) will have to levy further special payments on its member institutions. The court proceedings on the legality of this special payment are still ongoing.[20]

The insolvency proceedings relating to FXdirekt Bank AG were opened on 9 January 2013. As a result, BaFin established a compensation event on 22 January 2013. Consequently, clients were able to claim up to 90% of the liabilities from securities transactions owed to them by the securities trading bank, subject to a cap of €20,000, from the EdW.

In November of the year under review, the EdW had largely completed the process of compensating FXdirekt Bank AG's clients. It decided on a total of 1,414 compensation claims and paid out around €5.7 million. Despite the ongoing financial burden on the EdW due to the repayment of the federal loan taken out for the Phoenix Kapitaldienst GmbH compensation event, the EdW did not have to collect any further special payments.

On 19 December 2013, BaFin established a compensation event for Dr. Seibold Capital

17 Federal Law Gazette (BGBl.) I 2012, p. 2369.

18 Since December 2013 Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz*). A list of members can be found in the appendices.

19 A list of the supervised institutions can be found at www.bafin.de/dok/2681194 (only available in German).

20 See BaFin's 2012 Annual Report, chapter VII, p. 203.

Three questions for ...

Gabriele Hahn, Chief Executive Director Regulatory Services/Human Resources

What was the main focus of your work in 2013?

▶ 2013 was a year of major supervisory and administrative projects for me. With regard to supervision, the main themes were the Single Supervisory Mechanism, sanctions and collective consumer protection. In the area of administration, the second phase of the BaFin-wide organisational review, modern HR management and strategic management took centre stage. All of these projects share the objective of making BaFin into a state-of-the-art organisation that is fit for the future and equipped to handle the upcoming challenges – including the Single Supervisory Mechanism and European reforms such as Solvency II and the European Market Infrastructure Regulation, to name but a few.

What will be your most challenging task in 2014?

▶ There are so many interesting things on the agenda for 2014 that it is hard to pick just one. Enhancing collective consumer protection is definitely among them, though.

What do you stand for?

▶ Transparency, structure and reliability in all aspects of my work. In the area of supervision, a risk-based approach is also particularly crucial.

GmbH in Gmund am Tegernsee. The EdW has contacted the insolvency administrator and is preparing the compensation proceedings.

5.2.2 Deposits from German commonhold associations (*Wohnungseigentümergemeinschaften*)

In the year under review, BaFin successfully pushed for section 4 (5) of the Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz* – EAEG) to be amended so that accounts of German commonhold associations (*Wohnungseigentümergemeinschaften*) are considered as joint accounts for the purposes of statutory deposit guarantee schemes.[21] The amendment entered into force on 1 January 2014. Since all members of a German commonhold association are now considered account holders, the maximum statutory compensation of €100,000 applies to the share of the deposit held by each individual member. This provides greater protection for the funds, which often have to be saved by the commonholders over a long period.

Before the act was amended, the deposits of German commonhold associations were treated in the same way as individual accounts and were therefore only guaranteed up to a maximum of €100,000 if a compensation event occurred. This was due to the fact that German commonhold associations did not have legal personality when the EAEG entered into force on 1 August 1998. They have only been able to acquire their own rights since the law was amended in 2007. Since then, German commonhold association administrators have been required to deposit the funds they receive from the commonholders in the name of the association, so that the association itself is the accountholder.

21 The amendment to the EAEG (Federal Law Gazette (BGBl.) I 1998, p. 1842) was included as an annex to the CRD IV Implementation Act (BGBl. I 2013, p. 3395).

5.2.3 Reform of the European Directive on Deposit Guarantee Schemes

The European Commission, Council and Parliament resumed their informal negotiations on the proposed amendment to the European Directive on Deposit Guarantee Schemes[22] in the second half of 2013, after a long break. On 17 December 2013, the negotiators from the European Parliament and the member states agreed to tighten up the rules for European deposit guarantee schemes. Accordingly, all deposit-taking credit institutions will in future be allocated to a statutory or officially recognised deposit guarantee scheme recognised in the respective member state. The institutional guarantee schemes of the German Savings Banks Association (*Deutscher Sparkassen- und Giroverband* – DSGV) and the National Association of German Cooperative Banks (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* – BVR) can apply for recognition as deposit guarantee schemes and must then comply with the requirements of the Directive.

The Directive itself governs the compensation procedure, subjects the guarantee schemes to supervision and specifies the conditions in which credit institutions can receive support. The member states must have implemented the Directive within 12 months of its entry into force, which will probably mean by May 2015. This Directive is designed to achieve maximum harmonisation, so no further statutory protection is provided. In future, all depositors will have a legal right to compensation for deposits of up to €100,000. Customers did not previously have this right under bank guarantee schemes.

All of a member state's recognised and statutory deposit guarantee schemes will have ten years from the entry into force of the Directive to save funds equivalent to at least 0.8% of the covered deposits of their member institutions. A maximum of 30% of the funding can be made up of irrevocable payment commitments by the institutions. In addition, each year the guarantee schemes may collect a maximum of 0.5% of the covered deposits as special payments from their member institutions, if the funds already collected are insufficient to cover a current compensation event. Any additional funding requirements must be covered by taking out loans. These can be paid off over an extended period through annual special contributions.

The current deadline to pay out the deposit compensation of 20 days from the date the compensation event is established must be reduced to 15 days as from 31 December 2018, to ten days as from 1 January 2021 and to seven days after 31 December 2023. The Directive also provides for the deposit guarantee scheme contributions to be based on the amount of the covered deposits and the level of risk to which an institution is exposed. The European Banking Authority (EBA) is responsible for setting standards for establishing risk-based contributions. Compared with other countries, the German guarantee schemes already have very highly developed risk-based contribution mechanisms. The compatibility of these mechanisms with EBA requirements needs to be assessed.

The compensation schemes are required to contribute to the resolution costs when resolution measures are applied under the Recovery and Resolution Directive and the Single Resolution Mechanism (SRM) Regulation, provided depositors are still able to access their deposits as a result of these measures.

5.3 Key information for investment products

The Council of the European Union and the European Parliament published their final drafts of a regulation on key information documents for investment products, the Packaged Retail Investment Products Regulation (PRIPs Regulation) in May and November 2013, respectively. The European Commission had already published its proposal in summer 2012. The regulation aims to ensure that product providers in future supply a short key information document (KID), which clearly

22 Directive 94/19/EC, OJ EU L 135, p. 1ff.

presents the risks associated with the product concerned and also discloses the associated fees and remunerations. This should allow investors to compare products.

5.4 Consumer complaints and enquiries

BaFin's existing complaints procedure was codified in the Act on the Strengthening of German Financial Supervision (*Gesetz zur Stärkung der deutschen Finanzaufsicht*). The Act introduced section 4b of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz* – FinDAG), which entered into force on 1 January 2013. According to this provision, customers of supervised companies and consumer protection organisations[23] can complain to BaFin if they suspect that supervisory regulations have been breached. BaFin must comment on complaints within a reasonable period of time. To investigate complaints, BaFin may request detailed statements from the companies concerned.

5.4.1 Complaints about credit and financial services institutions

In 2013, BaFin processed a total of 5,918 submissions relating to credit and financial services institutions (previous year: 5,134), of which 5,644 were complaints and 274 general enquiries. The figure includes 27 cases where BaFin issued statements to the Petitions Committee of the *Bundestag* (the lower house of the German parliament). In addition, BaFin received 57 information requests about former banks, and especially their legal successors. The complaints were upheld in 1,152 cases, including two petitions.

The complaints concerned virtually the full range of products and services offered by the supervised institutions. Although building societies' right to terminate building savings contracts (*Bausparverträge*) with savings levels in excess of the targeted savings amount has been recognised by a court ruling, this topic was again the subject of several submissions. As in previous years, in addition to lending, customers complained about institutions taking longer than legally permitted to process bank transfers, or charging notification fees for returned direct debits, for example. BaFin also regularly received enquiries regarding garnishment protection accounts (*Pfändungsschutzkonten*). Overall, the main focus was on issues relating to the winding up of individual contracts.

Table 2 Complaints by group of institutions in 2013

Group of institutions	Total number of submissions
Private commercial banks	3,138
Savings banks	665
Public-sector banks	169
Cooperative banks	793
Mortgage banks	33
Building societies	350
Financial services providers (e.g. leasing and factoring companies)	292
Foreign banks	204

Selected cases

In 2013, BaFin was contacted by several consumers who had entered into forward loan agreements – real estate loans that are only paid out after an agreed period – a number of years ago. They asked for help in cancelling their contracts, as interest rates had since declined and it would therefore be possible to refinance at more favourable terms. However, BaFin is unable to provide assistance to consumers in such cases: in principle, the agreements are binding on both parties and must be executed as agreed. Neither the bank nor the customer is able to predict capital market developments, so forward loans always involve an element of uncertainty for both parties. In addition, it

23 Only consumer protection organisations that are included in the Federal Office of Justice's list of qualified institutions.

Consumer hotline

Citizens can call BaFin's consumer hotline at +49 (0) 228 299 70 299. Many people make use of this service: in July 2013, BaFin dealt with the 200,000th call since the hotline was set up in 2006.

In 2013, advisers provided information on financial market topics to 22,027 (previous year: 22,064) callers. Of these, 40% related to the insurance sector and 44% to the banking sector; 11% of calls concerned securities supervision.

Consumers' questions varied widely. For example, at the start of 2013, many consumers had questions about securities trading bank FXdirekt. BaFin had established a compensation event because the bank was no longer able to settle liabilities arising from securities transactions.[24] Several callers also had questions regarding garnishment protection accounts (*Pfändungsschutzkonten*) and institutions' policies on fees, particularly handling charges for loans. The insurance enquiries received related to the refusal to pay out private health insurance claims and to premium adjustments.

would not make financial sense for consumers to withdraw from a forward loan agreement to enter into a new contract at the current terms, as the bank would then charge a non-utilisation fee, which would probably more than offset the interest advantage gained.

Several consumers asked BaFin to review the cancellation policy clauses in their loan contracts. This was prompted by media reports that such cancellation policy clauses are often incorrect. In such cases, it is possible to cancel or withdraw from a loan without penalty even years later. However, BaFin is unable to act in the interests of individual customers and review their contractual documents, nor is it permitted to provide legal advice. Consumers should instead consult a lawyer or consumer advice centres. In any case, only the civil courts are competent to decide on the legality of cancellation policy clauses.

One consumer complained about the management fees for their garnishment protection account (*Pfändungsschutzkonto*), stating that these were higher than the fees for normal current accounts. The maximum amount of such fees is not regulated by law. However, in two judgements, the Federal Court of Justice (*Bundesgerichtshof* – BGH) ruled that clauses introduced by credit institutions that stipulate a higher fee for managing a garnishment protection account than for managing a normal current account are invalid.[25] BaFin advised the institution concerned of these judgements, and the bank confirmed that it will in future apply the same pricing to garnishment protection accounts as to its standard accounts.

5.4.2 Complaints about insurance undertakings

In 2013, BaFin processed nearly the same number of submissions as in the previous year, finalising 10,868 (previous year: 10,954). The submissions received comprised 8,809 complaints, 500 general enquiries not based on a complaint and 109 petitions that BaFin received via the *Bundestag* or the Federal Ministry of Finance. In addition, it received 1,450 written submissions that did not fall within its remit.

Expressed in terms of the total number of submissions, complainants were successful in 29.7% of proceedings (previous year: 26.5%), while 57% of the submissions were unfounded and BaFin was not the competent authority in 13.3% of the cases. If only the proceedings for which BaFin is the competent authority are taken into account, the success ratio was 34.3%.

24 See chapter II 5.2.2.

25 Judgements dated 13 November 2012, case ref.: XI ZR 500/11 and XI ZR 145/12.

Table 3 Submissions received by insurance class (since 2009)

Year	Life	Motor	Health	Accident	Liability	Legal expenses	Building/ household	Other classes	Other complaints*
2013	2,874	1,604	1,927	331	550	635	822	570	1,555
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

* Wrong address, brokers, etc.

The table below shows the main reasons for complaints:

Table 4 Reasons for complaints 2013

Reason	Number
Claims handling/delays	1,336
Amount of insurance payment	1,081
Coverage issues	1,072
Termination	1,049
Advertising/advice/application processing	639
Contractual amendments/ extensions	611
Tariff issues/no-claim rating	486
Premium payments, dunning	480
Changes and adjustments to premiums	477
Processing quality or duration of complaints processing	455

Selected cases

On 12 September 2012, the BGH ruled that it is not permissible, in the event of a change in tariff, to apply the absolute excess under the initial tariff and a treatment-based excess under the target tariff at the same time.[26] BaFin ensured that the insurer concerned took the necessary measures to implement the ruling. It was required first of all to inform the relevant customers and pay back the overpayments it received due to the combination of excesses. Following this, it had to develop a permissible process for dealing with future tariff changes.

In 2013, the BGH expanded on its rulings on the amount of minimum surrender values and sums insured under paid-up policies in the area of life insurance. On 26 June 2013, it decided that acquisition costs must not be deducted when paying out the minimum surrender value, including deductions in instalments.[27] BaFin's evaluation of the complaints found that some insurers had improperly deducted the acquisition costs in instalments. On 11 September 2013, among other dates, the BGH also expressly confirmed the practice adopted by life insurers of calculating the surrender value and paid-up sum insured based on half of the non-zillmerised net premium reserve.[28] In addition, the BGH clarified that its 2012 ruling also applies to unit-linked endowment insurance policies.

When processing the complaints, BaFin found that some of the general insurance terms and conditions of two warranty and breakdown insurers did not comply with the BGH's rulings. BaFin found fault with a total of three clauses. In one case, the general insurance terms and conditions specified that repair bills must be presented within one month. Since this represents an unreasonable disadvantage for the warranty holder, the BGH had already ruled such a clause invalid

26 Case ref.: IV ZR 28/12.

27 Case ref.: IV ZR 39/10.

28 Case ref.: IV ZR 114/13.

in 2008.[29] Another clause specified that the insurance undertaking would not be required to pay out if the customer did not perform the maintenance work required or recommended by the vehicle manufacturer. The BGH ruled this clause to be invalid.[30] In addition, the general insurance terms and conditions specified that the required or recommended maintenance, inspection and servicing work must be performed at a workshop authorised by the brand manufacturer. The BGH had already ruled such a clause invalid in 2006.[31] Both insurance undertakings have agreed to comply with these requirements in future.

5.4.3 Complaints relating to securities transactions

In 2013, BaFin received 671 complaints about credit and financial services institutions (previous year: 666) and 467 written enquiries by investors (previous year: 780).

In addition, BaFin received 22 written complaints about investment research (previous year: 14). BaFin responded to 37 written enquiries related to the interpretation of section 34b of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG) (previous year: 65), the relevant provision applicable to financial instruments research.

Selected cases

One consumer alerted BaFin to the fact that a bank was improperly advertising a product. The bank did not provide a balanced picture of the risks and opportunities associated with the product in its marketing communications. The WpHG specifies that all information, including marketing communications, which investment services enterprises make available to their clients must be fair, clear and not misleading. BaFin took action to ensure that the bank removed the material from display. The bank also improved its internal controls at BaFin's request.

Another customer complained that he had been charged undue costs for securities transactions. He was asked to pay "offline processing fees", among other things, although he had submitted an online banking order. BaFin asked the bank to submit a response. The bank explained that this had been caused by a technical fault, which it then corrected. The bank reimbursed the complainant and the other affected customers for the incorrect charges.

5.4.4 Complaints guidance for banks and investment services enterprises

In November 2013, the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) published draft guidelines for complaints-handling for the securities and banking sectors for consultation.

The content of the guidelines is almost identical to the guidelines for insurance undertakings issued by the European Insurance and Occupational Pensions Authority (EIOPA) in 2012.[32] The guidelines describe procedures for complaints-handling by banks, management companies, alternative investment funds and payment institutions. They specify the information that the companies must provide to complainants. Among other things, the companies must confirm receipt of complaints in writing and provide information on when the complaint will be processed. In addition, they must provide written notification of the decision regarding the complaint, as well as information about other complaints bodies and dispute resolution entities. Lastly, the guidelines require companies to gather complaints data internally and to pass it on to the supervisory authorities.

5.4.5 Complaints guidance for insurance intermediaries

EIOPA also issued guidelines on complaints-handling by insurance intermediaries in November 2013. The content is based on the corresponding guidelines for insurers. Under

29 Case ref.: VIII ZR 354/08.

30 Case ref.: VIII ZR 251/06

31 Case ref.: VIII ZR 206/12.

32 http://www.bafin.de/dok/3828172 (only available in German).

the guidelines, insurance intermediaries are now also required to handle complaints more systematically and in a manner that is transparent for the potential complainant. In addition, they are required to provide complaints data to the supervisory authorities.

The supervisory authorities in the EU member states must inform EIOPA whether and how they will implement the guidelines within three months of their publication in all official languages. BaFin has already implemented the guidelines to the extent permitted by its powers. It did this by including tied agents in the scope of the circular on complaints-handling and its collective administrative acts. Thanks to the ombudsman for insurers, consumers in Germany already enjoy a high level of protection in respect of insurance intermediaries.

Alongside the guidelines, EIOPA also published a report on complaints-handling by insurance intermediaries, which gives a good overview of supervisory practice in EU member states. EIOPA assists small intermediaries in particular by providing brief instructions on the practical implementation of the guidelines.

5.5 Dispute resolution

In April 2013, the European lawmakers adopted new dispute resolution rules: the Directive on Alternative Dispute Resolution (ADR) and the Regulation on Online Dispute Resolution (ODR).[33] They are intended to improve legal protection for consumers by sparing them protracted and costly court proceedings.

The member states must transpose the ADR Directive into national law by 9 July 2015. It specifies that alternative dispute resolution (ADR) entities must be created for all financial services. The member states must meet the requirements of the Directive as a minimum, but may also impose more extensive requirements. Under the Directive, ADR entities are required to deal with both domestic and cross-border disputes. They must be independent and not subject to any instructions. Their employees must have proven knowledge and expertise in dispute resolution.

Each member state must designate a national authority that is responsible for approving ADR entities. In Germany, the authority has not yet been decided. To ensure that the dispute resolution process is transparent, the ADR entities must provide extensive information on their websites and make it possible to submit complaints online. Traders must indicate in their general terms and conditions, on their websites and in the event of complaints that consumers have access to ADR procedures. The procedures must be free of charge for consumers and must last no more than 90 days.

The ODR Regulation is directly applicable, so there is no need to transpose it into national law. It enters into force on 9 January 2016, with the exception of individual articles, which have been applicable since July 2013 or which will apply from 9 July 2015. The ODR Regulation is intended to make it easier for consumers to reach the competent entity. It supplements the ADR Directive with procedural aspects and gives the European Commission powers to establish an online point of contact for disputes, which will pass on the disputes it receives to the competent ADR entity. The Commission will establish the necessary platform by January 2016.

5.6 Outlook

In their coalition agreement of 27 November 2013, Germany's governing parties agreed that the federal government, with the cooperation of the ministries and BaFin, will review the options for action in the area of collective consumer protection. The focal points include the transparency and clarity of product information, as well as restrictions on distribution and the scope of supervisory powers.

A way of classifying products that clearly shows investors a product's complexity, risk level and appropriate investment horizon could be helpful. Changes are also conceivable with regard to

33 OJ EU L 165/63, p. 63ff. and p. 1ff.

Dispute resolution entities in Germany

There are already numerous ombudspersons' offices and dispute resolution entities for companies in the financial sector in Germany. BaFin's Arbitration Board under the Investment Code (*Kapitalanlagegesetzbuch* – KAGB) has published extensive information on BaFin's website.[34] Consumers can use this to find information on who is responsible for what and how to contact all dispute resolution entities for the German financial sector. In addition, they can use the new search function to quickly and easily find the competent entity for disputes with a specific company. Where appropriate, BaFin also refers consumers who complain about companies that it supervises to the dispute resolution entities. This procedure has now been legally defined in the new Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz* – FinDAG).

BaFin also strives to ensure effective communication between the ombudspersons' offices and dispute resolution entities. In mid-December 2013, it invited their representatives to Bonn to share experiences and exchange views. This was the second such meeting and a further is planned for 2014. The main topic at the 2013 meeting was the transposition of the Directive on Alternative Dispute Resolution (ADR) into German law. Among other things, the ombudspersons would like to see clearer regulation of the periods for dealing with dispute resolution cases than is provided for by the Directive. Overall, the existing dispute resolution entities for the German financial sector already meet most of the requirements of the ADR Directive.

the distribution channels for various financial products. For example, certain products should only be able to be sold by professional advisers that are subject to supervision.

The aim is to provide adequate protection for retail investors, while striking an appropriate balance between state regulation and the investor's personal responsibility.

6 Financial accounting and reporting

In response to the financial crisis, the International Accounting Standards Board (IASB) is revising IAS 39. In future, the provisions of this standard on the recognition and measurement of financial instruments will be fully replaced by a new standard, IFRS 9 Financial Instruments. The IASB has split the overall project into three phases.

One of the key changes in the first phase is the introduction of a new measurement category for certain financial assets. A final version of the standard is expected to be issued in the second quarter of 2014. In addition, the members of the IASB have agreed on early adoption of the own credit risk requirements. The standard is currently planned to enter into force on 1 January 2018.

In the second phase of the project, the IASB published a second exposure draft on impairment of financial instruments in March 2013. It has kept to its plans to use the expected loss model for impairment. A final version of the standard is set to be adopted in the second quarter of 2014. It seems that the IASB and the Financial Accounting Standards Board (FASB) are unable to agree on a single asset impairment model.

34 www.bafin.de/dok/2689650.

In the third phase of the project, in September 2012, the IASB published a review draft of the hedge accounting section of IFRS 9, which differs significantly from the approach under IAS 39. The IASB has now started detailed discussions on macro hedge accounting. A discussion paper is planned for the first quarter of 2014.

Revised IASB exposure draft on insurance contracts

The IASB took a further major step towards creating a unified IFRS for insurance contracts with the publication of a revised exposure draft on accounting for insurance contracts in June 2013. The exposure draft is intended to conclude the second phase of the original joint project with the FASB in the United States. Both standard setters participated in the deliberations on the comment letters on the first exposure draft, but then separately published two new exposure drafts in June 2013, resulting in diverging accounting for technical provisions by the two international standard setters.

The IASB's revised exposure draft represents a unified concept for accounting for all types of insurance and reinsurance contracts. It generally confirms the measurement model contained in the first exposure draft, according to which technical provisions are to be measured at their fulfilment value based on the three building blocks: discounted, probability-weighted cash flows, risk adjustment and contractual service margin. The exposure draft follows the principle-based approach of the IASB, whose future standard is intended to ensure consistent, transparent and comparable reporting for annual financial statements in the insurance sector.

At the same time, the IASB wanted to dispel the concerns of users and readers of financial reports expressed in the comment letters on the first exposure draft. The concerns related in particular to short-term volatility and the recognition of long-term business in the balance sheets of life insurers. The IASB now provides for the mandatory recognition in other comprehensive income of interest rate-related value fluctuations caused by the updating of the discount rate on technical provisions. This provision is basically consistent with the new requirements of IFRS 9, which also provide for the recognition of changes in the fair value of financial instruments on the assets side in other comprehensive income. The optional application of this concept to the liabilities side of insurance undertakings' balance sheets could reduce further matching problems between the assets and liabilities side.

Another change proposed by the exposure draft is the recognition in equity of changes in the inputs used to estimate future expected cash flows by adjusting the contractual service margin. This avoids the impact of short-term volatility on profit or loss, consistent with the long-term business model of the insurance sector.

The mirroring approach is also intended to reduce asymmetries in insurers' balance sheets, by measuring the cash flows from insurance contracts on the same basis as the underlying instruments. Many market participants support this principle of presenting the measurement interdependencies in the balance sheet. However, the implementation of a solution such as this needs a more practicable structure than provided for in the current IASB proposal.

In addition to these three significant changes, which are intended to reduce short-term volatility, the IASB's revised exposure draft also changes the presentation of insurance business in the statement of comprehensive income. In particular, the draft proposes the inclusion of more volume information, which was not provided for in the margin-based approach of the previous draft. The effect of the proposed amendments on the practicability and clarity of the provisions is not yet foreseeable.

The IASB will probably give users a transition period of three years following publication before initial application of the final standard. A deliberately long transition period seems to have been selected to give insurers the

opportunity to prepare for the changes to their financial accounting and reporting – an approach that should be viewed positively.

Agreement on audit reform

The European Parliament, the Commission and the Council agreed on the audit reform proposals in December 2013. In future, audit firms will be required to rotate every ten years. Member states can extend the maximum audit tenure for public-interest entities in cases where the auditor wins a new tender (maximum extension of ten years), or a joint audit is conducted (maximum extension of 14 years). The negotiations also focused on the prohibition of the provision of non-audit services and the supervision of auditors.

A list of prohibited non-audit services will be published. Consulting services may account for a maximum of 70% of the average statutory audit fee to reduce the risk of conflicts of interest arising for auditors. The Commission's proposal to coordinate auditor supervision activities within the framework of the European Securities and Markets Authority (ESMA) was not approved. Instead, the cooperation between national supervisory authorities at EU level is to be improved using a committee of European audit supervisors. The aim of the EU audit reform process is to complete the legislative process before the European elections in May 2014.

Improvements to audit reports

In July 2013, the International Auditing and Assurance Standards Board (IAASB) proposed a new international audit standard, ISA 701, for listed entities to improve the informational value of the audit opinion. Under the proposed standard, the auditor would select key matters that are of interest to the reader and describe these in the audit opinion. However, it is not intended that the auditor should assume the responsibilities of the management or supervisory body. Further proposed changes relate to the explanations regarding the auditor's independence and the going concern approach, as well as communication with the entity's supervisory body. These subjects are to be more clearly presented.

Although the proposals are generally supported at international and national level, clearer explanations of individual aspects would be useful. This will be essential for the uniform application of the standards in practice.

7 Prevention of money laundering

FATF guidance on e-money products

BaFin contributed to the guidance on anti-money laundering supervision of e-money products that was published by the Financial Action Task Force (FATF) in June 2013 to assist e-money providers, supervisors and national lawmakers.

The FATF guidance recommends that national lawmakers take a risk-based approach to the regulation of e-money products. This is designed to avoid subjecting all e-money products to the same supervisory requirements. As recommended by the FATF, the necessary risk analysis should be based on a specific risk matrix, which includes both risk factors (e.g. anonymity, possibility of a cash payout, etc.) and risk mitigation measures (e.g. setting of maximum amounts and thresholds).

In addition, the new FATF publication includes in-depth explanations and practical examples of the individual risk factors and mitigation measures. If the risk analysis finds that a product represents a low risk of money laundering and terrorist financing, the provider of this product could be allowed to apply simplified customer due diligence measures. The provider may even be fully exempted from customer due diligence requirements if it can

be proved that the risk is very low. In Germany, this principle is governed by section 25n of the Banking Act (*Kreditwesengesetz* – KWG).

However, the specific features of an e-money product can require the application of enhanced due diligence measures. In the case of complex e-money models, the FATF also provides for the possibility of other parties being subject to money laundering requirements in addition to the central issuer of the e-money. Such parties include network operators, programme managers and exchangers. In certain circumstances, the FATF considers it appropriate and permissible for agents and distributors of e-money products to also be subject to obligations to prevent money laundering and terrorist financing.

FATF guidance on politically exposed persons

In addition, the FATF published guidance on politically exposed persons (PEPs) in June 2013. This guidance is also underpinned by a risk-based approach. Accordingly, business relationships with domestic PEPs must be individually assessed to determine the level of risk they pose. The institution must adapt the ongoing supervision of the business relationship in accordance with the level of risk determined. Foreign PEPs are still always considered high risk customers. Business relationships with foreign PEPs must therefore be subject to enhanced due diligence requirements.

The guidance clearly states that to determine whether someone is a PEP, the customer must be properly identified. The guidance provides information on the procedures that have proved effective in determining PEP status and what additional requirements should be applied to identify family members and close associates of PEPs. There are significant regional differences worldwide between terms such as "prominent public function", "family" and "close associate". The guidance also assesses the different external sources that can be used to determine a customer's PEP status.

Finally, the guidance lists numerous warning signs that institutions can look for in existing business relationships to determine whether a PEP in its customer base could be engaged in money laundering activities.

Joint Anti-Money Laundering Working Group

At the end of 2013, the joint working group of BaFin, the Federal Ministry of Finance and the associations of banks belonging to the German Banking Industry Committee (*Deutsche Kreditwirtschaft* – DK) completed the revision of the interpretation and application guidance for banks on the prevention of money laundering, terrorist financing and other punishable offences. The new guidance was published on the DK website at the start of March 2014.

In particular, new sections were added, which further specify the requirements applicable to the operation of IT systems, and which cover the investigation of suspicious or unusual circumstances (now section 25h (2) and (3) of the KWG). The joint working group also revised the chapter on determining beneficial owners. The beneficial owner is the individual who initiates a transaction or through whom a business relationship is ultimately established. The beneficial owner can also be the natural person who owns or controls a contractual partner in the form of a legal person or other legal structure.

8 Enquiries under the Freedom of Information Act

The Freedom of Information Act (*Informations-freiheitsgesetz* – IFG) entered into force at the start of 2006. Since then, anyone has the right to request access to official information from the Federal authorities. The main function of the IFG is to improve the supervision and acceptance of government actions.

Table 5 IFG-statistics

Supervisory areas	Number	Application withdrawn	Access to information granted	Partial access to information	Access to information denied	In process	Objection filed	Appeal lodged
Banking supervision	218	0	0	3	218	0	202	973
Insurance supervision	6	0	7	0	2	3	1	1
Securities supervision	72	4	31	13	24	4	7	1
Other	11	2	6	0	3	0	266	0
Total	**307**	**6**	**44**	**16**	**247**	**7**	**476**	**975**

Legal uncertainty continues

According to a ruling of the Federal Administrative Court (*Bundesverwaltungsgericht* – BVerwG), the obligation of confidentiality under section 9 of the Banking Act (*Kreditwesengesetz* – KWG) is not an adequate reason to refuse to present documents that are the subject matter of a dispute in accordance with section 99 (1) sentence 2 second alternative of the Rules of the Administrative Courts (*Verwaltungsgerichtsordnung* – VwGO).[35] Further to this ruling, the Administrative Court in Frankfurt am Main referred the matter to the European Court of Justice (ECJ) for a preliminary ruling in March 2013. In accordance with Article 267 of the Treaty on the Functioning of the European Union (TFEU), the preliminary ruling procedure should clarify significant procedural and legal questions regarding the IFG, section 9 of the KWG and section 99 of the VwGO, as well as relevant European directives.[36]

Suspension of judicial proceedings

Insofar as the outcome of the preliminary ruling is relevant to the IFG proceedings pending at the Administrative Court in Frankfurt am Main, the Administrative Court has suspended these proceedings until the ECJ's decision is known. However, the Higher Administrative Court (Verwaltungsgerichtshof – VGH) in Hesse does not at present intend to suspend pending IFG proceedings. Until a decision has been made regarding the extent to which the relevant provisions of the European Directive on professional secrecy extend to the IFG and national procedural law, BaFin is therefore concerned that court decisions that are incompatible with European law may be handed down.

9 Authorisation requirements and prosecution of unauthorised business activities

9.1 Authorisation requirements

BaFin examines whether investment and retirement savings offerings require authorisation under the laws whose observance it is responsible for supervising. BaFin investigates any companies that undertake these business activities without the required authorisation and enforces measures under the Industrial

35 Federal Administrative Court (Bundesverwaltungsgericht – BVerwG), decision dated 27 August 2012 (case ref.: 20 F 3.12).

36 OJ EU, C 156, p. 22.

Code (*Gewerbeordnung* – GewO) to ensure that the companies comply with the authorisation requirement. In such cases, BaFin works closely with the prosecuting authorities.

Investment providers have the opportunity to ask BaFin to examine whether authorisation is required for planned business ventures. This gives them certainty about whether their business activities require authorisation under the Banking Act (*Kreditwesengesetz* – KWG), the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG), the Payment Services Supervision Act (*Zahlungsdiensteaufsichtgesetz* – ZAG), or the Investment Code (*Kapitalanlagegesetzbuch* – KAGB). Companies may only pursue activities requiring authorisation once this has been given in writing by BaFin. Providers that engage in commercial activity without the relevant authorisation incur criminal liability. BaFin can prohibit providers from carrying on such business activities and force them to be wound up, irrespective of whether the prosecuting authorities take action.

In the year under review, BaFin received 957 requests to examine whether authorisation was required for planned business ventures (previous year: 723). BaFin dealt with 653 requests by the end of the year, in most cases finding that authorisation was required (previous year: 580).

The Act Implementing the AIFM Directive (*AIFM-Umsetzungsgesetz* – AIFM-UmsG), which entered into force on 22 July 2013, introduces new criteria and concepts that extend BaFin's investigative role.[37]

In accordance with the substantive definition of investment funds, BaFin now reviews whether the KAGB applies to investments in assets. This means that, in addition to the legal assessment of general authorisation requests, it must also examine the prospectuses submitted within a specified deadline. One of the audit focuses in 2013 was wind farms and solar farms. In this context, the issue of whether a company's operating activity was outside the financial sector frequently arose. In accordance with its interpretive letter on the scope of the KAGB, BaFin always finds in favour of an operating activity if an applicant is a manufacturer or is commercially active in the course of its main business activity and if it retains the full right to determine the work performed, and full rights of control and instruction when outsourcing individual business activities.

The Act Implementing the AIFM Directive[38] also extended the list of financial services in section 1 (1a) of the KWG to include limited custody business. Section 1 (1a) sentence 2 no. 12 of the KWG defines this as the safe custody and management of securities exclusively for alternative investment funds (AIFs) within the meaning of section 1 (3) of the KAGB. BaFin explains the new activity in greater detail in its guidance notice on the limited custody business.

The Act Implementing the AIFM Directive also explains that a business activity can only be classified as investment management (section 1 (1a) sentence 2 no. 11 of the KWG) if it is not already considered collective asset management within the meaning of the KAGB. The Act also contains a number of editorial amendments to the definitions and exemptions set out in the KWG to bring them into line with the concepts contained in the KAGB. Accordingly, BaFin updated its guidance notices on banking business and financial services, which build on the definition of financial instruments under section 1 (11) of the KWG.

BaFin has also issued a guidance notice on activity as a central counterparty (section 1 (1) sentence 2 no. 12 of the KWG). The German term *zentrale Gegenpartei* was introduced as a new legal term by the Act Implementing the European Regulation[39] on OTC Derivatives, Central Counterparties and Trade Repositories[40] and replaces the German term previously used for central counterparty, *zentraler Kontrahent*.

37 See chapter V.

38 Federal Law Gazette (BGBl.) 2013 part I no. 35, p. 1981.

39 Regulation (EU) No. 648, OJ EU L 201, p. 1.

40 Federal Law Gazette (BGBl.) I 2013, p. 174.

9.2 Trading in Bitcoins

An increasing number of requests to examine whether authorisation is required in connection with the trade in and commercial use of Bitcoins have recently been received from interested parties in Germany and abroad.

Bitcoins, which have been in circulation since 2009, are a form of private currency based on cryptography, also known as a cryptocurrency or Internet currency. The Bitcoin system is based on the concept of creating a cryptocurrency as a substitute currency whose supply is mathematically limited, alongside legal tender. Unlike legal tender, unlimited amounts of which can theoretically be issued by central banks, or the book money of commercial banks, Bitcoins are created using a mathematical process that is accessible to anyone with a powerful enough computer. The more Bitcoins created, the more complex the computing tasks become, causing the growth in Bitcoin supply to slow down. Ultimately, a maximum volume of 21 million Bitcoins will be created. However, these can be divided to eight decimal places. In June 2011, the number of Bitcoins created already amounted to 6.4 million; at the start of December 2013, there were just over 12 million.

Since Bitcoins are created using open source software, anyone can in principle participate in the project. The individual participants (clients) log into the peer-to-peer system and create the currency by solving CPU-intensive cryptographic tasks (mining). This form of currency creation is the gold prospecting of the digital age. Prospectors back then were also able to immediately use the fruit of their labour as a means of payment, or hoard it as an asset, at least temporarily. Until the maximum number of Bitcoins has been created, clients are only limited by the available computing power. The probability of a client being the first to find the right solution and obtaining a new Bitcoin rises in proportion to the computing power used.

There is no central body that conducts, monitors, or manages payments, or generates Bitcoins. Equally, the process of creating the currency is not supervised by any government body. Newly created Bitcoins are authenticated by the community through a peer-to-peer system in which all computers in the network have equal rights.

BaFin qualified Bitcoins as "*Rechnungseinheiten*" (units of account under German law) in August 2011 and, therefore, as financial instruments in accordance with section 1 (11) of the KWG.

Bitcoins do not qualify as e-money under European law or national provisions, as the currency is not issued in return for payment of a sum of money. Instead, they are freely created through the use of the required computing power. Equally, the monetary value of Bitcoins is not derived from a claim against the issuer under the law of obligations. Bitcoins derive their monetary value solely from the fact that they are actually used and accepted as a private means of payment.

Rechnungseinheiten are like currency units in that they are units of account, but unlike currency units they are not denominated in legal tender. They include units of value that serve as private means of payment in barter transactions, for example, as well as any other private money or complementary currency used as a means of payment in settlement accounts by virtue of private-law agreements.

The creation of Bitcoins and their use as a means of payment does not require authorisation within the scope of BaFin's responsibilities. However, if the Bitcoins themselves are traded, contrary to their actual function, they are deemed to be financial instruments requiring authorisation in accordance with section 1 (1a) sentence 2 nos. 1 to 4 of the KWG. In accordance with section 1 (1a) of the KWG, the trading must be conducted commercially or on a scale which requires a commercially organised business undertaking. Key examples of this are proprietary trading, the purchase and sale of financial instruments for one's own account as a service for others, or investment broking, broking transactions (including via Internet platforms) to purchase and sell financial instruments. If such transactions are carried out for

commission, they may also be considered to be principal broking services under section 1 (1) sentence 2 no. 4 of the KWG and, as such, banking business requiring authorisation.

9.3 Exemptions

BaFin exempted seven companies from supervision for the first time. At the end of 2013, a total of 334 institutions were exempt from the authorisation requirement, as the nature of their business means that they do not require supervision. Business that does not require authorisation normally relates to low-level auxiliary or ancillary transactions conducted in association with principal business activities that do not otherwise need authorisation.

Providers from third countries outside the EU can also apply for exemption if they want to commence cross-border activities in Germany. However, this is only possible if they are subject to equivalent supervision in their home country. BaFin exempted five foreign companies in 2013.

Purchase of second-hand life insurance policies

In 2013, BaFin intervened against five offerings to "purchase" second-hand life insurance policies on the grounds of the unauthorised conduct of banking business. Further proceedings were initiated. As in previous years, the offerings provided for the purchase price to be paid to the insurance policyholder ("seller") at a later date. The intention was to use the capital from the life insurance policy or other financial investment to generate a higher return and to then pay it out as part of the purchase price. BaFin considers such business models to be an investment offer, which represents deposit business and thus banking business within the meaning of section 1 (1) sentence 2 no. 1 of the KWG. In line with this, civil courts have now also judged the contracts of individual providers to be invalid in cases with comparable purchase models.[41] However, the matter has yet to be clarified by an administrative court.

The companies concerned have sought legal remedies against the prohibition and liquidation orders. BaFin will continue to seek further court clarification of individual cases.

In BaFin's view, qualified subordination clauses do not exclude the unconditional repayability of the funds and therefore the existence of deposit business if the structure of the offering leads investors to expect that, in return for the assignment of their assets, they will be paid a "fixed purchase price", which depends on the surrender value of their financial investment, at a later date. In this case, investors accept no financing responsibility at all for the provider.

If BaFin orders the unauthorised deposit business to be wound up, the money accepted must be repaid to the investors, the former policyholders. If providers attempt to circumvent the liquidation order by entering into civil law agreements with investors containing other provisions on the investment or payout of the funds, this is not considered liquidation within the meaning of the law. The providers cannot evade their public law obligations by entering into conflicting civil law agreements with the investors.

Illegal investment schemes

Illegal investment schemes comprise banking, financial services, investment and insurance businesses, and payment services operated by providers that do not have the required authorisation. Individuals and companies that are involved in illegal investment schemes operate illegally and outside government regulation. It cannot be assured that they meet the personal, professional, or financial requirements for operating such businesses. BaFin has extensive powers of investigation and intervention to uncover and combat unauthorised business activities, even by international standards.

41 Nuremberg Higher Regional Court (case ref. 8 U 607/12), Frankfurt am Main Higher Regional Court (case ref. 2 U 178/12).

Peter Fitzek and his "Kingdom of Germany"

In the year under review, BaFin took action against the unauthorised business activities of Peter Fitzek. Among other things, Peter Fitzek offers "savings books" at a "Royal Bank of Germany" ("*Königliche Reichsbank*") and promised deposit security. He opened a "branch" of his "Royal Bank" in Wittenberg city centre. He also offers various insurance policies under the name of "*NeuDeutsche Gesundheitskasse*" and his "Kingdom of Germany" association, including health and pension insurance. In April, around 150 officials from BaFin, the *Deutsche Bundesbank* and the federal and state police searched 11 properties in Wittenberg and seized a large number of documents. This was the largest raid ever conducted by BaFin. BaFin subsequently issued numerous prohibition orders against Mr Fitzek and front men he used. It also imposed coercive fines totalling €3.15 million. In addition, BaFin informed the competent court of registration of the unauthorised use of the legally protected term "bank" (in "*Reichsbank*"), which then initiated proceedings for the unauthorised use of a registered business name against Peter Fitzek. The competent public prosecutor's office is investigating the suspected unauthorised conduct of banking and insurance business.

Supervisory and investigative measures

In 2013, BaFin initiated 672 new investigations (previous year: 641) and concluded 497 proceedings (previous year: 418). BaFin made formal requests for information and the submission of documents to suspicious companies in 52 cases (previous year: 73) and imposed coercive fines in 26 cases (previous year: 19).

As part of its investigations into unauthorised business operations, BaFin carried out 24 searches of premises and on-site inspections in 2013 (previous year: 21).

BaFin prohibited the continuation of unauthorised business operations in 16 cases (previous year: 19) and ordered the liquidation of the business in 26 cases (previous year: 26). A liquidator was appointed in one case (previous year: 4). A total of 36 entities voluntarily discontinued their business activities (previous year: 21) after BaFin notified them that their business required authorisation.

In the year under review, individuals or companies against which formal measures had been taken filed objections with BaFin in 48 cases (previous year: 39). BaFin completed 24 of a total of 38 procedures (previous year: 28) on the basis of objection notices (previous year: 15). Some of the affected parties took legal action against supervisory measures. Courts at all instances ruled in a total of 17 cases. In 14 and therefore the majority of the procedures (previous year: 12), the courts found in favour of BaFin. In three cases the courts ruled in favour of the affected parties (previous year: 2).

9.4 Money-remittance business

In the year under review, BaFin took action against companies whose business model consists of submitting card transactions to the acquirer on behalf of third-party service providers using their own merchant account and then paying out the sums received to the service provider. This business, which corresponds to an acquiring service in economic terms, is classified as remittance business from a supervisory perspective and, as a payment service, requires authorisation. In general, the purpose of such transactions is to make it possible to accept cards in cases where the service provider will not or cannot enter into an acceptance contract (e.g. for cost reasons or due to connections with the sex industry). These transactions differ in terms of the fees charged and risks assumed. The merchant account holder often charges the service provider significant fees for a cash advance and assuming the charge-back risk. Equally, in some cases fees are charged to the cardholder or own additional fees are not charged. Whether or not the merchant account holder also provides its own services and uses its acceptance contract for this purpose is

immaterial to the authorisation requirement for processing payments for third-party services. It can be difficult to prove that unauthorised business exists in "mixed" transactions such as this. A payment service requiring authorisation also exists if a merchant account holder acts as an aggregator of card revenue and pays out the funds from its own account.

10 Risk modelling

10.1 Supervisory assessment of internal models

Internal risk models (see info box "Internal models") provide banks – and, in future, insurers – with useful quantitative risk measures to estimate their capital requirements and manage risk. However, the informational value of capital ratios and the appropriateness of risk-weighted assets (RWAs) and, especially, the internal models used to determine them have been increasingly called into question in recent years. This has led international and European regulators to compare the RWA calculations of global systemically important banks, in particular, at supervisory level and to identify potential reasons and drivers for discrepancies.

The initial findings of the working groups established for this purpose have revealed wide variations in RWAs. This was largely attributable to the desired level of risk adequacy. However, since there were also other causes, the groups prepared a work programme to improve the regulatory requirements. Implementation of the programme is already underway and will continue in 2014. The programme includes guidance on the national implementation of the Basel framework, improvements to the disclosures under Pillar 3 of the Basel framework and ideas regarding limits or benchmarks for determining individual risk parameters. The initial assumption that the variances were primarily attributable to the internal models used was not confirmed. In interpreting the findings, it should also be taken into account that various assumptions and simplifications were required for the cross-checks. At any rate, overhasty regulatory conclusions should be avoided.

The international working groups of the Basel Committee on Banking Supervision (BCBS) and the European Banking Authority (EBA) will continue their work in 2014, focusing among other things on portfolios not previously taken

Internal models

Since the market risk amendment to Basel I was adopted in 1996, the objective of supervisory structures has been to determine capital adequacy based on the level of risk to which a business is exposed. In certain circumstances, internal models can be used for this purpose, rather than a standard model produced by the supervisory authority. Since the implementation of Basel II, it has been possible to determine both market risk and credit risk using internal models.

Solvency II will also introduce new risk-based capital requirements for insurance undertakings starting in 2016. These undertakings will then also be able to apply to use an internal model.[42]

Internal models are also intended to serve as risk management tools. They may only be used following approval by the supervisory authority, which audits them to ensure they meet the requirements in terms of their risk adequacy, their use in internal processes such as risk management (use test), and the quality of these processes.

42 See chapter IV 1.1.2 on the preliminary review of internal models.

into account and reviewing the feasibility of the above-mentioned short- and medium-term approaches to reducing the variances.

Internal models for insurers

Similar discussions also took place in the area of insurance supervision. Solvency II has not yet been implemented and insurance undertakings do not yet use internal models to determine their effective regulatory capital requirements. However, even at this early stage, mechanisms and tools are already being developed to enable the adequacy of the risk models and the resulting capital requirements to be guaranteed consistently across undertakings and over time.[43]

Responsible use of internal models

A further goal in addition to the above measures is to strengthen banks' validation function and incorporate it into a model risk management framework. This represents a significant step towards restoring trust in the results of model-based risk measurement.

The German Supervisory Authority has long had the objective of emphasising to institutions and other supervisory authorities the importance of comprehensively validating the models used in institutions and to strengthen banks' validation functions. Model validation forms a significant basis for both institutions and supervisors to obtain an adequate picture of the models' strengths and weaknesses and, where necessary, to initiate improvements. It is the responsibility of the entities to direct attention to the main variables and assumptions, support the interpretation of developments through transparent analyses, and at the same time appropriately present the inherent model risks and provide information on the management of these risks.

The model supervisor regularly reviews the quality of this validation function and, if necessary, takes appropriate measures to introduce improvements.

10.2 Validation of internal risk models

Like all models, internal risk models involve assumptions and simplifications. A critical task when using an internal risk model is to robustly and critically assess the appropriateness of these assumptions. In line with this, internal model validation analyses the model's fundamental fitness for purpose. However, since the risk profile is constantly changing due to external factors, entities need to review the continuing adequacy of their models on an ongoing basis.

The validation covers the internal model's completeness, forecasting quality and basic suitability. Potential weaknesses in the validation itself are also reviewed, with the aim of assessing whether the model is still fit for its intended purpose.

Consequently, an appropriate validation process is extremely important not only at a cross-sectoral level, for both banks and insurance undertakings, but also at a cross-pillar level, for both regulatory and economic capital. It is a key requirement of the Basel framework and the Capital Requirements Regulation (CRR)[44] for market risk models, Internal Ratings-Based (IRB) approaches and operational risk models. Given the significance of economic capital for banks in Pillar 2 of the Basel framework, validation of these parameters is also crucial to their effective use in capital and risk management.

Validation function at banks strengthened

BaFin had set its sights on significantly strengthening the model validation process well before public criticism of banks' risk models, in particular, began. In the past, institutions validated their models using numerous individual analyses in line with the statutory minimum capital requirements. However, this process did not achieve the actual aim of model validation, which is to comprehensively and critically assess the models used.

BaFin has therefore vigorously called for the extensive improvement of the validation

43 See chapter IV 1.1.2.

44 Regulation (EU) No. 575/2013, OJ EU L 176, p. 1ff.

function, repeatedly stressing the key elements of its future structure:

- Overarching validation concept
- Clear responsibilities and defined processes
- Evidence of all existing or potential model weaknesses
- Quantitative assessment of their materiality
- Management involvement
- Consistent, risk-based remediation

In 2013, supervisory model reviews largely focused on checking whether the comprehensive measures for extending and improving the validation function had been successful.

Validation processes significantly improved

Institutions have significantly improved their validation activities in relation to market risk. In addition to regularly reviewing models' forecasting quality (backtesting), banks that use internal models have now developed comprehensive validation concepts. Alongside the validation of mathematical/statistical methods, these include reviewing technical processes and, in some cases, evidence of the risks not included in the value at risk (VaR).

Credit risk modelling using IRBA rating systems presents a mixed picture. At selected institutions it is apparent that the validation processes have now reached a good level of maturity overall. In particular, organisational structures are in line with the requirements. For the most part, the validation reports are standardised and meaningful. The implementation of the validation results has only improved in recent years. Institutions still need to make further improvements in this area, in conjunction with the model change process.

With regard to the Advanced Measurement Approaches (AMAs) for operational risk, institutions have made most progress with implementing the relevant organisational requirements. The validation concepts need improvement in terms of quality rather than quantity. Here, too, implementation of the validation results needs to be improved.

Over the coming years, supervision will continue to focus on ensuring that institutions where internal models make a significant contribution to risk and capital management implement an effective and comprehensive model validation process, demonstrate their ability to control their model risks and responsibly apply suitable models.

Progress also made in the area of insurance

Under the future Solvency II supervisory regime, the validation process will be a prerequisite for the approval of insurance undertakings' internal models. The process will then be included in every on-site inspection in the pre-application phase.

At the beginning of the Solvency II pre-application phase, model validation at many insurance undertakings still demonstrated substantial deficits. However, significant progress has since been seen. The undertakings have now established extensive measures to validate the individual model components. They are now faced with the challenge of incorporating these into a comprehensive set of procedural rules while constantly monitoring the overall quality of the internal model.

A comparative study shows that large banks and insurance undertakings are currently fairing the best. They have the most extensive validation concepts and hold regular committee meetings to coordinate validation activities across departments and to implement improvement measures. Nevertheless, the main challenge of complex risk models is establishing and then implementing appropriate risk-based improvement measures.

10.3 Model changes

Internal risk models that are used to determine regulatory capital requirements need to be adjusted in line with changes in variables and conditions. These may arise due to external influences or internal changes, or result from validations. Since entities receive BaFin approval for precisely specified models, they must contact BaFin if they wish to make any changes to them.

Requirements for banks

BaFin has set out its requirements regarding the revision of internal models for market, credit and operational risk in guidance notices over many years. Typically, these differentiate between several types of model changes depending on their materiality and provide for a sliding scale of options for action on the part of the supervisor. The level at which the materiality thresholds are set is extremely important, as these thresholds determine whether the supervisor will be swamped by small, insignificant changes or – at the opposite extreme – involved in major model changes at too late a stage.

In December 2013, the EBA finalised the draft of a binding regulatory technical standard on changes and extensions to models for calculating credit risk, operational risk and market risk. The European Commission, which is responsible for adopting binding regulatory technical standards, passed this draft on to the Council for comments with no amendments.

BaFin is represented in the EBA working group on modelling, which drafted the regulatory standard. It was able to assert its position on several key points. For example, BaFin considered it important to maintain the category of extensions and changes that require notification to the competent authority before their implementation, which relates to less material changes. This category gives the supervisor the necessary flexibility and makes it possible for it to adopt a risk-based approach. This is also ensured by using qualitative criteria for the classification of model changes, which at BaFin's request are now more heavily weighted than quantitative criteria: the qualitative criteria should cover as many changes as possible for which a bank requires renewed supervisory approval. However, changes with a material impact can arise that are not recognised in accordance with the qualitative criteria as requiring authorisation. The application of a quantitative threshold is therefore proposed as a backstop for this residual supervisory risk.

With regard to the quantitative thresholds in the IRBA, BaFin successfully pressed for significantly higher thresholds to be set at least at the level of the individual institutions and for the removal of the originally planned additional threshold at subconsolidated level.

Requirements for insurers

Given that some models have largely been finalised, how model changes are handled is becoming increasingly important in the pre-application phase for internal models under Solvency II. The main objectives include

- efficiently gathering information on model changes while preserving the extensive information about the models gained by BaFin in the pre-application phase,
- meeting the requirements of the guidelines issued by the European Insurance and Occupational Pensions Authority (EIOPA) on preparing for Solvency II that came into force on 1 January 2014 and, in particular, continuously monitoring the model's appropriateness, and
- testing ongoing supervision of internal models following initial approval.

BaFin developed and successfully tested a concept for this in 2013.

Practical experience with model changes

In 2012 and 2013, BaFin reviewed numerous model changes in the above-mentioned risk categories at banks. In some cases, changes were considered to be more material than indicated by the institution. On-site inspections were carried out before material changes or extensions were authorised. Some model changes were only approved with reservations or subject to conditions.

III Supervision of banks, financial services institutions and payment institutions

1 Bases of supervision

1.1 Implementation of CRD IV and CRR

In June 2013, the European Commission published the extensive legislative package that transposes Basel III – among other things – into European law: the Capital Requirements Directive IV (CRD IV)[1] and the Capital Requirements Regulation (CRR).[2] CRD IV and the CRR will change the German supervisory regime permanently. The Directive was transposed into German law by way of the CRD IV Implementation Act (*CRD-IV-Umsetzungsgesetz*)[3]; the Regulation is directly applicable in all member states.

1.1.1 Own funds

The aim of the CRR is to improve the quality, quantity, consistency and transparency of components of regulatory own funds. The CRR entered into force on 28 June 2013 and has been applicable since 1 January 2014.

The provisions defining own funds are now all set out in the CRR (Articles 25 to 80 of the CRR). The provisions of section 10 of the Banking Act (*Kreditwesengesetz* – KWG), previously the key provisions governing the calculation of institutions' own funds, supplement the CRR and contain enabling provisions.

The CRR subdivides what was previously Tier 1 capital into Common Equity Tier 1 (CET1) and Additional Tier 1 (AT1) capital. The distinction between upper and lower Tier 2 (T2) capital has been removed. Tier 3 capital is no longer at all eligible, as it is insufficiently loss absorbent.

The CRR lists the eligible items in the individual categories of capital. It also establishes eligibility criteria for each category of capital, under which eligibility is established based not on the legal form or the designation of the capital instrument in question, but solely on it meeting the regulatory eligibility criteria (principle of substance over form). These eligibility criteria reflect key regulatory principles, namely the principle of effective capital raising, loss

1 Directive 2013/36/EU, OJ EU L 176, p. 338 ff.

2 Regulation (EU) No. 575/2013, OJ EU L 176, p. 1 ff.

3 Federal Law Gazette (BGBl.) I 2013, p. 3395.

Three questions for ...

Raimund Röseler, Chief Executive Director Banking Supervision

What was the main focus of your work in 2013?

▶ 2013 was dominated by the introduction of the CRD IV/CRR package and the preparations for the Single Supervisory Mechanism. Both projects represent an historic paradigm shift for European banking supervision – triggering related questions and uncertainty. In 2013, we had to ensure transparency in this regard. Our many conversations internally and externally were very helpful. I consider it important that we continue this communication. This is also illustrated by the many questions that continue to reach me – from affected institutions, from the political arena and from citizens too.

What will be your most challenging task in 2014?

▶ Following on from my first answer, 2014 is going to be a year full of challenging tasks. In the spring, we will also adapt the way in which banking supervision is organised in line with the future structure of European banking supervision. Front and centre here are my colleagues who largely have to manage the transition. In addition, months ahead of the planned official launch of the Single Supervisory Mechanism, many of my staff are already working on the comprehensive assessment of the banks that are to be directly supervised by the European Central Bank.

What do you stand for?

▶ Showing a positive curiosity about the future and being confident about safeguarding BaFin's high standing.

absorbency and permanence. Even if a capital instrument fails to meet just one eligibility criterion, this automatically results in its disqualification as own funds eligible for regulatory purposes. The requirements on institutions have also been tightened in that most capital deductions will have to be made from Common Equity Tier 1 capital in future and not, as was the case previously, by deducting half from Tier 1 capital and half from Tier 2 capital. The transitional provisions contained in the CRR enable institutions to make the transition to the new legal framework gradually, however. They provide for the same timetable for phase-in over the transition period as Basel III.

EBA technical standards

Numerous enabling provisions in the CRR task the European Banking Authority (EBA) with preparing binding technical standards setting out individual provisions of the CRR in greater detail. For example, the EBA is also developing a regulatory technical standard on own funds, dividing the topic into a total of four parts due to its scope and complexity. The first part contains detailed rules on CET1, AT1 and the deductions from CET1 as well as transitional provisions. Part two deals with the eligibility of components of CET1 at mutuals, cooperative societies, savings banks and similar institutions. The third part governs the treatment of deductions of indirect and synthetic holdings as well as eligible minority interests and defines the term "broad market index". Part four fleshes out the provisions on capital instruments with multiple distributions. Parts one and two of the technical standards have already been adopted by the European Commission and were published in the EU's Official Journal on 14 March 2014. The drafts of parts three and four have been sent to the European Commission by the EBA, but not yet published in the Official Journal.

1.1.2 Capital add-ons

The CRD IV Implementation Act will allow BaFin to require additional capital buffers for both systemically important institutions and systemic risks in future.

The capital buffer for systemically important institutions will distinguish between global and otherwise systemically important institutions (sections 10f and g of the KWG). The individual classification affects the amount of the capital buffer. The *Deutsche Bundesbank* and BaFin identify the institutions affected using a method based on the framework of the Basel Committee. This requires supervisors to consider the categories size, interconnectedness, substitutability, complexity and cross-jurisdictional activity. BaFin and the *Deutsche Bundesbank* must review the classification at least once a year. Depending on the classification, otherwise systemically important institutions must build up a capital buffer comprising Common Equity Tier 1 capital of up to 2% and global systemically important institutions a capital buffer of up to 3.5% of the total exposure. If, at a consolidated level, a capital buffer for otherwise systemically important institutions is required in addition to a capital buffer for global systemically important institutions, only the higher of the two buffers must be built up.

BaFin may impose the capital buffer for systemic risks (section 10e of the KWG) for all institutions or only for groups of institutions and apply it to certain risk exposures. It is intended to cover long-term, non-cyclical systemic or macroprudential risks that could cause disruption with a significant impact on the German financial system and the real economy in Germany. Before ordering a capital buffer, BaFin must carry out a special proportionality check. In particular, the capital buffer may not hinder the functioning of the European Economic Area's internal market. The point of reference in calculating the amount of the buffer is the relevant risk-weighted exposures and not the total exposure itself. The capital buffer must amount to at least 1%, but has no upper limit. In addition, BaFin must review the buffer for systemic risks at least once every two years.

An institution that has been identified as being systemically important and also holds systemic risks must only build up both capital buffers to the extent that they are intended to cover different risks.

1.1.3 Leverage ratio

The leverage ratio is a new measure that supplements the existing supervisory tools and may be applied to individual institutions at the supervisory authorities' discretion (Article 430 of the CRR).

Through the leverage ratio, the CRR is addressing the risk of excessive leverage at a regulatory level, as it expresses the institution's Tier 1 capital in relation to the sum of its non-risk weighted risk exposures. Institutions with excessive leverage could set in train a negative spiral if losses or a shortage of funding force them to reduce their own leverage through distress selling. This would depress prices for the assets being sold, which would likely lead to further valuation adjustments and therefore losses at these and other institutions.

The CRR does not yet stipulate a binding measure for the purpose of limiting the leverage ratio. However, institutions must report their leverage ratio to the competent supervisory authorities on a regular basis. For their part, these authorities must take the leverage ratio into account when reviewing and assessing an institution. As at 1 January 2015, institutions must also disclose their leverage ratio to others so that, from that date onwards, market participants can form their own opinion of institutions' leverage.

By 31 December 2016, the European Commission will submit a report to the European Parliament on the impact and effectiveness of the framework aimed at stemming the risk of excessive leverage, including a possible minimum leverage ratio – if appropriate, accompanied by a legislative

proposal. In the report, the Commission will comment on whether and, if appropriate, to what extent adjustments are needed to the definition and calibration of the leverage ratio and to what extent the specific features of institutions' different business models should be taken into account.

1.1.4 Uniform liquidity requirements in Europe

The CRR for the first time paves the way for the introduction of a uniform quantitative liquidity requirement in Europe by implementing large parts of the Basel liquidity framework adopted in 2013. Reporting in Europe for the observation period for the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) commenced with effect from the reporting date 31 March 2014.

Liquidity coverage ratio

The LCR is a liquidity coverage requirement based on a short-term stress scenario. It aims to enable banks to withstand a liquidity stress scenario in the short term, i.e. over a horizon of 30 calendar days, independently of new borrowing in the capital markets and central bank support. The LCR therefore compares the institution's highly liquid assets with net liquidity outflows in a stress scenario over a 30-day horizon. It shows that a lesson has been learnt from a crisis of confidence that accompanied the financial crisis, during which capital markets temporarily dried up for solvent banks too.

The Commission will specify the calibration of the LCR for Europe by 30 June 2014. In a departure from the Basel framework, it will take circumstances specific to Europe into account in doing so. For example, special rules were incorporated into the reporting requirements for business relationships within cross-guarantee schemes. The definition of highly liquid assets is also of key importance in Europe. For this, the EBA submitted a recommendation to the European Commission at the end of 2013, based on which the final definition will be established.

The LCR is being phased in: the stock of highly liquid assets must cover 60% of the net cash outflow under stressed conditions in 2015, 70% as at 2016 and 80% as at 2017. The LCR will then apply in full as at 2018, meaning that the highly liquid assets must cover 100% of net cash outflows in the stress scenario.

Net stable funding ratio

The net stable funding ratio (NSFR), a minimum requirement based on banks' long-term funding structure, aims to ensure that banks no longer fund long-term, illiquid assets through short-term capital market funding. Assets may be funded through short-term retail deposits, however, as these proved to be much more stable during the crisis than the more volatile capital market funding. Maturity transformation by way of retail deposits used to fund long-term business in the real economy is therefore expressly not the focus of the new rules.

The Basel Committee is revising the ratio in 2014. A public consultation on this closed at the beginning of April 2014. BaFin anticipates that the Basel Committee will modify the NSFR significantly. The ratio is not expected to be adopted until the end of 2014. For this reason, the CRR does not yet provide for the mandatory introduction of the ratio as a minimum standard in Europe.

1.1.5 Reporting

When the CRR entered into force, significant reporting requirements were harmonised across Europe. An EBA technical standard entitled the Implementing Technical Standard (ITS) on Supervisory Reporting sets out the requirements of the CRR in greater detail. The standard contains reporting rules for the following aspects:

- own funds (common reporting – COREP)
- financial information (financial reporting – FINREP)
- reporting on large exposures
- leverage ratio
- liquidity (LCR and NSFR).

Further harmonised reporting requirements are to be added to the ITS in 2014. The additional requirements relate to

- secured funding (asset encumbrance)
- extension of impaired loans on partly reduced terms (forbearance)
- non-performing loans
- additional parameters for monitoring liquidity under the CRR (additional monitoring metrics for liquidity).

For all aspects, the ITS specifies uniform future reporting formats and dates, reporting-specific definitions and reporting techniques.

The ITS becomes binding and thus directly applicable in all EU member states on publication of the implementing regulation[4].

1.1.6 New requirements for remuneration systems

With effect from 1 January 2014, lawmakers also put in place rules governing the ratio of variable to fixed remuneration by way of the CRD IV Implementation Act: as a rule, section 25a (5) of the Banking Act (*Kreditwesengesetz* – KWG) now caps the amount of the variable remuneration at 100% of the amount of the fixed remuneration. This provision applies to managers and all employees alike. As an exception, the amount of the variable remuneration may be up to 200% of the fixed remuneration if the institutions' shareholders, owners, members, or guarantors decide so.

The provisions of the revised Remuneration Regulation for Institutions (*Institutsvergütungsverordnung* – IVV) have likewise applied since 1 January 2014. The amendments also include changes necessitated by CRD IV and the CRR. BaFin expects the amended IVV to contribute to the requirements being more consistently implemented by institutions. It also expects the revised IVV to bolster the stability of institutions, as employee remuneration must be more risk-based and the new provisions are more effective than before at preventing employees from entering into risky transactions so as to receive large bonuses.

The revised IVV now contains a default presumption that institutions whose total assets amounted to at least € 15 billion on average at the reporting dates for the last three financial years ended are "major" within the meaning of the IVV and must therefore meet stricter requirements than other institutions. In addition, for the first time, institutions classified as posing a potential systemic risk in accordance with section 47 (1) of the KWG and financial trading institutions in accordance with section 25f (1) of the KWG must also be classified as major institutions. Finally, BaFin is able to classify an institution as major even if it does not reach the threshold, but it seems necessary to classify it as major due to the remuneration structure and the nature and risk content of its business activities.

Another new feature in the IVV is the remuneration oversight committee required to be established on the administrative or supervisory body. The likewise newly introduced remuneration officer serves as an extended arm of the remuneration oversight committee and does its groundwork.

A BaFin campaign examining the quality of remuneration systems revealed shortcomings at all 15 institutions examined.[5] The special audits carried out in 2013 by the *Deutsche Bundesbank* looked at compliance with the requirements of the 2013 version of the IVV. BaFin asked the institutions to quickly remedy the identified weaknesses. In doing so, they must observe the changes under the amended IVV.

1.1.7 Risk management

Institutions must define a sustainable business strategy. This requirement, already stipulated by BaFin in the Minimum Requirements for Risk Management (*Mindestanforderungen an das*

4 Regulation (EU) No. 1423/2013, OJ EU L 355, p. 60.

5 www.bafin.de/dok/4727388 (only available in German).

Risikomanagement – MaRisk) since 2009, has also been incorporated by lawmakers into the KWG by way of the CRD IV Implementation Act: section 25a (1) sentence 3 no. 1 of the KWG now clarifies that the business strategy must be geared towards the institution's sustainable development, meaning that this aspect has had legal force since 1 January 2014. In future, BaFin will therefore look at business strategies – as a product of the institutions' business models – in greater detail than it has thus far.

It is BaFin's responsibility to determine whether a business strategy is sustainable and will therefore enable income to continue to be generated over the long term, thereby safeguarding the enterprise's continued existence. To do so, it must analyse an institution's activities and lines of business, its results of operations and its balance sheet structure. This enables BaFin to better understand an institution's strengths and weaknesses and promptly identify potential risks. As before, however, BaFin will not interfere in institutions' corporate decisions. The actual content of the business strategies is and will remain for the institutions themselves to decide.

1.1.8 Supervisory measures and sanctions

CRD IV establishes EU-wide minimum standards for rules on measures and sanctions within the EU. The CRD IV Implementation Act adds significantly to the tools BaFin can use to intervene.

Increased own funds requirements for individual institutions

For example, BaFin's ability to impose increased own funds requirements on institutions in certain situations has been extended. What is important here is that the relevant list in section 10 (3) sentence 2 of the KWG sets out a mandatory requirement for BaFin to intervene: in the cases cited in the list, therefore, BaFin does not have any discretionary powers but must stipulate increased own funds requirements. In all other cases not listed in (3), on the other hand, sentence 1 grants BaFin discretion.

Under another new provision in the KWG, BaFin may define uniform increased capital requirements for different institutions provided, however, that those institutions – in BaFin's opinion – have similar risk profiles, could be exposed to similar risks, or give rise to similar risks to the financial system (section 10 (3) sentence 3 of the KWG).

Changes to the list of administrative fines

The CRD IV Implementation Act also made changes to the list of administrative fines. In doing so, it extended the list of administrative offences in section 56 of the KWG, for example to include breaches of the CRR. In addition, the requirements for culpable conduct were reduced from carelessness to ordinary negligence. The scope of the administrative fines, on the other hand, was increased: they start at a minimum of €100,000 and extend to a maximum of €5 million, although a fine of up to €5 million is only a possibility in certain, particularly serious cases.

Publication of measures

There is also a new requirement to announce final measures and final administrative fine decisions (section 60b of the KWG). BaFin must therefore publish measures against both legal and natural persons on its website. The information published may only be anonymised under certain conditions: for example, final measures must be anonymised if a natural person's right of personality would otherwise be violated or publishing personal data would be unreasonable for other reasons. Information need also not be published at all if doing so would pose a significant threat to the stability of the financial markets of the Federal Republic of Germany or one or more member states of the European Economic Area (EEA), for example, or cause the parties concerned unreasonable harm.

1.2 Work on the Basel framework

In 2013, the Basel Committee continued or started its work to revise the rules on the trading book, the securitisation framework and the Credit Risk Standardised Approach.

Revision of the trading book rules

At the end of January 2014, the Basel Committee concluded a second consultation on the fundamental review of the trading book rules.[6] In the consultative document, the Committee put forward detailed rules for discussion, thereby preparing the way for a quantitative analysis of the effects on own funds requirements. In particular, the consultative document contains detailed proposals on the standardised approach. Under these proposals, the standardised approach will give much greater consideration than is currently the case to portfolio effects, i.e. diversification and concentration effects. In this way, it will capture an institution's market risks more accurately than before. If a market risk model exhibits significant weaknesses, it will offer a more credible fallback. The Committee will analyse the submitted comments by June 2014.

More capital for securitisation exposures

The Basel Committee is also revising its securitisation framework with the aim of eliminating shortcomings in the applicable rules that came to light during the financial market crisis and thus strengthening the minimum own funds requirements for securitisation exposures allocated to banks' banking books. With this aim in mind, the Committee published a second consultative document and a draft standards text in December 2013. The consultative document takes into account the many comments on the first consultative document published in December 2012 as well as the results of an impact study carried out alongside this. In terms of content, the Basel Committee wishes to strike an appropriate balance between risk sensitivity on the one hand and comparability and a simpler, less complex framework on the other. To achieve this, the Committee has minimised the number of approaches that may be used, simplified the hierarchy of approaches and in some cases reduced the complexity of individual approaches. The most senior securitisation positions exposed to a low risk of loss must be backed by noticeably less capital (relatively speaking) compared with the first consultative document. Under the new proposals, it is still the case, however, that banks must hold significantly more capital than under the current framework for securitisation exposures held in the banking book.

Following the close of the second consultation and careful analysis of a further impact study that began in February 2014, the Basel Committee wishes to finish revising the securitisation framework by the end of 2014. The date for the implementation and first-time application of the new rules has yet to be determined. It is to be defined with sufficient lead time so that there is no need for grandfathering or transitional provisions.

Analysis of the Credit Risk Standardised Approach

In May 2013, a working group of the Basel Committee started to revise the standardised approach to credit risk. The starting point is, firstly, the shortcomings in the standardised approach that came to light during the last crisis, such as the heavy reliance of risk weights on external ratings. Secondly, there is an increased desire for simple regulation with clear, precise capital standards and simple capital calculations. Based on an analysis of strengths and weaknesses, the working group will review risk classes, adjust risk weights where appropriate and no longer automatically recognise external ratings as the key metric. In addition, national options are to be reduced. The revised rules will be tested in a quantitative impact study, which is to take place at the end of 2014 or in the first half of 2015.

1.3 Implementation of the Basel frameworks in the member countries

The Basel Committee reviews whether its member countries have implemented the own funds requirements frameworks appropriately. Through its Regulatory Consistency Assessment Programme (RCAP), it ascertains whether national legal provisions in the Basel

6 Fundamental review of the trading book: A revised market risk framework.

Committee's individual member countries are consistent with the minimum requirements under Basel II, Basel II.5 and Basel III. The Committee inspected the legal frameworks of Japan and Singapore in 2012 and concluded its reviews of Switzerland, China and Brazil in 2013. The Committee has not yet been able to complete the RCAPs started in 2012 for the EU and the USA, as large parts of the applicable rulebooks, CRD IV/CRR and the Dodd-Frank Act, came into force only recently. The reviews are to be completed in 2014 once the legislation that recently came into force has been assessed.

The Basel Committee conducts the reviews with teams comprising supervisors from its member countries. BaFin and *Deutsche Bundesbank* staff have also participated in the reviews – with the exception of the review of the EU rulebooks, as supervisors are not supposed to review the rules that they themselves are required to observe. The Basel Committee has published a summary of the findings of the review reports thus far on its website.

1.4 Margining of non-centrally cleared OTC derivatives

The Basel Committee introduced rules on the margining of non-centrally cleared OTC derivatives through a framework published in September 2013.[7] The framework starts by specifying which products and market participants fall within the scope of the new margining standards. In addition, it sets out the range of eligible and suitable collateral and the treatment of intragroup transactions. The new framework is based on eight elements, for each of which the Committee developed core principles and accompanying requirements. As a high-level paper, the framework also provides the individual jurisdictions with a basis on which to develop and adopt their own national rules and standards in future on issues related to the margining of OTC derivatives settled on a bilateral basis.

7 Margin requirements for non-centrally cleared derivatives.

1.5 Systemically important banks

As systemically important banks are supposed to limit their risk appetite, i.e. their willingness to tolerate risks, the Financial Stability Board (FSB) now wishes these banks to prepare frameworks that prevent them from entering into excessive risks. To this end, the FSB's Supervisory Intensity and Effectiveness (SIE) Group, which drew up supervisory standards for systemically important financial institutions, developed a set of principles and published them in November 2013.[8] These require frameworks to include effective rules on limits, monitoring compliance with limits and sanctions in the event of breaches in limits. Frameworks must also be consistent with the banks' business model, business strategy and capital planning in particular.

Risk culture at financial institutions was another key issue taken up by the SIE Group. In 2013, the Group developed guidance[9] in which it starts from the realisation that shortcomings in risk culture not only were a cause of the global financial crisis, but are often also the reason for other irregularities (such as LIBOR manipulation). In light of this, the document stresses how important a role a prudent risk culture plays in influencing the decisions taken by banks and the actions taken by their employees overall, and identifies fundamental elements of an appropriate risk culture. In particular, it provides supervisors with criteria that they can use to build a meaningful picture of an enterprise's risk culture or work towards an appropriate risk culture.

1.6 Ringfencing Act

The Ringfencing Act (*Risikoabschirmungsgesetz*) entered into force on 12 August 2013.[10] The aim of the Act is to protect client deposits and contribute to solving the too-big-to-fail problem. It is intended to remove misguided incentives and implicit state guarantees resulting from the

8 Principles for an Effective Risk Appetite Framework.

9 Guidance on Supervisory Interaction with Financial Institutions on Risk Culture.

10 Federal Law Gazette (BGBl.) I 2013, p. 3090.

SSG and FSB: reporting initiatives

The members of the Senior Supervisors Group (SSG) represent the supervisory authorities responsible for the world's largest banks. The Group exchanges information on key supervisory issues, such as strengthening risk management, risk control and risk reporting, so that cross-border supervisory initiatives can be initiated where necessary. In 2008, one such joint initiative led to the Top 20 project, the results of which were published by the SSG in a report in January 2014. In the course of the project, banks reported derivative and other counterparty data by business sector. In addition to better data on the participating banks, the project was also intended to identify and address weaknesses in banks' reporting systems. In the report, the SSG criticises the fact that banks' progress towards standardised, prompt and exact reporting of the principal counterparty risks still fails to meet supervisory expectations. Data quality was of particular concern, it said.

The SSG refined the Top 20 reporting format in a joint working group with the Data Gaps Initiative of the Financial Stability Board (FSB). Banks are now expected to report standardised Top 50 counterparty data, which still include derivatives trades, but now extend to aggregated data across business sectors as well. The deciding factor was that a counterparty exposure was large enough to be one of the bank's 50 top exposures.

The pilot for the amended reporting format began in October 2012. A small number of pilot banks reported Top 20 and Top 50 counterparty data at the same time. The SSG members responsible for those banks carried out quality assurance on the reported data and clarified any outstanding issues with the pilot banks. At the same time, technical and organisational measures were taken to establish the FSB Data Hub, which launched in March 2013. Since then, large internationally active banks have been reporting Top 50 counterparty data to the Hub, which analyses these data and provides supervisory authorities with analysis reports.

assumption by institutions that pose a potential systemic risk that the government will bail them out in the event of a crisis.

The Ringfencing Act comprises four sections, which modify the Banking Act (*Kreditwesengesetz* – KWG) (Articles 1 to 3) and the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) (Article 4) extensively. Article 1 deals with recovery and resolution planning for credit institutions. Article 2 relates to ringfencing, and Articles 3 and 4 to criminal liability for senior managers' misconduct in the area of risk management.

The provisions of the Ringfencing Act on recovery and resolution planning for credit institutions anticipate parts of the European directive on crisis management, which must be implemented by the member states by 1 January 2015.

1.6.1 Recovery and resolution planning

Under the new provisions, all credit institutions that pose a potential systemic risk must draw up recovery plans and implement them within their administrative procedures (sections 47 (1) and 47a ff. of the KWG). Recovery plans are intended to help credit institutions prepare for and improve their ability to withstand a crisis. The objective is to ensure that these institutions address in good time the organisational and business measures they have to take in the event of a crisis and to enable them to overcome any crises as quickly and effectively as possible using their own resources.

In particular, the credit institution's recovery plan must describe the action the management can take to stabilise the credit institution's financial position in different stress scenarios and thus ensure its ability to survive.

BaFin decides which banks are to be classified as posing a potential systemic risk in

consultation with the *Deutsche Bundesbank* on the basis of a qualitative and quantitative analysis. In doing so, BaFin gives particular consideration to the size of the credit institution, its domestic and cross-border activities, the degree of its interconnectedness with the domestic and global financial system and the substitutability of the services and financial infrastructure offered by the credit institution. In the course of 2014, BaFin will ask credit institutions that pose a potential systemic risk to submit their recovery plans.

Back in November 2012, BaFin had asked the national systemically important credit institutions to develop and submit recovery plans by the end of 2013, which the institutions did. BaFin will now assess the recovery plans in accordance with the legal requirements. Additionally, in April 2014, it published a circular on the Minimum Requirements for the Contents of Recovery Plans (*Mindestanforderungen an die Ausgestaltung von Sanierungsplänen* – MaSan).[11]

Rules on resolution planning were also incorporated into the KWG by way of the Ringfencing Act (sections 47 (2) and 47d ff. of the KWG). Under these rules, BaFin assesses the resolvability of all credit institutions and financial groups on an ongoing basis. If an institution is classified as posing a potential systemic risk, BaFin assumes that it cannot be resolved through insolvency proceedings. For these institutions that pose a potential systemic risk, BaFin must identify the impediments to resolution and adopt measures to remove those impediments and draft a resolution plan. The objective of resolution is to prevent or eliminate any systemic risk. The resolution plan must take account of both this objective and the other statutory objectives: to ensure the continuity of critical business activities, prevent contagion among other financial market participants, minimise the costs of resolution to the general public and protect depositors, investors and clients' funds and assets (section 47f (2) of the KWG).

11 www.bafin.de/dok/5147084 (only available in German).

1.6.2 Ringfencing of financial transactions

By adopting the Ringfencing Act, lawmakers are also following one of the recommendations made by the group headed by the Finnish central bank president Erkki Liikanen regarding the structural reform of the banking sector in the EU in October 2012, according to which certain, particularly risky financial transactions should be separated (ringfenced) at a legal and organisational level from an institution's deposit business. As well as protecting deposits from the risks resulting from risky trading business, the Ringfencing Act is also intended to prevent trading business from being funded through the use of deposits and thus enjoying the implicit guarantee of deposit guarantee schemes and the state. Any breach of the Act is punishable by a jail term of up to five years (section 54a of the KWG).

The Act affects groups of institutions that include a credit institution where the available for sale and held for trading measurement categories exceed €100 billion. The same applies if the above-mentioned measurement categories exceed 20% of the total assets of this credit institution or the group, provided the total assets of the credit institution or group reach at least €90 billion at the reporting date.

Under the new section 3 of the KWG, proprietary business, i.e. business performed for an institution's own account without providing a service to third parties (as distinct from proprietary trading), lending and guarantee business with hedge funds and similar entities and – as a special form of proprietary trading – high-frequency trading, provided there is no market making, are prohibited and therefore required to be transferred to a financial trading institution. BaFin can also order specific institutions to ringfence other business with the same degree of risk.

The prohibition excludes transactions entered into in order to hedge transactions with clients. Transactions used to manage interest rate, currency, liquidity, or credit risk – particularly within a network of associated institutions –

are also excluded, as are transactions to acquire and sell long-term equity investments. Transactions that are not entered into for the purpose of exploiting differences in buying and selling prices, market prices, or interest rates for short-term gain are likewise still permitted.

1.7 Circular on information sheets

Since 1 July 2011, for each financial instrument they recommend, investment services enterprises supplying investment advice to their retail clients have been obliged to provide them with a short, easy-to-understand information sheet describing the key features of the product in good time before any transaction is executed. Interpreting the obligation in practice has raised a variety of questions, which BaFin answered in its Circular 4/2013 (WA)[12] dated September 2013.

In the Circular, BaFin comments on the issue of obtaining information sheets from third parties, for example: investment services enterprises may use information sheets prepared by third parties when providing investment advice if the information sheets contain all the necessary information and the third party grants the investment services enterprise, its auditor and BaFin all information and audit rights required under supervisory law. Furthermore, responsibility for the information sheet used remains with the investment services enterprise.

An information sheet is only regarded as easy to understand if a reasonably well-informed investor is able to understand it without any special prior specialist or linguistic knowledge of financial instruments. The Circular clarifies that an exception only applies if the information sheet is only intended for certain groups of investors (investors with special prior knowledge, for example) and this is highlighted in the information sheet.

The Circular also explains the requirements to be placed on the information sheets' content. In particular, a number of practical implementation-related questions emerged when illustrating risks and costs. The main risks associated with the financial instrument must be illustrated in the information sheet and briefly explained in the correct order. Less relevant risks may not therefore be placed at the beginning.

Investors can only make wise investment decisions if they know the costs involved. Ideally, costs are given in euros and cents. It is also acceptable, however, to state the costs in the information sheet as an institution-specific maximum cost of purchase in the form of a percentage of the amount invested, supplemented with a minimum fee in euros if the institution providing advice charges such a fee. It is not permitted, though, to fail to state any costs in the information sheet at all and instead to refer to the schedule of prices and services or information provided by the investment adviser.

BaFin intends to integrate the Circular into the Minimum Requirements for the Compliance Function (*Mindestanforderungen an die Compliance* – MaComp).

1.8 Reference interest rates

One regulatory project that has been keeping numerous global and European bodies and supervisory authorities busy since the summer of 2012 runs under the heading of "benchmarks". One aim is to address the irregularities in the setting of benchmarks. Supervisors are focusing, among other things, on the interbank interest rates LIBOR (London Interbank Offered Rate) and Euribor (Euro Interbank Offered Rate) as well as reference prices in the markets for foreign exchange, precious metals, interest rate swaps and commodities.

Minimum requirements for benchmark processes

In 2013, supervisory authorities worldwide initiated extensive organisational reforms of the processes by which benchmarks are set.

12 www.bafin.de/dok/4607002.

Back in 2012, in light of specific accusations, BaFin set out in greater detail the requirements for quoting processes as part of sound administrative procedures on the basis of section 25a of the KWG and the MaRisk. BaFin asked the institutions concerned to implement the requirements through audit orders or in separate letters. In October 2013, BaFin then announced the supervisory requirements for quoting processes also to other institutions.[13]

The EBA adopted large parts of BaFin's requirements and integrated them into the recommendations[14] it published in January 2013 on the supervisory oversight of activities related to institutions' participation in the Euribor panel.

ESMA-EBA principles

Requirements aimed at all parties involved in setting benchmarks were drawn up at European and global level in 2013. On 6 June 2013, the EBA and the European Securities and Markets Authority (ESMA) presented principles for the processes by which benchmarks are set in the EU. The principles aim to make benchmarks less susceptible to manipulation and more informative and transparent. The principles cover the entire process, from the supply of data through to their publication and the use of the benchmarks. They apply not only to interbank interest rates, but also to indices and prices of other products such as equities, commodities, currencies and derivatives. At global level, a largely matching set of principles was presented by the International Organization of Securities Commissions (IOSCO) on 17 July 2013.

The ESMA-EBA principles are to serve as a framework for benchmarks until legally binding rules are introduced at European level. The first proposals for these are already in place. In Brussels, amendments to the Market Abuse Directive are being prepared, for example, under which the manipulation of benchmarks would be a criminal offence. In addition, on 18 September 2013, the European Commission presented a draft benchmark regulation on the calculation and setting of benchmarks. As well as LIBOR and Euribor, this also covers all benchmarks used in the financial sector along with extensive obligations for producers of benchmarks and data providers and powers for the supervisory authorities. At the heart of the draft is the idea that reference rates should, wherever possible, be based on data from real transactions in future. As transaction-based reference rates can also be manipulated, however, BaFin introduced into the ongoing dialogue between the supervisory authorities the idea of moving as much trading in certain market segments as possible to transparent trading venues directly or indirectly monitored by government, as is the case with over-the-counter derivatives.[15]

Reform of Euribor and possible alternatives

As regards Euribor, supervisory authorities and the operator Euribor-EBF are working to fundamentally reform it. In January 2013, the EBA and ESMA sent Euribor-EBF recommendations for changes to the Euribor processes, proposing among other things that Euribor setting for less important maturities be discontinued.[16] The EBA and ESMA reviewed the extent to which Euribor-EBF has implemented the recommendations and published a report on this on 20 February 2014.[17] According to the report, Euribor-EBF has made noticeable progress in reforming the reference interest rate, but there are still shortcomings in various areas. For example, no systems have yet been set up to enable Euribor-EBF to check whether the submissions from the panel banks adequately reflect the market. In addition, Euribor-EBF has not yet undergone an external audit. The EBA and ESMA are therefore calling on Euribor-EBF to systemically continue the reforms.

13 www.bafin.de/dok/4565196 (only available in German).

14 Recommendations on supervisory oversight of activities related to banks' participation in the Euribor panel.

15 See chapter I 3.

16 Report on the administration and management of Euribor.

17 Review of the Implementation of EBA-ESMA Recommendations to Euribor-EBF.

Penalties and fines

In 2013, various authorities, including the UK Financial Conduct Authority (FCA), the US Commodities Futures Trading Commission (CFTC) and the US Justice Department, imposed penalties totalling around US$1.7 billion on ICAP Plc., Rabobank B.A. and Royal Bank of Scotland Plc. due to misconduct in connection with interbank interest rates.

On 4 December 2013, the European Commission imposed fines totalling €1.71 billion on eight financial institutions for participating in cartels in the market for interest rate derivatives, for which LIBOR and Euribor are often the reference rate. Those affected were Deutsche Bank AG, Barclays Plc., Société Générale S.A., Royal Bank of Scotland Plc., UBS AG, JPMorgan Chase & Co., Citigroup Inc. and RP Martin Holdings Ltd. Deutsche Bank AG was fined around €725 million. The investigations have not yet been concluded, as a result of which it cannot be ruled out that penalties will be imposed on other banks.

The work of the Financial Stability Board (FSB), which in summer 2013 set up a working group to outline the alternatives to LIBOR, Euribor and Japan's Tokyo Interbank Offered Rate (TIBOR), goes one step further. Possible alternatives must be consistent with the IOSCO principles and therefore based on observable transactions. In addition, the working group is to draw up methods and strategies for the transition to a new benchmark regime and review LIBOR, Euribor and TIBOR with an eye towards the implementation of the IOSCO principles.

1.9 Home and host supervision: technical standards

The upcoming establishment of a single supervisory mechanism in the eurozone shows that European banking supervision is rapidly converging at present. One less high-profile way in which this is happening is through the harmonisation of cooperation between home and host supervisors in the supervision of cross-border banking groups. Like the Banking Directive before it[18], CRD IV provides the framework for cooperation. Whereas details were previously governed by guidelines that were not directly binding, however, they now become directly applicable law in the form of binding technical standards (BTSs). CRD IV requires the EBA to draft appropriate rules on cooperation between supervisory authorities.

In 2013, for example, the EBA initiated technical standards on the European passport, which governs cooperation in the case of cross-border services and when branches are established, and on the exchange of information when supervising branches. Another BTS governs a uniform procedure for joint decisions on the capital and liquidity in a banking group. All BTSs must be brought into force by the European Commission, however. The EBA is also developing rules on cooperation within supervisory colleges and procedural rules for joint decisions on internal models, which it will present to the European Commission by the end of 2014.

1.10 Amendments to the *Pfandbrief* Act

The CRD IV Implementation Act also resulted in significant amendments to the *Pfandbrief* Act (*Pfandbriefgesetz* – PfandBG), most of which entered into force on 1 January 2014. For example, section 4a of the PfandBG, which governs the relevance of collective action clauses in the issue terms and conditions of public-sector bonds for the eligibility of *Pfandbrief* cover, was amended, the transparency disclosures under section 28 of the PfandBG were extended and amendments were made affecting the cover pool administrator.[19] The PfandBG was also amended by the Act Implementing the AIFM Directive[20],

18 Directive 2006/48/EC, OJ EU L 177, p. 1 ff.

19 See 2012 Annual Report, p. 118 ff.

20 Act Implementing Directive 2011/61/EU on Alternative Investment Fund Managers (*Gesetz zur Umsetzung der Richtlinie 2011/61/EU über die Verwalter alternativer Investmentfonds)*, Federal Law Gazette (BGBl.) I 2013, p. 1981.

which entered into force on 22 July 2013 and extended the group of possible counterparties for cover pool derivatives.

BaFin sees the need for further amendments to the PfandBG due to the establishment of the Single Supervisory Mechanism (SSM) at the European Central Bank. Until now at *Pfandbrief* banks, BaFin has carried out general solvency supervision under the KWG and special public supervision under the PfandBG alone. It has also been able to use the general supervisory tools of solvency supervision under the KWG in carrying out special public supervision in the interests of *Pfandbrief* holders, for example through requests for information or regular reporting on risk-bearing capacity.

The transfer of certain decision-making powers in general solvency supervision to the SSM raises the question of whether BaFin can continue to make full use of the solvency supervision tools for public supervision for the protection of *Pfandbrief* holders, as responsibility for special public supervision for the protection of *Pfandbrief* holders remains entirely with BaFin, even if, in future, the *Pfandbrief* bank is subject to solvency supervision by the SSM, which therefore has decision-making powers in this respect. Since special public supervision is extremely important for the status of *Pfandbriefe*, it must be ensured that the PfandBG itself has the necessary supervisory tools at the ready to reflect the independent supervision it provides for.

Special public supervision of *Pfandbriefe*

The status of *Pfandbriefe* as covered bonds complying with the UCITS Directive (Article 52(4) of the Directive on Undertakings for Collective Investment in Transferable Securities – UCITS Directive) is subject to special public supervision in the interests of the holders of covered bonds such as *Pfandbriefe*. This status, in turn, is a requirement for various regulatory advantages, for example relating to the risk weighting when determining institutions' own funds requirements under Article 129 of the Capital Requirements Regulation (CRR).

Provisions are also required in light of the fact that BaFin is responsible for deciding on a *Pfandbrief* licence, while the SSM is responsible for decisions on the general banking licences of all deposit-taking credit institutions. Definition issues must likewise be resolved so that BaFin can make a decision on a *Pfandbrief* licence, a decision reserved for it, in line with the SSM's decisions on the general banking licence of deposit-taking institutions.

2 Single Supervisory Mechanism

2.1 SSM Regulation

In December 2012, the European finance ministers reached an agreement on the structure of a Single Supervisory Mechanism (SSM) for the eurozone. Less than a year later, on 4 November 2013, the Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation) entered into force.[21]

In the course of 2014, the ECB will take over direct oversight of all significant credit institutions from the participating member

21 Regulation (EU) No. 1024/2013, OJ EU L 287, p. 63 ff.

Staff recruitment for the SSM

At the end of September 2013, the ECB began the recruitment process for the SSM by advertising the most senior management positions. The other vacant positions are being advertised in stages by way of a top-down approach.

The ECB asked the national supervisory authorities across Europe to provide staff to assist with the preparations until such time as it has successfully recruited its own staff. As a result, several BaFin employees have been working at the ECB since April 2013.

The ECB approached the national supervisory authorities again in October and November 2013, asking for staff to assist in carrying out the comprehensive assessment (CA) and recruiting the middle management. In the case of the CA, assistance is initially to be provided for six months, although the ECB says employees' employment may be extended, and providing assistance does not exclude them from applying through the ECB's general selection procedure. For the assistance with recruitment, the ECB is planning a period of cooperation of at least five weeks, with working time limited to no more than 50% of working hours.

To prepare the BaFin employees for their future duties as part of a European banking supervisor, BaFin developed a comprehensive continuing professional development programme and conducted training sessions on the SSM.

states. These are credit institutions whose total assets amount to at least €30 billion or exceed 20% of the GDP of the respective country of domicile. The ECB will also directly supervise banks that have received or applied for assistance from the European Financial Stability Facility (EFSF) (until 30 June 2013) or the European Stability Mechanism (ESM) (as at 1 July 2013). The ECB will supervise at least the three most significant banks in each member state. The ECB may also take over supervision of other individual institutions in participating member states. As a rule, however, the national supervisory authorities remain responsible for supervising less significant banks. In the second half of 2014, the ECB will decide which institutions it will supervise in future.

The national supervisory authorities will support the ECB in carrying out its supervision in joint supervisory teams (JSTs). The working language at the ECB and in the JSTs will be English. However, the institutions being supervised are entitled to communication in the official language of their country of domicile.[22] The ECB will establish common supervisory standards for the supervisory authorities participating in the SSM and is authorised to issue instructions to the supervisory authorities.

On 30 January 2014, the supervisory board was set up within the ECB, comprising a chairman, a vice chairman, four ECB representatives and one member from each participating member state. BaFin will be represented on this board by its President. The supervisory board will develop 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, the matter may be brought to the mediation panel, to which each of the participating member states will assign one representative, either from the Governing Council or the supervisory board.

BaFin participated in the preparations for the SSM at the ECB at all levels of the hierarchy. Most of the work on the Framework Regulation and the supervisory manual was completed in the fourth quarter of 2013. The Framework Regulation was released for public consultation between the beginning of February and the beginning of March 2014. The ECB will adopt

22 Regulation No. 1 EC, OJ EC L 17 of 6 October 1958, p. 385.

and publish the final Framework Regulation by 4 May 2014.

2.2 Comprehensive assessment

Ahead of the launch of the SSM, the eurozone banks currently classified as significant are undergoing a comprehensive assessment, which among other things includes a balance sheet assessment (BSA). This covers 124 eurozone institutions or groups of institutions (including 24 German institutions or groups of institutions) classified as significant under the draft SSM Regulation. The ECB developed the method being used to conduct the BSA with the help of the national supervisory authorities and an external adviser. As resources are limited, however, a full balance sheet assessment is not taking place. Instead, a risk-based assessment is being carried out, focusing on bank portfolios that can be classified as particularly risky (targeted asset quality review).

The BSA is being conducted in three phases: in phase one, the national supervisory authorities suggested to the ECB and, following approval by the ECB, determined the risky portfolios for the actual asset quality review (phase two). Phase one began at the end of November 2013 and was completed in March 2014. On-site inspections of asset quality are being conducted by auditors in phase two. This second phase began in February 2014 and is expected to last five months. After the second phase, the results must undergo a quality assurance check in a third phase. To this end, BaFin will carry out comparisons, among other things, between the German institutions concerned, while the ECB will compare institutions on a cross-border basis. The joint ECB/EBA stress test is expected to begin during this third phase.

According to the ECB's planning, the results of the BSA and the joint stress test will be in place before the end of October 2014, i.e. in good time before the SSM assumes direct supervisory responsibility.

In parallel with the asset quality review, the ECB will use a newly designed risk assessment system for the first time. The results of the procedure are to support supervisors in phases one and two and be incorporated into the results of the BSA.

3 Preventive supervision

3.1 Risk classification

For around ten years now, BaFin has performed a risk classification of credit institutions, securities trading banks and financial services institutions. 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". The letter-based grading system bears no relation to the ratings awarded by an external rating agency, however. Therefore, a D-rated institution has not necessarily "defaulted" in the supervisory sense.

The second rating, systemic importance, reflects BaFin's estimate of the institution's importance. The Supervisory Authority uses the institution'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 risk classification is based on a risk profile that BaFin prepares and continually updates for each institution using the reports on the audits of the annual financial statements analysed by the *Deutsche Bundesbank*. In doing so, BaFin mainly takes into account current risk analyses and their possible effects on risk-bearing capacity as well as the findings of any special audits and requests for information. An institution's risk profile reflects its risk situation and capital resources, its risk management

system and the quality of its organisation and management. The *Bundesbank* and BaFin then base the intensity of their supervisory activities on the classification.

3.1.1 Credit institutions

At the credit institutions, there has mostly been only a marginal change in the systemic importance rating over the last seven years. Again, the percentage of institutions rated as having high and medium systemic importance increased only slightly compared with 2012. The qualitative results of the risk classification also remained at a stable level overall. In 2013, BaFin rated a smaller percentage of institutions as being of low quality, while the percentage of institutions of high quality increased slightly.

The credit institutions' quality and systemic importance ratings are illustrated in a matrix (see table 6 "Risk classification results of credit institutions in 2013").

3.1.2 Financial services institutions

BaFin's risk classification of financial services institutions covered 688 institutions in the year under review (previous year: 718). Although the weighting given to the factors incorporated into the risk classification has shifted slightly due to the amendment of the Investment Services Examination Regulation (*Wertpapierdienstleistungs-Prüfungsverordnung* – WpDPV), this did not result in any significant changes to the risk classification overall (see table 7, "Risk classification results of financial services providers in 2013").

3.2 IT security at banks

The importance of information and communication technology (IT) has grown enormously for credit institutions over the last two decades. All of the traditional business conducted by a bank – from deposit-taking through lending to payment transactions – runs on complex core banking systems. Branch operations are just as reliant on data centres as online or mobile

Table 6 Risk classification results of credit institutions in 2013

Institutions in %		Quality				Total
		A	B	C	D	
Systemic importance	High	0.3	0.7	1.2	0.2	2.4
	Medium	4.0	4.5	1.8	0.9	11.2
	Low	42.0	33.8	8.9	1.7	86.4
	Total	**46.3**	**39.0**	**11.9**	**2.8**	**100**

Table 7 Risk classification results of financial services providers in 2013

Institutions in %		Quality of the institution				Total
		A	B	C	D	
Systemic importance	High					
	Medium	11.9	15.5	3.2	0.6	31.2
	Low	24.7	38.4	5.2	0.7	69.0
	Total	**36.6**	**53.9**	**8.4**	**1.3**	**100***

* Deviations in the total figures are due to rounding differences.

banking. In trading business, increasing use is being made of algorithmic trading systems (algo trading, high-frequency trading). IT systems calculate key indicators for risk management and control, aggregate them and process them; reporting is also electronic. Internal and external communication depends just as much on IT as do numerous special applications that support institutions' individual business strategy – from real estate management through to sales software. And most business and client data only exists in electronic form, too.

To be commercially successful, an institution must therefore have efficient IT. This realisation is also reflected in supervisory law. Section 25a (1) of the KWG requires institutions to have adequate technical and organisational resources and an adequate contingency plan, particularly for IT systems. Under the KWG and the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk), institutions must make sure that their IT systems and IT processes ensure the integrity, availability, authenticity and confidentiality of data. The catchword for these aspects in practice is "IT security". The term "information security" is often used in practice as a synonym.

It is evident that institutions are still keen to modernise and streamline the IT systems in use and adapt them to new requirements. These mostly long-term IT projects are driven by cost pressures, changing business models, generally fiercer competition and new supervisory requirements. Added to this is an ever-growing threat to IT security from internal and external attackers. It is logical, therefore, that IT supervision at banks must also be stepped up as IT risks increase.

Supervisory focus on IT security

In recent years, BaFin has also focused increasingly on IT security at banks. In 2013, for example, special IT audits were ordered by BaFin at several institutions and carried out by the *Deutsche Bundesbank*. Supervisory interest here focused on the IT strategy, application development, the user authorisation procedure, IT risk management, provider management, IT crisis management and incident/problem management. In several cases in institutional support activities, BaFin also adopted a preventive approach by addressing issues related to planned changes to IT organisation. These supervisory activities helped to raise awareness of IT security at the institutions.

In 2013, BaFin worked together with the *Bundesbank* to flesh out the supervisory review and evaluation process with an eye towards IT security. To this end, several audit modules were developed, in particular setting out the requirements of AT 7.2 of the MaRisk in greater detail. The 15 audit modules planned in total are scheduled to be completed in 2014 and to be published in the form of the audit criteria they contain.

International rules on IT security

The subject of IT security was also taken

Information event on IT supervision at banks

At the end of October 2013, BaFin briefed around 180 representatives of institutions, associations, auditors and data centres on IT supervision at banks. During the one-day event, BaFin and speakers from the *Deutsche Bundesbank* explained the requirements and focal points of IT supervision and reported on the findings of special IT audits conducted in recent years. In addition, a broad outline was presented of the Recommendations for the Security of Internet Payments, a set of recommendations from the European Forum on the Security of Retail Payments (also referred to as the SecuRe Pay Forum), in which BaFin also participated.

The event programme and the presentations can be accessed on the BaFin website.[23] The dialogue initiated at this event is to be continued in 2014.

23 www.bafin.de/dok/4089600 (only available in German).

forward at regulatory level in 2013. At the beginning of the year under review, the European Forum on the Security of Retail Payments (SecuRe Pay Forum), in which BaFin is also represented, published its Recommendations for the Security of Internet Payments. These Recommendations are to be implemented by national supervisors by February 2015, which BaFin plans to do in the form of a circular. In particular, the new requirements stipulate an increase in Internet security, strong client authentication and extensive client education about IT security issues related to Internet payments.

3.3 Preparations for SEPA

The creation of a Single Euro Payments Area (SEPA) was supposed to be completed under the SEPA Regulation[24] by 1 February 2014. However, on 9 January 2014, the European Commission proposed allowing credit transfers and direct debits to continue to be processed in the old format until 1 August 2014 without repealing the launch date of 1 February 2014. The main reason given by the Commission for this action was that the timely migration of payments by 1 February 2014, particularly in the area of direct debits, was under threat due to the low take-up rate for the SEPA scheme across the EU. The European Parliament and the Council endorsed the proposal and amended the SEPA Regulation accordingly.[25] By then, German payment services providers and their clients had already gone to considerable lengths to meet the migration deadline. BaFin closely supervised those implementation activities so as to ensure that payment services providers in Germany meet the requirements of the SEPA Regulation. It assumed that timely migration to SEPA by 1 February 2014 would have been possible in Germany, even if further effort had been required on the part of some end user groups such as small enterprises and associations.

24 Regulation (EU) No. 260/2012, OJ EU L 94, p. 22-37.

25 Resolution adopted by the European Parliament on 4 February 2014.

BaFin surveys on SEPA implementation

Between June and August 2013, BaFin conducted an initial SEPA survey. It wrote to payment services providers in Germany to find out whether they are able, from both a technical and an organisational perspective, to process SEPA payments. The findings were satisfactory overall. BaFin had to follow up on two aspects, however. Firstly, the time scheduled for the technical modification of IT systems was very short given the migration date. Technical migration to SEPA was primarily the responsibility of external IT service providers, who were engaged to carry out payment transactions by 93% of those surveyed. From September 2013 onwards, BaFin therefore had reports submitted to it on the timely implementation of the SEPA project on a monthly basis. Secondly, it was found that, at the reporting date, those surveyed did not yet have sufficient knowledge of the extent to which SEPA had been implemented by their creditors.

At the beginning of October 2013, BaFin therefore sent the payment services providers a second questionnaire about creditors. The primary objective of this second survey was to require the payment services providers to do their best to assist creditors in migrating to SEPA direct debits and, in doing so, to identify important creditors. This objective was largely achieved: 90% of the banks that accept direct debits were aware of their clients' progress in migrating to SEPA. The survey also revealed that 90% of all direct debits processed are attributable to around 303,000 creditors. Most of the volume of direct debits processed was therefore caused by 18% of all creditors – the group referred to as key accounts.

SEPA migration a focus of audits

In addition to the measures described, in mid-2013 BaFin asked the auditors of the payment services providers' annual financial statements to include the issue of timely migration to SEPA in their partial audits beginning in the second half of 2013 for the 2013 year-end financial statements. BaFin experts also published several articles with the aim of informing

financial services institutions and their clients about the need to migrate to SEPA.[26]

BaFin completed its principal implementation projects at the beginning of 2014. On the whole, Germany's technical migration to the SEPA format took place on 1 February 2014 without any problems. As, under the amended SEPA Regulation, payment services providers may accept credit transfers and direct debits in the old format until 1 August 2014, BaFin will not apply the relevant penalties during that period.

3.4 Surveys and comparative studies

In 2013, BaFin conducted a number of comparative studies. In doing so, it approached the institutions if it did not have the necessary information, for example from their reporting. These cross-institutional requests for information were conducted on topics such as the problem of low interest rates, shipping and real estate exposures, and the quantitative impact of the Capital Requirements Regulation (CRR). In each case, BaFin selected the institutions according to risk-based criteria, as a result of which the group of institutions included differed depending on the topic. As it is particularly important from a prudential perspective, BaFin now also asks selected institutions to provide certain information, for example regarding shipping portfolios (see chapter III 3.4.1), at regular reporting dates.

BaFin carried out and to some extent published further analyses, such as on outsourcing or banks' internal governance structures, on the basis of the prudential data at hand.[27]

International surveys

The European and international surveys that national supervisory authorities are required to technically implement on a regular basis are also becoming ever more important. These are mostly prompted by the EBA or the Basel Committee on Banking Supervision (BCBS). Most recently, the transparency exercise took place on behalf of the EBA, which published the results on its website in mid-December 2013. Due to the implementation of the Single Supervisory Mechanism (SSM), which began in 2013, the surveys on behalf of the ECB also became a focus of cross-supervisory requests for information at the end of the year.

3.4.1 Survey on ship finance

The crisis in the shipping markets continued in 2013. Surplus capacity weighed on freight and charter rates. In addition, the relevant market indices were only marginally up on their historic lows and pointed merely to slight improvements.

Supervisory focus on shipping portfolios

Since the crisis began in 2009, BaFin has been devoting particularly close attention to banks' shipping portfolios in order to gain a current overview of the risk situation in this area. Initial surveys showed a low capacity to meet principal repayments, high loan-to-value ratios and an increased proportion of problem loans. Almost a quarter of exposures have a loan-to-value ratio of over 140%; this means that the loan is no longer fully covered by collateral.

In light of this, BaFin ordered a focus for the audit of the annual financial statements at 19 institutions under section 30 of the KWG so as to gain in-depth information about the risk content of the shipping portfolios as at 31 December 2012. The analysis of the audit focus through to mid-2013 showed that, although the level of exposure at most institutions had fallen by around 20% to €95.5 billion since 2009, the total amount of problem loans remained high at €31.9 billion, as a result of which the possibility of further write-downs cannot be ruled out.

Scheduled data collection exercise

Similar findings were also produced by an extensive data collection exercise, carried out by BaFin on a quarterly basis and for the first time as at 30 June 2013, regarding the current situation of shipping portfolios at the ten most

26 See, for example, BaFinJournal, October 2013, p. 9 ff.; BaFinJournal, February 2014, p. 4 (only available in German).

27 See BaFinJournal, August 2013, p. 22.

important ship finance providers. In this case too, the analysis of the data shows that the institutions have continuously reduced their portfolios. However, more than a quarter of the ship finance (26.3%) has a "default" rating. A high proportion (85.6%) of the aggregate shipping portfolio is still non-investment grade. As a result, allowances for losses on loans and advances rose by almost 80% year-on-year in 2013.

The auditors generally consider the allowances for losses on loans and advances to be adequate. This opinion was also confirmed in extensive talks between auditors and BaFin. Inputs such as forecast charter rates have a major impact on the level of allowances for losses on loans and advances. Past experience has already shown that market forecasts entail uncertainty due to the volatile environment. Much therefore depends on market trends going forward.

Overview of shipping portfolios

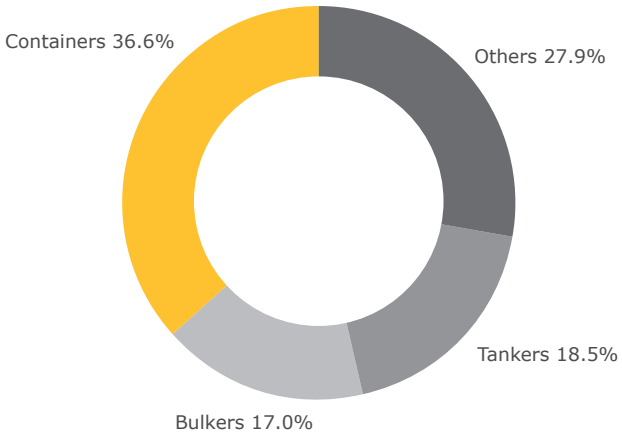
A look at the portfolios shows the emphasis to be clearly on container ships (36.6% of the total portfolio). Tankers, bulkers and "others", which include offshore vessels, cruise ships and shipyards, on the other hand, play a somewhat smaller role.

3.4.2 Survey on the securitisation positions held by German banks

For several years now, BaFin has been using a survey to calculate the securitisation positions held by selected German credit institutions, in cooperation with the *Bundesbank*. In 2013, the survey included a total of 13 institutions (previous year: 15). Two institutions were removed from the survey due to a new materiality threshold introduced for reporting. The materiality threshold consists of two conditions required to be met simultaneously, the first one based on the absolute size of the portfolio of collateralised debt obligations (CDOs) and asset-backed securities (ABSs), and the second on the relevance of the business for the institution in question. The two institutions that were removed fell short of this materiality threshold, as they have reduced parts of their portfolios considerably.

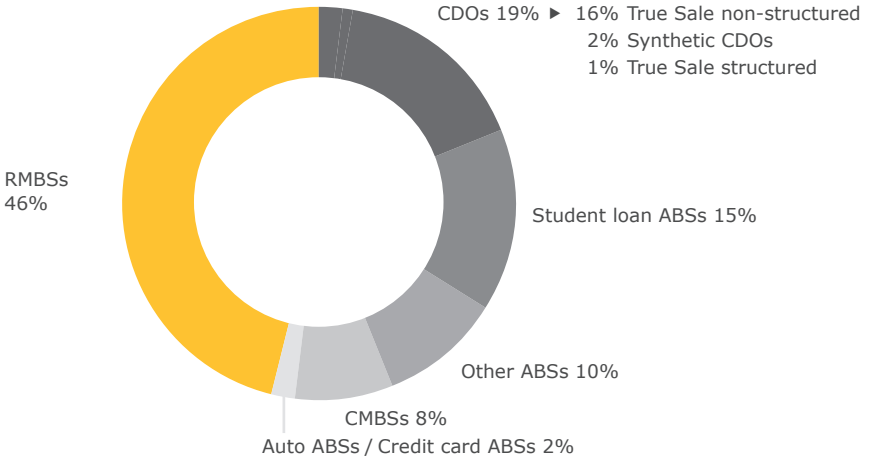
The total book value of the securitisation positions held by the 13 reporting banks amounted to around €88.4 billion as at 31 December 2013, a sharp decline of almost a quarter compared with the prior year-end figure for the 13 institutions (€114.3 billion). The reduction in the securitisation positions was due mainly to the maturity and repayment of some of the securities held, the netting of long and short positions and, to a smaller extent, exchange rate changes and value adjustments.

Figure 2 Breakdown of shipping portfolios



As at 31 December 2013

Figure 3 Securitisation positions by type of collateral



ABS	asset-backed securities
RMBS	residential mortgage-backed securities
CMBS	commercial mortgage-backed securities
CDO	collateralised debt obligations

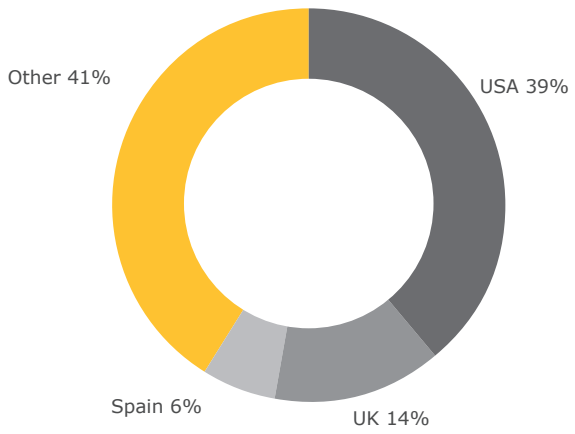
Source: *Deutsche Bundesbank*, BaFin, figures rounded to full percentage points

As at 31 December 2013

It is important to bear in mind that this 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 85% and therefore more than four-fifths of the mortgage-backed securities; the remainder consisted of CMBSs. The securities held are still very heterogeneous and cover a broad spectrum ranging from what tend to be more sound European residential mortgage securitisations through to heavily credit-impaired US subprime securities. At the end of 2013, around 50% of the mortgage-backed securities were rated AAA or AA (previous year: around 54%). The proportion of tranches rated subinvestment grade remained roughly unchanged at approximately 23%. At the same time, the proportion of unrated tranches

Figure 4 Regional breakdown of underlyings



Source: *Deutsche Bundesbank*, BaFin, figures rounded to full percentage points

As at 31 December 2013

increased, in particular due to a change in defining the portfolio.

Collateralised debt obligations (CDOs) also had a larger weighting, accounting for almost a fifth (around 19%) of the total securitisation portfolio of German banks. Most of these were true sale transactions. At € 10 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 € 13 billion. By contrast, other forms of investment, such as auto loan and credit card asset-backed securities, played a minor role.

Regional focus of the underlyings

Viewed by region, most of the securitised loans originated from the USA (39%), with the percentage showing a further decline compared with the previous year (45%). However, the regional breakdown varies considerably from bank to bank depending on their individual investment strategy. The proportion of securitisations backed by US collateral ranged from just under 75% to roughly 9% across the institutions. The regional breakdown by asset class was also heterogeneous.

3.5 Money laundering prevention

Through money laundering prevention, BaFin aims to prevent the financial system from being misused for the purposes of money laundering, terrorist financing and other punishable offences that may compromise an institution's assets. It ensures that the enterprises and individuals being supervised implement the legal requirements that exist for this purpose. These requirements on institutions result primarily from the Money Laundering Act (*Geldwäschegesetz* – GwG) and the Banking Act (*Kreditwesengesetz* – KWG) and are intended to ensure transparency over business relationships and financial transactions using a risk-based approach. Parties subject to the provisions must meet customer due diligence requirements, for example. As well as identifying the client and, if different, the beneficial owner, these include verifying the background to the business relationship and carrying out continual monitoring wherever possible. It is also necessary to establish whether the client is a politically exposed person requiring increased due diligence in managing the business relationship. The aim of these measures is to enable cash flows to be understood and any unusual or suspicious transactions or business relationships to be spotted. Suspicious transactions must be reported to the Financial Intelligence Unit (FIU) at the Federal Criminal Police Office (*Bundeskriminalamt*) and the competent criminal prosecution authorities.

3.5.1 Due diligence requirements in e-money business

As a rule, the general provisions of the GwG apply in e-money issuance. Since 2011, section 25i of the old version of the KWG, which at the beginning of 2014 was incorporated into section 25n of the KWG, has set out special organisational requirements for e-money business. In certain cases, simplified due diligence requirements may also be applied, provided there is a low risk of money laundering, terrorist financing, or other punishable offences to the institutions' detriment when using an e-money product. This is the case if the amount stored on the e-money product does not exceed € 100 a month and the e-money cannot be technically linked to another holder's e-money, and e-money redemption does not take place in cash or is limited to a maximum of € 20 in cash. Furthermore, BaFin may in specific cases permit an exemption from due diligence requirements (section 25n (5) of the KWG). In October 2013, BaFin published a guidance notice in order to speed up this process. It gives applicants guidance on the information and supporting evidence required to be submitted when applying for an exemption.

In the year under review, BaFin issued six orders under section 25i (5) of the old version of the KWG and received six new applications. Before submitting an application, various institutions made enquiries about the principles underlying section 25i (5) of the old version of the KWG.

At the same time, administrative practice in relation to section 25n (2) of the KWG was strengthened. Prepaid credit cards, for example, do not fall under this exempting provision, as the link to other e-money cannot be reliably ruled out in the case of these e-money products.

3.5.2 Audit campaign at institutions that are members of the same institutional protection scheme (*verbundgestützte Institute*)

For several years, auditors of annual financial statements have been required to assess a list of anti-money laundering obligations in Annex 6 to the Audit Report Regulation (*Prüfungsberichts-Verordnung* – PrüfbV) on a scale ranging from F 0 (complete absence of violations of standards) through F 4 (serious deficiencies) to F 5 (not applicable). In analysing these questionnaires, it was noted that the auditors had almost exclusively used F 0 findings. BaFin's experience in past audits, however, was that there was very rarely a complete absence of violations of standards in practice. In its anti-money laundering assessment for Germany in 2010, the International Monetary Fund (IMF) had also touched on the quality of the audits in some cases. BaFin therefore decided to conduct a total of 79 special audits at institutions across Germany that are members of the same institutional protection scheme.

In doing so, BaFin mainly targeted institutions with F 0 scores only. BaFin took into account the size (the total assets of the individual institutions should not be less than €400 million) and the number of regional associations. Audit firms engaged by BaFin then examined the twelve most important preventive measures aimed at preventing money laundering, terrorist financing and other punishable offences at the credit institutions selected. Examples of these measures include the obligation to identify the client, verifying the beneficial owner and using suitable monitoring systems to continually monitor existing clients.

BaFin ultimately concluded that most association auditors had clearly presented and transparently assessed the precautionary measures taken by the institutions in order to prevent money laundering. Within the individual associations, though, there are also sharp differences in information value and the assessment scale. This study could not be representative due to the relatively small number of institutions audited. However, the findings provide a good basis on which to improve the standard of auditing. With this in mind, BaFin has already held talks with the auditing associations, which were very constructive.

3.5.3 Audit focus at internationally active banks

Since 2009, internationally active banks have also had to apply the same strict standards in their measures to prevent money laundering and terrorist financing throughout the group as they do in Germany. In order to examine implementation, BaFin established an area of emphasis for the audit of the annual financial statements at 16 institutions. The auditors of the annual financial statements were expected to determine whether there were any implementation problems and report on the extent to which the group-wide due diligence requirements have been implemented and monitored. The findings show that, overall, there were relatively few legal implementation problems for the German institutions abroad. In some countries, however, special data protection regulations need to be taken into account.

There were occasional shortcomings in implementation when it came to actual integration or monitoring at branches locally. Above all, the sometimes less strict legal provisions in other countries make it difficult to introduce new and tighter requirements there. For example, German requirements when determining the beneficial owner cannot be fully implemented in some countries. Systematic institution-wide money laundering prevention is also made difficult by the rigorous bank secrecy still in place elsewhere.

4 Institutional supervision

4.1 Authorised institutions

4.1.1 Credit institutions

The number of authorised credit institutions fell again in 2013 and stood at 1,820 at year-end. There were 1,854 institutions in the previous year, as against 1,883 in 2011. This represents a decline of 1.8% compared with 2012.

Table 8 Number of banks by group of institutions

	2013	2012	2011
Commercial banks	184	183	185
Institutions belonging to the savings bank sector	426	432	436
Institutions belonging to the cooperative sector	1,083	1,106	1,125
Other institutions	127	133	137
Total	**1,820**	**1,854**	**1,883**

The institutions supervised by BaFin are divided into four groups: commercial banks, institutions belonging to the savings bank sector, institutions belonging to the cooperative sector and other institutions. The group comprising commercial banks includes 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 for an institution's assignment are its economic ties, as a result of which DZ Bank and WGZ Bank are allocated to the cooperative sector. The group of other institutions comprises building societies, *Pfandbrief* banks, securities trading banks and development banks operated by the federal government and the *Länder*.

In the savings bank sector, BaFin was supervising 417 savings banks, eight *Landesbanks* and DekaBank, the central provider of fund services for the Savings Banks Finance Group (*Sparkassen-Finanzgruppe*), at the end of 2013. The pace of mergers remained largely unchanged. The number of savings banks declined by six to 417 institutions (previous year: 423). This means that the number of supervised savings banks decreased by 1.4% year-on-year (see figure 5, "Number of savings banks").

BaFin was supervising a total of 1,079 primary cooperative institutions, two central institutions, ten related institutions providing specialist services and 49 housing cooperatives with a savings scheme (which also belong to the cooperative segment) at the end of 2013. The number of primary institutions therefore dropped by 23 or 2.1%; the pace of mergers

Figure 5 Number of savings banks

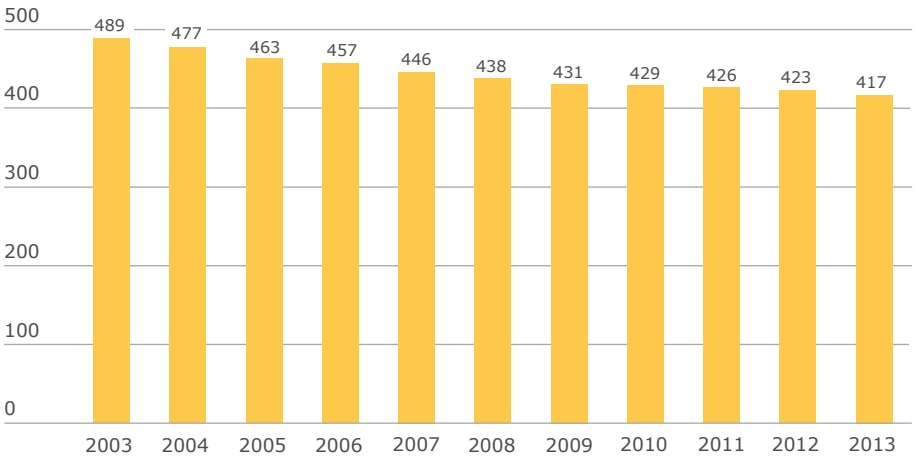
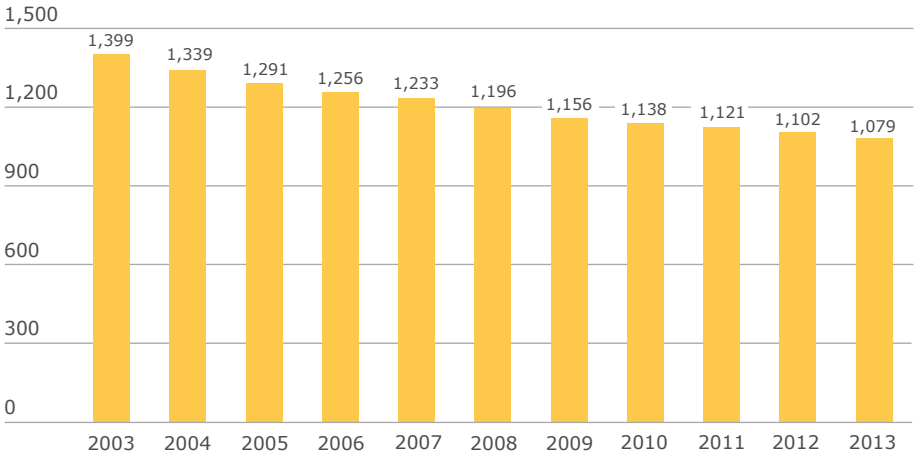


Figure 6 Number of primary cooperative institutions



among cooperative credit institutions increased slightly from a low level (see figure 6, "Number of primary cooperative institutions").

Number of *Pfandbrief* banks

At the end of the year, 76 institutions were authorised to issue *Pfandbriefe* (previous year: 76). The number of issuers did not increase year-on-year because, as well as there being one new arrival, one institution that settled its legacy issue in 2013 stopped operating. However, keen interest continues to be shown in the German *Pfandbrief*, including by institutions from other countries (in Europe) through subsidiary banks based in Germany. In the year under review, several *Pfandbrief* issuers also applied for and received an extension to their existing licence to conduct *Pfandbrief* business to include other types of *Pfandbrief*. The option available under the *Pfandbrief* Act since 2009 to use public-sector *Pfandbriefe* to refinance (government-) guaranteed export finance is also generating increasing interest.

Number of building societies

The number of supervised building societies remained unchanged in 2013 (22 institutions). At the end of the year under review, BaFin was supervising 12 private and ten public-sector regional building societies.

4.1.2 Financial services institutions

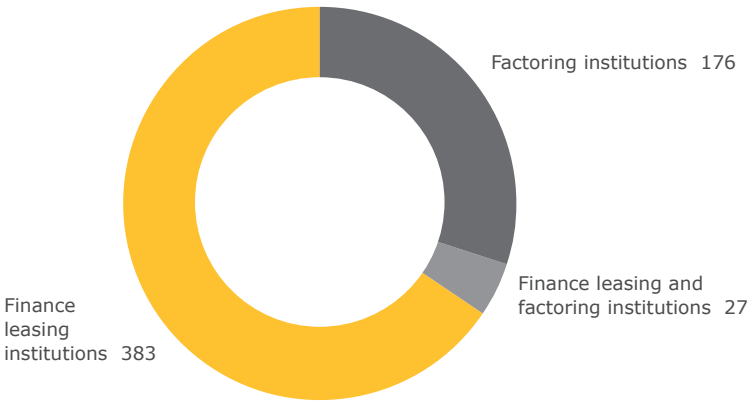
At the end of 2013, BaFin was supervising 702 financial services institutions (previous year: 681). 89 German branches of foreign institutions were also under its oversight (previous year: 75). A total of 155 financial services institutions were engaged only in investment and contract broking and the provision of investment advice (previous year: 162), while 531 institutions were authorised to conduct portfolio management (previous year: 519). Four financial services providers were authorised to obtain ownership or possession of client money or securities (previous year: 4). In 2013, 39 enterprises applied for authorisation to provide financial services (previous year: 36). Ten financial services institutions applied to have the scope of their authorisation extended (previous year: 14).

The number of tied agents fell again in the year under review, to around 34,500 compared with 39,600 in the previous year.

Leasing and factoring institutions

In 2013, 383 finance leasing institutions (previous year: 398), 176 factoring institutions (previous year: 178) and 27 institutions engaged in both finance leasing and factoring (previous year: also 27) held authorisations under the ongoing supervision of BaFin. In the year under review, BaFin revoked two authorisations from finance leasing and factoring institutions.

Figure 7 Breakdown of Group V institutions



As at 31 December 2013

The process of market consolidation that had been in evidence since supervision of leasing and factoring institutions ("Group V institutions") began has eased considerably. The number of authorisations waived fell sharply year-on-year and was close to the number of applications for authorisations. In the year under review, BaFin received 22 applications for new authorisations in accordance with section 32 of the KWG. In 19 cases, some relating to pending authorisation procedures from the previous year, the procedure ended with authorisation being granted. In 12 other cases, the applicants withdrew their application prior to the decision-making stage. Conversely, only 26 authorisations were waived in 2013 compared with 55 such waivers in the previous year.

4.1.3 Payment institutions and e-money institutions

In the year under review, 33 payment institutions and six 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 2013, seven new applications for authorisation were submitted; ten proceedings were concluded as a result of authorisation being withheld or the application being withdrawn. The quality of the applications for authorisation differs considerably. Applicants often underestimate the requirements and fail to systematically pursue the application after first submitting documents. BaFin granted authorisation in four cases.

At the end of 2013, a total of 319 payment and e-money institutions were operating in Germany under the EU passport system. In

Multilateral trading platforms and foreign market operators

In 2013, as in the previous year, a total of ten institutions in Germany were authorised to operate a multilateral trading facility (MTF). Two of these institutions only had an MTF licence, while eight companies 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. This means that these figures also remain unchanged compared with the previous year. 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.

18 cases, institutions have a physical presence in Germany through a branch. At the same date, a total of 5,400 reported payment agents were operating on behalf of 25 foreign payment institutions. In Germany, branches and agents are subject to anti-money laundering supervision by BaFin.

4.2 Economic environment

German banks continued to operate in a difficult environment in 2013. Their earnings were heavily impacted by the low level of interest rates, which is having an adverse effect on margins: existing business at high rates of interest is gradually being replaced by new business at lower rates.

The earnings of small and medium-sized institutions, whose business models are based to a particular extent on strong net interest income, were slightly more sensitive to sustained low interest rates than those of the major banks. The robust state of the economy had a positive impact on bank balance sheets and kept risk provisions in relation to the German corporate sector at a low level. The winners were therefore those institutions able to benefit from lending to the corporate sector. Conditions were difficult for banks with heavy exposure to ship finance or having to shoulder increased risks of default due to stressed real estate markets. Large, internationally active institutions managed to lift their capital ratio on average in 2013, thereby narrowing the gap to savings banks and cooperative banks, which traditionally are slightly better capitalised.

Low interest rates also pose a challenge for the building societies. The gap between constant interest rates on deposits over the term of a building savings contract and prevailing market rates continued to widen. Building society savers with old contracts at high rates saw few incentives to have their deposits paid out. At the same time, the fixed lending terms under such contracts were usually unable to compete with mortgages at lower interest rates adjusted in line with the overall level of interest rates. In 2013, many building societies responded to the pressure on earnings by offering new tariffs with lower deposit rates.

Sector index rises less than the DAX

The German banking shares index initially continued its upward trend at the beginning of 2013. In January, the extension of the deadline for implementing the liquidity buffer under Basel III had a positive impact. The Basel Committee on Banking Supervision (BCBS) decided that banks must only build up 60% of the required liquidity reserve by 2015 and also extended the range of eligible assets.

Figure 8 German banking shares index

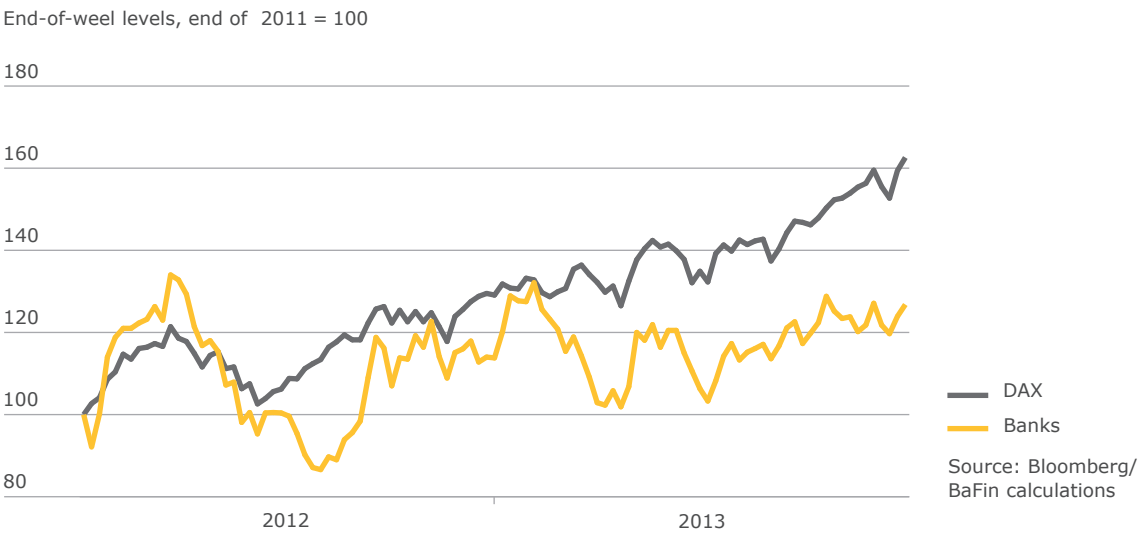
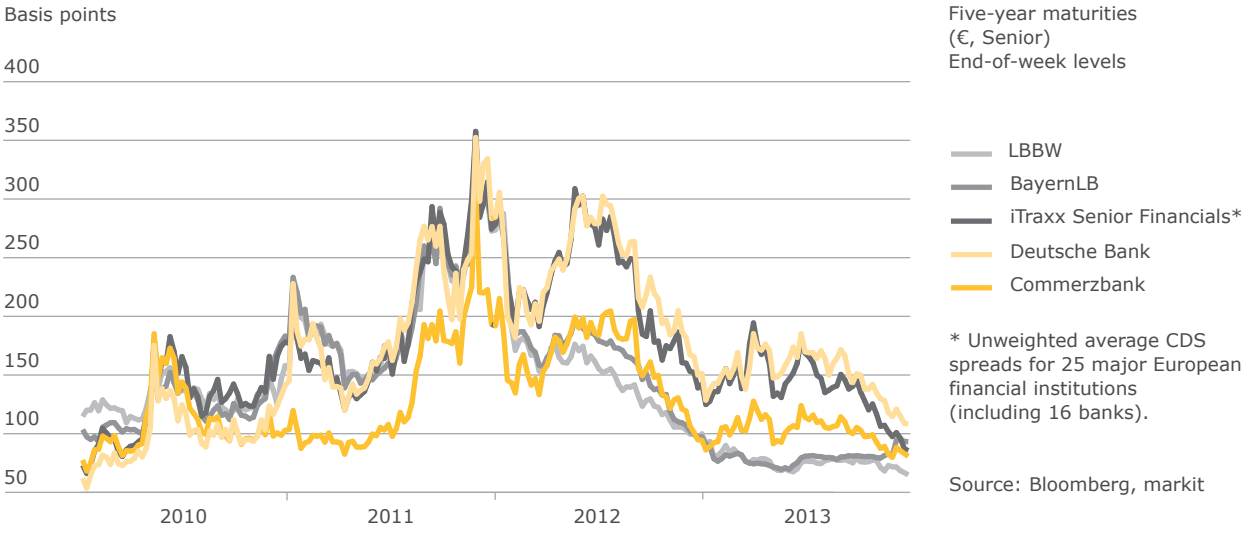


Figure 9 Credit default swap spreads for major German banks



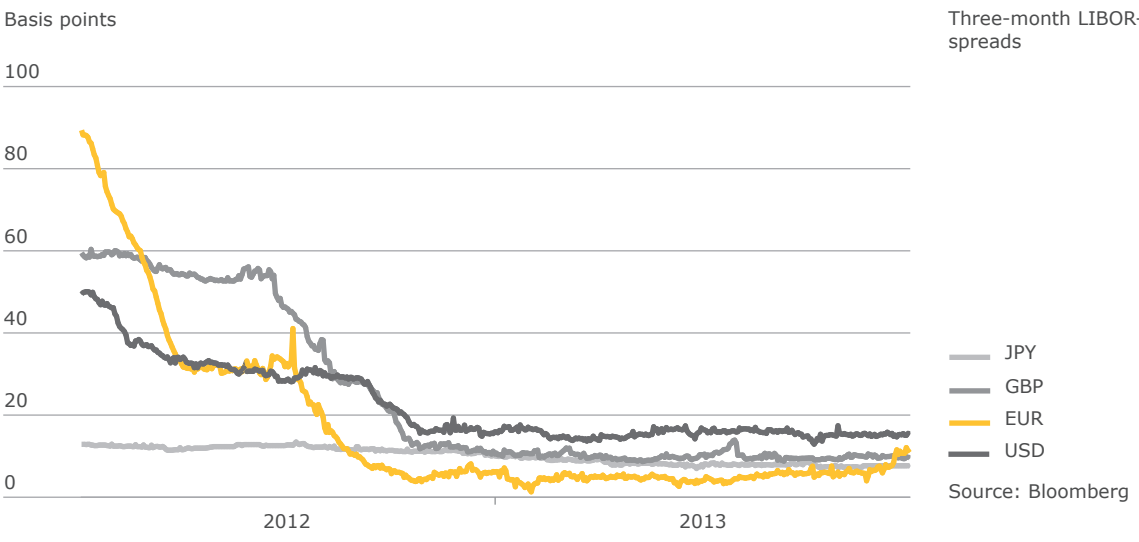
In February and March 2013, the Cyprus crisis caused uncertainty and put sustained pressure on banking stocks. Banking share prices fluctuated sharply as the year progressed. The main boost came from the ECB's cut in interest rates from 0.75% to 0.5% at the beginning of May. In June, speculation about the US Federal Reserve abandoning its ultra-loose monetary policy and the hearing before the German Constitutional Court (*Verfassungsgericht*) regarding the ECB's bond buying weighed heavily on banks' share prices.

Over the course of the year, the German banking shares index gained almost 12%, but failed to match the performance of the DAX by far. The challenges on the capital and earnings front were once again too great for this in 2013. In addition, the European banking sector is naturally more sensitive than other sectors to the still-smouldering European debt crisis.

Easing of risk and money market indicators

The trend in money market indicators has been driven to a considerable extent by the ECB's statement that it would do whatever it takes to preserve the eurozone. As a result, risk and money market indicators have mostly eased.

Figure 10 Interbank market indicators



Non-performing loans

The term "non-performing loans" (NPLs) is not specifically defined in Germany. To determine the rough volume of NPLs, BaFin and the *Deutsche Bundesbank* use the reported "l*eistungsgestörte Kredite*" in accordance with the Audit Report Regulation (*Prüfungsberichtsverordnung* – PrüfBV).

In 2012 – the audit reports for the 2013 annual financial statements were not yet available in all cases at the time of writing this report – the volume of NPLs in the German banking sector declined by 7.4% year-on-year to €166 billion; measured by the total volume of lending to non-banks, the NPL ratio fell slightly, to just under 2.9% compared with 3.0% in 2011. The ratio of NPLs to balance sheet capital declined from 31.6% to 28.5%. 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.

Sustained stable economic growth in Germany was accompanied by a decline in insolvencies and a historically low unemployment rate. In 2012 as well, this is likely to be the key factor behind the further improvement in credit quality.

Credit default swap (CDS) spreads for major German banks had reached historic highs of up to 350 basis points at the end of 2011 and narrowed significantly between the second half of 2012 and the beginning of 2013. In the further course of the year, CDS spreads were able to resist negative forces such as the Cyprus crisis and held steady.

Once again, hardly any cross-border lending took place in the interbank market in 2013. Many banks in crisis-hit eurozone countries remained without access to the interbank market. The supply of liquidity to banks depended primarily on the monetary policy measures implemented by the ECB. Many banks repaid the liquidity from the ECB's three-year tenders early, but several institutions from southern European countries in particular were still heavily dependent on central bank liquidity.

The LIBOR-OIS spread remained below eight basis points throughout 2013. This denotes the difference between the three-month London Interbank Offered Rate (LIBOR) and the interest rate for a three-month revolving overnight index swap (based on the overnight indexed swap (OIS) rate).

Credit standards tightened

At the beginning of 2013, German banks relaxed the credit standards for corporate clients for the first time since 2011. However, they then tightened them again slightly at the end of the year. By contrast, the trend towards tightening credit criteria at European banks as a whole continued throughout 2013, albeit at a declining rate. This was the finding of the quarterly Bank Lending Survey conducted by the ECB and the *Deutsche Bundesbank*. According to the survey, demand for corporate loans continued to fall – but at a slower pace in the course of the year. German banks also tended to report a decline in demand over the year. Having tightening their standards for residential building loans to private households at the beginning of the year, German banks then relaxed them again at the end of the year for the first time in almost three years. The trend at European banks outside Germany was similar.

4.3 Situation at the institutions

4.3.1 Situation at the major private commercial banks

2013 was another difficult year for German major private commercial banks. Results mostly fell short of expectations. In addition, many institutions continued to shorten their balance

sheets. This shrinking of balance sheets is the result of banks generally concentrating on core lines of business as they withdraw from areas they consider to be more risky. At the same time, the capital ratios of major private commercial banks increased on average in 2013.

Net interest income in particular came under pressure due to the ongoing period of low interest rates and the resulting narrow spread between short- and long-term interest rates. Net fee and commission income, on the other hand, remained largely stable overall, with the trend varying from institution to institution. Net trading income was significantly lower despite the generally more upbeat mood on the financial markets. At some of the institutions, the decline in allowances for losses on loans and advances due to the fairly robust state of the economy served to prop up results. In some cases, these allowances almost fell to historic lows, although the picture was mixed overall. The fact that allowances for losses on loans and advances declined on average is particularly notable, as some of the major private commercial banks had focused on the crisis-hit ship finance markets or were exposed to foreign real estate markets marked by increased risks of default. It is partly attributable to the fact that the institutions were successful in scaling back their portfolios in these troubled areas. Efforts to reduce administrative expenses met with varying degrees of success. At some institutions, the need for additional provisions for legal risks had a strongly negative impact.

The latest economic forecasts predict that the period of low interest rates will continue in 2014. A sharp rise in allowances for losses on loans and advances due to the state of the economy is unlikely. However, the outcome of the asset quality review to be performed together with the ECB ahead of the launch of the SSM and the subsequent stress test remains to be seen.

4.3.2 Situation at the *Pfandbrief* banks

Although there was a noticeable easing of the strains in the international financial markets in 2013, the impact of the European sovereign debt crisis and the resulting mark-to-market losses on bonds issued by peripheral European states in particular continued to weigh on the balance sheets and risk-bearing capacity of several institutions. In addition, sustained low interest rates are exacerbating the sometimes structurally weak earnings generated by *Pfandbrief* banks primarily engaged in government finance. Added to this are increased sectoral credit risks, for example due to the sharp fall in freight and charter rates in the ship finance segment.

Nevertheless, the *Pfandbrief* remains a cost-effective and comparatively crisis-proof source of funding and, due not least to the regulatory framework, is a particularly safe and transparent financial product from an investor perspective. This applies in particular to mortgage *Pfandbriefe*, which have held up well compared with rival foreign covered bonds, even in times of unrest in the markets.

Total *Pfandbrief* sales

As in previous years, however, the number of issues continued to decline overall, with *Pfandbriefe* worth €49.5 billion being sold in 2013. New issues had amounted to €56.5 billion and €71.6 billion respectively in 2012 and 2011 and in some cases significantly more than €100 billion in the years before (see table 9, "Gross *Pfandbrief* sales", page 97). This trend in total sales in recent years is due mainly to the declining importance of public-sector *Pfandbriefe*. However, it is also influenced by the supply of liquidity from the ECB, which is much more cost-effective for institutions than the *Pfandbrief*. Thus, the year under review also saw a decline in the volume of mortgage *Pfandbriefe* issued.

Overall, though, the market was again much more receptive to *Pfandbrief* issues than other funding instruments in 2013. Measured by issue volumes, at €33.9 billion (previous year: €42.2 billion), more than twice as many mortgage *Pfandbriefe* (in each case including ship and aircraft *Pfandbriefe*) were sold in the year under review as public-sector *Pfandbriefe*, which

Table 9 Gross *Pfandbrief* sales

Year	Mortgage *Pfandbriefe* (€ billion)	Public-sector *Pfandbriefe* (€ billion)	Total sales (€ billion)
2007	27.5	108.0	135.3
2008	63.4	89.5	152.9
2009	58.1	52.3	110.4
2010	45.4	41.6	87.0
2011	41.1	30.5	71.6
2012	42.2	14.3	56.6
2013	33.9	15.6	49.5

last year recorded total issues of €15.6 billion (previous year: €14.3 billion). New issues of public-sector *Pfandbriefe* were up slightly on 2012. Compared with the years before, however, sales have fallen sharply, mainly because of changes to the business models of several *Pfandbrief* banks and the decreasing need for funding in the government finance segment; in 2007, the institutions issued public-sector *Pfandbriefe* worth around €108 billion.

Given the sustained high volume of real estate finance and despite the slight year-on-year decline in issue volumes, BaFin expects the mortgage *Pfandbrief* to continue to gain in importance compared with the public-sector *Pfandbrief* and to remain a preferred funding tool of institutions in the future.

Volume of outstanding Pfandbriefe declines

The total volume of outstanding *Pfandbriefe* continued to fall in the year under review, as new issues were again more than offset by maturing ones. At the end of 2013, it stood at around €452.2 billion. The changes in volumes of outstanding *Pfandbriefe* in recent years and the increasing relative importance of mortgage *Pfandbriefe* are reflected in the following table 10 ("Volumes of outstanding *Pfandbriefe*"). At €246.0 billion at the end of 2013, the volume of outstanding public-sector *Pfandbriefe* still exceeded the volume of outstanding mortgage, ship and aircraft *Pfandbriefe*, which totalled €206.2 billion. The volume of outstanding public-sector *Pfandbriefe* has more than halved since 2007, however, while the volume of outstanding mortgage *Pfandbriefe* has remained largely stable.

4.3.3 Situation at the private commercial, regional and specialist banks

In the year under review, supervision of the private commercial banks was dominated by the

Table 10 Volumes of outstanding *Pfandbriefe*

Year	Mortgage *Pfandbriefe* (€ billion)	Public-sector *Pfandbriefe* (€ billion)	Total outstanding (€ billion)
2007	217.1	699.4	916.5
2008	217.9	620.6	838.6
2009	231.9	524.9	756.8
2010	231.3	444.4	675.7
2011	230.3	355.7	586.0
2012	223.8	301.1	524.9
2013	206.2	246.0	452.2

preparations for the new supervisory regime under the new capital rules (CRR/CRD IV/ Basel III). The capital requirements under the CRR pose a particular challenge for this group of institutions. Often, these credit institutions – some of which have been family-owned for generations – are still being operated in the legal form of a commercial partnership, for which the private banker's personal liability is a key feature and also the basis of commercial success. The specific features of their capital resources result in a fundamental need for adjustment in light of the newly formulated requirements in the CRR for both Tier 1 and Tier 2 capital, under which not only legacy items, such as the possible eligibility thus far of partners' unencumbered personal assets (section 64e of the KWG), cease to apply without any transition period, but above all certain contractual arrangements under commercial law as well. Within a short period, however, these can be brought into line with the new, principle-based own funds requirements. The process of adjustment and change has not yet been completed. In addition to general supervisory oversight, BaFin is also involved because, since June 2013, it has had to approve the issue of Common Equity Tier 1 instruments (Article 26 (3) of the CRR).

4.3.4 Situation at the *Landesbanks*

Earnings at the *Landesbanks* mostly improved year-on-year in 2013, but continue to be impacted by cuts in their business models. In addition, the institutions vary considerably in how they are working off their legacy liabilities. As a result, earnings remain depressed at most *Landesbanks*. They therefore continued to shorten their balance sheets considerably.

The rating agencies' evaluations were stable in the course of the year. However, the agencies have announced a review of the banking sector for 2014 and already pointed out that they will reassess the support provided by owners in light of the tighter EU state aid rules.

EU conditions and state aid proceedings

In the year under review, the *Landesbanks* implemented the conditions that the European Commission had attached to its approval of state aid in previous years.

At the request of HSH Nordbank, the *Länder* of Hamburg and Schleswig-Holstein restored their second-loss guarantee, which had been reduced from €10 billion to €7 billion in 2011, to the original amount of €10 billion as at 30 June 2013, thereby significantly strengthening the bank's capital ratios. The European Commission regarded this restoration of the guarantee as renewed state aid, provisionally approved it and opened an investigation. This investigation will focus mainly on the viability of the business model in light of the negative impact of the ongoing crisis in shipping markets and the fact that expenses for the guarantee premiums have increased again.

4.3.5 Situation at the savings banks

Despite a decline in net interest income, the savings banks achieved satisfactory results overall in financial year 2013. They gained market share both in retail and corporate banking. Net profit was roughly on a level with the previous year. The investment in the savings bank-owned Landesbank Berlin Holding, which had to be written down sharply for the fourth year in succession, had a negative impact again. The institutions were also affected by their clients' continued reluctance to invest in securities. Expenses for allowances for losses on loans and advances and risk provisioning in the securities business remain at a relatively low level. Following further additions to contingency and other reserves, the vast majority of the savings banks appear well placed to meet the increasing capital requirements under the CRR.

Low interest rate environment has a negative impact

Nevertheless, the comparatively positive results for 2013 should not hide the fact that earnings at the savings banks have been on a downward trajectory for several years. This is due mainly to the decline in net interest income. Looking to the coming years, sustained low interest rates

are therefore a cause of increasing concern. In particular, the liability-laden savings banks face the problem of having to replace maturing proprietary investments with lower-yielding securities. Given the current trend in interest rates, it is also becoming increasingly difficult to generate income from maturity transformation, an option used by many savings banks.

Largest savings bank under ECB supervision in future

Although the savings banks have average total assets of around €1 billion and only the larger banks in the eurozone member states are to be placed under the supervision of the ECB, the debate about the SSM has not passed the German savings banks by. With total assets of around €40 billion, Hamburger Sparkasse AG will be the only savings bank in Germany to be directly supervised by the ECB from autumn 2014 onwards together with its parent holding company HASPA Finanzholding.

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

The business environment remained difficult for securities trading banks and exchange brokers last year. Although the DAX rose to a record high in 2013, trading volumes did not recover to the same extent, as retail investors were still very hesitant. As a result, competitive pressures remained fierce. Continuing advances in exchange trading, the entry into the market of more algo traders and the expansion of alternative trading platforms are also contributing factors. For example, Deutsche Börse's fee model, which provides for a specialist service fee, resulted in a drop in income for the institutions previously active as lead brokers.

As in previous years, BaFin identified organisational weaknesses at several institutions, mainly in risk management and control, in the risk-bearing capacity concepts applied and in the documentation of transactions. BaFin has therefore expressly required the management and the supervisory boards of the institutions concerned to remedy those deficiencies.

Energy derivatives trading disappoints expectations

The turnover generated by energy derivatives traders authorised by BaFin again fell short of the institutions' original expectations in 2013. The European Energy Exchange (EEX) continued to expand and cement its role as a European energy exchange. Trading volumes on EEX account for only a proportion of the transactions executed, however. In light of the changes to clearing requirements under the European Markets Infrastructure Regulation (EMIR), market participants are expected to transfer more and more over-the-counter energy products to a collateralised, standardised environment guaranteed by a central counterparty. Interest in financial products remains relatively weak, however.

4.3.7 Situation at the building societies

As in the previous year, the situation at the building societies was impacted by sustained low interest rates in the year under review. Although both the number of new contracts and building savings volumes reached a high level, as they did in previous years, selling building savings loans remained difficult. Many building society savers shun building savings loans and instead take out loans offered by other providers of real estate finance on comparatively more attractive terms (see info box "Termination of building savings contracts in the low interest rate environment", page 100). Overall, therefore, building savings loans continue to decline as a percentage of the building societies' total lending volume.

4.3.8 Situation at the cooperative banks

Earnings at the cooperative banks improved year-on-year in 2013. Net profit reached €2.6 billion and was therefore 15% up on the previous year. This performance was mainly attributable to business expansion and cost savings. Despite a number of regulatory challenges and the ongoing period of low interest rates, 2013 was a satisfactory financial year overall. The primary institutions were therefore able again to recognise adequate provisions in the form of reserves.

Termination of building savings contracts in the low interest rate environment

For several years, building societies have been terminating building savings contracts which, measured by current interest rates, pay a high rate of interest. The press has reported on this practice on several occasions. Such terminations mostly affect building savings contracts where the building society saver's savings have already reached or even exceeded the contractually agreed savings amount. One feature of a buildings savings contract is that it is for a particular targeted savings amount. The contractual purpose of the building society savers' saving is to receive a loan on predetermined terms when a building savings contract meets the requirements for a loan to be granted. The amount of the loan is usually the difference between the targeted savings amount and the balance of the building society saver's savings account, after reaching a contractually agreed minimum savings amount.

Once the building society saver has saved the full targeted amount, there is no longer any scope to extend a building savings loan. In this case, the building societies usually terminate the building savings contract because – as they argue – it has failed to achieve its purpose. Civil-law rulings in recent years have confirmed this legal view.

Due to the excess supply of liquidity at low interest rates, the cooperative banks will generate lower income for the foreseeable future. Nevertheless, the profitability of the institutions in the cooperative sector is satisfactory. The reduction in interest income expected by the sector is being offset by the sharper fall in interest expenses during the same period. Net interest income therefore remains at a high level overall. As a result, the primary cooperatives were able to generate an adequate profit margin on net interest income despite an unfavourable yield curve and the resulting fall in income from maturity transformation. In addition, for almost ten years now, the cooperative banks have been chalking up clear successes on the cost management front, which has reduced their expenses significantly relative to their total assets. The stable economic situation, with employment rising and insolvency figures falling, is likewise supporting the cooperative banks' earnings. The cooperative banks' 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.

Regulatory challenges

Among other things, however, the new liquidity coverage ratio (LCR) and the increased own funds requirements under the CRR will place further foreseeable strains on the cooperative banking sector and institutions. Taken as a whole, these measures represent a considerable burden on the cooperative banking sector. In the area of interest rate risk, for example, this results from the substantial effort institutions must go to in order to meet the Basel II ratio. This ratio measures the impact of a sudden and unexpected change in interest rates of plus/minus 200 basis points on the present value of the interest rate portfolio so as to determine the change in present value in relation to own funds. By using hedging strategies, many credit institutions try to reduce interest rate risk and thus remain below the threshold for the Basel II ratio at which they draw the attention of banking supervisors.

Furthermore, in the event of a rapid rise in interest rates, institutions may suffer a decline in income from maturity transformation in future if they have a fixed long-term rate on the assets side (e.g. a fixed-rate mortgage) but short-term funding. This is due to the fact that, over a certain period, the institutions must pass on a smaller or larger proportion of the rise in interest rates to savers, but are unable to pass on the rise in interest rates in the same way to clients on the assets side of the balance sheet.

4.3.9 Situation at the finance leasing and factoring institutions

As in the previous year, the finance leasing and factoring sector faced a difficult economic environment, as the German industry continued to have a modest appetite for capital spending. In December 2013, the ifo Institute predicted that total capital expenditure in Germany will have fallen by around 0.6% year-on-year in 2013, but issued a positive forecast for 2014. At leasing and factoring institutions, this was reflected in new leasing business, which stagnated at around €48.5 billion. Factoring revenues increased noticeably compared with the previous year, according to surveys by the German Factoring Association (*Deutscher Factoring-Verband*). Taken as a whole, these financial services institutions once again managed to slightly increase their share of corporate finance compared with other forms of finance.

4.3.10 Situation at the payment and e-money institutions

Payment institutions and e-money institutions provide many different types of service. These range from remitting amounts accepted in cash in order to disburse them to recipients in third countries ("traditional" remittance business) through to payments business by operating payment accounts. The business carried on by these institutions also includes credit transfer and direct debit business as well as issuing and processing credit cards and e-money in various forms. However, payment services and e-money issuance are also among the traditional lines of business pursued by credit institutions, which are therefore in competition with the pure-play payment and e-money service providers. In Germany, payments business therefore continues to be operated almost exclusively by credit institutions.

In traditional remittance business for certain destinations, the dominance of US remittance groups with global operations is making business increasingly difficult for German niche providers. These groups maintain networks of agents through EU subsidiaries in Germany and offer remittances to almost every region of the world.

4.3.11 Foreign banks

Credit institutions belonging to a foreign group remain a mainstay of the German financial market. Most of the foreign institutions focus their business activities on lending, private banking, investment banking, or custodian bank operations. On the funding side, foreign banks continued to try hard to attract the bank deposits of German retail clients. At the end of 2013, four of the ten institutions with the highest volume of deposits were units of foreign groups. Due to legal reforms, unsecured lending to foreign group companies has been restricted since 2014. As a rule, unsecured lending is now only possible in an amount equal to the institution's own funds. Previously, institutions were able to make unrestricted use of the sometimes lower interest rates in Germany to provide liquidity to a foreign parent cost-effectively, for example through cash transactions, direct equity interests, or intragroup lending. In the case of foreign banks, BaFin's strategy is to conduct independent host supervision within the confines of the options assigned to it. Among other things, it requires subsidiaries and non-European branches to have separate risk management and monitoring processes. In addition, BaFin works closely together with the home supervisor to ensure that the German units are integrated into group-wide management processes. Finally, the home supervisor and BaFin regularly exchange views and information on the business performance and organisational deficiencies of foreign banks in supervisory colleges.

In the previous year, due to the importance of foreign banks for the German market, BaFin for the first time asked certain institutions to provide recovery plans, which it refined together with the institutions and discussed with the other competent supervisory authorities in the crisis management groups in 2013. Those affected include both institutions that are important for the functioning of the market due to their size and banks that

constitute an important part of the market infrastructure. In the event that one of those institutions experiences serious financial problems, the plans that have been drawn up are intended to enable the institution concerned to swiftlyrecover, while at the same time minimising the external impact.

4.4 Supervisory activities

4.4.1 Credit institutions

One excellent tool available to banking supervisors is the special audit, which has its legal basis in section 44 (1) sentence 2 of the KWG. In this context, BaFin distinguishes between requested audits, audits initiated by BaFin

Audit focus on remuneration practice

In 2013, BaFin conducted special audits into institutions' internal implementation of prudential remuneration requirements at a total of 15 institutions. The aim of the audit campaign was to examine whether remuneration systems had been appropriately designed and whether institutions had appropriately implemented the requirements of the Remuneration Regulation for Institutions (*Institutsvergütungsverordnung* – InstitutsVergV (old version)).

Ultimately, the remuneration systems of all the institutions audited exhibited what were in some cases substantial qualitative defects.[28] Deficiencies were found, among other things, in how risk takers are identified at major institutions, how employee bonuses are determined and how payment restrictions are dealt with.

Twelve of the institutions audited have been defined as major within the meaning of the InstitutsVergV. Shortcomings were found at all twelve in relation to how risk takers were identified. Often, there was no comprehensive, regularly updated and appropriately documented risk analysis. In several cases, BaFin also found fault with the criteria used in the risk analysis, which served as the basis for identification. Two other institutions had classified themselves as "not major", although the classifications were based on poor-quality risk analyses.

At several of the institutions audited, there was no guarantee that the remuneration systems were aligned with the institutions' strategies and the associated objectives.

In addition, the assessment periods for determining the variable remuneration of senior managers and risk takers were unsatisfactory in many cases.

The parameters that the institutions used to determine the variable remuneration were insufficient in several cases. Significant deficits were also revealed in the institutions' systematic examination of the extent to which the total variable remuneration could be reconciled with the need to ensure an adequate capital base.

The main problems in terms of payment restrictions were the lack of appropriate criteria for reducing the retained variable remuneration ("malus" triggers). For example, some institutions defined criteria or thresholds in such a way that an examination of whether a malus was necessary would only take place in the event of extremely adverse developments or serious individual misconduct. In addition, the assessment periods for determining the variable remuneration component for risk takers and senior managers were frequently inadequate.

With regard to the amended version of the InstitutsVergV, which entered into force on 1 January 2014, BaFin found that only four institutions already complied with the 100% cap on the ratio of the variable remuneration component to the fixed remuneration component at the time of the audit. At seven further institutions, the ratio of fixed to variable remuneration would only have been permitted under the new law if an increase in the maximum amount to 200% of the fixed remuneration had previously been approved.

28 One audit had not yet been fully analysed at the time of going to print.

and scheduled audits. In the first case, BaFin conducts the audit at an institution's request. These audits primarily include acceptance tests for institutions' internal risk measurement procedures, 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. Scheduled audits comprise 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.

Special audits in 2013

The banking supervisors continued to perform extensive audit activities in 2013. Of the total of 305 special audits (previous year: 273), 220 were initiated by BaFin, compared with 187 in the previous year. A total of 94 audits initiated by BaFin were conducted for a specific reason; the remaining 126 cases were scheduled examinations. In addition, there were 67 requested special audits (previous year: 66) and 18 statutory cover audits (previous year: 20).

Table 12 ("Breakdown of special audits in 2013 by groups of institutions") shows a breakdown of the audits by groups of institutions. The groups of institutions it lists also comprise their respective central banks; the *Landesbanks* belong to the savings bank sector, while DZ Bank and WGZ Bank belong to

Table 11 Breakdown of special audits by area of emphasis

As at 31 December of the respective year

	2013	2012
Impairment-related special audits	38	33
Section 25a (1) of the KWG (MaRisk)	182	154
Cover	18	20
Market risk models	7	7
IRBA (credit risk measurement)	58	54
AMA (operational risk measurement)	2	4
Liquidity risk measurement	0	1
Total	**305**	**273**

Table 12 Breakdown of special audits in 2013 by groups of institutions

As at 31 December 2013

	Commercial banks	Savings bank sector	Cooperative sector	Other institutions
Impairment-related special audits	1	4	28	5
Section 25a (1) of the KWG (MaRisk)	48	41	75	18
Cover	3	10	0	5
Market risk models	3	2	2	0
IRBA (credit risk measurement)	28	9	2	19
AMA (operational risk measurement)	2	0	0	0
Liquidity risk measurement	0	0	0	0
Total	**85**	**66**	**107**	**47**
Audit ratio in % (excluding cover audits)	**26.6**	**10.6**	**9.5**	**18.1**

the cooperative sector. The "Other institutions" group includes, for example, the former mortgage banks, building societies, 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.

Risk matrix as an element of risk-based supervision

Combining the audit figures with the classifying risk matrix reveals that the special audits were risk-based. Table 13 ("Breakdown of special audits initiated by BaFin in 2013 by risk class") 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.

The more critical BaFin's rating of an institution's quality, the greater its need to examine the facts in detail. Accordingly, roughly one in three problematic D-rated institutions became the subject of an audit initiated by BaFin. The proportion of audits at banks with high systemic importance was 109.3% and therefore significantly higher than in the previous year (92.3%).

In 2013, audits were again conducted at institutions which BaFin rates 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 6.4% in the year under review.

Supervisory law objections and sanctions

In the year under review, the results of special audits and requests for information in particular resulted in 178 supervisory law objections and sanctions. The figures are not comparable with the prior-year data, as BaFin was able to use an amended and partly extended list of sanctions in the year under review. Table 14 ("Supervisory law objections and sanctions in 2013", page 105) shows a breakdown of the objections and sanctions by groups of institutions.

Use of IRBAs

As at 31 December 2013, 49 institutions and groups of institutions were using internal securitisation rating systems and assessment approaches (IRBAs) to calculate their capital requirements for counterparty risk. 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

Table 13 Breakdown of special audits initiated by BaFin in 2013 by risk class

As at 31 December 2013

Special audits initiated by BaFin		Quality of the institution*				Total	Institutions in %**
		A	B	C	D		
Systemic importance	High	1	6	36	4	47	109.3***
	Medium	8	18	7	8	41	20.3
	Low	45	63	19	4	131	8.4
	Total	**54**	**87**	**62**	**16**	**219******	**12.0**
	Institutions in %**	**6.4**	**12.3**	**28.7**	**32.0**	**12.1**	

* 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 audits.
*** Some institutions with high systemic importance were audited more than once.
**** One audited institution does not currently have a risk classification.

Table 14 Supervisory law objections and sanctions in 2013

As at 31 December 2013

Type of sanction			Group of institutions				
			Commercial banks	Savings bank sector	Cooperative sector	Other institutions	Total
Substantial objections/letters			14	31	70	1	**116**
Sanctions against managers	Dismissal requests	Formal	0	0	0	0	**0**
		Informal	0	0	1	0	**1**
		By third party	0	0	0	0	**0**
	Cautions		4	0	2	2	**8**
Sanctions against supervisory/ administrative board members	Dismissal requests	Formal	0	0	0	0	**0**
		Informal	0	0	0	1	**1**
		By third party	0	0	0	0	**0**
	Cautions		0	0	10	0	**10**
Sanctions related to own funds/liquidity, exceeding the large exposure limit (sections 10, 13 and 45 of the KWG)			10	9	0	1	**20**
Sanctions in accordance with section 25a of the KWG			8	1	0	0	**9**
Sanctions in accordance with sections 45, 45b and 46 of the KWG*			8	0	4	1	**13**
Total			**44**	**41**	**87**	**6**	**178**

* 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).

loss given default and conversion factor as well (advanced approach). Of the 49 IRBA institutions, 18 used the advanced IRBA on a group or individual basis.

Use of AMAs

At the end of 2013, 15 institutions and groups of institutions used an Advanced Measurement Approach (AMA) for operational risk. BaFin was responsible for the approval procedures in seven cases as home supervisor and in eight cases as host supervisor. The 15 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 sector.

BaFin performed follow-up audits or audits of model revisions at several AMA institutions in the year under review. During these audits, BaFin took action in particular to ensure that the institutions improve their procedures and models for legal risks.

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

Authorisation of internal market risk models

At the end of 2013, 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: 11, see table 15 "Risk models and factor ranges", page 106).

Offshore leaks

In April 2013, the International Consortium of Investigative Journalists set up a research project (Offshore Leaks) in an effort to expose the flight of capital to tax havens. German journalists are also involved in this project, in particular analysing data on money flows from German credit institutions to offshore financial centres. The media reports published to date have often theorised that the purpose of moving capital to offshore locations is primarily to evade taxes and carry on money laundering. It is regularly the case that BaFin is already aware of German credit institutions' business activities in offshore locations through its ongoing supervision. In principle, it is not a concern from a supervisory perspective if German credit institutions conduct business in offshore locations, provided they observe German laws and supervisory requirements in doing so.

To establish whether, in specific cases, offshore activities were in breach of legal provisions, BaFin had been selectively carrying out surveys at German credit institutions and taking further supervisory measures such as special audits since as far back as 2009.

In summer 2013, BaFin again made a cross-institution request for information at selected institutions in order to gain an overview of German banks' business activities in certain offshore jurisdictions. The main focus of the request for information was on the type of business conducted locally and the income generated from it. In some cases, BaFin discussed the findings of the investigations in in-depth talks with individual institutions. Ultimately, however, there was no indication that German institutions were conducting improper business across the board.

Table 15 Risk models and factor ranges

Year	New applications	Applications withdrawn	Rejections	Number of model banks	Minimum add. factor*	Maximum add. factor*	Median
1997	5	0	2	3	–	–	–
1998	15	2	4	9	0.1	2.0	1.45
1999	5	0	0	8	0.1	1.6	0.85
2000	2	0	0	10	0.0	1.6	0.30
2001	2	0	0	13	0.0	1.5	0.30
2002	1	0	0	14	0.0	1.0	0.25
2003	0	0	0	15	0.0	1.8	0.20
2004	1	1	0	15	0.0	1.0	0.30
2005	2	1	0	16	0.0	1.0	0.25
2006	0	1	0	15	0.0	1.0	0.2
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
2013	0	0	0	11	0.0	1.2	0.4

* Including additional factors effective as at 31 December 2013. Excluding the additional factor component due to backtesting exceptions in accordance with section 318 (2) of the SolvV (backtesting or quantitative additional factor; in accordance with Annex 1, Table 25 of the SolvV, this factor can be between 0.0 and 1.0).

The number of backtesting exceptions rose from four in the previous year to seven in 2013. The number of exceptions therefore remains at a low level after being much higher in 2011 (39) and 2010 (22).

In the year under review, the *Deutsche Bundesbank* carried out a total of six follow-up audits of internal market risk models.

4.4.2 Financial services institutions

In 2013, BaFin participated in 145 audits at financial services institutions (previous year: 135) and conducted 131 supervisory interviews with senior managers or management board members (previous year: 139). Thirty-nine authorisations held by financial services institutions ended (previous year: 45), in most cases because they were returned.

Opening of insolvency proceedings

In the year under review, BaFin applied for insolvency proceedings to be opened for three financial services institutions. In one case, the application was made with the approval of the institution concerned due to the threat of insolvency, as its principal client had terminated the business relationship and the institution's parent was no longer prepared to provide the necessary financial resources. In another case, an application was made for insolvency proceedings to be opened due to overindebtedness and insolvency, as the parent had placed itself under creditor protection through protective shield proceedings and the liquid assets were in the cash pool managed by the parent.

In the third case, the institution, Dr. Seibold Capital GmbH, which had already been cautioned in 2012 due to breaches of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG) and the Banking Act (*Kreditwesengesetz* – KWG), had returned its authorisation. After the portfolio manager's liquidation failed, BaFin applied for insolvency proceedings to be opened due to the threat of insolvency. In addition, BaFin declared a compensation event in accordance with section 5 (1) sentence 1 of the Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz* – EAEG). BaFin had learned that the institution was under the suspicion of not having settled liabilities to a client arising from securities transactions. There are indications that the manager of the institution did not leave the proceeds from the sale of a client's financial instruments in the settlement account or use them to purchase another financial instrument, as agreed, but transferred them to himself.

Investigations at a larger liability umbrella

In November 2013, the public prosecutor's office in Dresden also searched a larger liability umbrella (*Haftungsdach*), Infinus AG, during a nationwide raid on various companies and individuals. A liability umbrella is an enterprise that accepts liability for tied agents. Following the measures taken by the public prosecutor's office, the number of tied agents decreased.

BaFin is not expected to have to declare a compensation event. Presumably, this will not even change in the event that insolvency proceedings are opened in respect of the assets of Infinus AG Finanzdienstleistungsinstitut. The investors concerned made the payments for the order bonds brokered by the institution directly into the bank accounts of the issuers (Future Business KGaA and others) indicated on the subscription forms. Further information about questions frequently asked by investors are contained in an overview of frequently asked questions about INFINUS AG, a financial services institution of the Future Business Group.[29]

Administrative fine for breaches of the KWG

BaFin imposed fines totalling €20,000 on one financial services institution that had failed to submit the annual financial statements prepared for 2009 to BaFin and the *Bundesbank* in good time. The managing director also had to pay a fine totalling €20,000, as he had not reported

29 See www.bafin.de/dok/4657796 (only available in German).

in good time that, in two cases, a person had commenced activity as a manager and that, in one case, a person had commenced activity as an administrative board member.

Leasing and factoring institutions

In 2013, BaFin and the *Deutsche Bundesbank* paid particular attention to the quality of the reports on the audits of the annual financial statements of medium-sized finance leasing and factoring institutions. To improve communication with the auditors of the annual financial statements, a procedure was established for written feedback on the reports on the audits of the annual financial statements so as to convey the areas of emphasis of the reports required under supervisory law. In addition, the Chamber of Public Accountants (*Wirtschaftsprüferkammer*) organised two open workshops for public accountants together with the *Bundesbank* and BaFin so as to exchange views and discuss any issues about which there was uncertainty.

When supervision of finance leasing and factoring institutions was introduced, there were institutions belonging to the sector with dubious, sometimes even criminal business models based on criminal offences such as fraud or breach of fiduciary duty, for example. Through systematic intervention, it was possible to block those enterprises' access to the market. BaFin is still cooperating closely with the criminal prosecution authorities so as to help them deal with such cases at a criminal law level. In future, BaFin will continue to take vigorous action against dubious business models and if necessary involve the competent criminal prosecution authorities.

Measures and proceedings

In eight cases, BaFin cautioned managers of a finance leasing or factoring institution or sent them letters of disapproval. In the same period, Group V institutions provided notification of their intention to appoint managers or holders of general commercial power of attorney in 131 cases and of their intention to appoint supervisory board members in 81 cases. In such cases, BaFin checks whether the persons in question are reliable and adequately qualified.

In the year under review, BaFin initiated 69 holder control procedures in accordance with section 2c of the KWG in conjunction with the Holder Control Regulation (*Inhaberkontrollverordnung* – InhKontrollV), under which prospective purchasers had provided notification of their intention to purchase a qualifying holding in a Group V institution. In these proceedings, which have to be completed by a certain deadline, among other things BaFin is required to build up a comprehensive picture of the integrity and aims of the potential purchaser and to check the existence and origin of the funds used to make the purchase.

4.4.3 Payment institutions and e-money institutions

The year under review was the second full financial year in which payment institutions were under supervision in accordance with the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG). In some cases, weaknesses in risk management were identified that could not be suspected from the documents used to apply for authorisation. BaFin conducted supervisory visits and supervisory interviews in order to become better acquainted with the institutions. A special audit was ordered at one institution, and BaFin instructed another institution on how to comply with the safeguarding requirements aimed at protecting client money.

The risk-based money laundering requirements must be observed when issuing and distributing e-money. To ensure equal treatment of e-money distributed in Germany, BaFin also closely analyses the distribution channels of cross-border credit and e-money institutions, as even if the issuing institution operates across borders, distribution in Germany must meet the country's anti-money laundering requirements.

Payment agents

In addition, BaFin carries out anti-money laundering supervision of payment agents

that operate in Germany on behalf of a foreign payment institution. As there are no statutory notification and submission requirements, the audits on the basis of the ZAG are usually the only suitable source of information (see section 26 (4) of the ZAG in conjunction with section 14 (1) sentence 2 of the ZAG). In 2013, BaFin ordered a total of 237 such audits at payment agents, but it was only able to carry out 66 of those audits. One of the main reasons for this is still the registers kept by the payment institutions' home supervisors. Their entries are often not up-to-date. For example, BaFin was unable to carry out 100 planned audits because the payment agents in question were not operating, were no longer operating, or had never operated at the address given despite the entry in the register. The supervisors were unable to carry out 71 audits for other reasons, for example because the payment agent was temporarily absent.

As in previous years, 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. BaFin initiated a total of 46 administrative fine proceedings against payment agents in 2013, 15 of which were concluded with final and non-appealable decisions. BaFin also brought to a close a further ten proceedings from previous years with final and non-appealable decisions. Nevertheless, it was found that the foreign payment institutions have adapted both the IT systems made available to agents and the training systems they use to train payment agents on the basis of the audits conducted by BaFin. These changes helped to improve legal compliance.

More suspicious transaction reports in accordance with the GwG

In 2013, the number of suspicious transaction reports in accordance with sections 14 and 11 of the Money Laundering Act (*Geldwäschegesetz* – GwG) increased sharply year-on-year to a total of 66 compared with just eight suspicious transaction reports in the previous year.

Besides the larger number of audits at payment agents, this was also due to changes to the evaluation methods. In the course of its supervisory activities in 2013, BaFin also filed three criminal complaints due to breaches of section 31 (1) of the ZAG and section 267 of the Criminal Code (*Strafgesetzbuch* – StGB).

E-money agents

Two types of distribution assistant are distinguished in the distribution of e-money: besides e-money agents (section 1a (6) of the ZAG), there are also the 2c agents (obliged entities pursuant to section 2 (1) no. 2c of the GwG). These are enterprises and individuals that distribute and/or redeem e-money on behalf of – mostly foreign – credit institutions. Both e-money and 2c agents are only obliged under the GwG, meaning that BaFin primarily checks whether these agents meet anti-money laundering requirements. In 2013, the supervisory focus was on 2c agents.

BaFin ordered a total of 42 audits at e-money and 2c agents in the year under review, 22 of which could be carried out. BaFin was unable to enforce the remaining 20 audit orders for the same reasons as at the payment agents. The main impediment, therefore, was incomplete or inaccurate information in the register entries kept by the home supervisors in question. All audits carried out by the supervisors at 2c agents showed that these individuals were only very insufficiently informed about and aware of the money-laundering risks associated with the products being distributed and their specific features. They did not fully comply with anti-money laundering obligations. Almost all audits led to objections. Another significant finding of audits into the distribution of e-money and subsequent extensive investigations was that e-money is increasingly being distributed by natural and legal persons in their own name and outside regular distribution channels. The resulting secondary market for e-money poses considerable money-laundering risks. Not least, this may encourage financial crime.

4.4.4 Account information access procedure in accordance with section 24c of the KWG

Credit institutions, asset management companies and payment institutions are required by section 24c (1) of the KWG to keep a file in which certain account master data, such as the account number, name and date of birth of account holders and authorised users and the date of opening and closure, are stored. BaFin may request individual items of data from this file insofar as this is necessary to fulfil its supervisory functions. Upon request, BaFin also provides information from the account information access file to the authorities named in section 24c (3) of the KWG. The number of requests rose by 7% year-on-year. The average time taken to process a request for account information was still around two weeks. Most account information was again requested for the police authorities.

In the case of ten credit institutions, BaFin examined on site the quality of the data required to be held for automated account information access. As in the previous year, the most frequent source of error when opening an account was the failure to capture names in full or exactly during the authentication check. Occasionally, BaFin's findings were more serious, for example if authorised users were reported whose authorisation to use the account had expired more than three years ago. Overall, however, it can also be seen that the institutions have drawn up adequate work instructions on how to capture data correctly and given them appropriate consideration in their internal control systems.

Table 16 Requests for account information in 2013

As at 31 December of the respective year

Account information recipients	2013		2012	
	absolute	in %	absolute	in %
BaFin	1,218	1	992	0.9
Tax authorities*	13,397	10.9	13,286	11.6
Police authorities	75,296	61.4	68,066	59.5
Public prosecutors	25,434	20.7	24,629	21.5
Customs authorities*	7,052	5.7	7,207	6.3
Other	267	0.2	184	0.2
Total	**122,664**	**100****	**114,364**	**100**

* Tax and customs authorities are only authorised to request account information from BaFin in accordance with section 24c of the KWG in connection with criminal proceedings.

** Deviations in the total figures are due to rounding differences.

5 Market supervision

5.1 Employee and Complaints Register

BaFin has been keeping the Employee and Complaints Register since November 2012. A total of 161,728 investment advisers, 26,135 sales officers and 2,337 compliance officers were entered in the Register at the end of 2013. Some employees were working both as an investment adviser and as a sales officer. The exact breakdown is shown in the following table 17 ("Data on the Employee and Complaints Register", page 111).

Interviews with investment advisers

Investment services enterprises must report each complaint, regardless of whether it is founded or unfounded. The complaints are initially entered in the Employee and Complaints Register as a mere number. As a result, the number of complaints per group of institutions, investment services enterprise, or investment adviser cannot be used as the sole indicator of an irregularity at an investment services enterprise. A cluster of complaints does not at first glance indicate whether this

Table 17 Data on the Employee and Complaints Register

As at 31 December 2013

	Investment advisers	Sales officers	Compliance officers	Complaints
Private commercial and foreign banks	50,360	8,742	113	4,019
Savings banks/*Landesbanks*	63,342	9,616	426	3,234
Cooperative banks	42,506	7,334	1,052	2,246
Financial services providers	5,520	443	746	221

stems from the regional focus of business, a particularly large number of clients, or an actual irregularity, for example.

BaFin selectively investigated any cluster of complaints and to this end conducted 230 on-site interviews with 1,303 investment advisers and sales officers. In doing so, it examined specific complaints and also probed the investment advisers' expertise as required by law. Regardless of the size of an investment services enterprise or whether it belonged to the savings bank, the cooperative, or the private commercial banking sector, it was found that the advisers generally had the necessary expertise and advised investors appropriately. Occasionally, however, employees were not able to adequately explain the financial instruments being recommended, had not given clients sufficient information about the risks associated with the investment, or had not satisfactorily documented the advice and recommendation. BaFin took action at the institutions concerned to ensure that they remedied these weaknesses without delay. This was done, for example, by raising awareness among the employees concerned and giving them additional training and by the institutions stepping up their internal controls.

If an enterprise breaches the requirements of the Employee and Complaints Register (under section 34d of the WpHG), BaFin may issue cautions, administrative fines and, as a last resort, temporary prohibitions on employment. BaFin has not yet had to make use of these sanctioning options, however. It clarified shortcomings with the investment advisers, sales officers, compliance officers, or managers of investment services enterprises and suggested improvements, whereupon the institutions remedied the identified weaknesses without delay.

Unsuitable recommendations

Due to clusters of complaints, BaFin identified systematic errors in the provision of investment advice at several institutions. Recommended financial instruments were not compatible with the risk appetite specified by the client. The products were investment funds invested to a larger extent in equities, foreign-currency bonds, or non-investment grade bonds. The institutions also recommended those investment funds to investors who wished to invest in bond funds or similar securities without any foreign currency risk.

BaFin examined executed transactions in detail and the related internal bank processes based on random sampling. It found that the investment funds recommended were not suitable for every buyer. The investment services enterprises concerned therefore spoke to their clients about the difference in the investment objectives and clarified with each one whether they nevertheless wished to keep the financial instrument or withdraw from the purchase. The institutions also took measures to prevent clients being recommended unsuitable financial instruments by revising the processes used to classify financial instruments.

5.2 Investment advice minutes

The information in the investment advice minutes enables BaFin to understand what the client and the investment adviser discussed during the consultation. It is important, therefore, that the minutes contain as much information as possible. Only in this way can BaFin establish whether the adviser's recommendations regarding particular financial products are suitable for the client.

In 2013, BaFin examined 2,289 sets of investment advice minutes as part of its supervisory activities. In addition, the investment advice minutes are among the standard documents required if BaFin investigates clusters of complaints in the Employee and Complaints Register. This is because the investment advice minutes are the only way for BaFin to build up a picture of what was discussed during the consultation and thus central to its examination of the suitability of an investment recommendation.

The audits showed that the quality of the minutes continued to increase year-on-year. Some institutions now require their employees to use free text fields instead of pre-prepared text blocks so as to better illustrate the individual consultation. Free text fields make what was actually said and took place clearer to both BaFin and the clients themselves. Investors should therefore read through the minutes carefully, compare the content with the actual consultation and insist that all the information important to them is included in the minutes.

In 2013, investment advice minutes were often said to be responsible for the fact that the advisory business of investment services enterprises had declined. BaFin spoke with market participants about this allegation and established that the question of whether an institution offers investment advice or intends to withdraw from providing it depends on a number of business decisions and market conditions. The statutory documentation requirement is just one aspect here. Nevertheless, BaFin will continue to monitor the decline in advisory business.

5.3 Other focal points of supervision

In 2012 and 2013, BaFin had gained an overview of the practices of investment services enterprises in outsourcing the compliance function to external service providers. It did not find any evidence of generally inadmissible or unsuitable systems, but did identify deficiencies in the preparation, agreement and monitoring of outsourcing arrangements. In particular, the individual risk analyses and organisational, monitoring and management systems required at the outsourcing institutions and their external service providers under the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk) and the Minimum Requirements for the Compliance Function (*Mindestanforderungen an die Compliance-Funktion* – MaComp) were adversely affected by limited cost budgets and IT systems. As a result, the compliance function was of inadequate quality in some cases.

The investment services enterprises concerned were required to remedy these deficiencies in the organisation of the compliance function. BaFin will also incorporate the findings of its reviews into the MaComp rules on outsourcing and adapt these accordingly.

Sales guidelines and sales officers

The term "sales guidelines" was defined in law upon the introduction of the Act to Increase Investor Protection and Improve the Functioning of the Capital Markets (*Anlegerschutz- und Funktionsverbesserungsgesetz* – AnsFuG) in 2011. The AnsFuG requires investment services enterprises to design, implement and monitor their sales guidelines in such a way that client interests are not adversely affected – for example by maintaining organisational arrangements. In addition, the obligation to report sales officers to the Employee and Complaints Register was incorporated into the WpHG.

This amendment triggered a number of interpretation-related questions at the institutions concerned, prompting BaFin to combine and answer the most frequently asked questions

together. These FAQs are published on BaFin's website.[30]

Cooperation with the IdW and auditors

In November 2013, BaFin held its annual meeting with the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer in Deutschland e.V.* – IdW). On the agenda were an exchange of experience related to the past audit season and a look forward to the coming audit season. Among other things, BaFin explained its expectations in connection with new supervisory requirements, such as the list of inducements and inducement applications.

At the end of 2013, a meeting was also held with the cooperative auditing associations and the auditing bodies of savings banks and giro associations. The focus here was on initial experience of the changes to the Investment Services Examination Regulation (*Wertpapierdienstleistungsprüfungsverordnung* – WpDPV), which entered into force on 1 June 2013. Items under discussion included the question of how to determine the number of employees attributable to the compliance function, which has recently been required to be included in the report.

Annual audits by engaged auditors

During the 2013 audit season, BaFin had the annual WpHG audit carried out at 16 institutions (14 credit institutions, two financial services institutions) by auditors it had engaged. BaFin selected the institutions according to risk-based criteria based on random sampling. BaFin will analyse the audit reports systematically and decide whether audits are to be carried out by engaged auditors in the coming years as well.

5.4 Rules of conduct for financial instruments analysis

At the end of 2013, BaFin was supervising a total of 315 credit and financial services institutions that either produced their own research or acquired third-party reports for their clients or for public dissemination (previous year: 297).

The trend already in evidence in recent years for institutions to discontinue investment research in favour of buying it in continued in 2013. As the legal requirements on persons who merely disseminate investment research are significantly lower than those on those who produce it, institutions can save a considerable amount of costs due to the low regulatory burden. The investment research bought in was in some cases produced by investment services enterprises or independent financial analysts that had notified BaFin of their activities in accordance with section 34c of the WpHG. The purchasers of the research then disseminated it to other institutions, institutional investors and retail clients, just as they did previously with the investment research they produced themselves.

In addition, 169 independent natural or legal persons who had notified BaFin of their activities in accordance with section 34c of the WpHG were subject to supervision by BaFin (previous year: 159).

One focus of the enquiries received by BaFin in 2013 regarding activities that are required to be reported were "signal providers" and automated trading systems based on technical analysis models.

5.5 Administrative fines

BaFin initiated 33 new proceedings because investment services enterprises had breached the rules of conduct, organisation and transparency (previous year: 29). It also concluded seven proceedings by imposing an administrative fine (previous year: 7). BaFin discontinued eight proceedings, four for discretionary reasons.

In the year under review, BaFin initiated 15 new proceedings against institutions that had failed to draw up investment advice minutes or to provide them to their clients in a timely manner or at all (previous year: 20). It imposed three

30 See www.bafin.de/dok/4252718 (only available in German).

administrative fines of up to €10,000. All cases involved a breach of the duty of supervision, as the employees responsible at the investment services enterprises had not taken sufficient precautions to prevent such breaches. BaFin discontinued four proceedings, one for discretionary reasons. Thirty-one cases were still pending at the end of 2013.

Furthermore, BaFin imposed a fine of €10,000 on one investment services enterprise that had failed to notify BaFin of the annual auditor before issuing the audit engagement.

BaFin imposed a fine of €3,500 on one enterprise that had published investment research on the Internet without notifying BaFin of its investment research activities beforehand.

IV Supervision of insurance undertakings and pension funds

1 Bases of supervision

1.1 Solvency II

The Solvency II Directive[1] introduces a new pan-European supervisory regime. It is the largest Europe-wide reform of insurance supervision in recent decades. Both supervisors and insurance undertakings must be able to identify risks at an early stage. Solvency II's new risk-based approach is designed to enable exactly this. The new framework is expected to come into force on 1 January 2016 now that the trialogue parties (the European Commission, the Council and the Parliament) have reached an agreement on Omnibus II. See figure 11 on page 117 for the legislative process that will now follow.

1.1.1 Omnibus II

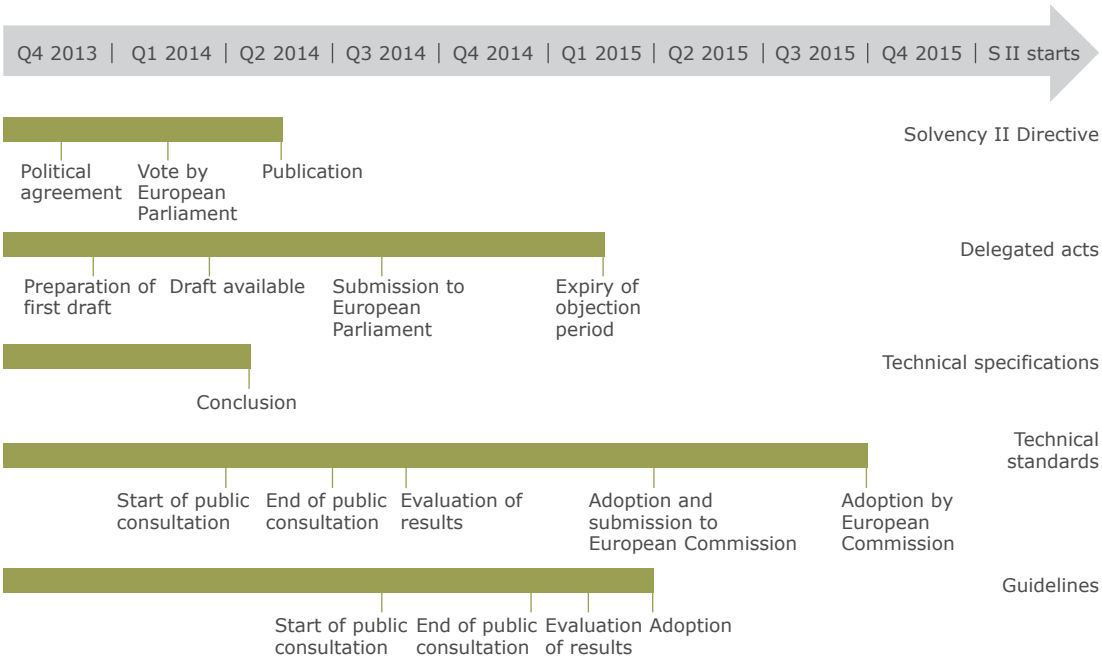
The trialogue parties reached an agreement on the Omnibus II Directive, which amends the existing Solvency II Directive, on 13 November 2013. The amendment is necessary to define the functions and rights of the European Insurance and Occupational Pensions Authority (EIOPA) within the scope of the Solvency II framework and to reflect the changes to the European legislative process introduced by the provisions of the Lisbon Treaty.

Under the Omnibus II Directive, EIOPA's powers to develop technical standards will be expanded to more areas of the Solvency II Directive than initially envisaged. One example of this is the technical standard on decision-making processes and calculating or lowering loss absorbency requirements (see figure 11 "Legislative process up to the implementation of Solvency II", page 117).[2] In addition, the Directive sets out EIOPA's specific duties in greater detail, such as regularly publishing technical information on the calculation of provisions. It also makes EIOPA responsible for resolving disagreements, particularly with respect to group supervision. EIOPA can now also be called on in cases in which clear final decision rules were previously provided for solo

1 Directive 2009/138/EC, OJ EU L 335, p. 1 ff.

2 Some powers had already been conferred under the Omnibus I Directive (Directive 2010/78/EU, OJ EU L 331/120, p. 1 ff.).

Figure 11 Legislative process up to the implementation of Solvency II



Key: Q – Quarter

Source: BaFin

or group supervisors. Furthermore, the powers conferred on the European Commission under the Solvency II Directive, which are still based on the legal position of the Treaty of Nice, were brought into line with the Lisbon Treaty. The European Commission has the right to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union (TFEU) and implementing acts in accordance with Article 291 of the TFEU.[3]

As part of their negotiations on the Omnibus II Directive, the trialogue parties made content-related changes to and agreed on the details of a Long-Term Guarantee (LTG) Package. The package had previously been reviewed in the long-term guarantees assessment (see info box "Long-term guarantees assessment", page 118). This package of measures sets out how insurance undertakings should treat their long-term guarantees business from the point of view of the supervisor. The LTG package provides for an early extrapolation of the risk-free interest rate curve for measuring provisions and the option of applying a matching adjustment to that curve in the case of matched portfolios. Matched portfolios are defined as an investment portfolio to which certain policies and obligations are allocated. In addition, a volatility adjustment aims to mitigate procyclical effects in the case of rising spreads in the financial markets. The LTG package contains transitional measures on the evaluation of provisions for a smoother transition to the new solvency regime. It also extends the recovery period for covering solvency capital requirements in exceptional situations.

The Quick Fix II Directive[4] entered into force on 19 December 2013 once agreement was reached on the Omnibus II Directive. It postpones the date by which the member states must transpose the Solvency II Directive into national law to 31 March 2015 and sets 1 January 2016 as the starting date for the new supervisory regime.

1.1.2 Preparations for Solvency II

BaFin will continue to prepare for the requirements of the new supervisory regime with its internal Solvency II project, which was launched

3 These replace the previous implementing measures.

4 Directive 2013/58/EU OJ EU, L 341, p. 1 ff.

Long-term guarantees assessment

The long-term guarantees assessment (LTGA) conducted by EIOPA in 2013 addressed the content of the package of measures proposed by the trialogue parties in the Omnibus II negotiations, which aims to resolve the issues surrounding the measurement of long-term obligations under Solvency II. The background is that the current low interest rate environment means that the introduction of valuation models based on market values are problematic for insurance undertakings, which have given their customers long-term interest guarantees.

The study was designed to show how the various planned measures affect the following goals: consumer protection, effective and efficient supervision, financial stability, solvency, competition and long-term investment. It also aims to highlight the incentives for good risk management and indicate the cost of implementation.

The undertakings conducted a study containing both quantitative and qualitative elements at the beginning of 2013. BaFin coordinated the process for the German market by validating and analysing the results together with EIOPA. From BaFin's point of view, the study showed that the "interest rate transitional", a transitional requirement to use the yield curve for discounting, is the most effective instrument for adapting the Solvency II valuation model to the specific features of the long-term guarantees business.

In addition to the report submitted by EIOPA to the Commission in July 2013, BaFin published the results relevant to the German market.[6]

in 2011, as well as other measures.[5] It will also take further preparatory measures resulting from parts of Solvency II being fast-tracked.

EIOPA Guidelines

In response to the postponement of the implementation of Solvency II until 1 January 2016, EIOPA published preparatory guidelines on 31 October 2013 following a three-month public consultation.

The requirements for the system of governance, the forward-looking assessment of own risk (FLAOR, see info box "ORSA/FLAOR"), reporting

ORSA / FLAOR

The EIOPA Guidelines pull forward elements of ORSA (own risk and solvency assessment), which is part of Solvency II. In the ORSA, undertakings assess all own risks specific to their business and calculate the resulting capital requirements over a forward-looking, multi-year horizon. The undertakings must explain the impact of their strategic decisions on their future capital requirements. The ORSA thus establishes a stronger link between risk and capital management.

EIOPA is fast-tracking part of the practical implementation of Solvency II during the preparatory phase: the "forward looking assessment of own risk" (FLAOR) by the affected undertakings and groups. In the first step, all undertakings will be required to conduct a forward-looking assessment of their own risks in 2014. Some undertakings will be implementing the other two elements in 2015. They report the results of their assessment to the supervisory authorities.

5 See 2012 Annual Report, p. 84 f.

and the pre-application phase for internal models are therefore now available in all of the official languages of the European Union. The guidelines are aimed at national supervisory authorities and have been applicable since 1 January 2014. They serve to ensure that undertakings and supervisory authorities adopt a uniform approach to preparing for the new requirements in those parts of Solvency II that are not yet significantly affected by the Omnibus II Directive or by the delegated acts for the Solvency II Directive.

BaFin is also planning a voluntary test run of quantitative and narrative Solvency II reporting from mid-2015. The aim is for the undertakings to submit to BaFin the same information they will report on an annual and quarterly basis in future.

The "comply or explain" mechanism was set in motion by the publication of the preparatory guidelines. Within the scope of this mechanism, national supervisory authorities such as BaFin were required to inform EIOPA whether they intended to apply each EIOPA Guideline or not within two months.

BaFin's gap analysis

BaFin informed EIOPA that it either already applies or intends to comply with all preparatory guidelines. BaFin will modify its existing administrative practice where necessary and possible.

BaFin conducted a gap analysis before the preparatory guidelines were adopted to determine which guidelines are already applicable under current German legislation. This allowed BaFin firstly to prepare its responses to EIOPA's comply or explain question and, secondly, to determine how to put these guidelines into practice. Supervisory action is taken if undertakings do not comply with the aims of the guidelines already corresponding to national legislation. However, BaFin cannot require the undertakings to comply with guidelines that serve as preparation for Solvency II but do not yet correspond to current legislation.

In 2014 and 2015, BaFin will encourage the undertakings to make adequate preparations and implement the planned amendments on a step-by-step basis. The aim is for the undertakings to fully meet all Solvency II requirements from 1 January 2016.

BaFin's implementation roadmap

At the end of 2013, BaFin started preparations for Solvency II by informing the undertakings how it proposed to implement the preparatory guidelines over the next two years. BaFin published explanatory texts on the preparatory guidelines in German at the start of November 2013. Unlike the guidelines themselves, these do not have to be translated by EIOPA. However, they contain important information that is needed to fully understand the guidelines. On 20 December 2013, BaFin published information on what it expects from undertakings in the preparatory phase and an explanation of its course of action during this phase on its website.[7]

Between now and mid-2015, BaFin will successively publish more in-depth explanations of the 15 thematic blocks arising from the preparatory guidelines (a total of 192) and inform the undertakings concerned of what it expects from them for each of the thematic blocks. These explanations aim to assist the undertakings in their preparations and are embedded in the dialogue phases, which enable the undertakings to influence what is included in the planned explanations and also comment on these retrospectively. BaFin will publish the explanations in circulars when Solvency II enters into force, taking into account the comments received and practical experience gained in the preparatory phase. The undertakings will be expected to provide BaFin with an update about the current situation after each explanation is published and inform BaFin of its preparations in the areas concerned. This enables BaFin to follow up on any undertakings that have not taken sufficient precautions to be able to comply with the Solvency II requirements in good time.

6 http://www.bafin.de/dok/3998596.

7 http://www.bafin.de/dok/4575025 (only available in German).

BaFin Solvency II conference

BaFin held its fifth conference on Solvency II on 14 November 2013 at the Rheinische Landesmuseum. Representatives from the insurance sector, BaFin, the Federal Ministry of Finance (BMF) and EIOPA discussed the upcoming challenges posed by Solvency II under the motto "Further steps on the path to Solvency II". After focussing on the consequences of the expected postponement of Solvency II at the previous conference, this time they specifically addressed the preparatory phase between now and 2016 following the political compromise by the trialogue parties on the Omnibus II Directive in the night of 13 November 2013. This included topics such as the timetable for the legal bases that are still outstanding and their implementation at European and national level.

In 2014, BaFin will support the Solvency II undertakings by translating the technical specifications issued by EIOPA on the quantitative requirements under Solvency II. These play a key role in the implementation of reporting in the preparatory phase. Where necessary, BaFin will supplement these with additional explanations to take into account considerations specific to Germany.

With respect to the risk-bearing capacity concept, BaFin will require all undertakings to assess their overall solvency needs in 2014. The related reporting to BaFin is not fundamentally new; this is already part of the internal risk reports that must be submitted by the undertakings. BaFin expects all of the undertakings that fall within the scope of Solvency II to take into account the additional process-related, procedural and reporting requirements from 2014 onwards.

There is currently no binding legal basis for the remaining elements of the FLAOR and for reporting to the supervisory authority under Solvency II. BaFin is relying on the future Solvency II undertakings participating on a voluntary basis, hoping to convince all of the affected insurers that taking advantage of this opportunity is in their own interests: it will better prepare them for the new supervisory regime and enable them to identify and address any weaknesses in good time. BaFin expects all of the affected undertakings to participate.

Continuation of the pre-application phase for internal models

BaFin also continued the pre-application phase for internal models in accordance with Solvency II in 2013. It conducted preliminary assessments on the internal models of seven undertakings or groups of undertakings. BaFin's audit staff examined the status of implementation by the undertakings and thus the extent to which the individual internal models are sufficiently robust. If the audit staff identified a stable model with a high degree of maturity, future assessments will be able to focus on material changes to the model if the undertaking meets certain requirements. Moreover, assessments in the pre-application phase over the coming year are expected to be dominated by the EIOPA Guidelines. Among other things, these govern cooperation within the supervisory colleges, such as how tasks are divided between the competent supervisory authorities or how responsible authorities from third countries should be involved. The primary aim of the guidelines in terms of principle-based supervision under Solvency II is for the competent supervisory authorities to form an opinion on how the undertakings implement the requirements for the internal models. The guidelines provide a framework for this.

Arbeitskreis Interne Modelle (Internal Models Working Group)

The Internal Models Working Group (*Arbeitskreis Interne Modelle* – AKIM) is a forum to which BaFin invites representatives from the undertakings. It is chaired by BaFin and serves to facilitate the exchange of information between BaFin, the insurance undertakings and the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e.V.* – GDV). The

Three questions for ...

**Felix Hufeld,
Chief Executive Director
Insurance and Pension Funds
Supervision**

What areas did you focus on in 2013?

▶ Without a doubt all of the different aspects of Solvency II, particularly the negotiations on the Omnibus II Directive and the Long-Term Guarantee Package – the measures to enhance the supervisory treatment of long-term guarantees. The ongoing low interest rate phase is of course also worth mentioning, as this has posed great challenges for life insurers in particular, as well as for us as supervisors.

What will be your most challenging task in 2014?

▶ We will address a number of important topics. It is difficult to say which will be the most challenging – this remains to be seen. In any case, the preparatory phase for Solvency II will keep us busy in both 2014 and 2015. In summer 2014, we will examine what own funds requirements for life insurers will look like under Solvency II and what effect this will have on the Long-Term Guarantee Package. In addition, we will address in detail how to further strengthen the risk-bearing capacity of life insurers in light of the low interest rates. This serves to protect all policyholders. My aim is to further sharpen BaFin's profile, especially in consumer protection.

What do you stand for?

▶ A supervisory authority that combines expertise, a solution-driven approach, reliability and a healthy dose of pragmatism, and that can also take strong action where appropriate.

AKIM only met once in 2013 as a result of the delay to the political agreement process on the Omnibus II Directive. At the event, participants discussed EIOPA's plans to harmonise the application process for internal models using a Europe-wide template. This is designed to provide an overview of the documentation. The members of the AKIM were in favour of the suggestion developed by BaFin in this connection.

EIOPA study on supervisory practices during the pre-application phase

EIOPA conducted a peer review on how the individual national supervisory authorities were handling the pre-application phase in 2012. In its final report – "Peer Reviews on Pre-application of Internal Models for NSAs and Colleges – Final Report" – dated July 2013, EIOPA confirmed that the national supervisory authorities were handling the extremely complex area of model reviews well, although some details could be improved. In particular, the approaches and the requirements of the individual European member states should be harmonised. EIOPA will continue to monitor developments in this area in 2014.

1.2 Occupational retirement provision

1.2.1 Planned amendment to the IORP Directive

The European Commission plans to amend the Directive on the activities and supervision of institutions for occupational retirement provision (IORP Directive). The aim is to improve the business organisation and transparency of institutions for occupational retirement provision (IORPs). The Directive will not address the issue of IORPs' solvency.

The draft, which was originally announced for autumn 2013, was presented on 27 March 2014.

1.2.2 EIOPA's evaluation report on QIS on IORPs

On 4 July 2013, EIOPA published its final report on the quantitative impact study (QIS) on IORPs (Report on QIS on IORPs). EIOPA had already published a preliminary report in April 2013 (QIS on IORPs Preliminary Results for the European Commission).

It conducted the QIS from October to December 2012. The study was designed to show how different approaches used to account for security and benefits adjustment mechanisms and to measure balance sheet items would impact the own funds requirements for IORPs – which include both *Pensionskassen* and pension funds in Germany – under supervisory law in the future. EIOPA based its calculations in the QIS on market-compliant valuation techniques and used the holistic balance sheet (HBS) concept. It also took into account performance adjustment options and security mechanisms (see info box "Holistic balance sheet").

The final report on the results of the QIS also includes a section analysing the existing pension protection schemes and their impact on the results of the QIS. This is of particular significance since Germany has a long-established, strong pension protection scheme in the shape of the *Pensions-Sicherungs-Verein VVaG* (PSVaG). The PSVaG covers occupational pension schemes operated by pension funds, among other things.

The report shows that supervisory requirements based on the holistic balance sheet could lead to problems in several member states. This is also attributable to the fact that, at present, it would hardly be possible for uniform European requirements to properly account for the large variations between IORPs in different member states.

Holistic balance sheet

The holistic balance sheet (HBS) concept was developed by EIOPA following a call for advice by the European Commission on the revision of the IORP Directive. It was published in 2012 as part of EIOPA's response to the European Commission.

As well as IORPs' assets and liabilities, the holistic balance sheet takes into account 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).

The HBS is drawn up from the perspective of the future and current beneficiaries to allow all security mechanisms to be taken into account. It uses market-compliant valuation techniques and is designed to be generally applicable to all types of IORPs and all types of commitments. This means that it should be applicable to both defined contribution and defined benefit commitments, independent of whether the benefit has been guaranteed by the IORP or the employer.

It is currently still unclear whether the theoretical HBS concept can be implemented in practice and whether it can be used effectively in the supervision of IORPs. EIOPA is therefore continuing to work on answering the outstanding questions on the HBS.

1.2.3 EIOPA's activities on Pillar 1

EIOPA supports in principle the concept of a holistic balance sheet and the associated market-compliant valuation and risk-based calculation of solvency capital requirements. However, in its report on the QIS on IORPs, EIOPA explained that a number of content-related questions would have to be resolved before the concept of a holistic balance sheet could be used as a basis for future solvency rules under European law.

EIOPA therefore conducted a public consultation in 2013 to receive further information on

potential measurement approaches for sponsor support. EIOPA has also stated in its agenda for 2014 that it will work intensively on answering outstanding questions in connection with various aspects of and items in the holistic balance sheet.

1.3 Supervision of systemically important insurers

1.3.1 Systemic importance of insurance undertakings

The Financial Stability Board (FSB) published a list of global systemically important insurers (G-SIIs) for the first time on 18 July 2013. The nine undertakings listed include one German insurance group, Allianz. The methodology used to identify the G-SIIs was developed by the International Association of Insurance Supervisors (IAIS) together with the national supervisory authorities as part of a project on the regulation of global systemically important financial institutions coordinated by the FSB.

The IAIS also established a framework of policy measures for the supervisory treatment of G-SIIs. Its requirements relate to three areas:

- improved group supervision,
- recovery and resolution planning in accordance with the requirements set out in the FSB's key attributes of effective resolution regimes, and
- higher loss absorption.

The group supervisor of a G-SII will be given direct powers over holding companies and will monitor these. The G-SIIs will develop and implement a systemic risk management plan (SRMP). The group supervisor will comment on this SRMP after consulting the other supervisory authorities involved. Liquidity risk and managing this risk must be assessed by the G-SIIs themselves to enable the group supervisor to monitor liquidity planning and management at group level.

According to the IAIS's framework, the group supervisor of a G-SII will establish a crisis management group to improve that institution's resolvability. All of the insurance groups identified as G-SIIs must also draw up recovery plans, while the group supervisor of a G-SIIs is responsible for developing a resolution plan and finalising this in consultation with the crisis management group.

The IAIS framework also provides for capital add-ons for non-traditional and non-insurance activities to improve the loss absorption capacity of G-SIIs.[8] The undertakings defined as a G-SII in 2017 must comply with the new loss absorption capacity requirements for the first time in January 2019. BaFin is analysing whether and how applicable laws need to be amended in connection with the implementation of the IAIS requirements, such as the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG).

There are currently no reinsurers on the FSB's list. The IAIS will conduct a further analysis of these by mid-2014. The FSB is then expected to decide whether they are systemically important. BaFin is currently examining whether there are also insurance undertakings that are systemically important at a national level only.

1.3.2 Optimisation of forward-looking tools

It is important for BaFin to identify potential risks as early as possible and align its activities to these findings, including with respect to the discussion on insurers' systemic importance. This relates to both microprudential supervision and potential macroprudential developments.

Insurers focus on risk aspects and the value and structure of investments, and thus their ability to meet their obligations under insurance contracts at all times, rather than on liquidity and interbank trading as banks do. There is therefore a need for insurance-specific recovery and resolution measures such as portfolio transfers or guarantee schemes. Forward-looking supervision does not just mean identifying risks at an early stage, but also

8 See chapter IV 1.4.

addressing these in good time where possible from a supervisory point of view to safeguard the interests of the insureds and ensure financial stability. BaFin is therefore examining whether and how existing supervisory intervention measures will have to be further adapted.

The key attributes of effective resolution regimes for financial institutions published by the FSB on the treatment of systemically important financial institutions apply not only to the undertakings that have already been identified as G-SIIs, but to all insurers that have been classified as systemically important by the relevant supervisory authority. In addition to the systemic risk management plan, the insurers identified as G-SIIs around the world are to draw up a recovery plan by the end of 2014. A resolution plan must also be developed for each G-SII under the direction of the group supervisor. The analyses performed in this connection mean that the undertakings and the Supervisory Authority are addressing in detail the impact of and countermeasures to conceivable crisis scenarios that could affect the undertaking in question. The undertakings must take the findings of these analyses into account in their risk management. BaFin will incorporate the results into its supervisory activities.

To be able to better assess macroprudential risks, lawmakers bundled the expertise of the *Deutsche Bundesbank*, the BMF, BaFin and the Federal Agency for Financial Market Stabilisation (*Bundesanstalt für Finanzmarktstabilisierung* – FMSA) in the Financial Stability Commission.[9] The commission discusses and evaluates developments at an early stage, and issues warnings or recommendations as necessary.

1.4 Improved loss absorption capacity of G-SIIs

The IAIS aims to improve the loss absorption capacity of internationally active insurance undertakings. The IAIS is expected to have fleshed out the details of implementation by 2015, including uniform bases for defining the higher loss absorbency (HLA) requirements and improving comparability. The IAIS will therefore first establish uniform basic capital requirements (BCRs) by the end of 2014 – the first step towards developing the insurance capital standard (ICS), a more comprehensive risk-based capital standard. The ICS will be developed by the IAIS by the end of 2016. It will be applicable globally via the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame, see info box) and will enter into force in 2019. In the long term, the ICS is expected to replace the BCR as the basis for

ComFrame

The IAIS's Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) is a framework aimed at both large, internationally active insurance groups (IAIGs) and their supervisory authorities. It comprises a wide range of requirements that better reflect the high level of complexity and the particularly international nature of IAIGs, from governance through risk management down to cooperation with foreign supervisory authorities. ComFrame builds on the global principles on insurance supervision set out in the Insurance Core Principles (ICPs) and expands them for IAIGs.

The IAIS started field testing the draft ComFrame at the beginning of 2014. This impact study is aimed at supervisory authorities and internationally active insurance groups, which participated in the sample test on a voluntary basis. The IAIS will adapt the framework as required. The impact study was preceded by a development phase that began in 2010. Most recently, the IAIS released ComFrame for public consultation from 18 October to 16 December 2013. The IAIS is planning to formally adopt the ComFrame in 2018. The national supervisory authorities will then start to implement the framework.

9 See chapter II 2.1.

improved absorption capacity. The higher loss absorption capacity requirements are still in the development stage and are expected to be defined by the end of 2015. They are also scheduled to enter into force at the beginning of 2019.

1.5 Regulations

1.5.1 Regulation on the Calculation and Distribution of Surpluses in Health Insurance

The Long-term Care Reorientation Act (*Gesetz zur Neuausrichtung der Pflegeversicherung* – PNG) dated 23 October 2012 incorporated provisions on subsidised long-term care insurance into the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG). In accordance with section 81d (1) of the VAG, an irregularity jeopardising the interests of the insured is deemed to exist in SLT health insurance if the health insurer does not make adequate allocations to the provision for bonuses. This is deemed to be the case in particular if the allocations to the provision for bonuses of a health insurance undertaking do not comply with the rate stipulated for allocations by statutory order in accordance with section 81d (3) of the VAG.[10] The allocation rate for subsidised long-term care insurance is laid down in the Regulation on the Calculation and Distribution of Surpluses in Health Insurance (*Überschussverordnung* – ÜbschV) and should amount to 80% of the gross surplus generated by subsidised long-term care insurance. The ÜbschV is being amended accordingly and is expected to be adopted this year.

The opportunity was also taken to set out the allocation of interest surplus in the ÜbschV in greater detail due to the increasingly diverse discount rates used for health insurers' portfolios.

10 This applies separately to SLT health insurance (health insurance operated in accordance with the technical principles of life insurance) within the meaning of section 12 (1) sentence 1 of the VAG, compulsory private long-term care insurance within the meaning of section 12 f. of the VAG and subsidised long-term care insurance within the meaning of section 12 f. of the VAG.

1.5.2 Capital Resources Regulation and Reinsurer Capital Resources Regulation

The Regulation Amending the Capital Resources Regulation (*Verordnung zur Änderung der Kapitalausstattungsverordnung* – KapAusstV) and the Reinsurer Capital Resources Regulation (*Rückversicherungs-Kapitalausstattungs-Verordnung* – RückKapV) was adopted on 21 August 2013. The regulation contains provisions that raise the minimum guarantee funds as well as the thresholds for the premium index and the claims index. The revised amounts had to be applied on the day following promulgation. The amending regulation was necessary because the European Commission had raised the amounts.

1.5.3 Insurance Reporting Regulation and Pension Funds Reporting Regulation

The Third Regulation Amending the Insurance Reporting Regulation (*Dritte Verordnung zur Änderung der Versicherungsberichterstattungs-Verordnung* – BerVersV) and the Third Regulation Amending the Pension Funds Reporting Regulation (*Dritte Verordnung zur Änderung der Pensionsfondsberichterstattungsverordnung* – BerPensV) were promulgated on 16 December 2013. The Regulation Amending the BerVersV sets out the subsidised private long-term care insurance introduced by the PNG. A minimum rate for allocations to the provision for bonuses has applied for this since 1 January 2013. A corresponding amendment was made to section 81d of the VAG. The lawmakers also edited and updated both regulations.

1.5.4 Investment Regulation

The Act Implementing the Alternative Investment Fund Managers Directive (AIFM Directive) entered into force on 22 July 2013. As a result of the Act Implementing the AIFM Directive, the Investment Act (*Investmentgesetz* – InvG) was repealed and replaced by the Investment Code (*Kapitalanlagegesetzbuch* – KAGB). The KAGB contains both provisions of the AIFM Directive[11]

11 Directive 2011/61/EU, OJ EU L 174, p. 1 ff.

and provisions previously included in the InvG, which implemented the UCITS Directive.[12]

The entry into force of the KAGB requires the Regulation on the Investment of Restricted Assets of Insurance Undertakings (*Verordnung über die Anlage des gebundenen Vermögens von Versicherungsunternehmen* – AnlV) to be amended. Since the KAGB is complex and more comprehensive than the previous provisions, the previous references in the AnlV could not be simply carried over from the InvG to the KAGB. The KAGB covers both open-ended and closed-ended funds and is structured differently to the InvG. The amendments relate in particular to section 2 (1) nos. 15–17 of the AnlV. They also affect other asset classes in the AnlV, for example under section 2 (1) nos. 13 and 14c. The AnlV is expected to be amended in the near future.

1.6 BaFin circulars and consultations

1.6.1 Implementation of the Guidelines on Complaints Handling

EIOPA published the Guidelines on Complaints Handling by Insurance Undertakings on 14 June 2012. These entered into force on the same day. The guidelines comprise seven complaints handling principles. They are aimed at national supervisory authorities, which monitor complaints handling by insurance undertakings. The guidelines are designed to ensure that the undertakings comply with certain minimum supervisory standards when handling complaints.

To comply with the Guidelines, BaFin published a collective decree.[13] This collective decree was supplemented by Circular 3/2013 (VA) – Minimum requirements for complaints handling by insurance undertakings, with which BaFin transposed EIOPA Guidelines into national administrative practice for the first time. Undertakings can organise the nature, scope and complexity of their complaints system to largely correspond to the risks associated with their business operations (proportionality principle).

1.6.2 Upper age limit for guarantee asset trustees

Among other things, Circular 13/2005 (VA) sets out the selection, appointment and removal of guarantee asset trustees. The office of guarantee asset trustee was previously subject to an age limit of 70 years.

BaFin removed this age limit after examining the compatibility of the age limit for trustees with the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz* – AGG) as a result of a ruling by the Federal Administrative Court (*Bundesverwaltungsgericht* – BVerwG).[14] According to the Court's judgement, setting an age limit on a publicly appointed expert is unjustified unequal treatment because it breaches sections 1 and 2 (1) nos. 1 and 2 of the AGG. Guarantee asset trustees are subject to the same rules. The grounds for justification under sections 8 and 10 of the AGG and Article 2 (5) of the Employment Equality Framework Directive do not apply.[15]

Insurance undertakings, pension funds and *Pensionskassen* must now ensure that the trustees of their guarantee assets are both physically and mentally able to properly perform their fiduciary duties. If the undertakings have evidence that this is no longer certain, it is now their responsibility to remove the trustee concerned and inform BaFin.

12 See chapter V 1.1.

13 http://www.bafin.de/dok/4595212.

14 Judgement dated 1 February 2012, case ref.: 8 C 24.11.

15 Directive 2000/78/EC, OJ EU L 303, p. 16 ff.

2 Preventive supervision

2.1 Risk classification

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 their 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).

The following table ("Risk classification results for 2013") shows the assessment based on the data as at 31 December 2013:

Number of good-quality insurers on a level with the previous year

In its risk classification, BaFin rated 72% of the insurers as "A" or "B". This means that the proportion of insurance undertakings in this upper segment was on a level with the previous year. However, the risk classification showed a shift in the quality rating from "A" to "B" compared with the previous year. The number of undertakings rated "D" rose moderately 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

A decline in the number of undertakings rated "A" was observed in the individual insurance classes, with the exception of funeral expenses funds. The improved situation seen by health insurers in previous years did not continue. The proportion of undertakings rated "C" and "D" rose slightly. Undertakings with a "B" rating account for the largest share of this class, at 64%. Life insurers mainly achieved mid-grade ratings. The number of life insurers rated "B" or "C" rose by approximately 2% as against the previous year. The proportion of *Pensionskassen* with "B" ratings increased by approximately 12% year-on-year, while the proportion with "C" ratings declined slightly.

Property/casualty insurers saw a slight deterioration in ratings. The proportion of undertakings with a "D" rating rose by 1.4%; however, most (approximately 80%) have upper

Table 18 Risk classification results for 2013

Undertakings in %		Quality of the undertaking				Total
		A	B	C	D	
Market relevance	High	1.3	6.5	3.2	0.0	11.0
	Medium	3.1	11.9	5.9	0.0	20.9
	Low	9.5	39.7	17.0	1.9	68.1
	Total	**13.9**	**58.1**	**26.1**	**1.9**	**100.0**

quality ratings. There were no significant shifts for reinsurers, funeral expenses funds and pension funds.

Number of insurers continues to decline

The number of undertakings classified in the year under review declined further, continuing the downward trend in the number of insurers observed in the previous years. The proportion of undertakings with medium or high market relevance rose moderately, while there were fewer undertakings with low market relevance as against the previous year. This is because a number of undertakings exceeded the threshold for the next higher category. In a few cases, the higher classification was due to portfolio transfers and mergers.

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 2013. 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.

2.2 On-site inspections

On-site inspections are planned on the basis of a risk-based approach. As well as the results of the risk classification, one of the factors that BaFin takes into account is whether an insurer or pension fund was subject to an on-site inspection in the recent past. Ad hoc on-site inspections are also conducted. In the year under review, the insurance supervision directorate conducted a total of 42 on-site inspections, mainly unrelated to preparations for Solvency II. This reflects BaFin's decision to step up general inspection activity. The number of internal model reviews declined as against the previous year due to delays in model development on the part of the undertakings. In some cases, BaFin conducted supervisory interviews instead of the planned inspections.

The following risk matrix (Table 19 "On-site inspections by risk class in 2013") shows the breakdown of the inspections by risk class.

2.3 Areas of emphasis of inspections

One area of emphasis of the inspections was the pre-application phase for internal models under Solvency II. Furthermore, in the past two years, BaFin mainly conducted on-site inspections when there was specific cause to do so. It will increase the overall number of routine on-site inspections. These inspections will focus in particular on claims provisions and the financial position of the insurance undertakings.

Table 19 On-site inspections by risk class in 2013

On-site inspections		Quality of the undertaking				Total	Under-takings in %
		A	B	C	D		
Market relevance	High	3	8	8	0	19	47.5
	Medium	1	4	2	0	7	17.5
	Low	2	8	3	1	14	35.0
	Total*	**6**	**20**	**13**	**1**	**40**	**100.0**
	Undertakings in %	**15.0**	**50.0**	**32.5**	**2.5**	**100.0**	

* Two on-site inspections were also conducted at unclassified undertakings, bringing the total to 42 on-site inspections.

In accordance with section 64a of the VAG, set out in greater detail in Circular 3/2009 on Minimum Requirements for Risk Management in Insurance Undertakings (*Mindestanforderungen an das Risikomanagement VA* – MaRisk VA), all undertakings must have an adequate risk management system. Among other things, the undertakings must develop a risk strategy and a risk-bearing capacity concept on the basis of the overall risk attributable to the specific undertaking. They must establish effective internal control processes and separate incompatible functions to avoid conflicts of interest.

In 2014, BaFin will also conduct more on-site inspections to establish whether the undertakings have adequately implemented the risk management requirements for their individual risk profiles and integrated risk management into their decision-making structures. Alongside these on-site inspections, BaFin will continue to conduct supervisory interviews with management board members on risk management issues.

BaFin also expects the undertakings to calculate their individual overall solvency needs in 2014 as part of preparations for Solvency II (forward looking assessment of own risks – FLAOR).

2.4 Stress test

BaFin conducted a stress test in 2013 as at the 31 December 2012 balance sheet date. The stress test scenarios addressing equity price losses were again rule-based, with the applicable mark-down based on the level of the EURO STOXX 50 share price index as at 31 December 2012 (2,636 points). The following scenarios were calculated:

- Bonds-only scenario: 10% decrease in the price of fixed-income securities
- Equities-only scenario: 18% decrease in the price of shares
- Bonds and equities scenario: 5% decrease in the price of fixed-income securities and 13% decrease in the price of shares
- Equities and property scenario: 13% decline in the price of shares and 10% decline in the market value of property

EIOPA stress test

The European Insurance and Occupational Pensions Authority (EIOPA) has also conducted EU-wide stress tests for insurers since 2009 to test the resilience of the European insurance sector to potential adverse developments. In contrast to BaFin's stress test, the European stress test is performed at group level. It takes both assets and liabilities into account and is only conducted by selected insurers. EIOPA did not conduct any stress tests in 2013 due to the ongoing Omnibus II negotiations. Several large insurance groups from Germany are expected to participate in the next test, which is planned for 2014.

BaFin did not revise the stress test at a conceptual level as against the previous year; however, it will include information on fair values starting in 2014. Since the market values reflect the current value of individual investments, the greater focus on market value gives BaFin a deeper insight into whether and to what extent insurance undertakings' exposures entail market risks.

Life and health insurers

Ninety life insurers submitted a stress test in 2013. 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 90 life insurers reported positive results for the stress test in all four scenarios. No undertaking-specific characteristics had to be taken into account.

BaFin included 42 health insurers in its analysis of stress test results. Seven insurers were exempted from this requirement due to 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.

Property and casualty insurers

BaFin asked 180 of the 216 property and casualty insurers supervised by it to submit their stress test results. It exempted 36 undertakings from this requirement. Of the total figure, 175 property and casualty insurers reported positive stress test results in all four scenarios. Five failed one or more of the stress test scenarios. The reason for this in four cases was the greater extrapolation of the target values for the dynamic variables required by the stress test model, combined with special factors at the undertaking concerned. This related to changes in net premium income or net claims provisions, as well as the change to solvency requirements, for example. In one case, the results were negative because of a shortfall in the undertaking's minimum guarantee fund.

Pensionskassen

BaFin exempted 18 of the 148 *Pensionskassen* it supervised at the end of 2012 from their obligation to submit stress tests because of the low-risk nature of their investments. Nevertheless, two of these *Pensionskassen* submitted a stress test. Of the 132 stress tests submitted, 125 reported positive results in all four scenarios. The seven *Pensionskassen* with negative results generally reported minor shortfalls. BaFin is in close contact with these *Pensionskassen* to ensure that they improve their risk-bearing capacity.

2.5 Low interest rate phase

The ongoing low interest rates are proving a serious challenge for the German insurance industry. They are negatively impacting life insurers' ability to meet their obligations in the long term, which is why BaFin is addressing the issue in depth. In has already conducted a survey on the impact of low interest rates at industry level, for example.

In 2014, BaFin will continue to specifically analyse how life insurers perform in the low interest rate environment using the reports already provided by the undertakings, such as risk reports and the report of the appointed actuary. In addition, it will again conduct an industry survey comprising a five-year projection, which will be used for other supervisory activities. BaFin will decide on a case-by-case basis whether the undertaking should take further measures to successfully overcome the low interest rate phase. It will also analyse whether certain strategies adopted by the undertaking are sustainable from a risk point of view.

The ongoing low interest rate phase is also making it difficult for many *Pensionskassen* to meet their obligations. BaFin therefore asked the *Pensionskassen* to submit a five-year projection as at the 30 September 2013 reporting date to better assess whether they have already initiated or implemented adequate measures and which *Pensionskassen* will generate surpluses in the coming years. BaFin conducted supervisory interviews on the basis of the results. BaFin plans to again use projections in 2014.

The low interest rates are causing fewer problems for the health insurers, according to BaFin's assessments. This is largely due to the fact that the undertakings can adjust their premiums, thereby reducing the technical interest rate. As a result, the undertakings can raise their premiums high enough to be able to consistently fund their obligations. However, the cash flow from investment income generated beyond the level of the technical interest rate (excess yield) declined. As the excess yield serves to fund premium reductions in old age, fewer funds with which to limit premium increases are available from this source.

Most health insurers introduced a technical interest rate of 2.75% for the new gender-neutral tariffs.[16] The technical interest rate used for existing contracts may be lowered if the actuarial corporate interest rate (ACIR) is lower than the current technical interest rate. If the 2014 ACIR is lower than the current technical interest rate, BaFin will ask the undertaking how it intends to proceed. BaFin will conduct

16 Mandatory gender-neutral tariff calculation since 21 December 2012.

supervisory interviews with all of the affected health insurers that do not intend to adjust their premiums to the lower ACIR at the earliest opportunity.

2.6 Risk-based preventive supervisory toolkit

BaFin continually enhances its supervisory toolkit with a view to a risk-based and preventive supervisory approach. In the past, BaFin surveyed life insurers, health insurers, *Pensionskassen* and pension funds on their expected performance in the current financial year using regular projections, stipulating different capital market scenarios. In its projection as at 30 September 2013, BaFin also took performance in the following four years into account for the first time, since it will be several years before the full impact of prolonged low interest rates will be visible in financial reporting in accordance with the Commercial Code (*Handelsgesetzbuch* – HGB). BaFin thus has a standardised, medium-term analysis tool, which unlike the survey on the impact of low interest rates conducted in the past, is also suitable for routine use.

BaFin believes that forward-looking supervision should be further strengthened. One idea would be to expand the supervisory toolkit, for example, and allow BaFin to also intervene if the long-term risk-bearing capacity of an undertaking is compromised. This idea is closely related to multi-year projections, a tool already used today by BaFin.

2.7 Outlook: preventive insurance supervision in 2014

Preventive supervision will continue to be influenced by preparations for Solvency II in 2014. Interviews with undertakings are expected to provide BaFin with important information on how well-prepared the undertakings are. BaFin is particularly interested in the provisions governing risk self-assessment, reporting and internal models. The requirements for undertakings' governance systems will also change under the new supervisory regime. BaFin's work in 2014 will focus on governance at undertakings that are part of insurance groups which are expected to calculate solvency capital requirements at group level using the standard formula. A further area of emphasis of preventive supervision in 2014 will be the supervision of insurance groups and conglomerates. Assessment of private health insurers will focus on the general terms and conditions of the gender-neutral tariff to prevent indirect discrimination. BaFin will step up checks on insurers' portfolio management, claims administration and benefit claims processing to improve consumer protection.

2.8 Investments by insurers – overview [17]

As at 31 December 2013, investments by German insurers supervised by BaFin had an aggregate carrying amount of €1,522.7 billion (previous year: €1,480.1 billion). Broken down by insurance classes, health insurers (+7.1%) and *Pensionskassen* (+6.2%) recorded the largest percentage increases. Aggregate investments by all primary insurers supervised by BaFin increased by 4.2% in 2013 to €1,295.2 billion (+€51.7 billion). Only reinsurers saw investments decline slightly as against the previous year.

As in previous years, investments continued to focus on fixed-income securities and promissory note loans. There were minor shifts in fixed-rate investments. The share of directly held listed debt instruments rose by 14.8% to €218.8 billion in the year under review, while the share of investments at credit institutions declined, not least due to the still very low interest rate environment.

Indirect investments held by insurance undertakings via investment funds recorded above-average growth in 2013, rising by 9.7%, and now account for over a quarter of all investments, at €402.4 billion. The assets acquired via investment funds relate predominantly to listed securities.

17 See chapter IV 3.3 for details on investments by individual insurance classes and pension funds.

Table 20 Investments by insurance undertakings

Investments by insurance undertakings	Portfolio as at 31 December 2013		Portfolio as at 31 December 2012		Change in 2013	
	in € million	in %	in € million	in %	in € million	in %
Land, land rights and shares in real estate companies, REITs and closed-ended real estate funds	32,833	2.2	30,800	2.1	2,033	6.6
Fund units, shares in investment stock corporations and investment companies	402,381	26.4	366,654	24.8	35,727	9.7
Loans secured by mortgages and other land charges and shareholder loans to real estate companies	56,139	3.7	56,144	3.8	–5	0.0
Securities loans and loans secured by debt securities	613	0.0	1,748	0.1	–1,135	–64.9
Loans to EEA/OECD states, their regional governments and local authorities, and international organisations	123,156	8.1	120,536	8.1	2,620	2.2
Corporate loans	15,079	1.0	13,758	0.9	1,321	9.6
ABSs/CLNs	5,985	0.4	5,195	0.4	790	15.2
Policy loans	4,160	0.3	4,408	0.3	–248	–5.6
Pfandbriefe, municipal bonds and other debt instruments issued by credit institutions	246,554	16.2	257,523	17.4	–10,969	–4.3
Listed debt instruments	218,757	14.4	190,517	12.9	28,240	14.8
Other debt instruments	20,489	1.3	18,703	1.3	1,786	9.5
Subordinated debt assets/participation rights	27,579	1.8	25,915	1.8	1,664	6.4
Book-entry securities and open market instruments	1,027	0.1	2,219	0.1	–1,192	–53.7
Listed equities	7,567	0.5	6,263	0.4	1,304	20.8
Unlisted equities and interests in companies, excluding private equity holdings	129,367	8.5	132,586	9.0	–3,219	–2.4
Private equity holdings	11,576	0.8	11,699	0.8	–123	–1.1
Investments at credit institutions	187,300	12.3	202,053	13.7	–14,753	–7.3
Investments covered by the opening clause	19,096	1.3	17,093	1.2	2,003	11.7
Other investments	13,029	0.9	16,312	1.1	–3,283	–20.1
Total investments	**1,522,687**	**100.0**	**1,480,126**	**100.0**	**42,561**	**2.9**
Life insurers	793,153	52.1	768,904	51.9	24,249	3.2
Pensionskassen	131,085	8.6	123,439	8.3	7,646	6.2
Funeral expenses funds	2,006	0.1	1,972	0.1	34	1.7
Health insurers	218,820	14.4	204,263	13.8	14,557	7.1
Property/casualty insurers	150,157	9.9	144,910	9.8	5,247	3.6
Reinsurers	227,466	14.9	236,638	16.0	–9,172	–3.9
All insurers	**1,522,687**	**100.0**	**1,480,126**	**100.0**	**42,561**	**2.9**
Primary insurers	1,295,221	86.2	1,243,488	84.0	51,733	4.2

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

Aggregate direct investments in property rose by 6.6% year-on-year to €32.8 billion.

2.8.1 Impact of EMIR on insurance undertakings

The European Parliament and the Council adopted the European Market Infrastructure Regulation (EMIR) in July 2012.[18] All of the insurance undertakings, reinsurance undertakings and institutions for occupational retirement provision set out in Article 2 (8) of the EMIR fall within the scope of EMIR.

EMIR regulates OTC (over-the-counter) derivatives transactions. If the designated insurers and institutions for occupational retirement provision use derivatives as part of their investment management, they must satisfy the organisational and supervisory requirements set out in the regulation. As a rule, this will require considerable adjustment since the regulation introduces clearing and bilateral risk management requirements for OTC derivatives contracts and obligatory reporting of derivative contracts. Insurers subject to the reporting obligation set out in Article 9 of the EMIR, which entered into force on 12 February 2014, must report the information underlying the derivative contract to a trade repository. This trade repository has already been registered by the European Securities and Markets Authority (ESMA). Reporting applies to all derivatives within the meaning of Article 2 no. 5 of the EMIR. All derivative contracts concluded, modified, or terminated must be reported.

2.8.2 European government bonds in insurers' restricted assets

In the interpretive decision[19] published on its website in July 2013, BaFin ruled that the requirements set out in section B.3.1.c. of Circular 4/2011 (VA)[20] will again apply in principle from 1 January 2014 when assessing the security of European bonds and loans to European Union countries and their regional governments or local authorities. The pronouncements on government bonds published in issues 05/10 and 06/11 of the BaFinJournal and on BaFin's website in March 2012 are therefore no longer applicable.

Background to the amendment

The pronouncement in the 06/11 issue of the BaFinJournal only applied for as long as the European Stability Mechanism (ESM) was in force, i.e. until 2013. Since 2013 is now over and the European Financial Stability Facility (EFSF) has been replaced by the European Stability Mechanism (ESM), BaFin had to adapt the above pronouncements to current developments.

2.8.3 Investments in corporate loans

In an interpretive decision dated 10 June 2013,[21] BaFin relaxed the requirements for adding corporate loans to restricted assets when these loans do not fully meet the collateralisation requirements contained in the negative pledge.

In accordance with section 2 (1) no. 4a of the Regulation on the Investment of Restricted Assets of Insurance Undertakings (*Verordnung über die Anlage des gebundenen Vermögens von Versicherungsunternehmen* – AnlV), the restricted assets of insurance undertakings can in principle be invested in loans to companies, provided the credit quality of the borrower is assured and adequate collateral has been provided for the corporate loan. The requirements governing negative pledges are set out in section B.4.3 d of Circular 4/2011 (VA).

Negative pledges can only be used as collateral if the borrower is a particularly highly rated

18 Regulation (EU) No. 648/2012, OJ EU L 201, p. 1 ff. See also chapter V 1.2 for details.

19 http://www.bafin.de/dok/4051176 (only available in German).

20 The European requirements for reducing the significance of external ratings (see section 3.4.5) were taken into account.

21 http://www.bafin.de/dok/4607534.

company that is pre-eminent in its sector. If the borrower's credit quality is assessed on the basis of its financial ratios, compliance with the financial ratios must be contractually agreed for the entire term of the loan collateralised by a negative pledge. The lender must have an extraordinary call right if the borrower breaches the covenants.

Since 10 June 2013, loans with negative pledges can be granted even if compliance with the financial ratios during the entire term of the contract has not been contractually agreed. However, the financial ratios must still be complied with, even if compliance has not been explicitly stipulated in the contract and there is no extraordinary call right. Such loans must be counted towards the 5% loan ratio.[22]

If a covenant is breached, loans with adequate collateral can only be held in accordance with the opening clause (see section 2 (2) of the AnlV).

2.8.4 High-yield investments

In an interpretative decision dated 24 June 2013,[23] BaFin announced that insurance undertakings may acquire high-yield bonds with adequate collateral in accordance with the opening clause, even if the high-yield ratio has already been utilised. The high-yield ratio itself remains unchanged. The interpretative decision gives insurance undertakings greater investment flexibility.

Provided they have sufficient risk-bearing capacity within the scope of their schedule of investments (section 2 (1) of the AnlV), insurance undertakings may invest in high-yield bonds with at least speculative grade ratings (e.g. "B-" from Standard & Poor's and Fitch or "B3" from Moody's) or an internal rating corresponding to one of these ratings categories.

The directly and indirectly held share of high-yield bonds may not exceed 5% of the guarantee assets and of the other restricted assets (high-yield ratio) and must be included in the calculation of the risk asset ratio in accordance with section 3 (3) sentence 1 of the AnlV.

2.8.5 Significance of external ratings

Since June 2013, insurers, reinsurers and institutions for occupational retirement provision are required to conduct their own credit risk assessment and may not rely solely or automatically on external ratings when assessing the credit quality of an enterprise or a financial instrument. This is set out in the new Article 5a of the Regulation on Credit Rating Agencies.[24]

BaFin published an interpretative decision[25] on this in two versions on its website: "Hinweise zur Verwendung externer Ratings und zur Durchführung eigener Kreditrisikobewertungen" ("Guidance on the use of external ratings and on conducting credit risk assessments" – only available in German).

In the first version of the interpretative decision published in June 2013, BaFin made insurers aware of the new obligation. It also adapted its existing administrative practice as laid down in Investment Circular 4/2011 (VA) to the new requirements in Article 5a of the Regulation on Credit Rating Agencies. Under the existing administrative practice, insurance undertakings were permitted to assess the credit risk themselves to avoid dependencies on rating agencies. This was subject to the insurance undertaking having the personnel and technical resources necessary to do this. The option granted to undertakings to conduct their own credit risk assessments is now formulated as a requirement.

In the second version of the interpretative decision published in October 2013, BaFin amended its guidance from June 2013 and set

22 The 5% loan ratio counts towards the 50% minimum diversification requirement for loans in accordance with section 2 (1) nos. 3 and 4a of the AnlV and investments in accordance with section 2 (1) no. 11 of the AnlV.

23 http://www.bafin.de/dok/4019216 (only available in German).

24 Regulation (EU) No. 462/2013, OJ EU L 146, p. 1 ff.

25 http://www.bafin.de/dok/4028348 (only available in German).

§

Regulation on Credit Rating Agencies

Article 5a: Over-reliance on credit ratings by financial institutions

(1) The entities referred to in the first subparagraph of Article 4 (1) [insurance undertakings, reinsurance undertakings and institutions for occupational retirement] shall make their own credit risk assessment and shall not solely or mechanistically rely on credit ratings for assessing the creditworthiness of an entity or financial instrument.

(2) Sectoral competent authorities in charge of supervising the entities referred to in the first subparagraph of Article 4 (1) shall, taking into account the nature, scale and complexity of their activities, monitor the adequacy of their credit risk assessment processes, assess the use of contractual references to credit ratings and, where appropriate, encourage them to mitigate the impact of such references, with a view to reducing sole and mechanistic reliance on credit ratings, in line with specific sectoral legislation.

out undertakings' new obligation to conduct their own credit risk assessments in greater detail.

BaFin considers it sufficient if the undertaking reviews the external ratings for reasonableness. A credit risk assessment can be reviewed for reasonableness on the basis of a rating report by the external agency, for example. This must be documented in a verifiable manner. If the exposure is better rated in the undertaking's own assessment than in the external rating, the qualitative assessment described must be supplemented by an appropriate quantitative assessment. Insurers do not have to conduct their own, additional assessments of the credit quality of funds managed by German management companies (*Kapitalverwaltungsgesellschaften*). However, they must ensure that the management company complies with supervisory rating and credit check requirements.

New European requirements

With the two interpretive decisions, BaFin brought its insurance supervision practices into line with the European Regulation Amending the Regulation on Credit Rating Agencies and the Amending Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision.[26] Both entered into force on 20 June 2013.

Insurers, reinsurers and institutions for occupational retirement provision are particularly affected by the insertion of Article 5a into the European Regulation on Credit Rating Agencies. (see info box "Regulation on Credit Rating Agencies").

2.9 Composition of the risk asset ratio

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

The evaluations in table 21 ("Composition of the risk asset ratio", page 136) 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 €1,252.1 billion as at 31 December 2013 (previous year: €1,199.0 billion).

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, 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 investments in funds that are risky or cannot be clearly assigned to other investment types.

The risk asset ratio for primary insurers at the end of 2013 was 11.3% of their restricted assets, almost unchanged as against the

26 Directive 2013/14/EU, OJ EU L 145, p. 1 ff.

Table 21 Composition of the risk asset ratio

As at 31 December 2013

Investment type pursuant to section 2 (1) no. ... of the AnlV	Restricted assets									
	Life insurers		Health insurers		Property/ casualty insurers		*Pensions-kassen*		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 %	Absolut in Mio. €	Share in %
Total investments*	773,390	100.0	216,536	100.0	132,018	100.0	130,142	100.0	1,252,086	100.0
Of which attributable to:										
Securities loans (no. 2), where equities (no. 12) are the subject of the loan	152	0.0	0	0.0	2	0.0	0	0.0	154	0.0
Subordinated debt assets and profit participation (no. 9)	12,842	1.7	3,490	1.6	1,935	1.5	2,176	1.7	20,443	1.6
Listed equities (no. 12)	1,296	0.2	179	0.1	514	0.4	26	0.0	2,015	0.2
Unlisted equities and interests in companies (no. 13)	14,172	1.8	3,862	1.8	3,478	2.6	939	0.7	22,451	1.8
Fund units (nos. 15–17, incl. hedge funds) that										
– include equities, participation rights, etc.	24,299	3.1	4,675	2.2	7,753	5.9	6,658	5.1	43,385	3.5
– cannot be clearly assigned to other investment types; fund residual value and non-transparent funds	12,205	1.6	2,152	1.0	2,465	1.9	2,020	1.6	18,842	1.5
High-yield bonds and investments in default status	11,963	1.5	3,590	1.7	1,971	1.5	2,191	1.7	19,715	1.6
Increased fund market risk potential **	10,400	1.3	506	0.2	949	0.7	489	0.4	12,344	1.0
Investments linked to hedge funds (partly already contained in other nos. of the AnlV)	736	0.1	308	0.1	126	0.1	615	0.5	1,785	0.1
Investments linked to commodity risks (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	**88,065**	**11.4**	**18,762**	**8.7**	**19,193**	**14.5**	**15,114**	**11.6**	**141,134**	**11.3**

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 2013 for life, health and property/casualty insurers, as well as *Pensionskassen*, from financial statement forms 670 and 673, collective decree dated 21 June 2011

Table 22 Share of total investments attributable to selected asset classes

As at 31 December 2013

Investment type	Total assets									
	Life insurers		Health insurerse		Property/ casualty insurers		*Pensions-kassen*		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 %	Absolut in Mio. €	Share in %
Total investments*	793,153	100.0	218,820	100.0	150,157	100.0	131,085	100.0	1,293,215	100.0
Of which attributable to:										
Investments in private equity holdings	7,333	0.9	1,157	0.5	1,987	1.3	611	0.5	11,088	0.9
Directly held asset-backed securities and credit-linked notes	2,698	0.3	529	0.2	607	0.4	275	0.2	4,109	0.3
Asset-backed securities and credit-linked notes held via funds	4,471	0.6	919	0.4	1,246	0.8	883	0.7	7,519	0.6
Investments in hedge funds and investments linked to hedge funds (held directly and via funds)	1,727	0.2	646	0.3	440	0.3	922	0.7	3,735	0.3
Investments with commodity risks (held directly and via funds)	871	0.1	341	0.2	333	0.2	158	0.1	1,703	0.1

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

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

Source: Sector totals as at 31 December 2013 for life, health and property/casualty insurers, as well as *Pensionskassen*, from financial statement forms 670 and 673, collective decree dated 21 June 2011

previous year (11.2%). Insurance undertakings again fell well below the risk asset cap of 35% of the restricted assets stipulated in the AnlV. The risk asset ratio varies from class to class, ranging from 8.7% for health insurers to 14.5% for property/casualty insurers.

The largest individual item within risk assets was investments in equities (mostly listed) held through funds, which accounted for 3.5% of restricted assets (previous year: 2.8%). The trend seen in previous years of primarily acquiring shares via funds continued.

There were minor changes in alternative investments compared with the previous year: directly and indirectly held asset-backed securities and credit-linked notes increased, while investments in hedge funds and commodities declined slightly.

3 Supervision of undertakings

3.1 Authorised insurance undertakings and pension funds

The number of insurance undertakings supervised by BaFin declined slightly. At the end of the year under review, BaFin supervised a total of 584 insurance undertakings (previous year: 592) and 31 pension funds. 560 insurance undertakings were engaged in business activities and 24 were not. In order to give as full a picture as possible of the insurance

Table 23 Number of supervised insurance undertakings and pension funds*

As at 31 December 2013

	Insurers with business activities			Insurers without business activities		
	BaFin supervision	*Länder* supervision	Total	BaFin supervision	*Länder* supervision	Total
Life insurers	90	3	93	9	0	9
Pensionskassen	147	0	147	1	0	1
Funeral expenses funds	36	0	36	2	0	2
Health insurers	48	0	48	0	0	0
Property/ casualty insurers**	210	6	216	6	1	7
Reinsurers	29	0	29	6	0	6
Total	**560**	**9**	**569**	**24**	**1**	**25**
Pension funds	31	0	31	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 2012 statistics – Primary insurers and pension funds, p. 9, table 5).
** One property/casualty insurer primarily offers Non-SLT health insurance (health insurance operated on a similar technical basis to that of non-life insurance) and is included in the stress test and projection for health insurers in chapters IV 2.4 and IV 3.3.2.

market in Germany, all information given in the rest of this chapter also includes ten public-law insurance undertakings supervised by the *Länder* (nine conducting business activities and one without business activities). The breakdown by segments is shown in table 23 ("Number of supervised insurance undertakings and pension funds").

Table 24 Registrations by EEA life insurers in 2013

As at 31 December 2013

Country	CBS*	BO**
France	1	
United Kingdom	2	
of which: Gibraltar	1	
Ireland	1	1
Croatia	1	
Netherlands	1	

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

Life insurers

Three German life insurers supervised by BaFin ceased operating in 2013. Six foreign life insurers from the European Economic Area (EEA, see table 24 "Registrations by EEA life insurers in 2013") registered for the cross-border provision of services (CBS) in Germany (previous year: 7).

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 four undertakings ceased operating. One Austrian property and casualty insurer established a branch office in Germany. Two branches of undertakings from Luxembourg and France ceased operating. Twenty-one insurers from the EEA (see table 25 "Registrations by EEA property and casualty insurers in 2013", page 139) registered for the cross-border provision of services in Germany (previous year: 27). Other insurers that had already registered for the cross-border provision of

Tabelle 25 Registrations by EEA property and casualty insurers in 2013

As at 31 December 2013

Country	CBS*	BO**
Bulgaria	1	
France	1	
United Kingdom	4	
of which: Gibraltar	1	
Ireland	2	
Croatia	3	
Liechtenstein	1	
Luxembourg	2	
Malta	1	
Netherlands	2	
Austria		1
Romania	1	
Sweden	1	
Spain	1	
Hungary	1	

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

services in Germany notified an expansion in their business activity. Forty-one insurers ceased providing services in Germany in 2013 (previous year: 48).

Reinsurers

The number of active reinsurers declined to 28 in the year under review. One reinsurer transferred its entire portfolio to a primary insurer retrospectively effective 30 June 2012. The reinsurer was then dissolved.

In addition, six branches of undertakings from the EEA (Ireland, Spain, Luxembourg and three from France) and one third-country branch (USA) were operating in Germany. Six reinsurers were not taking on new business.

Pensionskassen, pension funds and funeral expenses funds

Two *Pensionskassen* ceased operating and one started operating. One new pension fund was established and one funeral expenses fund stopped taking on new business.

3.2 Economic environment

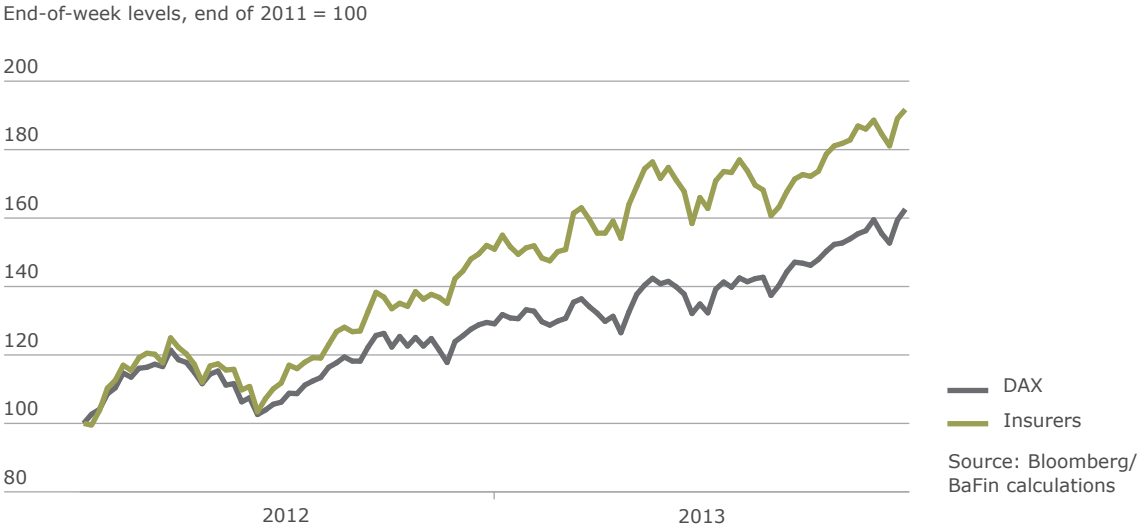
In its seventh year, the financial crisis continued to pose an enormous challenge for the German insurance sector. Life insurers in particular were affected by the sustained low interest rates. However, the German insurance sector again proved robust in this difficult environment. Steady demand for insurance cover led to a stable growth in premium income at primary insurers and pension funds. Following €185.5 billion in 2012, these undertakings posted 4.4% growth to €193.6 billion in 2013.

The low interest rates are posing serious problems for the German insurance industry because they make it difficult to generate the decidedly high guarantee payments promised in the past. Ten-year Bund yields trended sideways in 2013, fluctuating between 1.17% and 2.05%. They fell to the new record low of 1.17% in the spring after the European Central Bank (ECB) cut its key interest rate from 0.75% to 0.5%. Yields recovered in the course of the year, although the ECB further cut its key interest rate to 0.25% on the back of expectations that the US Federal Reserve would soon scale back its asset purchases (tapering). Ten-year Bunds yielded 1.93% at the end of the year.

Insurance shares

Buoyed by the continued cheap money policy at the central banks and healthy economic data on both sides of the Atlantic, German insurers' share prices again recorded strong growth in 2013, at 27%. Price growth for 2012 and 2013 combined was almost 92% compared with 2011. In 2013, price trends almost exactly mirrored Germany's DAX index. Whereas insurers significantly outperformed the DAX in the spring, the gap between the two indices narrowed again in the summer, and the 27% price increase posted by insurance stocks at the

Figure 12 Sector index for German insurance shares



end of the year was only marginally better than the 26% recorded by the DAX. However, as in the previous year, insurers clearly outperformed the banks, which only managed a price increase of just under 12% in 2013.

Further contraction in credit default swap spreads

CDS spreads for European insurers retreated further in 2013, narrowing by an average of 44%. Among other things, this is due to the subsiding European sovereign debt crisis, strong economic data and the continuing accommodative monetary policy stance of the central banks. 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. Allianz's CDS spread in particular narrowed considerably by 46% in 2013, with the result that the CDS spreads for the two major German insurers were almost identical at the end of 2013, at 44 (Allianz) and 43 (Munich Re) basis points.

Rating agencies reported a stable outlook for German insurers in 2013. They stressed that

Figure 13 CDS spreads for selected insurers

the insurers remained resilient – despite the persistently low level of interest rates and investment income. The *Zinszusatzreserve* (an additional provision to the premium reserve introduced in response to the lower interest rate environment) that insurers have been obliged to establish since 2011 had no negative impact on the outlook. With an eye on the low interest rates, however, the rating agencies called on life insurers in particular to reduce their exposure to investment products that are sensitive to interest rate movements. The undertakings could lift their income, for example, by rolling out a greater number of product innovations.

Moderate loss levels

With total losses of US$125 billion and insured losses of US$31 billion, loss levels in 2013 were lower than both the previous year and the ten-year average. Total losses in 2013 were 28% lower than in the previous year and 32% lower than the ten-year average. Insured losses fell even more sharply – by 52% compared with the previous year and 45% compared with the ten-year average. The largest economic losses were attributable to the damage caused by flooding in Europe (US$15.2 billion). However, at US$3.7 billion, the largest insured losses were caused by hailstorms in Germany. The largest humanitarian disaster was caused by typhoon Haiyan in the Philippines, which killed more than 6,000 people.

3.3 Position of the insurance sector[27]

The insurance business is still dominated by a low interest rate environment, which is depressing insurers' income and making it more difficult for them to meet their contractual benefit obligations. Life insurers and *Pensionskassen* are affected by this in particular. If interest rates remain at today's level, income from investments will decline faster than the guaranteed interest in the portfolio. *Pensionskassen* are even more heavily impacted by this than life insurers due to the longer-term nature of their business, even if they have other compensation mechanisms.

Life insurers have established a *Zinszusatzreserve* (an additional provision to the premium reserve introduced in response to the lower interest rate environment) since 2011. Although this represents a high additional cost, it is necessary to ensure that guarantee obligations can be fulfilled in the long term.

The introduction of Solvency II on 1 January 2016 will result in additional expenses for the life insurance sector to ensure its ability to comply with the requirements of the new framework. These factors mean that conditions for the insurance industry are not straightforward.

Nevertheless, the life insurers and *Pensionskassen* will be able to meet their benefit obligations in the short and medium term. However, to ensure their long-term ability to meet obligations, and due to the prevailing low interest rate environment, forward-looking measures are required outside the individual undertakings' areas of responsibility.

New investment strategies

In order to mitigate the effects of the low interest rate environment, insurance undertakings are developing new investment strategies, among other things. For example, there is growing interest in long-term investments in infrastructure and real estate. In principle, BaFin has no objections to these kinds of investments, which insurers expect to deliver higher investment income.

The undertakings must also be able to assess the risks of such investments, however, and must have adequate risk management. Providers of products in particular are calling for the supervisory requirements to be changed. For example, they are asking for investment ratios and caps to be relaxed or extended as part of the revision of the Investment Regulation (*Anlageverordnung* – AnlV). However, both BaFin and the insurers believe that the undertakings' readiness to invest is currently limited less by overly tight supervisory requirements, but rather by a lack of attractive investment opportunities from a risk/reward perspective.

27 The 2013 figures are only preliminary. They are based on the interim reporting as at 31 December 2013.

3.3.1 Life insurers

Business trends

New direct life insurance business declined by 11.9% year-on-year, from 5.9 million to 5.2 million new policies in 2013. The total value of new policies underwritten decreased accordingly by 7.7% to €239.8 billion (previous year: €259.9 billion).

The share of the total number of new policies accounted for by term insurance policies increased by 1.5 percentage points year-on-year to 32.0%. The share accounted for by endowment insurance policies declined by 0.8 percentage points in the same period, to 11.3%. This represents a decline from 710,846 policies to 594,262. The share attributable to pension and other insurance contracts also recorded a decrease, falling by 0.7 percentage points to 56.7%, which is reflected by a decline from 3,371,055 policies in the previous year to 2,973,686.

Early terminations of life insurance policies (surrender, conversion to paid-up policies and other forms of early termination) declined slightly from 2.9 million contracts in 2012 to 2.8 million contracts in the year under review. By contrast, the total sum insured under contracts terminated early rose slightly to €111.3 billion (previous year: €109.1 billion). The proportion of early terminations of endowment policies declined from 28.0% in the previous year to 26.0%, and the proportion of the total sum insured decreased from 17.7% to 15.4%.

There were a total of 86.9 million direct insurance contracts in 2013, representing a 2.0% decrease compared with the previous year. By contrast, the sum insured rose to €2,794 billion (+2.2%). Term insurance policies recorded a decrease both in the number of contracts – from 13.7 million to 12.6 million – and in the sum insured, which declined from €695.4 billion to €668.7 billion. Pension and other insurance contracts continued the positive trend recorded in the previous years. Their share of overall policies rose from 45.5% to 48.1%, while their share of the total sum insured rose from 47.7% to 51.1%.

Gross premiums written in the direct insurance business of the life insurers supervised by BaFin amounted to €86.2 billion in the year under review (previous year: €82.5 billion). This represents a 4.5% increase as against the previous year.

Investments

Aggregate investments increased from €764 billion to €793 billion (+3.8%). Since interest rates on the capital market have recovered slightly, net hidden reserves at the end of the year decreased to €72.0 billion (previous year: €102.6 billion). This corresponds to 9.1% of the aggregate investments, following 13.4% in the previous year.

Preliminary figures put the average net investment return at 4.62% in 2013, on a level with the prior-year figure of 4.6%. The reason for the high net return is that the insurers have increasingly liquidated valuation reserves in order to fund the high cost of establishing the *Zinszusatzreserve*.

Projections

BaFin surveyed the life insurers using two projections in the year under review: one as at 30 June, the other as at 30 September 2013. 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 changes in the insurers' business performance, solvency and valuation reserves.

For the projection as at 30 June, the insurers had to simulate the impact of a 20% drop in equity prices and a 200 basis point rise in interest rates on their current profit for the year. The latter scenario allows BaFin to assess the impact of a significant short-term interest rate hike on the insurers' performance.

All of the life insurers included in the projection were able to withstand the defined scenarios financially: they would be able to fulfil their obligations even if the capital market scenarios used were to materialise.

In the projection as at 30 September, the insurers also had to factor in the four subsequent financial years. The evaluation of the expanded projections submitted confirmed BaFin's assessment that the life insurers can fulfil their contractual obligations in the short to medium term.

However, the multi-year projection showed that the insurers' financial position would again deteriorate in 2017. As a result of this outlook, BaFin will also continue to pay close attention to ensuring that the insurers analyse their future financial development at an early stage and in a forward-looking and critical manner in a persistently low interest rate phase. It is essential that the life insurers introduce appropriate measures in time and make the relevant preparations. Many insurers will therefore have to ask themselves in the coming years whether further reducing discretionary bonuses is necessary, or even inevitable.

Solvency

All life insurers comply with the solvency requirements according to the projection as at 31 December 2013. The downward trend of the past years continued, however. Whereas the solvency margin ratio requirement was still 169% in the previous year, it declined in 2013 to a projected figure of 161%.

Life insurers reduce discretionary bonuses

Because interest rates for new investments are still low, many life insurers further reduced their discretionary bonuses for 2014. 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 3.31% for the sector. This figure was 3.51% in 2013 and 3.80% in 2012.

Zinszusatzreserve

Since 2011, life insurers have had to establish a *Zinszusatzreserve* to provide for the lower investment income in the future and the guarantee obligations, which remain high. They spent a good €6 billion on this in 2013 alone. In the year under review, policies with a guaranteed return of 3.5% were also included in the *Zinszusatzreserve* for the first time because the reference interest rate fell to 3.41%.

The cumulative *Zinszusatzreserve* therefore stood at an absolute amount of €13.3 billion at the end of 2013. Establishing the *Zinszusatzreserve* is a heavy burden on the sector, but it is the right tool for securing policyholders' guarantees for the long term in low interest rate periods.

Policyholder participation in the valuation reserves

The current arrangements for policyholder participation in the valuation reserves (funded by fixed-income securities) are having the effect of making insurers pay out particularly high amounts to their outgoing customers in the current low interest rate environment. This is caused by the hidden reserves from fixed-income securities, which rose from €3 billion at the start of 2011 to almost €90 billion at the end of 2012 due to declining capital market interest rates. Outgoing policyholders therefore received additional payouts of almost €3 billion in 2012. Another payout of this size is expected for the year under review. This siphons off a disproportionate amount of funds from the much larger group of remaining policyholders, meaning that this group's discretionary bonus is more heavily reduced. Customers whose contracts still have a long duration gain nothing from the currently high valuation reserves funded by fixed-income securities because these will be reversed in the medium to long term.

This disadvantage of the current legal rules on participation in the valuation reserves is known. BaFin still believes it is necessary to correct the rules.

Judgements of the Federal Court of Justice

In the second half of 2012, the Federal Court of Justice (*Bundesgerichtshof* – BGH) ruled on several occasions[28] that certain clauses in the general terms and conditions of insurance policies are ineffective. The clauses were used in endowment insurance contracts as well as for deferred and unit-linked pension insurance contracts. They provide for the acquisition costs to be offset by the first premiums paid by the policy holder using the zillmerisation method. The BGH believes that such clauses inappropriately disadvantage policyholders and are therefore materially ineffective.

The clauses declared ineffective created a gap in the rules: if a policyholder cancelled their contract early or converted it into a paid-up policy, it was unclear how to calculate the surrender value or the paid-up sum insured and how to offset the acquisition costs.

The BGF ruled on these issues with its judgements of 11 September 2013.[29] According to these judgements, the policyholder is owed the obligation promised in principle, but the surrender value must reach a certain minimum amount. The minimum amount corresponds to half of the non-zillmerised net premium reserve calculated based on the actuarial assumptions used in the premium calculation.

The BGH thus carried over its ruling from 2005[30] on calculating the surrender value in the case of intransparent clauses from the 1994 to 2001 tariff generation and extended it to contracts that were entered into until the end of 2007. As a result, all contracts entered into until the end of 2007 that are based on the ineffective clauses mentioned are treated in accordance with the same principles.

According to the BGH, section 169 (3) sentence 1 of the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG) only applies to contracts entered into after 2008. In this case, the surrender value corresponds in principle to the net premium reserve of the insurance policy. If the policyholder cancels their contract, the net premium reserve must equal at least the amount resulting from equal allocation of the recognised acquisition and distribution costs over the first five years of the policy.

BaFin will ensure that the policies concerned are subsequently adjusted by the insurance undertakings and that justified claims are paid out in a timely manner.

New products

Some life insurers are responding to the low interest rates and the future capital regulations under Solvency II by developing new products. Unlike purely unit-linked insurance policies, in which the investment risk is borne entirely by the customer, the product innovations in the year under review contain guaranteed benefits.

BaFin welcomes the fact that the German life insurance sector is reacting to the changed market conditions by introducing new life insurance products. The insurance industry is thus fulfilling its duty to find appropriate solutions to the current low interest rate environment.

In this way, insurers are closer to providing savers who are seeking to make financial provision with a broad-based, sustainable product offering that meets their respective needs. However, customers should not be overwhelmed by overly complex products – new products must be understandable.

28 Judgements dated 25 July 2012 (case ref.: IV ZR 201/10), 19 December 2012 (case ref.: IV ZR 200/10), 14 November 2012 (case ref.: IV ZR 198/10) and 17 October 2012 (case ref.: IV ZR 202/10).

29 Case refs.: IV ZR 17/13 and IV ZR 114/13.

30 Judgement dated 12 October 2005 (case ref.: IV ZR 162/03).

3.3.2 Private health insurers

Business trends

The 48 private health insurers supervised by BaFin generated premium income of approximately €36 billion in 2013, representing year-on-year growth of around 1%. This means that premium growth was lower than in the previous year. This is attributable to two key reasons:

Firstly, health insurers have offered significantly fewer starter tariffs since 2012. These tariffs were subject to public criticism in the past. The smaller volume of new business is leading to lower premium growth.

Secondly, the debates about changes in the healthcare system and political developments both affected the market for private health insurance. Potential customers tended to await further developments and deferred taking out private health insurance. The discussion about the gender-neutral tariffs and their mandatory introduction in December 2012 probably also played a role in this context. This also had a negative impact on new business in the year under review.

Comprehensive health insurance, with almost nine million persons insured and premium income of €25.9 billion, continues to be the most important business line for the private health insurers. It accounts for around 73% of all premium income. Together with the other types of insurance, such as compulsory long-term care insurance, daily benefits insurance and other partial insurance types, the private health insurance undertakings insure more than 38 million people.

Investments

The health insurers increased their investment portfolio by 7% to approximately €218 billion in the year under review. Investments remained focused on fixed-income securities. *Pfandbriefe*, municipal bonds and other debt instruments accounted for approximately 24% of all investments. These were also the largest single item in the portfolio of direct investments. Listed debt instruments accounted for a further 13%, while promissory note loans and registered bonds issued by credit institutions accounted for 20%. The health insurers invested around 22% of their portfolio in investment funds. BaFin did not identify any significant shifts between the asset classes.

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. Interest rates rose slightly, but remained at a very low level. The health insurers' reserve situation therefore remains comfortable. Net hidden reserves contained in the investments amounted to almost €27 billion as at 31 December 2012; they decreased by around 20% year-on-year to €21 billion due to the slight interest rate rise.

Preliminary figures put the average net investment return at around 4% in the year under review, more or less at the previous year's level of just over 4%.

Projections

BaFin also surveyed the health insurers using two projections in the year under review to simulate the impact of negative capital market developments on the insurers' performance. It uses the projections as an additional risk-based supervisory tool on top of the BaFin stress tests. The projections were prepared as at 30 June 2013 and as at 30 September 2013.

As in the previous years, BaFin's projection as at 30 June 2013 defined four different scenarios based on market developments. Like the life insurers, the health insurers had to simulate the impact of a 20% drop in equity prices and a 200 basis point rise in interest rates on their current profit for the year. The latter scenario allowed BaFin to assess the effects of a significant short-term interest rate rise. BaFin asked 37 health insurance undertakings to prepare the projection and report the results. It exempted 12 insurers from the requirement to submit a projection because of the very low-risk nature of their investment portfolio.

All of the health insurers included withstood the assumed scenarios financially. In all four scenarios, all of the health insurers were able to meet their guaranteed return obligations. In a small number of cases, net investment income falls slightly short of the level needed to finance the technical interest rate for the provision for increasing age. However, the undertakings would have been able to generate sufficient surpluses from other sources (e.g. safety loading) to guarantee the necessary addition to the provision for increasing age.

The projection as at 30 September 2013 focussed on examining the impact of the low interest rates on the insurers. BaFin requested an additional five-year projection for this. In one scenario, the insurers had to assume that new investments and reinvestments were made exclusively in ten-year *Pfandbriefe* with an interest rate of 2.5%. In a second scenario, the health insurers could make new investments and reinvestments according to their corporate planning.

Forty insurers participated in the projection as at 30 September 2013. BaFin exempted just nine insurers that offer Non-SLT health insurance from participating. These do not have to establish a provision for increasing age and do not have to generate a specific technical interest rate.

Solvency

All health insurers comply with the solvency requirements according to the projection as at 31 December 2013. At an estimated approximately 248%, the required solvency margin ratio for this sector is expected to be slightly lower than the 252%[31] reported in the previous year. The sector continues to have a good level of own funds.

Emergency tariff

Since the introduction of the compulsory insurance requirement in 2009, non-paying policyholders can no longer have their insurance cancelled. Previously, their contracts were suspended and the benefits reduced to an emergency level, and after one year they were insured under the basic tariff. Since the insurance premiums for this were higher than those of the original tariff in most cases, the amount of outstanding premiums rose. In other words, the regulations did not have the desired effect of protecting policyholders who owed premiums from further overindebtedness and avoiding a financial burden on the policyholders as a group.

An emergency tariff was therefore introduced in private health insurance on 1 August 2013. Policyholders who do not meet their obligation to pay premiums will be transferred to the emergency tariff following a statutory dunning process. The original tariff remains suspended until all outstanding premium amounts, including the surcharges for late payment and the collection costs, are paid. Consequently, there have been no more compulsory transfers of suspended contracts to the basic tariff since the introduction of the emergency tariff.

The aim of the legislation was to ensure the lowest possible premium in the emergency tariff. Policyholders insured under the emergency tariff therefore only have access to benefits required to treat acute illnesses and painful conditions as well as for pregnancy and motherhood. Provisions for increasing age are no longer established. Furthermore, provisions for increasing age that have already been accumulated can also be used to reduce premiums. These withdrawals are capped at 25% of the monthly premium. Provisions for increasing age otherwise serve as a financial buffer that can be accumulated in younger years to prevent premium increases in old age, or at least to mitigate them. According to present information, the monthly contributions are usually around €100.

Additionally, insurance contracts that were already suspended under the previous regulations at the date on which the emergency

31 This refers to the figure as at 31 December 2012 that was forecast at 266% in the 2012 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.

tariff entered into force are deemed to be transferred to the emergency tariff with retroactive effect from the date on which the benefits of the contract were suspended, if the monthly premium under the emergency tariff is lower than the premium owed at the date of suspension. However, the policyholder concerned has the right to object to the retroactive switch within six months after the insurer has informed them of their right to object and of the consequences of the retroactive insurance.

Results of the ACIRP

The ACIRP (Actuarial Corporate Interest Rate Process) is a forward-looking, preventive supervisory tool that forecasts the current return obtainable with a degree of certainty in the next two financial years.

In this year's ACIRP (forecast for financial year 2014), 18 insurers were unable to demonstrate that they would also be in a position to generate the technical interest rate used in the calculation in the future with the required high level of security. The undertakings should therefore lower the technical interest rate accordingly in all tariffs if premiums are adjusted.

In addition, the relevant working groups of the German Actuarial Association (*Deutsche Aktuarvereinigung e.V.* – DAV) are currently considering how a sufficient excess yield can be generated when setting the technical interest rate in future so as to stabilise the premiums for older policyholders.

3.3.3 Property and casualty insurers

Business trends

Property and casualty insurers recorded a year-on-year increase in gross premiums written in the direct insurance business in 2013 to €64.7 billion (previous year: €60.5 billion).

Gross expenditures for claims relating to the year under review increased by 14.6% to €24.0 billion (previous year: €21.0 billion). Gross expenditures for claims relating to previous years rose only slightly year-on-year, by 1.9% to €15.1 billion. Provisions recognised for individual claims relating to the year under review amounted to €18.9 billion, compared with €15.6 billion in the previous year, while provisions recognised for individual claims relating to prior years amounted to €50.7 billion, compared with €48.4 billion in the previous year.

With gross premiums written amounting to €22.5 billion, motor vehicle insurance was by far the largest insurance class, rising by

Right to change to a closed tariff

The right to change tariffs in accordance with section 204 (1) sentence 1 no. 1 of the VVG also includes the right to change to a closed tariff; the only thing that is not possible is switching from a gender-neutral tariff back to a gender-specific tariff. BaFin notified this interpretation of the law to a private health insurance undertaking that did not allow its policyholders to switch to closed tariffs, i.e. tariffs no longer available in the market for new contracts. The Federal Ministry of Finance and the Federal Ministry of Justice confirmed this interpretation of the law.

Neither the wording of the Act nor the legal materials contain any indications that policyholders may only change to tariffs available in the market. Furthermore, section 204 (1) sentence 1 no. 1 last half-sentence of the VVG was explicitly amended in April 2013 to prohibit switching from the new gender-neutral tariffs to the gender-specific tariffs that have been closed to new contracts from 21 December 2012. If the legislation had assumed a restricted right to change tariffs originally, this amendment would not have been required.

7.3% compared with the previous year. Gross expenditures for claims relating to the year under review rose by 13.4% year-on-year, while gross expenditures for claims relating to previous years were up 2.1% and thus recorded a comparably low increase. Overall, gross provisions recognised for individual claims relating to the year under review rose by 13.8% year-on-year, while they increased by 1.4% for outstanding claims relating to the previous year.

Property and casualty insurers collected premiums of €8.4 billion (+7.3%) for general liability insurance. At €0.95 billion, claims relating to the year under review rose by 5.1% year-on-year. Property and casualty insurers paid out €2.6 billion (+6.2%) for claims relating to previous years. Gross provisions for individual claims, which are particularly important in this insurance class, rose by 14.8% to €2.6 billion for outstanding claims relating to the year under review, while gross provisions for outstanding individual claims relating to the previous year rose to €15.2 billion (+4.6%).

Insurers recorded gross fire insurance premiums written of €1.8 billion (+10.4%). Gross expenditures for claims relating to the year under review declined by 3.2% to €477.0 million.

Insurers collected premiums for comprehensive homeowners' insurance and comprehensive contents insurance contracts of €8.1 billion (+8.6%). Expenditures for claims relating to the year under review rose drastically by 31.3% year-on-year, and provisions for individual claims also increased significantly by 83.0%. Expenditures for claims relating to previous years were down 2.4% on the prior year, while provisions for claims relating to previous years rose by 3.5% compared with 2012.

Premium income for general accident insurance contracts rose marginally from €6.1 billion in the previous year to €6.3 billion in the year under review (+3.5%). Gross expenditures for claims relating to the year under review amounted to €338 million. €2.1 billion was reserved for outstanding claims relating to the year under review (+5.4%).

Higher losses from natural events

Germany was impacted by a large number of natural events in the year under review, which led to unusually high claims expenditures for the German property and casualty insurers. By far the most expensive natural disaster in the first half of the year were the floods in central Europe. The losses amounted to approximately €12 billion, of which a good €2.3 billion was insured.[32] The German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e.V.* – GDV) estimates total losses of €1.8 billion for German insurers. Many rivers recorded historically high levels; Passau, for example, reported the highest water level since 1501. Although in many places water levels rose higher than in the 2002 Elbe flood, the amount of insured losses was below the €3.4 billion paid for that flood in 2002.

The second half of the year brought with it more payouts for the property and casualty insurers. For example, the severe hailstorms in July and August caused total insured losses of €3.1 billion[33], with Baden-Württemberg and Lower Saxony particularly affected. The hailstorms were the most expensive loss event in the world during the year under review, and Germany's most expensive hail event ever. They were followed by the severe storms Christian and Xaver in autumn and early winter, each of which are likely to have caused insured losses in the three-digit millions.

These natural events will probably push the average combined ratio of the property and casualty insurers significantly higher than 100%. This will particularly impact those insurers that have a high share of business in the regions and insurance classes that were especially affected by the natural events. This applies to the public insurers, for example, since they are almost exclusively regionally active and are traditionally heavily represented in residential building insurance.

32 Munich Re: NatCatService.

33 Munich Re: NatCatService.

Solvency

At 308%, the solvency margin ratio for property and casualty insurers at the end of 2012 was slightly higher than the previous year's figure of 306%. This increase 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 higher than that of the solvency margin to be established, causing the solvency margin ratio to rise slightly overall.

With the exception of one insurer, all property and casualty insurers complied with the solvency requirements as at 31 December 2012. BaFin has introduced measures to restore solvency margin coverage. The sector's own funds are still at a very high level and significantly higher than the minimum capital requirements.

3.3.4 Reinsurers

Business trends

The large number of natural events in Germany also impacted the reinsurers' overall claims. The hailstorms in Germany and the floods in central Europe were among the prominent natural disasters in financial year 2013. At US$31 billion, reinsurers' overall claims worldwide were nevertheless slightly below average because there were no further loss-intensive natural disasters, and the hurricane season in particular was very mild. Reinsurers are expecting combined ratios significantly lower than 100%.[34] However, this does not apply to reinsurers that are strongly focussed on the German market.

Claims expenditure in 2013, which was slightly below average worldwide, also increased the pressure on rates, particularly where covering natural disaster risks is concerned.

The key driver for competitive pressures was the strong inflow of alternative capital, however. Hedge funds and pension funds are increasingly investing in catastrophe bonds and collateralised reinsurance. The market for insurance-linked securities (ILSs) now has a volume of around US$45 billion and makes up almost 15% of the global reinsurance market for catastrophe risk.[35] In light of the low interest rates, investors are drawn to the relatively attractive returns in the ILS market.

Although capital market investors increasingly also take into account other risks such as longevity risk when searching for returns, the ILS market continues to be heavily dominated by natural disaster risk, especially US risk. The intensified competitive pressure caused by the inflow of alternative capital therefore primarily impacts reinsurers who, like the ILS market, focus on covering natural disaster risk.

Overall, competitive pressure in the reinsurance sector is increasing. Pressure on profitability in the reinsurance business is continuing to rise at the same time in light of the persistently low interest rates.

Solvency

At the end of 2012, the supervised reinsurers in Germany had own funds amounting to €72.2 billion (previous year: €69.1 billion). The solvency margin as at the same date was €7.4 billion (previous year: €6.8 billion). This reduced the solvency margin ratio slightly to 971.8% (previous year: 1,018.9%).

With the exception of one undertaking, all reinsurers complied with the solvency requirements as at 31 December 2012. The one undertaking increased its own funds so that it now complies with the solvency requirements.

As before, the reason for the high level of own funds is the unusual feature of the German insurance industry that certain large German reinsurers also assume the function of holding

34 Swiss Re: Global insurance review 2013 and outlook 2014/15, November 2013.

35 Guy Carpenter: Mid-year Market Overview September 2013.

company 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 269.2% in 2012 for reinsurers supervised in Germany (previous year: 272.6%). The lower average solvency ratio is attributable to disproportionately increased solvency margins. Average own funds also increased in 2012, which is probably primarily due to significantly reduced claims expenditures relating to natural disasters compared with the previous year (earthquakes in Japan and New Zealand, floods in Thailand).

3.3.5 *Pensionskassen*

Business trends

According to projections, growth in premium income for all *Pensionskassen* was lower in 2013 than in the previous year. Premium income amounted to approximately €6.4 billion in the year under review, a year-on-year rise of around 2.6%. The increase was 5.9% in 2012.

As in the previous year, the premium income of the *Pensionskassen* competing on the open market (*Wettbewerbspensionskassen*), which have been established since 2002, rose only slightly, amounting to approximately €2.7 billion.

In the case of *Pensionskassen* funded largely by employers, premium income trends depend on the headcount at the sponsoring company. The premium income of these *Pensionskassen* also continued to rise, and amounted to around €3.7 billion (previous year: €3.6 billion).

Investments

The aggregate investment portfolio of the 146 *Pensionskassen* supervised by BaFin increased by around 6.3% in 2013 to approximately €131.1 billion (previous year: €123.3 billion). The dominant investment types are still 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 continues to report high valuation reserves, especially in interest-bearing securities. Based on preliminary figures, the *Pensionskassen* had hidden reserves across all investments of approximately €12.5 billion at the end of the year (previous year: €16.7 billion). This corresponds to roughly 9.5% of the aggregate investments, following 13.5% in the previous year.

Projections

BaFin asked the *Pensionskassen* to prepare projections as at 30 September 2013 in which they projected their profit for the financial year in four equity and interest rate scenarios. The projection was also extended by four years in light of the persistently low interest rate phase.[36]

The projections revealed that the solvency margin ratio is more or less at the prior-year level. The undertakings comply with the solvency requirements as a rule. The sector's short-term risk-bearing capacity therefore seems to still be assured. Based on the projections, the net return on investment for all *Pensionskassen* was approximately 4.3% in 2013, down slightly on the figure for the previous year (4.4%). The persistently low interest rates are proving to be a particular challenge for the sector. 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. If it should be necessary for individual *Pensionskassen* to reinforce their biometric actuarial assumptions or reduce the technical interest rate, it may become more difficult for the *Pensionskassen* to finance increases in reserves that then prove to be necessary.

Solvency

The forecast solvency margin ratio for the *Pensionskassen* was an average of 134% as at

36 See chapter IV 2.6.

the 2013 reporting date, matching the figure for the previous year. According to the estimates, three *Pensionskassen* were unable to meet the solvency margin ratio in full as at 31 December 2013. They forecast shortfalls of widely differing amounts. BaFin 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. The two other *Pensionskassen* submitted plans some years ago; BaFin checks compliance with these on an ongoing basis.

Impact of the low interest rate environment

The low interest rates are heavily impacting the *Pensionskassen*. If interest rates remain at today's level, *Pensionskassen* will be hit even harder than the life insurers due to the longer-term nature of their business. Unlike life insurers, the contracts held by *Pensionskassen* are almost exclusively policies that provide for the payment of lifelong pensions to the insureds.

BaFin is therefore supervising and supporting the *Pensionskassen* intensively so that they can retain and further strengthen their risk-bearing capacity even in a long-term low interest rate environment, and will continue to do so in 2014.

Pensionskassen should take measures to strengthen their risk-bearing capacity as early as possible; this is also underlined by the results of the projection mentioned above. In the year under review, BaFin still had to make some Pensionskassen aware of the fact that, in times when investment income will probably decline further, strengthening margins takes priority over discretionary bonuses.

As a rule, *Pensionskassen* with the legal form of stock corporations belong to guarantee schemes in accordance with section 124 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG). If an employer offers occupational retirement provision via a *Pensionskasse*, it is legally obliged to pay the benefits directly to the employees if necessary (subsidiary liability of the employer under the Occupational Pensions Act (*Gesetz zur Verbesserung der betrieblichen Altersversorgung* – BetrAVG). This gives the affected employees additional security.

3.3.6 Pension funds

Business trends

Pension funds recorded gross premium income of €742 million in the year under review. This represents a significant decline compared with the previous year (€831 million). The fluctuations in premium income are attributable in particular to the fact that, in pension funds, the premiums are often paid in the form of single premiums, depending on the type of commitment agreed.

The number of beneficiaries rose to a total of 927,240 persons in the year under review (previous year: 908,184), with 597,930 beneficiaries being members of defined contribution plans and 40,494 members of defined benefit plans. The majority of the pension funds newly authorised in previous years focused on 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.

Benefit payouts decreased from €1,563 million to €1,280 million in the year under review. The payouts were made to 290,404 persons who drew benefits.

Investments

Investments for the account and at the risk of pension funds increased from €1,372 million to €1,602 million in the year under review, a rise of 16.8% (previous year: +15.4%). Pension fund portfolios were dominated by contracts with life insurers, bearer bonds, other fixed-income securities and investment units. At the 31 December 2013 balance sheet date, net hidden reserves in the investments made by pension funds amounted to approximately €42 million. All 31 pension funds supervised by BaFin in 2013 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 2013, from €26.5 billion in the previous year to approximately €26.6 billion. Roughly 92.2% of these investments consisted of investment units. These investments are measured at fair value in accordance with section 341 (4) of the Commercial Code (*Handelsgesetzbuch* – 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.

Projections

In 2013, BaFin asked all 31 pension funds to submit an extended projection as at 30 September 2013. The observation period for the projection was extended to five years (current financial year plus four subsequent years). In order to limit complexity, the results for the current financial year were only extrapolated in one scenario. The objective of extending the projection was to better assess the medium-term ability to meet guarantees and changes in solvency against the background of the persistently low interest rate phase. 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 20% 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.

The assessment of the projections indicated that the 31 pension funds included would be able to withstand the defined scenarios financially.

Solvency

According to the projection in the year under review, all of the supervised pension funds had sufficient available own funds free of foreseeable liabilities and hence complied with the solvency requirements. 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 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.

3.4 Supervision of cross-border insurance groups

At the end of 2013, BaFin was involved in supervising a total of 29 insurance groups that operate cross-border business activities via subsidiaries. The importance and size of these groups varied considerably. There were both globally active insurance and reinsurance groups and very small groups of companies.

For 16 of the 29 groups, BaFin was the group supervisor. This meant that it had the lead role in exercising group supervision and also had to ensure that the supervisors involved worked together effectively and efficiently. To achieve this, BaFin coordinated the exchange of information between the supervisors involved in institutionalised working groups, the supervisory colleges.

Focus of the EEA supervisory colleges

The EEA supervisory colleges intensified their exchange of information to allow them to better analyse the risk exposures of the supervised insurance undertakings by working together. The aim was and is to further strengthen group supervision. As group supervisor, BaFin was able to apply its proven risk classification methodology to the supervisory colleges under its leadership. If necessary, it adapted the flow of information between the responsible authorities to this methodology. BaFin also ensured that all of the supervisory colleges it leads are already working today in accordance with the future EIOPA Guidelines for supervisory colleges.

National supervisory colleges

A national supervisory college was held for almost all insurance groups in 2013. National colleges are used to exchange information between all authorities involved in group supervision and BaFin's directorates. They take the form of a meeting of all BaFin and *Bundesbank* supervisors who are actively supervising the insurance group in question. Together, they identified cross-group risk areas in 2013 and discussed internal, cross-divisional issues at the groups, such as the preparations for their internal models. The participants rated the technical exchange of information very highly and were able to deploy the knowledge they had gained to good effect in their daily work. The national colleges will therefore be held each year in the future.

The regular exchange of information between all authorities involved in group supervision and BaFin's directorates is indispensable. Nowadays, a large number of insurance groups are active in more than one class of insurance in the German market – they offer not only life, but also health and accident insurance. The centralisation of activities within the groups means that investment and asset management companies are also often part of insurance groups. Additionally, financial conglomerates are active in the banking business, and the institutions therefore approach the supervisors with a diverse range of questions.

The issues addressed by the international colleges attended by the representatives of foreign supervisory authorities, and regularly by EIOPA representatives as well, do not overlap with the national colleges. The international colleges focus on matters of cross-border relevance, while topics that are of specific relevance for the German market take a back seat.

3.5 Measures to protect policyholders

3.5.1 Incentives in insurance sales

The sales networks of insurance undertakings have been increasingly attracting a bad press in recent years. Travel incentives are a prominent example of how undesirable developments in the sales networks of individual undertakings can cause considerable damage to their reputation and, ultimately, to the image of the entire industry. BaFin was prompted by this problem to develop corresponding recommendations[37].

BaFin's recommendations are designed to encourage the insurers to be more proactive in structuring their sales networks. Through individual agreements with their agents and distributors, the insurers can establish legally binding arrangements and thus prevent damage – for example reputational damage – that can be caused by sales activities to the greatest possible extent. BaFin cannot expect the undertakings to avoid risks entirely – at least as long as insurers take adequate precautions to ensure that they can manage and, if necessary, bear the risks associated with their business activities, such as reputational risk or operational risk.

The insurers must therefore decide what sorts of incentives they can offer their sales network without running the risk of reputational damage, while at the same time not endangering the competitiveness of their sales activities.

The role of insurance supervision

BaFin's responsibility for supervising insurance intermediaries is very limited. It ensures that insurance undertakings only work with agents who comply with the trade law requirements set out in section 34d of the Industrial Code (*Gewerbeordnung*).

In addition, BaFin indirectly supervises "tied agents", who exclusively mediate products of a single insurance undertaking or insurance group. Insurance undertakings are required to work only with tied agents who are reliable and properly qualified and who have an adequate financial position. BaFin ensures that the insurance undertakings comply with this obligation.

37 See expert article Incentives in sales: http://www.bafin.de/dok/4569228.

BaFin has no direct ability to influence the intermediaries' conduct. Supervision of insurance brokers and agents is the responsibility of the chambers of industry and commerce. BaFin is therefore unable to publish binding standards for structuring incentives.

European standards for insurance intermediaries

On 27 November 2013, EIOPA published a report[38] setting out the standards required by the member states for the knowledge, ability and continuing education and training of insurance intermediaries. Based on these, EIOPA has developed its own minimum requirements for knowledge, ability and "continuous professional development". EIOPA is using this report in preparation for the tasks that will arise under the proposed Second Insurance Mediation Directive (IMD2). EIOPA is expected to advise the European Commission on the wording of delegated acts addressing the issues of knowledge, ability and continuous professional development.

Consumer trends

At the end of 2013, EIOPA published a report on consumer trends in 2012[39]. This is based on both quantitative and, for the first time, qualitative information reported by the national supervisory authorities. EIOPA identified several interesting trends after evaluating this data. For example, new sales and marketing channels are evolving for insurance, especially on the Internet where consumers are also increasingly relying on comparison websites. According to EIOPA, new products on the market include cell phone insurance as well as new forms of packaged products, for example new bank accounts bundled with the sale of insurance. However, the consumer report also draws attention to problems: consumers are frequently buying inappropriate insurance products because of poor advice, misleading – or even deliberately withheld – information.

3.5.2 Product information sheets

With an eye on collective consumer protection, an area which BaFin also systematically promotes as part of its insurance supervisory activities, it examined both legal aspects and the wording of product information sheets (see info box "Product information sheets", page 155) used in life insurance and in property and casualty insurance during the year under review.

BaFin did not identify any systematic breaches by insurers of the requirements of the Regulation on Information Obligations for Insurance Contracts (*VVG-Informationspflichtenverordnung* – VVG-InfoV). There were only breaches in a small number of cases. For example, some insurers overloaded their product information sheets in part with unnecessary additional information. This has an adverse effects on the clarity of the information. In some cases, insurers did not explain technical terms in sufficient detail.

It was apparent that insurers were using inappropriately small typefaces in some product information sheets, and that the information printed on the product information sheets was too dense, which impaired their readability.

Although BaFin can verify compliance with the provisions of section 4 (2) of the VVG-InfoV relatively easily, assessing the layout of the product information sheets and the language used in them is much more difficult. The VVG-InfoV gives the insurance undertakings a certain degree of freedom in this respect.

BaFin will incorporate the results of its examination in the course of its ongoing supervision and will discuss the individual results with the undertakings concerned. Additionally, BaFin used this examination as an opportunity to urge industry representatives to make the product information sheets more understandable and transparent.

38 EIOPA Report on Good Supervisory Practices.

39 EIOPA Consumer Trends Report, 11 November 2013.

Product information sheets

Product information sheets contain consumer information that insurers are required by section 7 (2) of the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG) in conjunction with section 4 (1) of the Regulation on Information Obligations for Insurance Contracts (*VVG-Informationspflichtenverordnung* – VVG-InfoV) to disclose to policyholders before signature of a contract.

The product information sheets must contain the information that is of particular significance to the conclusion or performance of the insurance contract. Section 4 (2) of the VVG-InfoV lists this information in detail:

In addition to details on the type of insurance contract on offer, a description of the risks insured and the excluded risks is particularly important, for example. The insurer must also disclose details on the level of the premium, when it is due and the period for which it is payable. The policyholder must be informed of the consequences of late or non-payment of premiums. The product information sheets must also contain information about benefit exclusions.

Information on the obligations that the policyholder has to comply with when the contract is concluded, during the lifetime of the contract and if the insured event occurs are also particularly significant. In addition, the insurer must inform the policyholder about the legal consequences of non-compliance with these obligations. Moreover, the product information sheets must contain information about when cover begins and ends. Finally, policyholders must be informed about options available to them for terminating the contract.

Under section 4 (5) sentence 2 of the VVG-InfoV, the insurer must present the information concisely in a clear and comprehensible format.

More transparent information about costs

BaFin believes that there is a need to further reinforce consumer protection: insurance contracts should be more transparent in future. For example, there should be a requirement to disclose more detailed information about administrative costs. This would allow policyholders to compare different insurance quotations more easily.

3.5.3 Claims settlement practices

A number of allegations have appeared in the media recently that insurers are systematically delaying the payment of benefits or even refusing to pay them at all. It is alleged that they have been exploiting their stronger economic position even though the claims made by the insureds are justified. This prompted BaFin to examine the insurers' claims settlement practices.

BaFin evaluated both the court and the out-of-court claims settlement practices of the insurers and analysed them in terms of quantitative and qualitative aspects. Examples of questions that arose in this connection included: Are there abusive claims settlement practices in the market, such as conspicuous divergences in rejection rates? Do the insurers apply qualitative management techniques, such as incentives, to optimise their claims settlement?

The reviews are still ongoing. Following the first examinations, BaFin was unable to identify cases in which insurers were systematically delaying or refusing to pay benefits.

BaFin will continue to track this topic and will again examine in 2014 whether insurers are using abusive practices to manage their claims settlement or benefit processing. It will increasingly include this topic in its regular on-site inspections, as well as conduct random reviews of the claims settlement practices of individual insurance undertakings.

Complaints management at insurance undertakings

Collective consumer protection is a very important issue in insurance supervision: BaFin ensures that the insurance undertakings comply with the legal requirements and are fair in their dealings with their customers – for example when handling customer complaints.

BaFin therefore issued a collective decree and Circular 3/2013 (VA)[40] – Minimum requirements for complaints-handling by insurance undertakings, which translated EIOPA Guidelines into national administrative practice for the first time. Since then, all insurers must clearly define their complaints management processes and document them in writing, among other things. The reason for this is that an intelligent complaints management system not only benefits the undertakings themselves, but also the consumers. In addition, it can be extremely profitable to incorporate insights from complaints into claims settlement and product development processes. This is something that also benefits the policyholders.

V Supervision of securities trading and the investment business

1 Bases of supervision

1.1 Investment Code

Supervision of German investment funds and their management companies has been put on a new basis as from July 2013: upon entry into force of the Act Implementing the Alternative Investment Fund Managers Directive (*AIFM-Umsetzungsgesetz*) on 22 July 2013, the Investment Act (*Investmentgesetz – InvG*) of 15 December 2003 was repealed and replaced by the new Investment Code (*Kapitalanlagegesetzbuch* – KAGB). The new Code has resulted in changes to the terminology, among other things. For example, what used to be called "*Kapitalanlagegesellschaft*" is now called "*Kapitalverwaltungsgesellschaft*"; this can take the form of a German AIF management company (*AIF-Kapitalverwaltungsgesellschaft*) or of a German UCITS management company (*OGAW-Kapitalverwaltungsgesellschaft*). The Investment Code also provides comprehensive rules detailing the management and custody requirements for all investment funds. The latter include undertakings for collective investment in transferable securities (UCITS) in accordance with the UCITS Directive previously referred to in the Investment Act as "*richtlinienkonforme Sondervermögen*" (common funds complying with the UCITS Directive), as well as alternative investment funds (AIFs), i.e. all non-UCITS.

The KAGB hinges on the new definition of investment fund (*Investmentvermögen*) because it is this which determines whether the KAGB applies. An investment fund is any collective investment undertaking which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which is not an operating company outside the financial sector. The KAGB covers all investment funds, regardless of their legal form and regardless of whether they are open-ended or closed-ended funds. This means that many investments in Germany's unregulated capital market are for the first time also subject to an authorisation requirement and ongoing supervision. This applies both to the products and to the management companies. In future, participation rights and registered bonds will

Three questions for ...

Karl-Burkhard Caspari, Chief Executive Director Securities Supervision/Asset Management

What was the main focus of your work in 2013?

▶ In 2013, we were kept busy by new regulatory projects and their implementation, in particular by the Investment Code, the European Market Infrastructure Regulation and the High Frequency Trading Act.

What will be your most challenging task in 2014?

▶ 2014 has already got off to a lively start for securities supervision with the insolvency proceedings for profit participation rights provider Prokon, which is not subject to supervision by us. This event has further increased the focus on investor protection. One of our most challenging – and most important – tasks for 2014 is to strengthen this protection. Of course, we also have to keep the interests of other capital market players in mind.

What do you stand for?

▶ For a proactive but sensitive supervisory authority. Supervision has to be strong, but also needs to be exercised reliably and judiciously.

likewise only be considered investments within the meaning of the Capital Investment Act (*Vermögensanlagengesetz* – VermAnlG) if they are not investment funds governed by the KAGB.

Seven regulations entered into force at the same time as the KAGB. For example, the Derivatives Regulation (*Derivateverordnung* – DerivateV) has been completely revised. It implements both the provisions of the KAGB and key elements of the guidelines on exchange-traded funds published by the European Securities and Markets Authority (ESMA) in July 2013. These are intended to improve the basic information provided to investors, for example by requiring a description of the indices and the use of leverage on which the investment strategy is based. In addition, the guidelines contain new rules for OTC (over-the-counter) derivatives transactions, securities lending and repo transactions. For example, the German management company must now be able to terminate securities loans at any time. Moreover, collateral that the fund has accepted in connection with derivatives, securities lending, or repo transactions must not be reinvested. Another regulation, the Investment Accounting and Valuation Regulation (*Kapitalanlage-Rechnungslegungs- und -Bewertungsverordnung* – KARBV), sets out the disclosures required to be made in the annual reports of investment funds and how assets have to be measured. The regulation also specifies that the annual reports have to consolidate information on accounting policies, the risk profile, liquidity management, and the leverage used in a single exhibit. The Investment Audit Reports Regulation (*Kapitalanlage-Prüfungsberichte-Verordnung* – KAPrüfBV) establishes uniform standards for auditing German UCITS management companies (*OGAW-Kapitalverwaltungsgesellschaften*) and German AIF management companies (*AIF-Kapitalverwaltungsgesellschaften*). They specify, for example, that the auditors will in future check whether the requirements of the European regulation on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR) have

been met. In addition, they will have to perform a more detailed assessment of, above all, the valuation technique, the liquidity management system and the results of stress tests.

1.2 European Market Infrastructure Regulation

One focal point of the implementation of EMIR in 2013 was to resolve interpretation issues and to coordinate them with other national supervisory authorities and ESMA. The results have been collated in a list of Questions and Answers, which is continuously updated.[1] The list provides information on how to interpret the EMIR requirements.

The European Regulation had implemented the G20's demand for central clearing and in August 2012 introduced the requirement to clear standardised OTC derivatives via a central counterparty (CCP). CCPs require prior authorisation by the respective national supervisory authority. Since the clearing activities for the financial markets of the EU member states are closely interwoven, a supervisory college consisting of a number of supervisory authorities decides on the authorisation. Central counterparties from third countries can, by contrast, be recognised by ESMA and may operate in the European Union, if they meet the EMIR requirements. The groups of derivatives that will require clearing in the EU in future will be determined by the European Commission on the recommendation of ESMA, as soon as the first central counterparty has been authorised. No central counterparty has to date been authorised in Germany under EMIR.

Clearing is not mandatory for non-standardised OTC derivatives, but the counterparties to these types of contracts have to meet special requirements for managing the risks associated with these transactions. For example, counterparties have to confirm to each other within certain periods that they have entered into OTC transactions and must reconcile the portfolios of such transactions with their respective counterparties at certain intervals. These requirements are intended to ensure that the parties have an overview of their obligations from OTC derivatives transactions at all times.

The EMIR requirements apply to both financial counterparties – such as credit institutions or insurance undertakings already subject to ongoing supervision – and non-financial counterparties of OTC derivatives contracts. This means that counterparties may also be export-focused small and medium-sized enterprises that use OTC derivatives contracts to hedge their currency risk. In December 2013, the European Commission specified in this regard how entities such as local authorities and sole traders are to be classified. The key criterion is whether the entity engages in any business activity. For local authorities, this needs to be examined on an individual basis; sole traders are normally assumed to engage in such activities.

The second key obligation under EMIR in addition to the clearing obligation is that of comprehensive reporting on derivatives transactions entered into. As from 12 February 2014, all derivatives contracts entered into, modified, or terminated prematurely have to be communicated to the trade repository within one trading day. This reporting requirement applies not only to transactions that are cleared centrally, but also to transactions that are entered into bilaterally between two parties and that are not subject to the clearing obligation. Trade repositories are service companies that are initially authorised by ESMA in accordance with the provisions of EMIR and whose activities are then supervised by it. In 2013, ESMA authorised six trade repositories.

1.3 Markets in Financial Instruments Directive

Despite intensive efforts, the European legislative process for the reform of the Markets in Financial Instruments Directive (MiFID) was not completed in 2013. After the European Council had adopted a general approach with proposed

1 http://www.esma.europa.eu/system/files/2013-1959_qa_on_emir_implementation.pdf.

amendments to the European Commission's draft at the end of June, the trilogue negotiations commenced in July. However, the contracting parties were unable to reach a political compromise by the end of the year.

MiFID II will introduce comprehensive regulation of securities transactions by financial institutions and of activities on the financial markets (exchanges, electronic trading platforms). Rules will be adopted for the whole of Europe in several key areas in which Germany has already taken action at a national level (for example regulation of high-frequency trading and fee-based investment advice). In addition to the amended Directive, the legislative proposal includes a Regulation (Markets in Financial Instruments Regulation – MiFIR), which is intended to regulate certain aspects contained in the previous Directive.

Among other things, the MiFID/MiFIR rules will

- improve investor protection by imposing stricter rules on securities investment broking and advice and introducing specific requirements for fee-based investment advice and independent investment advice;
- regulate the development process for financial products (known as product governance, see info box "Product oversight and governance");
- reduce the specific risks for trading on the financial markets associated with high-frequency trading by, among other things, instituting a licensing requirement for high-frequency traders and introducing minimum price variances;
- ensure greater transparency of financial market trading by tightening the transparency requirements and extending them to include derivatives transactions;
- mandate that standardised derivatives must be traded on trading venues;
- set position limits for participants in commodity derivatives markets and introduce special transparency requirements;
- extend regulation to trading on previously unregulated organised trading facilities (OTFs);
- ensure the provisions of MiFID and other European regulations can be applied to commodity derivatives by adopting a broad definition of these types of derivatives, while at the same time taking the interests of the real economy into account.

Product oversight and governance

Product oversight and governance is the name given to the requirements that investment services enterprises have to meet when designing and marketing new financial products. These include determining the target customer group, managing conflicts of interest, conducting stress tests and scenario analyses, making costs more transparent and monitoring product distribution. In addition, post-sale obligations are intended to require investment services enterprises to take suitable action if, for example, a product turns out to be riskier than initially thought. Product governance plays an important role in the international and European debate on enhancing investor protection, for example at the International Organization of Securities Commissions (IOSCO) and at ESMA in relation to the implementation of MiFID II. The aim is to hold the manufacturers of investment products more accountable.

Once the legislative process has been completed, ESMA will release initial draft implementation measures for consultation.

1.4 Market Abuse Directive

In 2013, the European lawmakers also worked on the revision of the Market Abuse Directive.[2] The existing rules are to be expanded and incorporated into the Market Abuse Regulation. The latter aims to harmonise supervisory law in the member states, since it will take effect immediately. The new Regulation will also cover the manipulation of benchmarks such as the

2 Directive 2003/6/EC, OJ EU L 96, p. 16ff.

LIBOR and Euribor reference interest rates. In addition, attempted market manipulation is to be made a criminal offence. What is more, the ability to prosecute market abuse is no longer to be limited to products traded on an organised market. The prohibition will also apply to financial instruments traded on multilateral trading facilities (MTFs) and the new trading venue category of organised trading facilities. In addition, the Regulation provides for possible administrative measures that supervisory authorities can use to react; for example, they can revoke or temporarily suspend authorisations. Moreover, significantly tougher administrative sanctions will be introduced. For example, it will be possible to impose administrative fines running into millions.

There are also plans to harmonise the minimum criminal sanctions applicable in cases of market abuse through a Directive. To date, the member states have had very different rules for these types of sanctions. Although the enactment of specific criminal law provisions will primarily remain the responsibility of the member states, they are required to transpose the new provisions of the Directive into national law.

1.5 Transparency Directive

The revised Transparency Directive entered into force on 26 November 2013.[3] The member states now have two years to transpose it into national law; in the intervening period, ESMA initially will be working on various regulatory technical standards to interpret some provisions in greater detail.

Significantly tougher sanctions have been introduced for violations of transparency requirements. Legal persons will in future face administrative fines of up to € 10 million or 5% of total annual revenue. The use of a company's annual revenue as the basis for imposing an administrative fine is a new feature; the German legal system only applies this mechanism in isolated areas, such as antitrust law. Natural persons must also expect tougher sanctions: the upper limit for fines that can be imposed on them in future will be doubled to at least € 2 million. In addition, it is to become mandatory for national supervisory authorities to publish the sanctions, disclosing the identity of the person responsible and the nature of the violation. Only if there are special reasons and the publication of personal data would be disproportionate will the data be anonymised or publication delayed.

Interim management statements, which have previously been a mandatory reporting requirement, will be abolished. This move is primarily aimed at curtailing short-term speculatory activity on the financial markets. Another objective is to improve the exchange of information on the capital market using technical advances. For example, there are plans to implement a common European electronic access point by 2018 so as to improve investors' access to information outside their home state. By 2020, there will also be a harmonised electronic format for annual financial reports.

Overall, there is a trend in many areas of European regulation spanning individual directives away from the concept of minimum harmonisation and towards maximum harmonisation. In the past, the definition of minimum standards was the norm. Member states were not allowed to fall short of these requirements, but were free to exceed them. This will no longer be possible in future, unless expressly permitted by one of the few exemptions.

3 Directive 2013/50/EU, OJ EU L 294, p. 13ff.

2 Monitoring of market transparency and integrity

2.1 Market analysis

To monitor the prohibition on market manipulation and insider trading, BaFin analysed trading activities in 425 cases (previous year: 354). A total of 119 analyses (previous year: 100) found evidence either of market manipulation (79, previous year: 76) or of insider trading (40, previous year: 24).

In its market analyses, BaFin primarily draws on reported transaction data and suspicious transaction reports from credit institutions and financial services institutions. In 2013, BaFin was sent approximately 772 million transaction data records via the German reporting system (previous year: 698 million) and a further 714 million reports via the pan-European platform (previous year: 606 million). In addition, BaFin received 503 suspicious transaction reports (previous year: 547), most of them related to suspected market manipulation (362).

In addition to its analyses, BaFin drew up a total of eight expert reports (previous year: 18) for public prosecutors' offices and courts. These help during court proceedings to assess whether market manipulation has in fact influenced the quoted or market price. Only if this can be demonstrated can market manipulation be prosecuted as a criminal offence; otherwise it can only be pursued as an administrative offence.

2.1.1 Market manipulation analyses

If the 79 positive manipulation analyses (previous year: 76) are broken down by underlying subject matter, the majority by far, as in previous years, related to information offences (43, previous year: 43). These relate to incorrect, misleading, or withheld information as well as – above all – scalping. They are followed by sham activities (25, previous year: 31) such as collusive transactions and manipulation of the order situation or of reference prices (10, previous year: 2).

As in previous years, the analyses related mostly to securities traded on the regulated unofficial market (65, previous year: 63). Although the First Quotation Board, the segment with the least stringent regulatory requirements, was closed down in December 2012, the number of manipulation analyses has not yet decreased. This is primarily due to proceedings still pending from previous years. Companies on the organised market were affected to a much smaller extent, with only twelve cases being analysed (previous year: 10).

As soon as BaFin becomes aware of new concerted manipulation attempts, for example by phone, spam e-mail, or fax, it immediately issues a warning on its website. In 2013, it published nine such warnings (previous year: 12). It also at once informs the affected trading venues and credit and financial services institutions of such attempts. This allows them to respond immediately, suspend or discontinue trading and take precautions to protect their customers.

2.1.2 Insider analyses

The number of positive insider analyses rose sharply compared with 2012 (40, previous year: 24). This is due in particular to a new approach that BaFin has pursued since 2013. Under this approach, selected ad hoc disclosures are pre-analysed systematically and in a highly standardised manner in order to pinpoint relevant disclosures with greater accuracy than before. As in the previous year, there were two main areas of focus: companies' earnings figures (15, previous year: 5) and mergers and acquisitions (13, previous year: 11). The majority related to the organised market, with 34 cases (previous year: 19); the regulated unofficial market was affected in four cases (previous year: 4).

2.2 Market manipulation

2.2.1 Investigations

In 2013, BaFin launched 218 new investigations relating to suspected market manipulation. For the first time in three years, the number declined slightly (previous year: 250). Scalping in particular became less frequent following the closure of the First Quotation Board. In addition to concrete enquiries from public prosecutors' offices and police authorities (32), new investigations were triggered especially by referrals from the German exchanges' trading surveillance units (136). In terms of content, most of the referrals by the trading surveillance units related to cases of trade-based manipulation such as sham transactions, collusive transactions, or reference price manipulation. Most of the enquiries made by criminal prosecution authorities were about information-based manipulation.

In 2013, BaFin continued its in-depth information exchange with foreign supervisory authorities in market manipulation proceedings. It made enquiries to foreign authorities in 172 cases (previous year: 132). Most of them related to data concerning customers who had engaged in suspicious trading activities on a German exchange via a foreign institution. Foreign supervisory authorities requested administrative assistance from BaFin in 33 cases (previous year: 19).

BaFin found initial indications of criminal market manipulation in 142 cases (previous year: 121) and filed complaints against 281 suspects with the relevant public prosecutors' offices (previous year: 229). BaFin continued to pursue ten investigations involving 18 suspects through its own administrative fines section, because there was evidence of attempted market manipulation. In 66 cases, the investigations did not find any evidence of violations. A total of 208 investigations were still pending at the end of 2013.

2.2.2 Sanctions

In 2013, a total of four people were convicted of market manipulation following a full public trial (previous year: 14). The courts passed sentences against four people (previous year: 10) following summary proceedings. The public prosecutors' offices discontinued 121 preliminary investigations. In 56 of these cases, a conviction was not sufficiently probable to bring a charge; the public prosecutors' offices discontinued these proceedings in accordance with section 170 (2) of the Code of Criminal Procedure (*Strafprozessordnung* – StPO). Another five investigations were provisionally discontinued in accordance with section 154f of the StPO because the defendants' place of abode was unknown. In addition, the public prosecutors' offices discontinued 27 cases due to insignificance in accordance with section 153 of the StPO, because they regarded the perpetrator's degree of fault as minor and there was no public interest in criminal prosecution. In another 21 cases, the investigations launched were discontinued in

Table 26 Market manipulation investigations

Period	New investigations	Results							Pending
		Discontinued	Referred to public prosecutors' offices or BaFin's administrative fines section						
			Public prosecutors		Administrative fines section		Total (cases)		Total
			Cases	Individuals	Cases	Individuals			
2011	166	30	104	211	7	13	111		115
2012	250	30	121	229	6	6	127		208
2013	**218**	**66**	**142**	**281**	**10**	**18**	**152**		**208**

Table 27 Public prosecutors' and court reports and reports by BaFin's administrative fines section on completed market manipulation proceedings

Period	Total	Decisions made by public prosecutors' offices				
		Discontinued				Discontinued in accordance with section 153a of the StPO
2011	90	56				13
2012	127	74				19
		Discontinued in accordance with section 170 (2) of the StPO	Discontinued in accordance with section 153 of the StPO	Discontinued in accordance with sections 154, 154a of the StPO	Discontinued in accordance with section 154f of the StPO	
2013	**135**	**56**	**27**	**12**	**5**	**21**

Period	Total	Final court decisions in criminal proceedings				Decisions in administrative fine proceedings	
		Discontinued by court in accordance with section 153a of the StPO	Convictions following summary proceedings	Convictions following full trial	Acquittals	Discontinued	Final administrative fines
2011	90	0	8	3	0	8	2
2012	127	0	10	14	2	6	2
2013	**135**	**1**	**4**	**4**	**0**	**2**	**3**

accordance with section 153a of the StPO, after the defendants had made a payment as part of out-of-court settlements. Moreover, proceedings were discontinued in 12 cases in accordance with section 154 or 154a of the StPO. These provisions allow the prosecuting authorities to concentrate on substantively serious allegations and to deal efficiently with complex matters involving a large number of infringements of the law, thus accelerating proceedings. Proceedings can be discontinued, for example, if the importance of the expected punishment for the offence to be discontinued is not substantial compared to the legal consequences of another punishable offence. The fact that several investigations were discontinued in 2013 on the basis of these provisions documents clearly that violations of the ban on market manipulation increasingly also involve other serious criminal offences.

BaFin receives regular information from the public prosecutors about the results of preliminary investigations. In cases where BaFin had filed complaints before 2012, but not yet received any information about the outcome of the proceedings, it followed up with the public prosecutors' offices in 2013. In the process, it was revealed that some preliminary investigations had meanwhile been completed. For this reason, all figures also include investigations completed in previous years, but of which BaFin only became aware in 2013.

2.2.3 Selected cases

Adinotec AG

In a joined case involving unauthorised telephone orders (see info box, page 166), the Regional Court in Frankfurt am Main on 14 June 2013 sentenced the first defendant to a jail term of four years and four months for market manipulation and a particularly serious case of fraud. In May 2012, the convicted defendant had initiated unauthorised telephone orders for shares in Adinotec AG worth over €800,000.

The individual who has now been convicted was arrested in December 2012 and subsequently

Unauthorised telephone orders

Unauthorised telephone orders occur when persons contact credit institutions, passing themselves off as their customers, and place orders for third parties' securities accounts to purchase in most cases illiquid shares traded on the regulated unofficial market. Perpetrators then take advantage of the artificially created demand by selling their own blocks of shares at a profit. These persons commonly identify themselves to credit institutions using information obtained from the actual account holders, such as the securities account number or information about the shares in the trading portfolio. In many cases, the perpetrators are able to obtain this personal information by calling investors under the pretence of recommending shares and then telling them that they need account statements or copies of their identity cards to bill their commission.

remanded in custody. The money obtained through the offence was confiscated in Estonia and repaid to the credit institution affected. The court's final ruling concluded the first set of proceedings. Given the final and absolute conviction, another set of proceedings against the convicted individual was discontinued by the public prosecutor's office in Frankfurt am Main on 4 November 2013 in accordance with section 154 of the StPO. BaFin had previously filed a total of 14 complaints about unauthorised telephone orders relating to 46 different share classes. In these cases, orders totalling €7.7 million had been executed; execution was successfully prevented for orders worth the equivalent of another €4.6 million. The investigations into the other sets of circumstances are still ongoing.

IQ Investment AG

In a court case about market manipulation and insider trading that had been triggered by criminal complaints filed by BaFin, the Regional Court in Munich sentenced a businessman to a jail term of five years and three months on 29 April 2013. Initially the convicted defendant, together with other perpetrators, had fraudulently implemented a capital increase. To this end, he had submitted forged bank certificates to the registry court and in this way caused it to make an incorrect entry about a capital increase. He then traded shares – in

Influencing the share price and forfeiture

Due to collusive transactions in shares of Resprop Immobilien AG, the Regional Court in Düsseldorf had sentenced a defendant to a total fine of 120 daily units of €80 each. In addition, the Court had ordered that €63,700 be forfeited as compensation. The convicted defendant appealed, objecting in particular to the way the evidence had been assessed and to the forfeiture ruling. On 27 November 2013, the Federal Court of Justice (*Bundesgerichtshof* – BGH) confirmed the ruling handed down by the court of first instance and thus also major aspects of BaFin's administrative practice.[4] In the BGH's opinion, the share price of a financial instrument is influenced if it is increased, reduced, or even merely stabilised artificially, i.e. counter to the true economic conditions. In its opinion, the fact that the manipulated price was determined on the stock exchange is sufficient for establishing the required outcome of the offence. In contrast, it is not necessary for further transactions to be subsequently executed at the manipulated price level. In addition, the BGH explained that, when assessing where trading activities had sent false or misleading signals, it was irrelevant whether the manipulation was intentional. With regard to the forfeiture ruling, the BGH clarified that, in the case of criminal market manipulation through the sale of shares at a collusive price, the full purchase price obtained for the shares had been "obtained" and was therefore subject to forfeiture. This ruling is expected to apply by analogy to shares obtained at a collusive price.

4 Judgement dated 27 November 2013, case ref.: 3 StR 5/13.

the full knowledge that no capital increase had taken place. Through offsetting buy and sell orders, he managed to achieve quoted share prices that did not reflect the actual rules of supply and demand. In addition, he was alleged to have been jointly responsible for persuading investors to invest in a company on the basis of false information. He took advantage of the demand created in this way to sell his shares through securities accounts maintained by his wife and by an investment firm. The Regional Court's judgement is final. The Court ordered assistance with recovery for injured parties, in the amount of €3.5 million. The Munich I public prosecutor's office is continuing its investigations of a double-digit number of additional defendants in these proceedings.

MLP AG

On 30 January 2013, the public prosecutor's office in Hanover discontinued the preliminary investigations against the former CEO of a large German multi-level marketing organisation in return for a payment totalling €2.9 million as part of an out-of-court settlement in accordance with section 153a of the StPO. BaFin, whose complaint had triggered the proceedings, had found evidence that in 2008 the accused had deliberately failed to report changes in voting rights relating to his gradually increasing interest in MLP AG. In contravention of an existing legal obligation, he thus concealed circumstances that were material to valuing MLP AG shares. His actions also had an actual impact on the share price, because the failure to report the changes in voting rights prevented a significant rise in the price of MLP shares. During its preliminary investigations, the public prosecutor's office found that the actions amounted to punishable prohibited market manipulation, but believed that a payment of €2.9 million would be suitable to offset the public interest in criminal prosecution. It therefore discontinued the preliminary investigations in accordance with section 153a of the StPO.

2.3 Insider trading

2.3.1 Investigations

BaFin launched 42 new insider trading investigations (previous year: 26). The number of cross-border insider trading investigations also increased sharply. BaFin contacted foreign supervisory authorities in 63 cases (previous year: 31) and processed 32 enquiries from foreign supervisory authorities (previous year: 28). It referred 35 cases (previous year: 11) involving a total of 99 people (previous year: 25) to public prosecutors' offices. No evidence of insider trading was found in 13 cases investigated. A total of 26 investigations had not been completed at the end of 2013, some of which related to previous years (see table 28 "Insider trading investigations").

2.3.2 Sanctions

In 2013, eight people were convicted of insider trading (previous year: 7). A total of 12 cases were discontinued by the public prosecutors' offices, five of them as part of out-of-court settlements (see table 29 "Public prosecutors' reports on completed insider trading proceedings", page 168).

Table 28 Insider trading investigations

Period	New investigations	Results			Pending
		Discontinued	Referred to public prosecutors' offices		
	Insiders	Insiders	Cases	Individuals	Total
2011	29	14	20	52	29
2012	26	12	11	25	32
2013	**42**	**13**	**35**	**99**	**26**

Table 29 Public prosecutors' reports on completed insider trading proceedings

Period	Total	Discontinued	Discontinued after out-of-court settlement	Final court decisions			
				Decisions by the court	Convictions following summary proceedings	Convictions following full trial	Acquittals
2011	31	24	4	0	1	1	1
2012	51	34	10	2	2	3	0
2013	**27**	**12**	**5**	**0**	**8**	**0**	**2**

2.3.3 Selected cases

Vivacon AG

On 21 August 2013, the public prosecutor's office in Cologne discontinued proceedings against another defendant relating to insider trading in shares of Vivacon AG[5] in return for a payment of €320,000, as part of an out-of-court settlement in accordance with section 153a of the StPO. The governing body member of the real estate company, which had to publish a profit warning on 31 March 2009, was the sole shareholder of an investee that sold a total of 353,742 Vivacon shares in the period from January 2009 until shortly before the profit warning was published. The governing body member had approved these sales, thereby avoiding a loss of €308,409.08.

Solar Millennium AG

On 15 December 2009, Solar Millennium AG announced that it had appointed a new CEO as at 1 January 2010. Immediately prior to this announcement, a member of a governing body of the company had bought a total of 400 shares in the company for a total of €11,148 and sold most of them again at the beginning of 2010. He generated a gross profit of €3,436 in the process. The public prosecutor's office in Nuremberg-Fürth initiated summary proceedings and he was sentenced to a total of €6,300, payable in 90 daily units of €70 each.

Heiler Software AG

On 26 March 2013, the public prosecutor's office in Cologne discontinued proceedings against two defendants – one primary insider and one secondary insider – in return for payments totalling €10,000 and €2,700 respectively in accordance with section 153a of the StPO. The primary insider, an employee of a consulting firm, had bought shares in Heiler Software AG on 1 October 2012 before a takeover was announced by Informatica Deutschland AG. At the time of the announcement, the target company's share price was €2.85; as a result of the publication, it rose by 147.5% to €7.04. The primary insider also passed on the information to his life partner. On 26 September 2012, this individual also acquired 2,000 Heiler shares at a price of €2.81; she sold them on 6 November 2012 for €7.04, thus generating a gross profit of €8,460.

2.4 Ad hoc disclosures and directors' dealings

2.4.1 Ad hoc disclosures

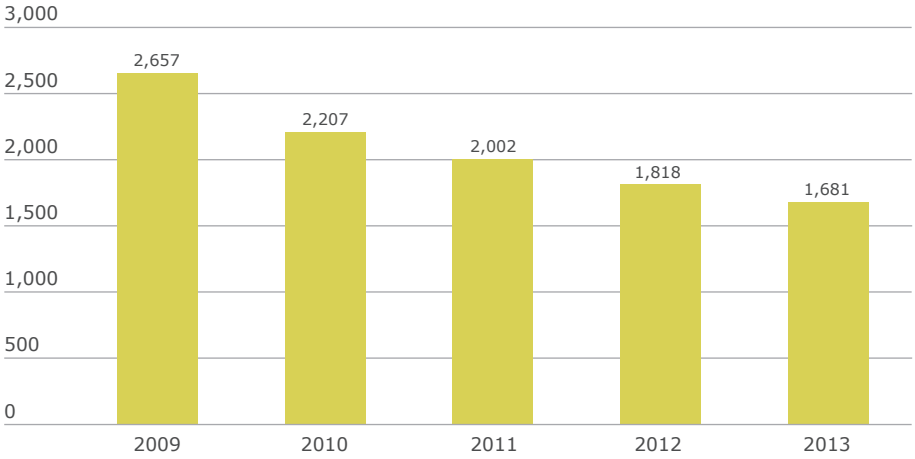
In total, 1,681 ad hoc disclosures were published in 2013 (previous year: 1,818, see figure 14 "Ad hoc disclosures", page 169). Of particular relevance to the question of the point at which a disclosure requirement is triggered was a decision of the Federal Court of Justice (*Bundesgerichtshof* – BGH). The court decided on 23 April 2013 that intermediate steps in a protracted process may also constitute inside information.[6] The BGH's decision was based on the order for reference by the European Court of Justice (ECJ) of 28 June 2012.[7] Even before the ECJ's judgement, BaFin had taken

5 See 2012 Annual Report, p. 173.

6 Decision dated 23 April 2013, case ref. II ZB 7/09.

7 Case ref. C-19/11.

Figure 14 Ad hoc disclosures



the view that in multistage decision processes each intermediate step may constitute inside information. As a result, it considered the disclosure issued by Daimler AG about the departure of its CEO, Jürgen Schrempp, to be late.[8] The BGH explained in this context that the future event could also influence the assessment of the relevance for the share price of the intermediate step that had already occurred. However, the probability of the future event was not the only criterion in this regard. When making their investment decisions, investors could interpret the information about the intermediate step not only as reference to the future event, but also as a fact that had already occurred, which in that form could already have an impact on the issuer. When assessing the relevance for the share price of the respective intermediate steps, the probability of the (final) event is therefore not the only criterion to be considered. The point at which future circumstances would have to be assumed to be sufficiently probable does not only have to be determined on the basis of a pure probability assessment, but also according to the rules of general experience. An intermediate step or the end result could consequently constitute inside information about a future circumstance, if experience has shown that it is more likely than not to occur. This corresponds to BaFin's administrative practice, which also uses this definition of sufficient probability (more likely than not, 50% + X). The BGH referred the case back to the Higher Regional Court in Stuttgart for a final ruling.

8 See 2012 Annual Report, p. 182f.

2.4.2 Directors' dealings

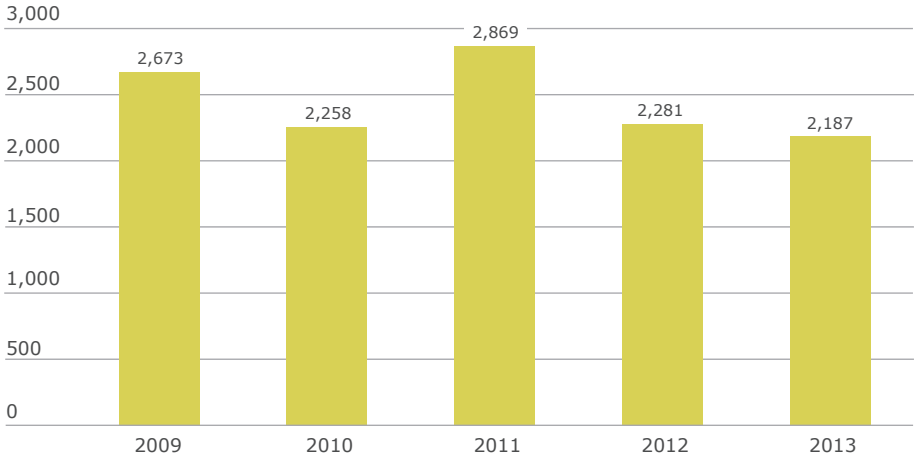
In 2013, executive managers and their related parties reported a total of 2,187 securities transactions for their own account (previous year: 2,281, see figure 15 "Directors' dealings", page 170). Share transactions accounted for approximately 95%, the largest part of the data reported. Other reportable transactions include, for example, transactions in securities with conversion rights into shares, call or put options on shares, or rights whose price depends on listed share prices.

2.5 Monitoring of short selling

Since 1 November 2012, the effective date of the EU Short Selling Regulation, there has been a ban on short sales in shares and certain types of sovereign debt as well as on taking positions in or entering into sovereign credit default swaps (CDSs) other than for hedging purposes. In addition, there are transparency requirements for net short positions in shares and certain types of sovereign debt. The European Regulation replaced national provisions.

In 2013, BaFin investigated a total of 19 new cases of potential violations of the old national bans on short selling (previous year: 11).

Figure 15 Directors' dealings



It continued to pursue three investigations as administrative offences; six cases were discontinued (previous year: 27). Ten investigations were still pending at the end of 2013. BaFin also investigated 19 cases of potential violations of the EU Short Selling Regulation (previous year: 6). It discontinued five investigations; the other cases were still pending at the end of 2013.

For shares admitted to trading on an organised market or multilateral trading facility, 233 parties subject to notification requirements notified BaFin of a total of 6,702 net short positions in 166 different shares; this corresponds to an average of 27 notifications per trading day. A notification has to be issued when the shares reach or fall below the threshold of 0.2% of the issued share capital and each 0.1% above

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Legality of requests for information and documentation

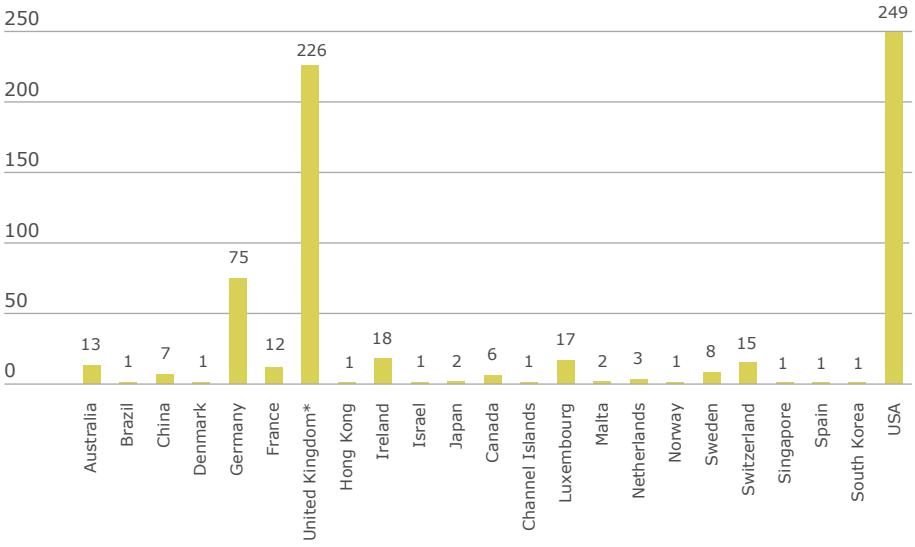
The Administrative Court (*Verwaltungsgericht* – VG) in Frankfurt am Main[9] and the Higher Administrative Court in Hesse (*Hessischer Verwaltungsgerichtshof* – HessVGH)[10] have confirmed in summary proceedings and in the principal proceedings in the court of first instance[11] the legality of a request for information and documentation by BaFin, which was used to examine possible uncovered short sales. By doing so, the courts gave more detailed guidance about the preconditions for and limits of requests made on the basis of section 4 (3) of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG). In the case concerned, BaFin had obtained evidence for monitoring the requirements and prohibitions under the WpHG, which made it necessary to clarify the issues involved. The courts took the view that this was possible on the basis of a request for information and documentation. It said that only a low investigation threshold applied to these types of requests. In this respect, a prima facie (criminal) case and (functional) evidence in accordance with section 4 (3) of the WpHG were not identical. BaFin could perform its supervisory functions and pursue administrative offences at the same time. This was not in contravention of the prohibition on assuming multiple roles. Requests for information and requests for the submission of documents could occur concurrently; there was no hierarchical relationship.

9 Case ref. 9 L 2996/12.F.

10 Case ref. 6 B 583/13.

11 Case ref. 9 K 2217/12.F (not yet final).

Figure 16 Parties subject to notification requirements by country of origin



* Including overseas territories

As at 31 December 2013

that. 2,778 notifications had to be published in the Federal Gazette because the threshold of 0.5% of the share capital in issue had been exceeded or reached. In addition, BaFin received 109 notifications for federal government debt securities (initial threshold: 0.5%) and nine notification for debt securities of the federal states (initial threshold: 0.1%). BaFin investigated 13 cases of potential violations of the transparency requirements. Parties subject to notification requirements had reported or published their net short positions with a delay or incorrectly, or had failed to do so at all. BaFin discontinued three investigations; the other cases were still ongoing at the end of 2013.

Net short positions are notified using BaFin's reporting and publication platform. By the end of 2013, BaFin had received 1,543 applications for authorisation from 662 companies (previous year: 528) and from 12 private individuals. It provided access in the case of 729 applications and rejected 144 applications, while 546 applications were withdrawn. As in previous years, most parties subject to notification requirements came from the United Kingdom and the USA.

In the period up to the end of 2013, 49 market makers (previous year: 47) and 33 primary dealers (previous year: 30) notified BaFin of their activity and made use of the exemptions from the ban on short selling and transparency requirements (see table 30 "Notifications by market makers and primary dealers in 2013"). The companies are exempt for the financial instruments for which they have notified

Table 30 Notifications by market makers and primary dealers in 2013

As at 31 December 2013

EU Short Selling Regulation	Market makers	Primary dealers
Total number of companies	**49**	**33**
of which from Germany	45	9
of which from abroad	4*	24**
Total number of notifications in 2013	**1,001**	**3**

* Non-EU third country.
** Domiciled outside Germany.

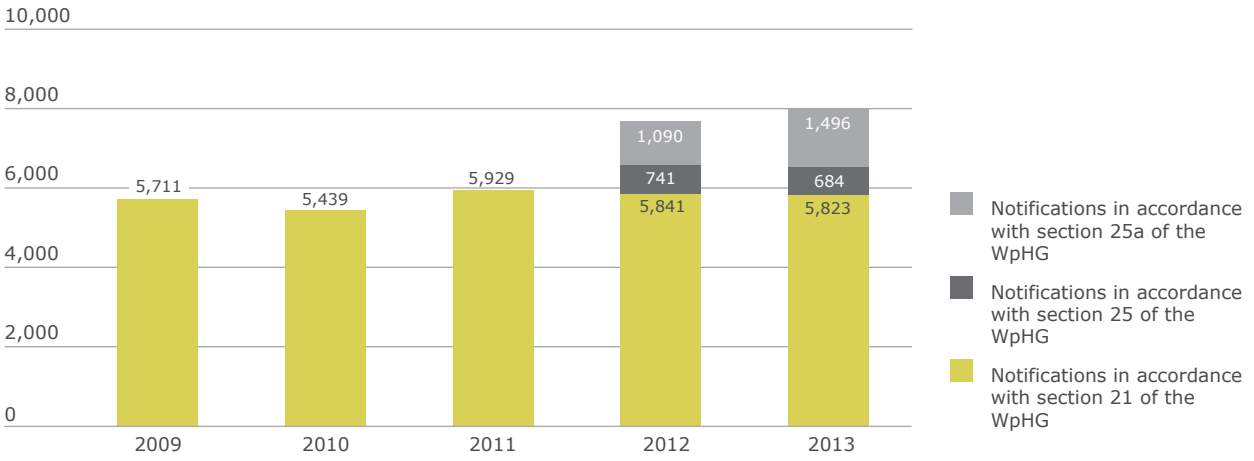
their activity. Forty of the 49 market makers submitted further notifications of intent, which are required if market makers extend their activities to include a new instrument or primary dealers extend their activities to include public-sector debt securities from another issuer. By the end of 2013, BaFin had received a total of 1,221 notifications of intent from market makers and 36 notifications of intent from primary dealers.

2.6 Voting rights and duties to provide information to securities holders

2.6.1 Voting rights

5,823 voting rights notifications were issued in 2013 (previous year: 5,841, see figure 17 "Voting rights notifications"). The number of notifications relating to financial instruments in accordance with section 25 of the Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG), such as call options with physical settlement and rights of redemption under securities loans, declined slightly to 684 (previous year: 741), while the number of notifications in accordance with section 25a of the WpHG increased (1,496, previous year: 1,090). These notifications are necessary, for example, in the case of call options with cash settlement, put options, or rights of first refusal. BaFin received a total of more than 7,000 notifications in accordance with sections 21, 25 and 25a of the WpHG and monitored their publication.

Figure 17 Voting rights notifications



Requirements for voting rights notifications

In 2013, BaFin provided more specific guidance for its requirements on notifications in accordance with sections 25 and 25a of the WpHG, which must be issued for example in the case of options, conditional share purchase agreements, or agreements on rights of first refusal. It also amended the rules for securities lending in line with recent court rulings. In addition, it extended the settlement period of share purchase transactions for which notification in accordance with section 25 of the WpHG is not normally required to t+3 (trading day + three days). The reason for this adjustment is that international transactions normally take up to three days to be settled. Moreover, BaFin explained the rules that apply to the trading portfolio that has been exempted from the notification requirement. The trading portfolio is determined by adding the voting interest held in accordance with sections 21 and 22 of the WpHG and that held in accordance with section 25 of the WpHG. This means that exemption is only considered once. However, it cannot be claimed for voting rights in accordance with section 25a of the WpHG.

The number of companies admitted to trading on the organised market declined to 773 (previous year: 795). However, the number of notifications they published on changes in their voting share capital rose to 346 (previous year: 324). At the end of 2013, five real estate investment trusts (REITs) were subject to supervision by BaFin.

2.6.2 Duties to provide information to securities holders

In 2013, issuers of listed securities announced a total of 265 planned changes in the legal basis of their activities (previous year: 355). In addition, in 510 cases, they published the attendance rights, the agenda and the total number of shares and voting rights when convening their annual general meeting (previous year: 601). 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 2,097 cases (previous year: 2,614).

3 Prospectuses

3.1 Securities prospectuses

In 2013, BaFin approved a total of 3,224 securities prospectuses, registration documents and supplements (previous year: 3,043, see table 31 "Number of approvals in 2013 and 2012"). It refused to grant approval in one case.

Table 31 Number of approvals in 2013 and 2012

Produkt	2013	2012
Shares (IPOs/capital increases)	75	75
Derivatives	223	150
Debt securities	168	187
Registration documents	33	28
Supplements	2,725	2,603
Total	**3,224**	**3,043**

Total issuance reached another record high with 2,173,708 securities prospectuses and final terms (previous year: 1,945,201, see figure 18 "Total issue volume", page 174). The number of final terms alone amounted to 2,173,316 (previous year: 1,945,068). However, there were no more issues based on supplements governed by the old Prospectus Act (*Verkaufsprospektgesetz* – VerkProspG) (previous year: 4). There was also another significant rise to 5,738 in the number of prospectuses and supplements that BaFin notified to EU countries outside Germany (previous year: 5,065, see table 32 "Notifications", page 174).

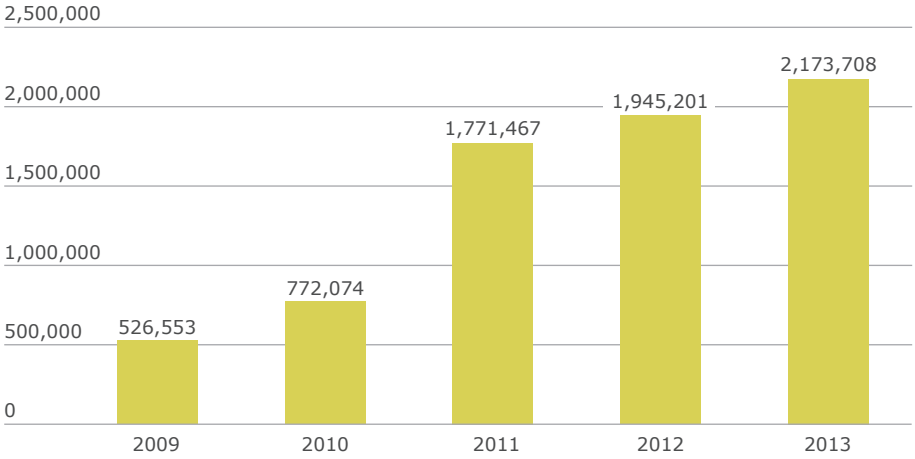
One supervisory focus in 2013 was how certain secondary market offerings should be classified under prospectus law. To this end, BaFin issued detailed guidance on the concept of "offer of securities to the public".[12] For example, if issuers publish all the characteristics of a security as well as its ask and bid prices and, if appropriate, other non-promotional information as part of a secondary market transaction this is no longer deemed an offer of securities to the public for which a prospectus must be drawn up. However, the changed supervisory practice only applies to securities that are also traded on an organised market or on the regulated unofficial market of a German stock exchange.

The legal classification of pre-emption rights offers had already been amended in 2012 on the basis of a Regulation Amending the Prospectus Regulation[13]. Since then, offers to

12 http://www.bafin.de/dok/4635494.

13 Regulation (EU) No. 486/2012, OJ EU L 150, p. 1ff.

Figure 18 Total issue volume



existing shareholders to acquire new shares have been deemed an offer to the public for which a prospectus is required. This applies irrespective of whether pre-emption rights are publicly traded. In 2013, BaFin examined 36 pre-emption rights offers, which had been published in the electronic Federal Gazette, but for which no prospectus had been approved. For 20 pre-emption rights offers, the issuers or offerors were able to demonstrate that exemptions applied. Such exemptions apply, for example, if the offer is addressed to fewer than 150 non-qualified investors per signatory state to the European Economic Area (EEA). The other investigations are continuing.

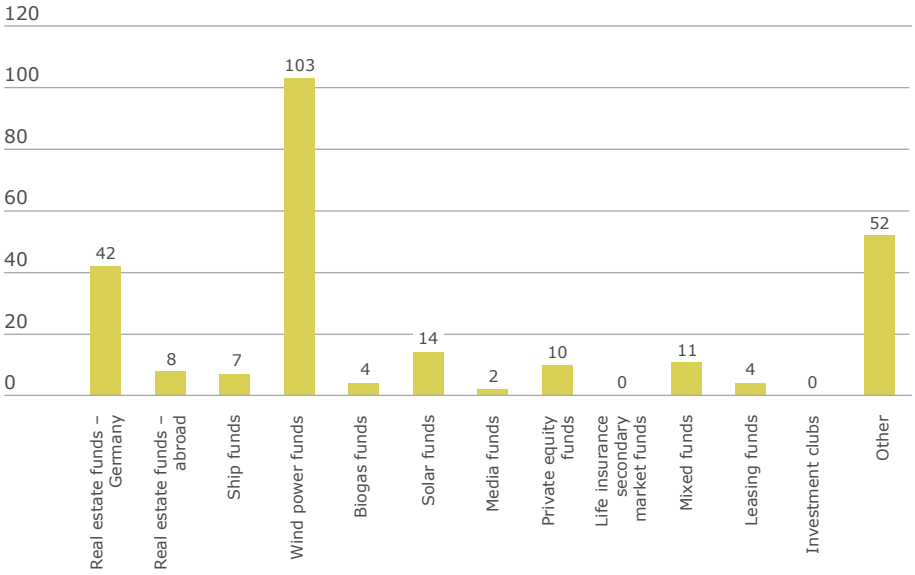
Table 32 Notifications

	Notifications issued	Notifications received
Belgium	114	9
Denmark	79	0
Finland	131	0
France	195	102
United Kingdom	222	182
Ireland	70	162
Italy	214	1
Liechtenstein	155	6
Luxembourg	1,468	867
Netherlands	200	136
Norway	175	0
Austria	2,365	64
Poland	18	0
Sweden	152	0
Spain	122	0
Czech Republic	45	0
Other	13	0
Total	**5,738**	**1,529**

3.2 Prospectuses for capital investments

Since the Investment Code (*Kapitalanlagegesetzbuch* – KAGB) entered into force on 22 July 2013, many of the closed-ended funds, for which previously a prospectus for capital investments not evidenced by securities had to be submitted, are now treated as investment funds. The new legal situation and uncertainty about its scope resulted in a significant decline in the number of prospectuses submitted for approval compared with previous years. In 2013, BaFin examined 257 prospectuses for capital investments (previous year: 412), more than two-thirds (172) of them before the KAGB entered into force. A total of 197 prospectuses were approved (previous year: 308). Issuers withdrew their applications in 72 cases (previous year: 57). Unlike the number of submissions, the number of withdrawals increased significantly after July 2013 (42). The reason is that many issuers had not yet prepared themselves for the new legal situation.

Figure 19 Prospectuses by target investment in 2013



Almost half (45%) of the investments offered focused on renewable energy (previous year: 25%): wind power (39%, previous year: 16%), solar power (5%, previous year: 8%) and biogas (1%, previous year: 1%). Only 17% of the investments went into domestic properties (previous year: 26%). The proportion accounted for by ship funds also continued to decline and stood at only 3% (previous year: 4%). At 21%, the proportion of other target investments, such as profit participation rights or registered bonds with an investment focus on media, energy production rights, or financial assets, was significant for the first time when compared to conventional target investments. The reason is that, under the KAGB a large number of investment models such as (foreign) closed-ended real estate funds, which were previously capital investments, are classified for the most part as investment funds. This means that the more conventional major providers and issuing houses are now subject to supervision in accordance with the KAGB, while predominately smaller issuers and public participation models – primarily community-owned wind farms – continue to fall under capital investments.

The absolute number of supplements was virtually unchanged in 2013 (407, previous year: 420), although the number of new submissions was down significantly. This can probably be attributed primarily to the longer placement periods of capital investments dating from prior years as well as the fact that changes occur more frequently if the placement periods are longer, in which case issuers announce them in a supplement. A total of 48 supplements were submitted under the Capital Investment Act (*Vermögensanlagengesetz*), and 359 under the Prospectus Act (*Verkaufsprospektgesetz*).

4 Corporate takeovers

4.1 Offer procedures

In 2013, BaFin examined 23 offer documents and approved their publication in all cases (previous year: 27). It prohibited one offer, because the bidder company had published it in the Federal Gazette (*Bundesanzeiger*) without previously submitting an offer document to BaFin.

Acting in concert

An ESMA working group issued a statement in 2013 on the issue of when cooperation between shareholders constitutes acting in concert, which is important under takeover law. The White List compiled by the Takeover Bids Network is intended for capital market participants. It distinguishes coordinated conduct that does not trigger a mandatory bid from conduct that does.

Since the rules for acting in concert differ significantly in the individual member states of the European Union, the White List is intended to help international investors in particular. The members of the Takeover Bids Network are those institutions of EEA countries responsible for ensuring compliance with the regulations implementing the Takeover Directive in the respective member states.

In particular, the takeover offer submitted by Vodafone Vierte Verwaltungsgesellschaft mbH, a subsidiary of Vodafone Group Plc, to the shareholders of Kabel Deutschland Holding AG attracted great public interest in 2013. At €7.5 billion, this was also the offer with the highest transaction volume. In addition, it included an arrangement under which the dividend for financial year 2013, which had already been announced, would have been included in the amount attributable to the shareholders of the target company, even though legally the bidder would have been entitled to the dividend if the offer had been consummated early. This arrangement did not apply in the end, because the takeover offer was only consummated after the relevant annual general meeting. The offer was implemented successfully. According to the final notification, the acceptance ratio was 76.57%.

4.2 Exemption procedures

BaFin examined 111 applications for exemption or non-consideration of voting rights (previous year: 150). In 49 cases, holders of voting rights requested non-consideration in accordance with section 36 of the WpÜG (previous year: 90), while 62 applications for exemption were

Cross-border offer

BaFin can allow a bidder to exclude from the offer certain shareholders who are resident, domiciled, or ordinarily resident in a country outside the European Economic Area. The exchange offer of Deutsche Wohnen AG to the shareholders of GSW Immobilien AG prompted BaFin to issue details of its administrative practice in this regard. Shareholders from certain countries can only be excluded if the offer has a cross-border effect, i.e. if the laws of the other country are also applicable to the shareholders of the target company. In addition, it must be unreasonable to expect the bidder to make such an offer, because the other country's provisions have to be complied with in addition to the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz* – WpÜG). BaFin requires in this context that the bidder take measures in preparation for the transaction to ensure that it can comply with the foreign laws. This may be unreasonable for the bidder if to do so it has to rely on the help of third parties – for example the target company – but is unable to get this help in time. If the foreign laws require that the offer be reviewed by an authority, the bidder also has to take steps to coordinate the review processes by the authorities involved. BaFin has now additionally determined the cases in which such coordination may be unreasonable for the bidder. For example, it may be unreasonable for the bidder, if the review procedures cannot be coordinated because a time schedule determined by external circumstances makes successful coordination impossible – for example if the bidder wants to submit a rival offer.

made in accordance with section 37 of the WpÜG (previous year: 60). BaFin approved 56 applications (previous year: 89) and rejected two. A total of 21 applications were withdrawn and 42 were still being processed at the end of 2013.

In the exemption proceedings relating to centrotherm photovoltaics AG, BaFin for the first time ruled on a recovery plan in accordance with the new insolvency law. Centrotherm photovoltaics AG's recovery plan provided for, among other things, the assignment to a management company of a substantial portion of the claims held by creditors. The plan was for this company to contribute the claims to the target company by way of a combined capital decrease and non-cash capital increase, extinguishing them in this way. When examining these proceedings, BaFin focused on whether the management company had made a sufficient contribution to the recovery when it contributed the claims to the target company. Although the management company only had the task of transferring the claims held by creditors to the target company, BaFin believed that pooling in one company the claims held by creditors on the one hand and the new shares issued in return for contributing those claims to the target company on the other was a critical factor in ensuring the success of the planned recovery. In its decision, it also took into account that the insolvency plan had limited the nature and duration of the control exercised by the management company, and no unreasonable demands could therefore be made with respect to the size of the contribution to recovery.

5 Financial reporting enforcement

5.1 Monitoring of financial reporting

As at 1 July 2013, 751 companies from 19 countries (previous year: 825 companies from 20 countries) were subject to the two-tier enforcement procedure performed by BaFin and the Financial Reporting Enforcement Panel (FREP). According to information provided by the FREP, it completed a total of

Table 33 BaFin enforcement procedures from July 2005 to December 2013

	Error findings: yes	Error findings: no	Error publication: yes	Error publication: no
Company accepts FREP's findings	157		152	5
	(12)		(10)	(2)
Company does not accept FREP's findings	36	8	34	2
	(2)	(1)	(2)	(0)
Company refuses to cooperate with FREP	4	11	4	0
	(0)	(1)	(0)	(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	**200**	**19**	**192**	**8**
	(14)	**(2)**	**(12)**	**(2)**

In brackets: number of procedures in 2013.

Reimbursement of enforcement procedure costs

The Higher Regional Court (Oberlandesgericht) in Frankfurt ruled on 7 November 2013 that companies whose financial reports are examined by BaFin have to reimburse it for its costs.[14] This applies even in cases where the examination procedure is discontinued without a decision on the merits because there is no longer any public interest. The court explained that there were no grounds in this case for waiving the cost reimbursement requirement. In accordance with the exemption provision set out in section 17c sentence 2 of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz* – FinDAG), such grounds can only apply if the outcome of BaFin's examination differs from the FREP's in the company's favour.

The court also ruled that no exaggerated demands may be made with respect to the documentation of the number of hours needed to perform the examination. For example, it is not necessary to record in writing each individual activity performed by the employees dealing with the examination. Rather, it is sufficient if the working hours spent by the BaFin employees concerned are documented in bullet format per working day.

110 examinations (previous year: 113), of which 98 were sampling examinations. BaFin itself performed financial reporting enforcement procedures at 16 companies (previous year: 28). BaFin ordered error publications in 12 cases and refrained from ordering publication in two cases. It can do this, if there is no public interest in the information or the publication is likely to damage the legitimate interests of the company.

5.2 Publication of financial reports

In 2013, BaFin examined in approximately 2,100 cases whether the issuers had published their online annual and half-yearly financial reports as well as interim management statements on time (previous year: 2,200). 52 issuers had not published any financial report on the their website (previous year: 45); in some cases, no website with financial information could be identified at all. BaFin initiated administrative fine proceedings in these cases.

In addition, it launched 12 administrative procedures to enforce the financial reporting requirements (previous year: 8). Nine cases were still pending from 2012. BaFin closed nine administrative procedures (previous year: 11) after the issuers subsequently met their obligations. In two cases it had to threaten coercive fines of up to €37,500; these were ultimately imposed in one case. A total of 12 administrative procedures were still pending at the end of 2013.

6 Supervision of the investment business

There are signs that the German investment market may at last have overcome the consequences of the financial crisis. The market recovery began in 2012 and continued in 2013. Market participants continued to increase their business. However, the situation remained tense for those real estate funds and real estate funds of funds that have currently suspended unit redemption.

In 2013, BaFin continued the trend scouting activities it launched in 2012, which involve surveying the companies it supervises every six months on future trends in the fund sector. It

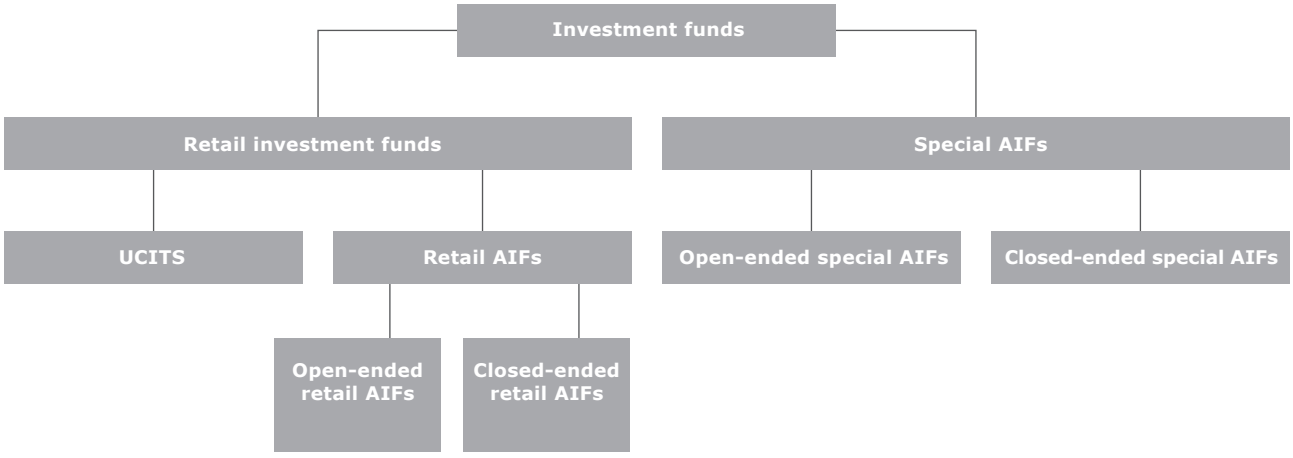
14 Case ref. WpÜG 1/13.

sought information about, among other things, the organisational measures taken to ensure compliance with the standards of proper and responsible treatment of investor money and rights in accordance with the Regulation on the Rules of Conduct and Organisational Rules pursuant to the Investment Act (*Investment-Verhaltens- und Organisationsverordnung* – InvVerOV).[15] The responses of the companies surveyed revealed that they had taken measures to ensure compliance with these rules of conduct. However, there was room for improvement, for example, in the way the communication of changes to the rules of conduct to employees is documented. At the end of 2013, BaFin additionally surveyed various companies about the use of dark pools and alternative trading venues, thus addressing a topical problem on the financial markets. In 2014, BaFin will analyse whether and to what extent the activities of the companies on such trading venues, which are not subject to pre-trade or post-trade transparency requirements, are relevant for the volumes traded there.

6.1 Changes as a result of the KAGB

A German management company (*Kapitalverwaltungsgesellschaft*) that manages open-ended or closed-ended funds needs written authorisation from BaFin and is subject to ongoing supervision by it. The KAGB distinguishes between external management companies (*externe Kapitalverwaltungsgesellschaft*) and internal management companies (*interne Kapitalverwaltungsgesellschaft)*. An external management company manages investment funds and requires authorisation as a German UCITS management company or German AIF management company, or both. External management companies can choose from one of the following legal forms: a German stock corporation (*Aktiengesellschaft*), a German private limited company (*Gesellschaft mit beschränkter Haftung* – GmbH), or a German limited partnership with a GmbH as general partner (GmbH & Co KG). An internal management company is the investment fund under its own management; it takes the legal form of a company if it has not appointed an external management company. Here, too, only certain legal forms may be chosen: internal management companies must take the legal form of an investment stock corporation (*Investmentaktiengesellschaft*) or an investment limited partnership (*Investmentkommanditgesellschaft*). In addition to

Figure 20 Investment fund types



15 Replaced as from 22 July 2013 onwards by the Regulation on the Rules of Conduct and Organisational Rules Pursuant to the Investment Code (Kapitalanlage-Verhaltens- und Organisationsverordnung – KAVerOV).

the authorisation requirement, the KAGB provides simplifications for certain German AIF management companies if the value of the assets under management does not exceed certain thresholds. Such companies are subject to registration and reporting requirements, but depending on the grounds for exemption, the substantive requirements are in some cases significantly lower than for German management companies that require authorisation.

Investment fund types

The KAGB distinguishes between retail investment funds and special AIFs (see figure 20 "Investment fund types", page 179). Retail investment funds are funds in which retail investors can invest; special AIFs, by contrast, are funds that are not available to retail investors. Retail investment funds can take the form of UCITS funds or retail AIFs. They have to meet special requirements to ensure investor protection. For example, they must comply

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UCITS funds

The requirements for UCITS funds (previously referred to as "*richtlinienkonforme Sondervermögen*" (common funds complying with the UCITS Directive)) in the KAGB differ only slightly from those in the Investment Act (*Investmentgesetz* – InvG). Changes resulted, for example, from the implementation of ESMA Guidelines. Units in UCITS can generally be surrendered at any time.

Open-ended retail AIFs

For open-ended retail AIFs, many of the provisions of the InvG have also been retained in the KAGB. Four different types of open-ended retail AIFs can be launched: mixed investment funds, other investment funds, funds of hedge funds, or open-ended real estate funds. However, mixed and other investment funds are no longer allowed to invest in holdings in undertakings or in real estate fund or hedge fund units. These restrictions are intended to take into account the special liquidity requirements that arise from the fact that units in mixed and other investment funds can be surrendered at short notice at any time. By contrast, the surrender of real estate fund and hedge fund units is subject to notice periods. Under the new legislation, hedge funds may only be launched as special AIFs; this means that they can no longer be subscribed for by private investors. This reflects the special risks to which this type of investment is exposed. For example, hedge funds are not subject to comprehensive risk diversification requirements.

Special AIFs

Unlike open-ended retail AIFs, special AIFs are allowed to invest in any type of asset whose market value can be determined. However, the asset mix must be sufficiently liquid to ensure that units can be redeemed when tendered. Moreover, in the case of open-ended, but not closed-ended, special AIFs the assets must meet the risk diversification requirements. For example, open-ended special AIFs may only invest in holdings in undertakings to the extent that the holding acquired does not give them control over unlisted companies. This type of investments is reserved for closed-ended special AIFs such as private equity funds.

Closed-ended retail AIFs

The KAGB has also introduced product regulation for closed-ended retail funds. In the past, these types of funds only required a prospectus in accordance with the Capital Investment Act (*Vermögensanlagegesetz*). It was not necessary to obtain authorisation from BaFin, and nor was there ongoing supervision. Closed-ended retail AIFs can invest in tangible assets such as real estate, aircraft, ships, or renewable energy assets. Holdings in project companies for public-private partnerships or holdings in unlisted companies, units in other closed-ended AIFs as well as securities, money market instruments and bank balances can also be acquired by closed-ended retail AIFs. When doing so, they have to adhere to risk diversification principles, but may deviate from them under certain conditions, for example if the fund rules specify a minimum investment amount of €20,000.

with various investment limits in relation to assets and issuers and meet certain information requirements towards investors.

Fund rules

As before, BaFin has to approve the fund rules for UCITS funds and retail AIFs as well as any amendments to these rules. In the process, it examines whether the rules are understandable and the interests of investors are protected. The fund rules contain information on, among other things, assets, investment limits, redemption methods, unit classes, costs and the application of income. Unlike open-ended retail AIFs, closed-ended retail AIFs already have to define in their fund rules what assets will be acquired and to what extent, because investors should not enter into the long-term commitment associated with a closed-ended fund without this information. Moreover, BaFin can only approve an amendment to the investment principles, costs, or significant investor rights of a closed-ended domestic retail AIF subject to the condition that at least two-thirds of the investors agree to this change. Unlike in an open-ended fund, investors do not have the option to avoid these significant amendments by redeeming their units. Special AIFs are only required to submit their fund rules to BaFin; they do not have to obtain approval for them.

Capital requirements

German management companies (*Kapitalverwaltungsgesellschaften*) have to maintain liquid funds. Internal management companies (*interne Kapitalverwaltungsgesellschaften)* require initial capital of €300,000, external management companies (*externe Kapitalverwaltungsgesellschaften*) initially require €125,000. At the same time, the KAGB has reduced the threshold for additional own funds requirements from the previous figure of €1.125 billion. In line with the UCITS and AIFM Directives, the requirement is now set at 0.02% of the amount by which the value of the investment fund managed by the company exceeds €250 million.

In addition, the KAGB requires German AIF management companies to have additional funds to cover professional liability risk or, alternatively, to insure against this risk. In accordance with Article 14 of the Level 2 Regulation, additional own funds of 0.01% of the assets under management are required for this. There are no entry thresholds designed as simplification options for small companies in this context, and no caps are provided for either. This means that very large companies will have to comply with substantial own funds requirements.

Organisational rules and rules of conduct

The requirements of the KAGB and of the Regulation on the Rules of Conduct and Organisational Rules pursuant to the Investment Code *(Kapitalanlage-Verhaltens- und Organisationsversordnung* – KAVerOV) relating to the organisation of German management companies, to conduct by them towards investors that does justice to their interests, and to their risk and liquidity management are derived from the standards set out in the InvG and in the Regulation on the Rules of Conduct and Organisational Rules pursuant to the Investment Act (*Investment-Verhaltens- und Organisationsverordnung* – InvVerOV) based on it, as well as from the Minimum Requirements for Risk Management in Investment Companies (*Mindestanforderungen an das Risikomanagement für Investmentgesellschaften* – InvMaRisk). A new requirement is that they have to define the maximum leverage for each investment fund. The companies also have to notify BaFin regularly of the leverage so it can identify any systemic risk. BaFin can limit leverage if it deems this necessary to maintain financial stability. In the KAVerOV, BaFin has harmonised the standards for German UCITS management companies and German AIF management companies as far as possible to allow uniform processes in the companies and to achieve a high level of investor protection for all retail funds. This has resulted in significantly more detailed rules for UCITS in relation to the rules on risk and liquidity management, to the special duties of care for investments in assets with restricted liquidity and in securitisation positions, as

well as to the selection and appointment of counterparties and prime brokers. Most of these additional requirements are due to the lessons learned and insights gained during the financial crisis.

Depositaries

The German management companies have to nominate a depositary for each open-ended or closed-ended investment fund. The depositary replaces the custodian bank under the InvG; it holds the assets in custody, but also performs control functions in relation to verifying ownership of tangible assets and other assets that cannot be held in custody.

For UCITS funds, only credit institutions can perform the depositary function, as in the past. For AIFs, financial services institutions are also eligible if they have been licensed in accordance with the Banking Act (*Kreditwesengesetz* – KWG) to perform limited custody business. Alternatively, for certain types of closed-ended AIFs, a trustee can be engaged as the depositary, if the trustee meets the personal and professional requirements for this. These include the requirement, for example, that – like auditors or tax advisers – trustees must be subject to professional rules and have sufficient financial guarantees in the form of capital and liability insurance.

Marketing

Marketing is defined as the direct or indirect offer or placement of units or shares in an investment fund. This means that even private placements, which were not covered by the definition of marketing to the public given in the InvG, are subject to rules with respect to their marketing; these require, for example, that a separate marketing notification be submitted to BaFin before an AIF can be marketed. Restrictively, marketing to professional and semi-professional investors is limited to cases in which it is performed at the initiative or on behalf of the management company and the investor is domiciled or resident in Germany, in another EU member state, or in another EEA signatory state. The definition of marketing is not met if the management company merely meets the legal requirements for publication in the Federal Gazette or the requirements of the KAGB to provide regular information to investors who are already invested in the investment fund concerned.

A prerequisite for cross-border marketing is that the management company has successfully completed the applicable notification procedure for the AIF it manages. The AIF marketing notification procedures under the KAGB vary according to criteria such as whether the units or shares are to be marketed to retail, semi-professional, or professional investors in Germany (see figure 21 "Rules governing cross-border marketing of AIFs").

Figure 21 Rules governing cross-border marketing of AIFs

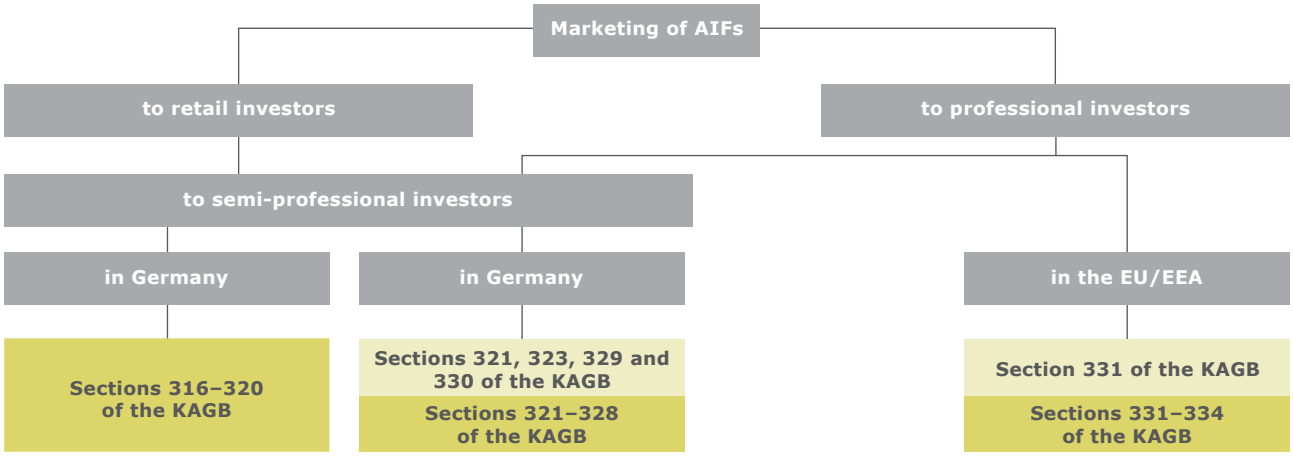


Table 34 Risk classification of German management companies in 2013

German management companies*		Quality				Total
		A	B	C	D	
Impact	High	30	2	0	0	32
	Medium	14	4	0	0	18
	Low	15	6	0	0	21
	Total	**59**	**12**	**0**	**0**	**71**

* Investment stock corporations in accordance with the InvG are not included.

6.2 German management companies (*Kapitalverwaltungsgesellschaften*)

In 2013, BaFin authorised six German management companies to manage investment funds in accordance with the KAGB (previous year: 3 authorisations in accordance with the InvG). Five German management companies surrendered their authorisations. This means that, at the end of the 2013, 90 German management companies were still authorised in accordance with the InvG on the basis of the transitional provisions (previous year: 78 asset management companies and 22 investment stock corporations in accordance with the InvG). In addition, by the end of 2013, 20 German management companies had been registered in accordance with section 44 of the KAGB. In 26 cases, German management 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.

In 2013, BaFin performed 96 supervisory visits and annual interviews on site (previous year: 54). In addition, it accompanied 22 audits and special audits at German management companies and depositaries.

6.3 Investment funds

At the end of 2013, German management companies managed a total of 5,840 common funds within the meaning of the InvG (previous year: 6,069; the number of investment funds within the meaning of the KAGB cannot be determined as at this date because of the transitional provisions). The assets contained in the common funds amounted to €1,421 billion (previous year: €1,309 billion). Of the common funds, 1,778 (previous year: 2,168) were retail funds with assets totalling €363.3 billion (previous year: €333.9 billion) and 4,062 (previous year: 3,901) were special AIFs with assets of €1,058 billion (previous year: €974.7 billion).

Aggregate (net) cash inflows into retail funds and special funds, both within the meaning of the InvG, amounted to €91.3 billion (previous year: €89.9 billion). (Gross) cash inflows amounted to €283.1 billion (previous year: €280.3 billion), of which €96.4 billion was attributable to retail investment funds (previous year: €84.6 billion) and €186.7 billion to special AIFs (previous year: €195.7 billion). Total cash outflows amounted to €191.8 billion.

In 2013, BaFin approved a total of 29 new retail investment funds in accordance with the KAGB (previous year: 132 approvals in accordance with the InvG). It permitted 993 retail investment funds to transition to the KAGB.

6.3.1 Open-ended real estate funds

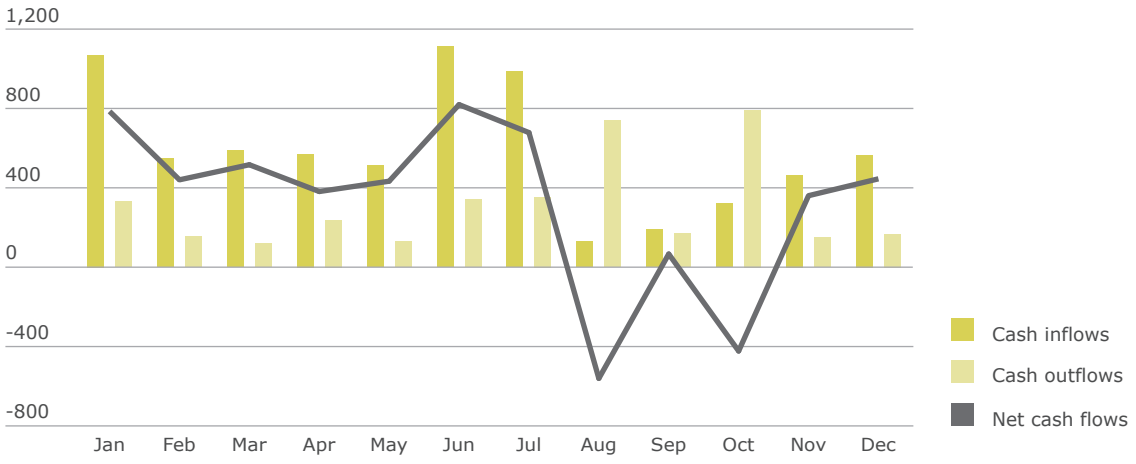
The key changes introduced by the KAGB in relation to open-ended real estate funds concern valuation and unit redemption. In future, real estate held by open-ended real estate funds will not be valued by an expert

committee, as before, but by two external experts who are independent of each other. Each has to submit a separate valuation. The new rules are based on the premise that the knowledge and experience of two independent experts will make the valuations more objective and more reliable. This is intended to help improve investor protection. There have also been changes to the options for redeeming units in open-ended real estate funds. Units acquired after the KAGB entered into force have to be held for at least 24 months; they can be redeemed after a notice period of 12 months. However, investors who held units in existing open-ended real estate funds when the KAGB entered into force can continue to redeem units worth up to €30,000 per calendar half-year without complying with a minimum holding period or notice period for redemption. The new rules have already had a tangible impact on the flows of funds at open-ended real estate funds for retail investors since August 2013. Whereas monthly cash inflows up to and including July 2013 exceeded €1 billion in some cases and net cash inflows were positive throughout, cash inflows initially almost ceased completely in the period after that. This cautious approach by investors is apparently due, at least in part, to pull-forward effects, as would seem to be confirmed by the return to positive net cash inflows since November 2013.

The number of open-ended real estate funds for retail investors declined slightly to 53 in 2013 (previous year: 55). The aggregate fund volume was €82.5 billion (previous year: €83.8 billion). The funds were managed by 20 German management companies (previous year: 21). BaFin approved five open-ended real estate funds for retail investors (previous year: 11), two of which were actually established. Three open-ended real estate funds for retail investors were reorganised as open-ended special real estate funds. In two cases, the management company was forced to institute the liquidation of an open-ended real estate fund for retail investors by terminating its management (previous year: 7). This means that, at the end of 2013, 16 open-ended real estate funds for retail investors with an aggregate fund volume of approximately €16.2 billion were being liquidated (previous year: 14). The management rights for three open-ended real estate funds for retail investors were transferred to the custodian bank as the depositary after the notice period expired. As before, 18 out of a total of 53 open-ended real estate funds for retail investors had temporarily suspended unit redemptions or were being liquidated.

The trend towards investments in open-ended real estate special funds continued in 2013. Although the number of open-ended real estate special funds declined slightly to 342 in 2013 (previous year: 361), the aggregate net asset value under management rose to €44.2 billion (previous year: €37.4 billion).

Figure 22 Fund flows at open-ended real estate funds for retail investors



BaFin authorised two companies to conduct real estate fund business in 2013 (previous year: 3). One authorisation was based on the old legal situation, while the other was granted in accordance with the KAGB.

6.3.2 Hedge funds

The first change relates to the names given to hedge funds: investment funds previously known as "single hedge funds" are now referred to simply as "hedge funds". Another innovation is that they can no longer be launched as retail investment funds. Consequently, hedge funds are a subcategory of open-ended special AIFs. They have to meet the requirements of section 282 of the KAGB in relation to target investments and investment limits. In addition, hedge funds' fund rules have to provide for either short selling of assets or the use of leverage to a substantial extent. The use of these techniques had already been a characteristic feature of single hedge funds under the Investment Act (Investmentgesetz – InvG). Leverage in this context is any method that increases the investment level of a fund, for example by borrowing, securities lending, or leveraged finance embedded in derivatives. The requirement of substantial leverage is met, for example, if the fund's calculated exposure exceeds its aggregate net asset value by a factor of three. Unlike the provisions of the InvG, the KAGB does not allow private individuals to acquire units in hedge funds without restriction. Only professional and semi-professional investors are allowed to do so.

By contrast, the KAGB has hardly introduced any changes for funds of hedge funds. These are still required to invest most of their assets in units or shares of hedge funds. Funds of hedge funds are not allowed to use short selling or leverage. Short-term borrowings of 10% of the fund value are exempted from this prohibition. As before, units in funds of hedge funds can be acquired by all investor categories.

Based on section 350 of the KAGB, which contains special transitional provisions for hedge funds and open-ended special AIFs, 36 hedge funds were authorised at the end of 2013 (previous year: 27), including 22 single hedge funds and 14 special funds in accordance with the InvG as well as two hedge funds in accordance with the KAGB.

6.3.3 Foreign investment funds

The number of EU UCITS authorised for marketing increased significantly to 12,787 in 2013 (previous year: 8,345). BaFin processed a total of 1,104 new notifications by companies wanting to market UCITS in Germany (previous year: 906). As in previous years, most of the notifications came from Luxembourg (831). In addition, notifications were received from Ireland (166), France (41) and Austria (39). A total of 789 UCITS funds ceased marketing.

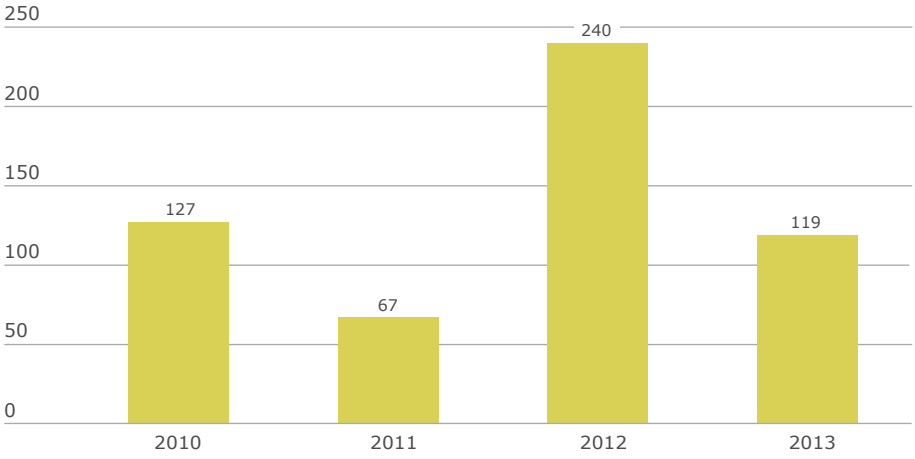
In addition, 134 EU AIFs (from EU member states) and foreign AIFs (from third countries) were authorised to conduct marketing in Germany (previous year: 117). They came from Luxembourg (98), the United Kingdom (17), Switzerland (10) as well as the USA, Austria and Ireland (3 each). Thirty-two AIFs started marketing in Germany in 2013, including 17 from the UK, 12 from Luxembourg and three from Ireland. Marketing for five AIFs from Luxembourg was discontinued.

7 Administrative fine proceedings

7.1 Administrative fines

In 2013, BaFin instituted 519 new proceedings for the imposition of administrative fines relating to potential violations of securities supervision provisions (previous year: 534). A total of 851 cases were still pending from previous years. BaFin imposed administrative fines totalling €3.3 million at the end of 119

Figure 23 Administrative fines



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Administrative fine guidelines

BaFin published administrative fine guidelines in 2013 for calculating administrative fines relating to ad hoc disclosure requirements, voting rights notification requirements and financial reporting. These guidelines ensure that comparable cases receive equal treatment. They also make the reasoning why BaFin has set administrative fines at a specific level clear and transparent. BaFin uses a three-stage system to assess the size of the issuer, the circumstances of the offence and the guilt of the party concerned. In a first step, it sets the basic amount for the specific violation. This is based on the size of the issuer and assessment criteria relevant to the offence. BaFin categorises the circumstances of the offence into minor, medium and serious. Potential circumstances are, for example, the nature and duration of the offence. In addition, issuers are assigned to groups A to D on the basis of their market capitalisation. This reflects their significance and position on the capital market. In a second step, the basic amount is adjusted in accordance with conduct before and after the offence. The amount may increase or decrease as a result. A confession normally leads to a reduction in the fine, while repeated violations normally increase the amount. In a third and last step, BaFin takes the offender's financial situation into account.

proceedings (previous year: 240, see figure 23 "Administrative fines"). This corresponded to a prosecution ratio of approximately 33%. BaFin discontinued 242 proceedings, 208 for discretionary reasons. A total of 1,006 cases (see table 35 "Administrative fine proceedings", page 187) were still pending at the end of 2013 (previous year: 851).

7.2 Selected cases

BaFin imposed an administrative fine of €24,000 against a natural person for prohibited market manipulation. This person had placed two limited sell orders for 50 contracts each in the Eurex trading system and only 1.16 seconds later issued buy orders for approximately 4,000 contracts with a price limit just below the sell limit. As a result, two transactions were executed and 100 contracts were sold at the desired limit. 0.31 seconds later, the buy orders were deleted; they had served merely to signal buying interest and had never been intended to be executed. The whole procedure took about three seconds.

BaFin imposed two administrative fines totalling €105,000 against a company that had violated its obligation to disclose and publish inside

Table 35 Administrative fine proceedings

	Number of cases pending at the beginning of 2013	Number of new cases in 2013	Administrative fines	Highest administrative fine imposed (€)	Discontinued for		Number of cases pending at the end of 2013
					for factual or legal reasons	discretionary reasons	
Reporting requirements (section 9 of the WpHG)	5	0	2	12,000	0	0	3
Ad hoc disclosures (section 15 of the WpHG)	60	36	7	97,500	0	14	75
Directors' dealings (section 15a of the WpHG)	8	2	1	5,500	0	1	8
Market manipulation (section 20a of the WpHG)	16	19	2	24,000	0	1	32
Notification and publication requirements (sections 21ff. of the WpHG)	504	342	53	48,000	12	131	650
Duties to provide information to securities holders (sections 30a ff. of the WpHG)	99	45	22	25,000	19	30	73
Short selling (section 30h of the WpHG)	3	3	3	63,000	0	0	3
Financial reporting requirements (sections 37v ff. of the WpHG)	100	55	22	50,000	2	18	113
Securities Prospectus Act	11	1	1	9,000	1	1	9
Capital Investment Act/ Prospectus Act	12	1	0	–	0	1	12
Takeovers (WpÜG)	30	15	6	100,000	0	11	28

information. The company's management board had resolved a capital increase. Since the supervisory board had not yet approved the transaction, the management board decided to exempt itself from the ad hoc disclosure requirement. However, it failed to inform BaFin in the advance notification of the reasons for the exemption and only did so in the course of the administrative fine proceedings. After the supervisory board had approved the transaction, the management board resolved to exempt itself further. Because of the turbulent market environment at the time, it feared that investors could lose confidence in the company if it failed to place all the new shares. This reason for exemption ceased to apply late in the evening one week later. However, the disclosure was only published the next morning shortly after the start of stock exchange trading, and therefore with a delay. The company should have informed the public of the resolved capital increase immediately after the reason for

exemption ceased to apply, i.e. on the previous evening.

BaFin imposed an administrative fine of €97,500 on another company. It had failed to publish its quarterly results via an ad hoc disclosure, although its revenue, EBITDA and consolidated profit had clearly performed well and significantly exceeded analyst expectations. Instead, the company had only announced the results in a press release.

Another administrative fine of €63,000 was levied by BaFin against an investment services enterprise. The employees of this enterprise had repeatedly violated the ban on short selling. In well over a hundred cases, they sold shares that the company did not have in its portfolio at the end of the trading day. BaFin subsequently found that the enterprise had failed to train its employees adequately. Moreover, there were no control processes to conduct systematic reviews of the workflows.

A bidder company that had failed to publish in time that it had gained control over a target company was ordered to pay an administrative fine of €100,000 by BaFin. The bidder had held more than 30% of the share capital and of the voting rights for 18 months before it fell below the control threshold again. BaFin uncovered this fact, enforced the mandatory offer that the company had failed to submit, and initiated the administrative fine proceedings.

VI About BaFin

1 Human resources and organisational developments

As at 31 December 2013, BaFin had 2,398 employees (previous year: 2,336) divided between its offices in Bonn (1,750) and Frankfurt am Main (648). Approximately 68.6% (1,644) are civil servants (*Beamte*) and approximately 31.4% (754) are public service employees covered by collective wage agreements (*Tarifbeschäftigte*).

Almost half of BaFin's workforce (1,132 people) is female. Around 23.8% of all management positions are held by women (see table 36 "Personnel").

Thirty-three BaFin employees are on long-term assignment to international institutions and supervisory authorities. Nine of these employees were seconded to the European Central Bank (ECB) at the end of 2013.

A total of 136 staff recruited

To manage its steadily growing workload, BaFin recruited a total of 136 new members of staff in 2013 (previous year: 262, see table 37 "Recruitment in 2013", page 191). The majority were fully qualified lawyers and economists, as well as university of applied sciences graduates and holders of bachelor's degrees. Candidates

Table 36 Personnel

As at 31 December 2013

Career level	Employees			Civil servants	Public service employees
	Total	Female	Male	Total	Total
Higher Civil Service	1,066	410	656	946	120
Upper Civil Service	773	354	419	628	145
Middle/Basic Civil Service	559	368	191	70	489
Total	**2,398**	**1,132**	**1,266**	**1,644**	**754**

Table 37 Recruitment in 2013

Career level	Total	Female	Male
Higher Civil Service	**75**	**34**	**41**
Qualification:			
Fully qualified lawyers	38		
Economists	30		
Mathematicians/ Statisticians	4		
Other	3		
Upper Civil Service	**33**	**15**	**18**
Qualification:			
Business lawyers	4		
Economists	18		
IT specialists	3		
Other	8		
Middle/Basic Civil Service	**6**	**3**	**3**
Candidates for entry to the Upper Civil Service/ Vocational trainees	**22**	**13**	**9**
Total	**136**	**65**	**71**

for entry to the Upper Civil Service, vocational trainees and temporary staff were also among the recruits.

Vocational training at BaFin

Fourteen candidates for entry to the Upper Civil Service began preparing for their careers with BaFin in 2013 (previous year: 11) and eight people commenced vocational training, as in the previous year. In collaboration with the *Deutsche Bundesbank*, BaFin is preparing 25 candidates for entry to the Upper Civil Service for their future responsibilities. BaFin currently also provides vocational training in two careers: office communication specialists (27 vocational trainees), and media and information services specialists (one vocational trainee). Consequently, at the end of 2013, BaFin had a total of 53 vocational trainees and candidates (previous year: 61).

Continuing professional development (CPD)

BaFin employees can take advantage of an extensive CPD offering. In 2013, 1,530 employees (previous year: 1,506) took part in at least one of a total of 645 internal and external CPD sessions (previous year: 575). The events held focused on specialist measures in particular. For example, they included multipart seminars on the introduction of Solvency II and sessions aimed at building cooperation with the ECB in connection with the introduction of the Single Supervisory Mechanism (SSM). The offering also included courses designed to enhance employees' foreign language skills and various courses on soft skills. On average, each employee received 5.03 days of training (previous year: 5.38 days).

Establishment of a Sanctions Committee

On 3 July 2013, BaFin established a Sanctions Committee with authority over all areas. The Committee supports the Executive Board in developing and enhancing a disciplinary strategy (policy) covering all BaFin's directorates. The Committee works with the latter to identify areas in which administrative procedures and the legal foundations for work can be standardised and improved, and initiates appropriate legislative amendments. It issues recommendations in order to ensure that disciplinary practice is consistent and in line with the law.

The Sanctions Committee discusses individual cases, such as the removal of managers, in an Individual Measures Panel. Depending on the gravity and significance of the measure, this Panel must be involved on either an obligatory or optional basis before the relevant administrative act is issued. The approval or rejection of a measure (with or without restrictions or conditions) by the Individual Measures Panel have the status of recommendations.

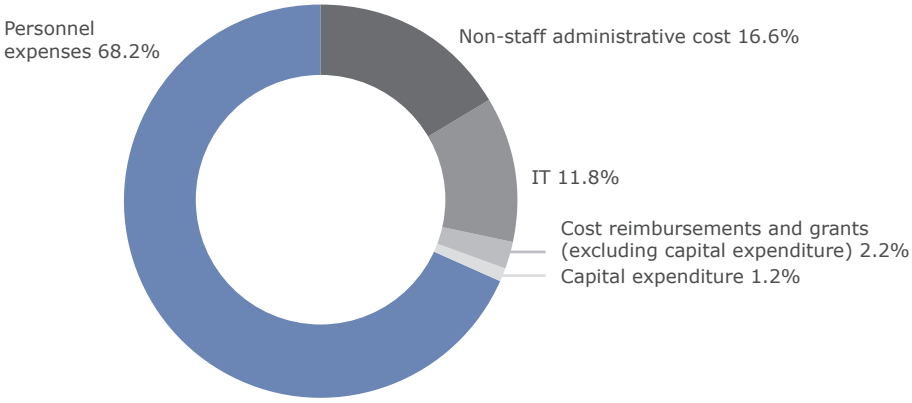
The Sanctions Committee falls within the President's area of responsibility.

2 Budget

2.1 Budget figures

BaFin's Administrative Council approved a budget of €190.7 million for 2013 (previous year: €170.3 million). Personnel expenses accounted for around 68.2% of the projected expenditure (€130.1 million; previous year: €112.3 million) and non-staff costs for around 16.6% (€31.6 million; previous year: €30.8 million); 11.8% was allocated for IT expenses (previous year: 11.6%), while capital expenditure represented 1.2% of the budget (previous year: 2.2%). Cost reimbursements and grants remained at the prior-year level, accounting for 2.2% of the budget.

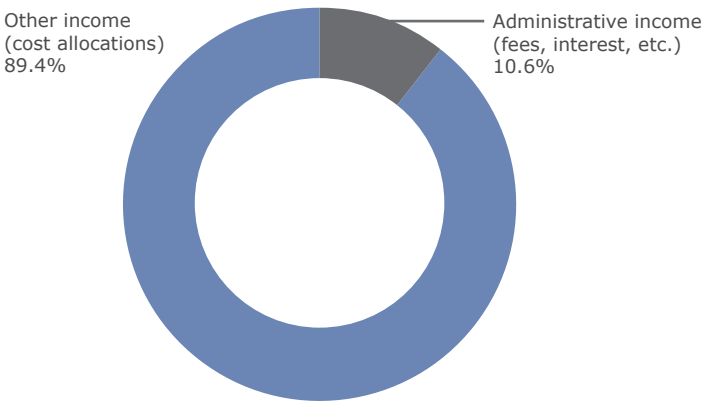
Figure 24 2013 budget expenditure



Financing through cost allocations and fees

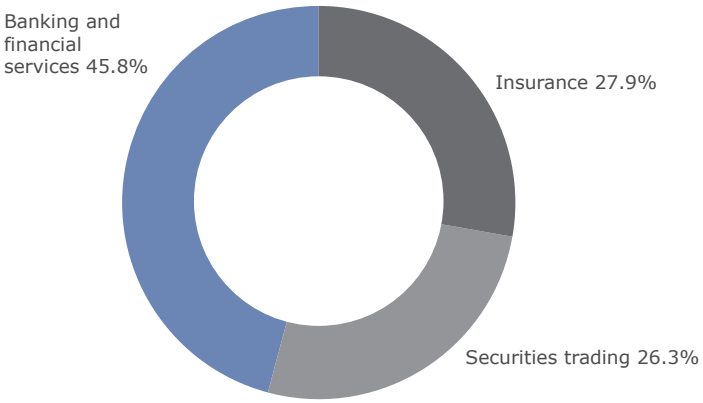
BaFin is independent of the federal budget and is fully self-financed from its own income. A large proportion of this is attributable to cost allocations levied on the supervised companies, a special levy with a financing function (projected figure for 2013: €170.5 million; previous year: €150.9 million). BaFin also generates administrative income such as fees and interest (projected figure for 2013: €20.2 million; previous year: €19.4 million).

Figure 25 2013 budget income



The final cost allocation for 2012 was performed in 2013. The banking industry contributed 45.8% of the total income from cost allocations. The insurance sector financed 27.9% and the securities trading sector 26.3%. The final cost allocation for 2013 will be performed in the course of 2014.

Figure 26 Cost allocations by supervisory area in 2012



BaFin's actual expenditure in 2013 was approximately €190.7 million (previous year: €165.3 million). Conversely, its income of amounted to €191.6 million (previous year: €166.4 million). The Administrative Council still has to approve the annual financial statements.

Separate enforcement budget

BaFin drew up a separate enforcement budget of €8.08 million (previous year: €7.83 million). This included a cost reimbursement to the German Financial Reporting Enforcement Panel (*Deutsche Prüfstelle für Rechnungslegung*) at the prior-year level (€6 million). Actual expenditure amounted to around €7.6 million (previous year: €7.5 million), while income (including advance cost allocation payments for 2014) stood at approximately €14.9 million (previous year: €15.2 million).

2.2 Federal Fees Act

Articles 1 and 2 of the Act on the Structural Reform of Federal Fees Law (*Gesetz zur Strukturreform des Gebührenrechts des Bundes*) entered into force on 15 August 2013. Article 1 contains the Federal Fees Act (*Bundesgebührengesetz* – BGebG); Article 2 contains the consequential amendments. At the same time, the Administrative Costs Act (*Verwaltungskostengesetz* – VwKostG) was repealed on 15 August.

The new act aims to modernise, amend and standardise all federal fees legislation. For one thing, it aims to relieve the specific laws and regulations regulating fees by summarising the general provisions, creating a central basis of authorisation for standardising fees and bundling the provisions of the specific laws into uniformly structured Special Fees Regulations. For another, the act provides a legally certain and transparent basis for charging fees. Together with the planned General Fees Regulation, it establishes clear, easy-to-follow rules for calculating fees, reinforces the principle that fees should cover costs and aligns fees legislation with basic business principles.

Changes with practical implications and transitional provisions

The new act introduces a number of changes as against the previous version of the VwKostG that have practical implications. These relate to when the liability to pay the fee arises, when the limitation period for payment expires, when fees fall due and surcharges for late payment.

In certain cases that are governed by section 23 of the BGebG, the VwKostG is still applicable in full or in part for a transitional period.

FinDAG and BaFin's Fees Regulations

In the short term, the new act only minimally impacts the provisions governing fees contained in the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz* – FinDAG), the supervisory laws and BaFin's Fees Regulations. The most important change is that the term "official acts" has been replaced by the term "individually attributable public services".

All of the rules governing fees contained in the FinDAG, the supervisory laws and BaFin's Fees Regulations will be abolished by 14 August 2018 at the latest. It is planned to replace them with the Federal Ministry of Finance's Special Fees Regulation.

3 Press and Public Relations

BaFin answered a total of 4,161 press enquiries in 2013. One of the main banking supervision topics was the preparations by institutions and BaFin for the Single Supervisory Mechanism (SSM). Among other things, the journalists' questions related to the upstream comprehensive assessment in which the European Central Bank (ECB) and the national supervisory authorities will comprehensively assess 124 banking groups in the eurozone – including 24 German banks – in the period up to November 2014.

Accusations of manipulation made waves

The accusations that key reference rates such as LIBOR, Euribor and other benchmarks had been manipulated also met with great media interest in the past year. BaFin President Dr Elke König addressed the issue in her speech at BaFin's annual press conference in May 2013, among other things. There were also numerous questions from the press about recovery and resolution planning by banks and about the new European legislative package for banks – CRD IV (Capital Requirements Directive IV) and CRR (Capital Requirements Regulation), both of which came into force on 1 January 2014. Certain provisions limiting debt and aiming to ensure stable refinancing were excluded and will only apply as from the beginning of 2015 or 2016. In addition, media representatives were interested in the areas of emphasis for BaFin's ship finance audits, for example, and in the special audits of banks' remuneration systems.

Continued interest in the Employee and Complaints Register

In the area of securities supervision, the Employee and Complaints Register launched by BaFin in November 2012 remained a press focus in 2013. Among other things, journalists wanted to know how many investment advisers and complaints had already been entered in the register. The implementation of the EU Alternative Investment Fund Managers Directive (AIFM Directive) and the introduction of the Investment Code (*Kapitalanlagegesetzbuch* – KAGB) on 22 July 2013 also attracted significant media attention. In addition, BaFin received a large number of enquiries about cases of market manipulation.

Low interest rate phase and Solvency II

Insurance supervision-related enquiries in 2013 mainly concerned the ongoing low interest rate phase and its impact on the sector. Important topics were, for instance, possible stabilisation and relief measures, the *Zinszusatzreserve* (an additional provision to the premium reserve introduced in response to the lower interest rate environment) established by life insurers, the latters' investment patterns and the new life insurance products with *Abschnittsgarantien* (limited-term interest guarantees for life insurance policies). Press representatives also sought information on the implementation of the Solvency II framework and the supplementary Omnibus II Directive.

In addition, BaFin received enquiries about the revision of the Directive on the activities and supervision of institutions for occupational retirement provision (IORP Directive).

Bitcoins and unauthorised business

The virtual currency Bitcoin also gave rise to a real flood of press enquiries in the past year. At the end of 2013, BaFin pointed out to the public the potential risks run by Bitcoin users. BaFin's actions against unauthorised business models also received media coverage. This included the prohibition of the banking and insurance business conducted by Peter F., who had established the "Kingdom of Germany" ("*Königreich Deutschland*") in Wittenberg (Saxony-Anhalt) in September 2012. He also declared himself the "supreme sovereign" and operated his own health, pension and liability insurance in addition to the "Royal Bank of Germany" ("*Königliche Reichsbank*"). Another topic that press representatives were interested in in 2013 was the purchase of second-hand life insurance policies and other investments, primarily due to a current investment scandal.

Press conference on consumer protection

Another key issue in 2013 was consumer protection: BaFin's Consumer Advisory Council (*Verbraucherbeirat*) commenced its duties in June. To mark its inaugural meeting, which was attended by the former Federal Consumer Affairs Minister Ilse Aigner along with the BaFin Executive Board, a joint press conference was held by BaFin, the Federal Ministry of Finance (BMF) and the Federal Ministry of Food, Agriculture and Consumer Protection (BMELV)[1].

Forum on White-collar Crime and the Capital Market

The Forum on White-collar Crime and the Capital Market, which BaFin hosts every year, celebrated its tenth anniversary in November 2013. Over the years, the event has become an important knowledge transfer platform for the police, public prosecutors, judges and financial supervisors in Germany and abroad. Whereas the first Forum in April 2004 had around 50 participants, more than 370 attended the BaFin event at the German National Library in Frankfurt am Main in 2013. Current capital market issues such as market manipulation in algorithmic trading and Bitcoins were on the agenda of the two-day event. In addition, BaFin demonstrated to participants interesting practical cases in the areas of market manipulation, insider trading and unauthorised businesses.

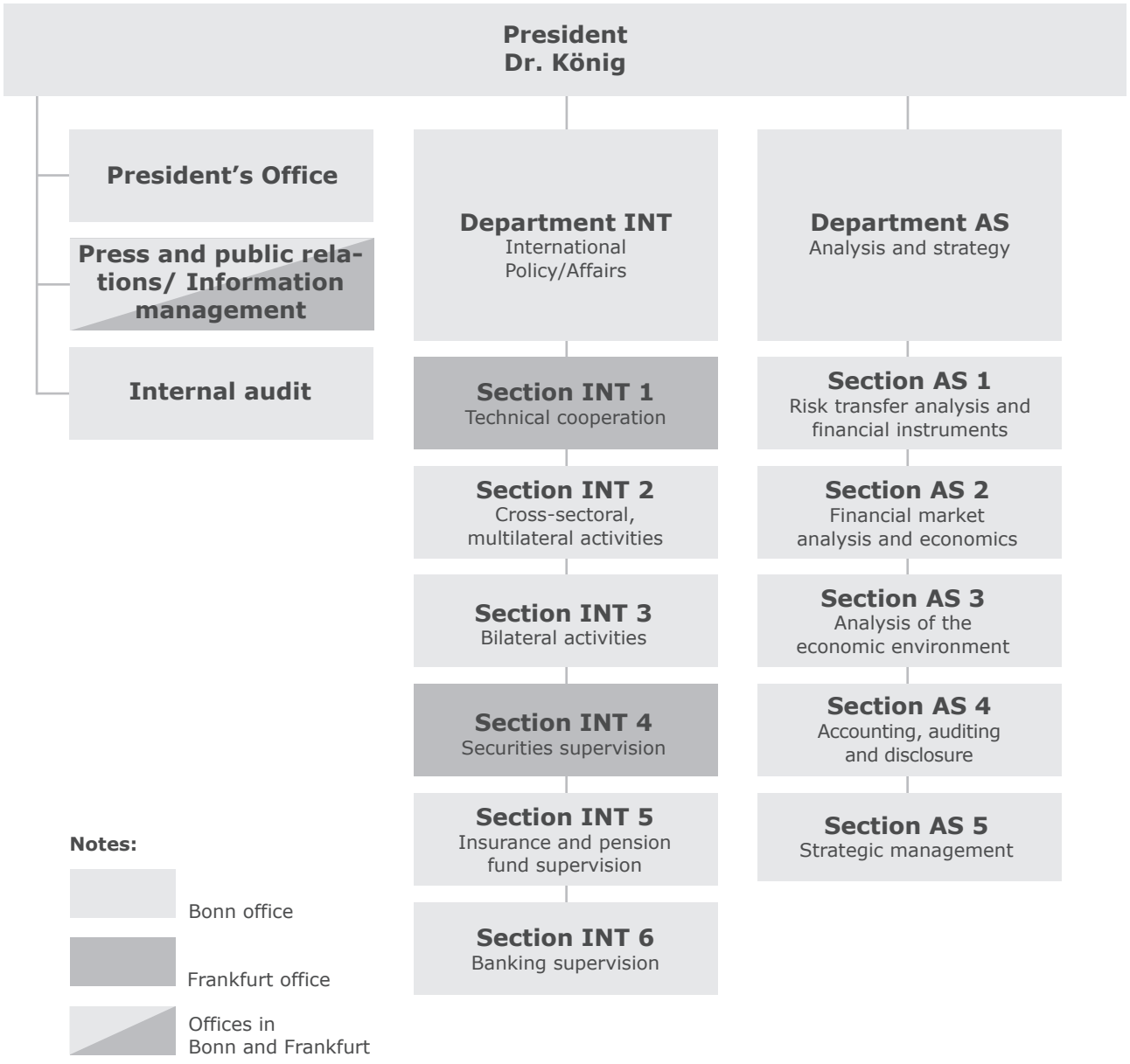
Information for investors

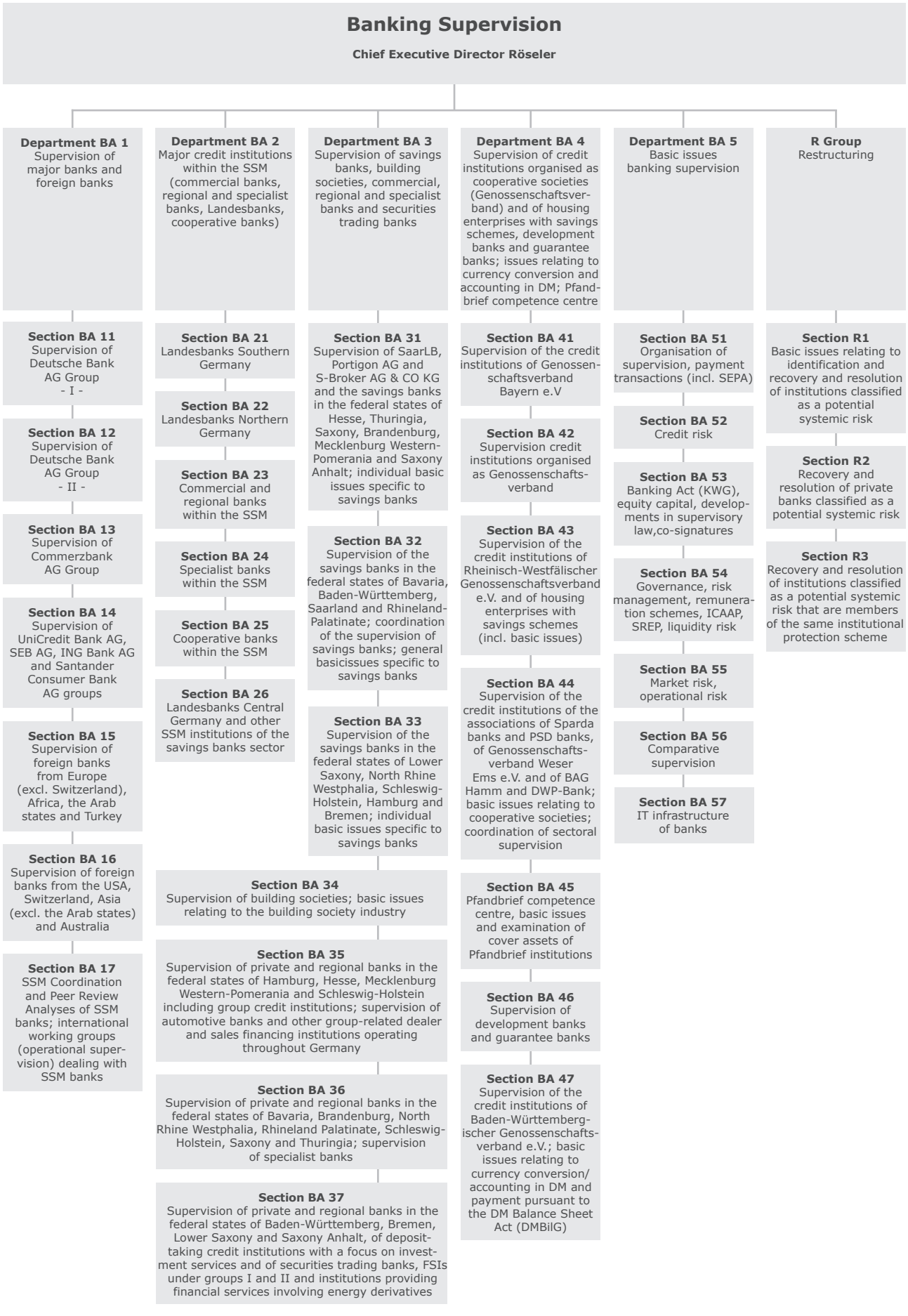
In April 2013, BaFin again participated in the "Invest" fair in Stuttgart, where almost 12,000 private and institutional investors could gather information about financial products and investment strategies. Among other things, BaFin explained the new Employee and Complaints Register and issued warnings about dubious investment tips. It also published the "Achtung: Marktmanipulation!" flyer ("*Warning: market manipulation!*" – only available in German) which draws attention to the most common scams and important warning signs for market manipulation. BaFin also took part in stock exchange days in Dresden, Munich, Berlin and Hamburg, and in the Federal Ministry of Finance's open day in Berlin.

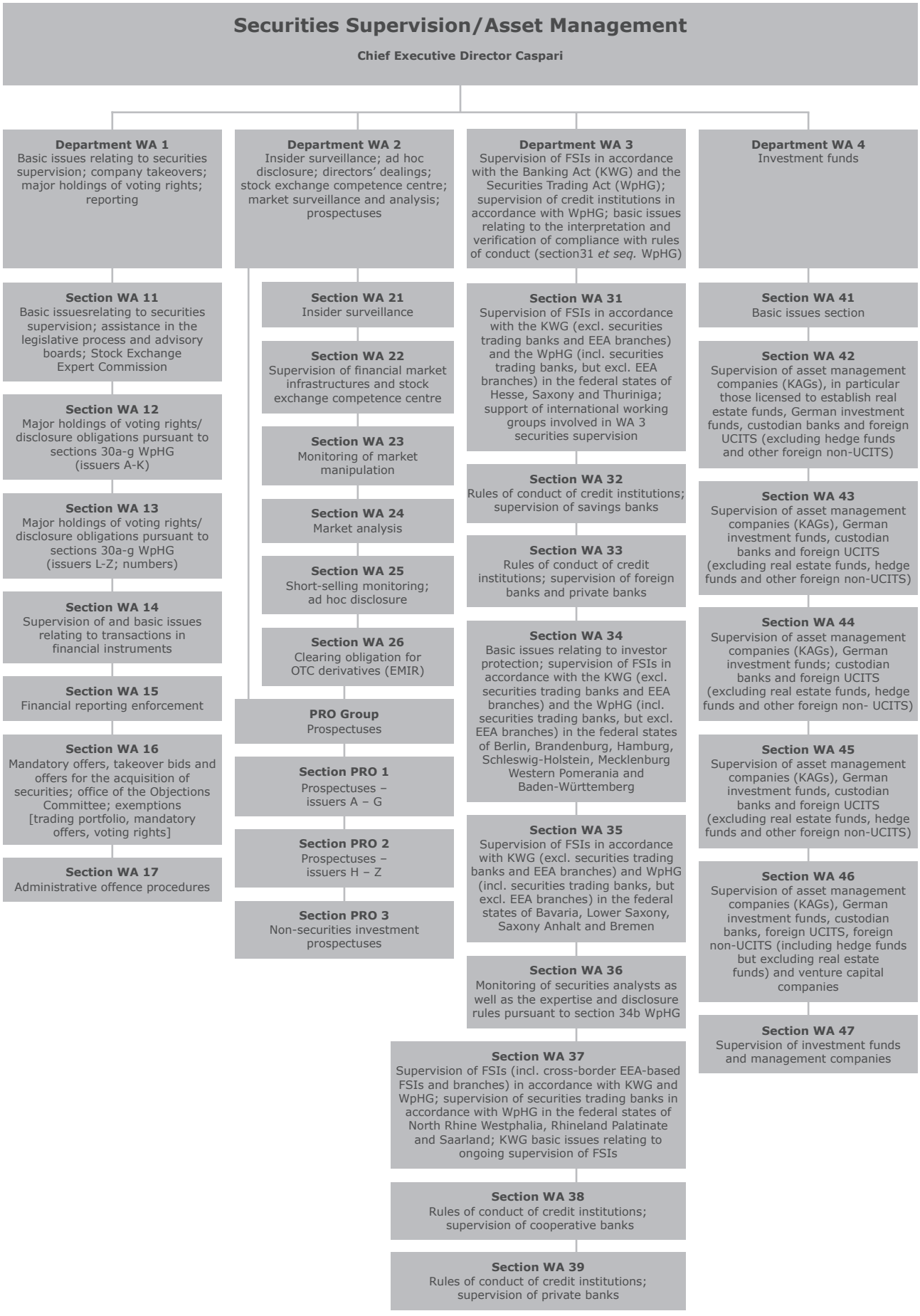
1 Since December 2013 Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz*).

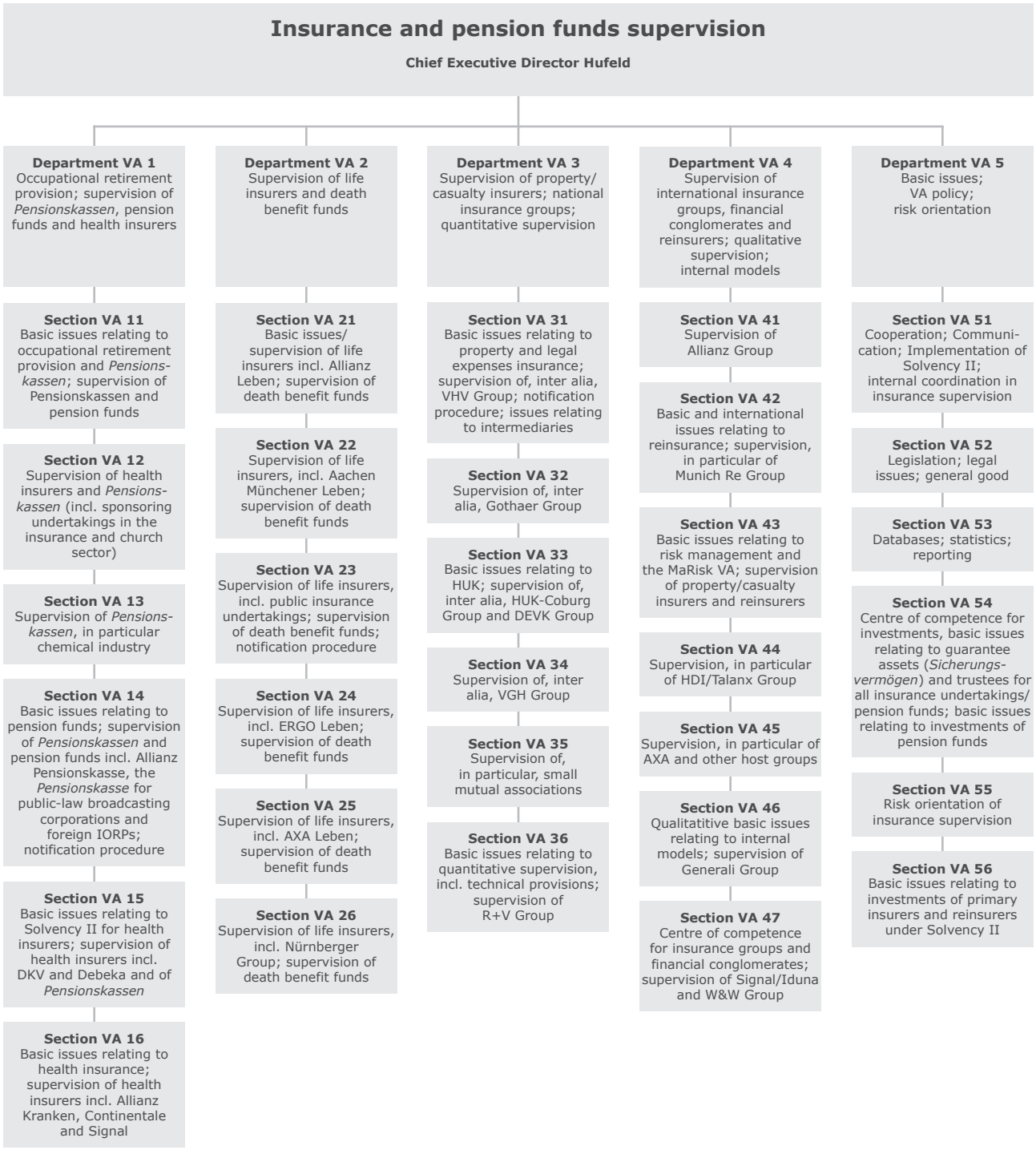
Appendix

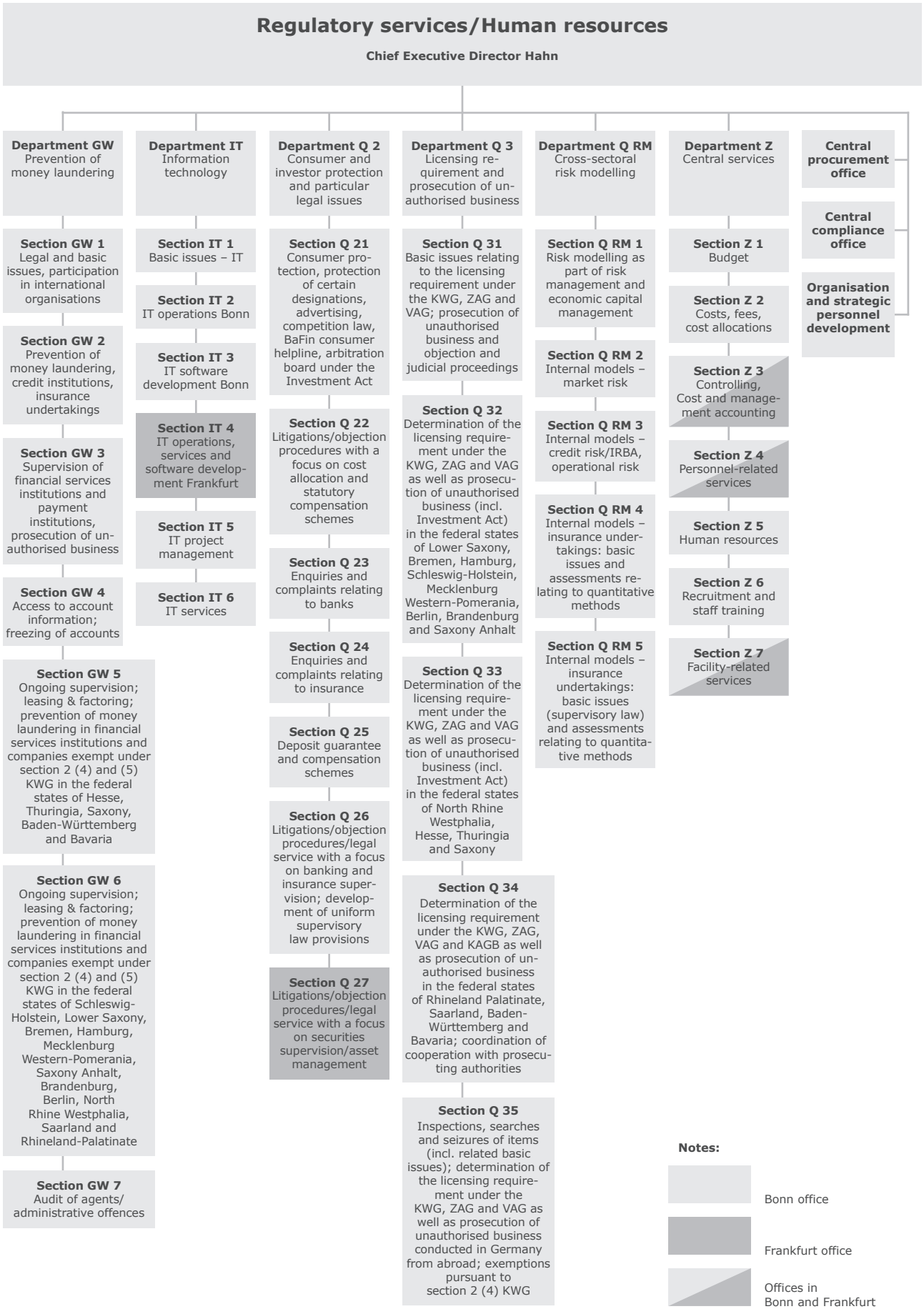
1 Organisation chart




Banking Supervision
Chief Executive Director Röseler
Department BA 1
Supervision of major banks and foreign banks
Section BA 11
Supervision of Deutsche Bank AG Group
- I -
Section BA 12
Supervision of Deutsche Bank AG Group
- II -
Section BA 13
Supervision of Commerzbank AG Group
Section BA 14
Supervision of UniCredit Bank AG, SEB AG, ING Bank AG and Santander Consumer Bank AG groups
Section BA 15
Supervision of foreign banks from Europe (excl. Switzerland), Africa, the Arab states and Turkey
Section BA 16
Supervision of foreign banks from the USA, Switzerland, Asia (excl. the Arab states) and Australia
Section BA 17
SSM Coordination and Peer Review Analyses of SSM banks; international working groups (operational supervision) dealing with SSM banks
Department BA 2
Major credit institutions within the SSM (commercial banks, regional and specialist banks, Landesbanks, cooperative banks)
Section BA 21
Landesbanks Southern Germany
Section BA 22
Landesbanks Northern Germany
Section BA 23
Commercial and regional banks within the SSM
Section BA 24
Specialist banks within the SSM
Section BA 25
Cooperative banks within the SSM
Section BA 26
Landesbanks Central Germany and other SSM institutions of the savings banks sector
Department BA 3
Supervision of savings banks, building societies, commercial, regional and specialist banks and securities trading banks
Section BA 31
Supervision of SaarLB, Portigon AG and S-Broker AG & CO KG and the savings banks in the federal states of Hesse, Thuringia, Saxony, Brandenburg, Mecklenburg Western-Pomerania and Saxony Anhalt; individual basic issues specific to savings banks
Section BA 32
Supervision of the savings banks in the federal states of Bavaria, Baden-Württemberg, Saarland and Rhineland-Palatinate; coordination of the supervision of savings banks; general basicissues specific to savings banks
Section BA 33
Supervision of the savings banks in the federal states of Lower Saxony, North Rhine Westphalia, Schleswig-Holstein, Hamburg and Bremen; individual basic issues specific to savings banks
Section BA 34
Supervision of building societies; basic issues relating to the building society industry
Section BA 35
Supervision of private and regional banks in the federal states of Hamburg, Hesse, Mecklenburg Western-Pomerania and Schleswig-Holstein including group credit institutions; supervision of automotive banks and other group-related dealer and sales financing institutions operating throughout Germany
Section BA 36
Supervision of private and regional banks in the federal states of Bavaria, Brandenburg, North Rhine Westphalia, Rhineland Palatinate, Schleswig-Holstein, Saxony and Thuringia; supervision of specialist banks
Section BA 37
Supervision of private and regional banks in the federal states of Baden-Württemberg, Bremen, Lower Saxony and Saxony Anhalt, of deposit-taking credit institutions with a focus on investment services and of securities trading banks, FSIs under groups I and II and institutions providing financial services involving energy derivatives
Department BA 4
Supervision of credit institutions organised as cooperative societies (Genossenschaftsverband) and of housing enterprises with savings schemes, development banks and guarantee banks; issues relating to currency conversion and accounting in DM; Pfandbrief competence centre
Section BA 41
Supervision of the credit institutions of Genossenschaftsverband Bayern e.V
Section BA 42
Supervision credit institutions organised as Genossenschaftsverband
Section BA 43
Supervision of the credit institutions of Rheinisch-Westfälischer Genossenschaftsverband e.V. and of housing enterprises with savings schemes (incl. basic issues)
Section BA 44
Supervision of the credit institutions of the associations of Sparda banks and PSD banks, of Genossenschaftsverband Weser Ems e.V. and of BAG Hamm and DWP-Bank; basic issues relating to cooperative societies; coordination of sectoral supervision
Section BA 45
Pfandbrief competence centre, basic issues and examination of cover assets of Pfandbrief institutions
Section BA 46
Supervision of development banks and guarantee banks
Section BA 47
Supervision of the credit institutions of Baden-Württembergischer Genossenschaftsverband e.V.; basic issues relating to currency conversion/ accounting in DM and payment pursuant to the DM Balance Sheet Act (DMBilG)
Department BA 5
Basic issues banking supervision
Section BA 51
Organisation of supervision, payment transactions (incl. SEPA)
Section BA 52
Credit risk
Section BA 53
Banking Act (KWG), equity capital, developments in supervisory law,co-signatures
Section BA 54
Governance, risk management, remuneration schemes, ICAAP, SREP, liquidity risk
Section BA 55
Market risk, operational risk
Section BA 56
Comparative supervision
Section BA 57
IT infrastructure of banks
R Group
Restructuring
Section R1
Basic issues relating to identification and recovery and resolution of institutions classified as a potential systemic risk
Section R2
Recovery and resolution of private banks classified as a potential systemic risk
Section R3
Recovery and resolution of institutions classified as a potential systemic risk that are members of the same institutional protection scheme


Securities Supervision/Asset Management
Chief Executive Director Caspari
Department WA 1
Basic issues relating to securities supervision; company takeovers; major holdings of voting rights; reporting
Section WA 11
Basic issuesrelating to securities supervision; assistance in the legislative process and advisory boards; Stock Exchange Expert Commission
Section WA 12
Major holdings of voting rights/ disclosure obligations pursuant to sections 30a-g WpHG (issuers A-K)
Section WA 13
Major holdings of voting rights/ disclosure obligations pursuant to sections 30a-g WpHG (issuers L-Z; numbers)
Section WA 14
Supervision of and basic issues relating to transactions in financial instruments
Section WA 15
Financial reporting enforcement
Section WA 16
Mandatory offers, takeover bids and offers for the acquisition of securities; office of the Objections Committee; exemptions [trading portfolio, mandatory offers, voting rights]
Section WA 17
Administrative offence procedures
Department WA 2
Insider surveillance; ad hoc disclosure; directors' dealings; stock exchange competence centre; market surveillance and analysis; prospectuses
Section WA 21
Insider surveillance
Section WA 22
Supervision of financial market infrastructures and stock exchange competence centre
Section WA 23
Monitoring of market manipulation
Section WA 24
Market analysis
Section WA 25
Short-selling monitoring; ad hoc disclosure
Section WA 26
Clearing obligation for OTC derivatives (EMIR)
PRO Group
Prospectuses
Section PRO 1
Prospectuses – issuers A – G
Section PRO 2
Prospectuses – issuers H – Z
Section PRO 3
Non-securities investment prospectuses
Department WA 3
Supervision of FSIs in accordance with the Banking Act (KWG) and the Securities Trading Act (WpHG); supervision of credit institutions in accordance with WpHG; basic issues relating to the interpretation and verification of compliance with rules of conduct (section31 et seq. WpHG)
Section WA 31
Supervision of FSIs in accordance with the KWG (excl. securities trading banks and EEA branches) and the WpHG (incl. securities trading banks, but excl. EEA branches) in the federal states of Hesse, Saxony and Thuriniga; support of international working groups involved in WA 3 securities supervision
Section WA 32
Rules of conduct of credit institutions; supervision of savings banks
Section WA 33
Rules of conduct of credit institutions; supervision of foreign banks and private banks
Section WA 34
Basic issues relating to investor protection; supervision of FSIs in accordance with the KWG (excl. securities trading banks and EEA branches) and the WpHG (incl. securities trading banks, but excl. EEA branches) in the federal states of Berlin, Brandenburg, Hamburg, Schleswig-Holstein, Mecklenburg Western Pomerania and Baden-Württemberg
Section WA 35
Supervision of FSIs in accordance with KWG (excl. securities trading banks and EEA branches) and WpHG (incl. securities trading banks, but excl. EEA branches) in the federal states of Bavaria, Lower Saxony, Saxony Anhalt and Bremen
Section WA 36
Monitoring of securities analysts as well as the expertise and disclosure rules pursuant to section 34b WpHG
Section WA 37
Supervision of FSIs (incl. cross-border EEA-based FSIs and branches) in accordance with KWG and WpHG; supervision of securities trading banks in accordance with WpHG in the federal states of North Rhine Westphalia, Rhineland Palatinate and Saarland; KWG basic issues relating to ongoing supervision of FSIs
Section WA 38
Rules of conduct of credit institutions; supervision of cooperative banks
Section WA 39
Rules of conduct of credit institutions; supervision of private banks
Department WA 4
Investment funds
Section WA 41
Basic issues section
Section WA 42
Supervision of asset management companies (KAGs), in particular those licensed to establish real estate funds, German investment funds, custodian banks and foreign UCITS (excluding hedge funds and other foreign non-UCITS)
Section WA 43
Supervision of asset management companies (KAGs), German investment funds, custodian banks and foreign UCITS (excluding real estate funds, hedge funds and other foreign non-UCITS)
Section WA 44
Supervision of asset management companies (KAGs), German investment funds; custodian banks and foreign UCITS (excluding real estate funds, hedge funds and other foreign non- UCITS)
Section WA 45
Supervision of asset management companies (KAGs), German investment funds, custodian banks and foreign UCITS (excluding real estate funds, hedge funds and other foreign non-UCITS)
Section WA 46
Supervision of asset management companies (KAGs), German investment funds, custodian banks, foreign UCITS, foreign non-UCITS (including hedge funds but excluding real estate funds) and venture capital companies
Section WA 47
Supervision of investment funds and management companies


Insurance and pension funds supervision
Chief Executive Director Hufeld
Department VA 1
Occupational retirement provision; supervision of Pensionskassen, pension funds and health insurers
Section VA 11
Basic issues relating to occupational retirement provision and Pensionskassen; supervision of Pensionskassen and pension funds
Section VA 12
Supervision of health insurers and Pensionskassen (incl. sponsoring undertakings in the insurance and church sector)
Section VA 13
Supervision of Pensionskassen, in particular chemical industry
Section VA 14
Basic issues relating to pension funds; supervision of Pensionskassen and pension funds incl. Allianz Pensionskasse, the Pensionskasse for public-law broadcasting corporations and foreign IORPs; notification procedure
Section VA 15
Basic issues relating to Solvency II for health insurers; supervision of health insurers incl. DKV and Debeka and of Pensionskassen
Section VA 16
Basic issues relating to health insurance; supervision of health insurers incl. Allianz Kranken, Continentale and Signal
Department VA 2
Supervision of life insurers and death benefit funds
Section VA 21
Basic issues/ supervision of life insurers incl. Allianz Leben; supervision of death benefit funds
Section VA 22
Supervision of life insurers, incl. Aachen Münchener Leben; supervision of death benefit funds
Section VA 23
Supervision of life insurers, incl. public insurance undertakings; supervision of death benefit funds; notification procedure
Section VA 24
Supervision of life insurers, incl. ERGO Leben; supervision of death benefit funds
Section VA 25
Supervision of life insurers, incl. AXA Leben; supervision of death benefit funds
Section VA 26
Supervision of life insurers, incl. Nürnberger Group; supervision of death benefit funds
Department VA 3
Supervision of property/ casualty insurers; national insurance groups; quantitative supervision
Section VA 31
Basic issues relating to property and legal expenses insurance; supervision of, inter alia, VHV Group; notification procedure; issues relating to intermediaries
Section VA 32
Supervision of, inter alia, Gothaer Group
Section VA 33
Basic issues relating to HUK; supervision of, inter alia, HUK-Coburg Group and DEVK Group
Section VA 34
Supervision of, inter alia, VGH Group
Section VA 35
Supervision of, in particular, small mutual associations
Section VA 36
Basic issues relating to quantitative supervision, incl. technical provisions; supervision of R+V Group
Department VA 4
Supervision of international insurance groups, financial conglomerates and reinsurers; qualitative supervision; internal models
Section VA 41
Supervision of Allianz Group
Section VA 42
Basic and international issues relating to reinsurance; supervision, in particular of Munich Re Group
Section VA 43
Basic issues relating to risk management and the MaRisk VA; supervision of property/casualty insurers and reinsurers
Section VA 44
Supervision, in particular of HDI/Talanx Group
Section VA 45
Supervision, in particular of AXA and other host groups
Section VA 46
Qualitatitive basic issues relating to internal models; supervision of Generali Group
Section VA 47
Centre of competence for insurance groups and financial conglomerates; supervision of Signal/Iduna and W&W Group
Department VA 5
Basic issues; VA policy; risk orientation
Section VA 51
Cooperation; Communication; Implementation of Solvency II; internal coordination in insurance supervision
Section VA 52
Legislation; legal issues; general good
Section VA 53
Databases; statistics; reporting
Section VA 54
Centre of competence for investments, basic issues relating to guarantee assets (Sicherungsvermögen) and trustees for all insurance undertakings/ pension funds; basic issues relating to investments of pension funds
Section VA 55
Risk orientation of insurance supervision
Section VA 56
Basic issues relating to investments of primary insurers and reinsurers under Solvency II


Regulatory services/Human resources
Chief Executive Director Hahn
Department GW
Prevention of money laundering
Section GW 1
Legal and basic issues, participation in international organisations
Section GW 2
Prevention of money laundering, credit institutions, insurance undertakings
Section GW 3
Supervision of financial services institutions and payment institutions, prosecution of unauthorised business
Section GW 4
Access to account information; freezing of accounts
Section GW 5
Ongoing supervision; leasing & factoring; prevention of money laundering in financial services institutions and companies exempt under section 2 (4) and (5) KWG in the federal states of Hesse, Thuringia, Saxony, Baden-Württemberg and Bavaria
Section GW 6
Ongoing supervision; leasing & factoring; prevention of money laundering in financial services institutions and companies exempt under section 2 (4) and (5) KWG in the federal states of Schleswig-Holstein, Lower Saxony, Bremen, Hamburg, Mecklenburg Western-Pomerania, Saxony Anhalt, Brandenburg, Berlin, North Rhine Westphalia, Saarland and Rhineland-Palatinate
Section GW 7
Audit of agents/ administrative offences
Department IT
Information technology
Section IT 1
Basic issues – IT
Section IT 2
IT operations Bonn
Section IT 3
IT software development Bonn
Section IT 4
IT operations, services and software development Frankfurt
Section IT 5
IT project management
Section IT 6
IT services
Department Q 2
Consumer and investor protection and particular legal issues
Section Q 21
Consumer protection, protection of certain designations, advertising, competition law, BaFin consumer helpline, arbitration board under the Investment Act
Section Q 22
Litigations/objection procedures with a focus on cost allocation and statutory compensation schemes
Section Q 23
Enquiries and complaints relating to banks
Section Q 24
Enquiries and complaints relating to insurance
Section Q 25
Deposit guarantee and compensation schemes
Section Q 26
Litigations/objection procedures/legal service with a focus on banking and insurance supervision; development of uniform supervisory law provisions
Section Q 27
Litigations/objection procedures/legal service with a focus on securities supervision/asset management
Department Q 3
Licensing requirement and prosecution of unauthorised business
Section Q 31
Basic issues relating to the licensing requirement under the KWG, ZAG and VAG; prosecution of unauthorised business and objection and judicial proceedings
Section Q 32
Determination of the licensing requirement under the KWG, ZAG and VAG as well as prosecution of unauthorised business (incl. Investment Act) in the federal states of Lower Saxony, Bremen, Hamburg, Schleswig-Holstein, Mecklenburg Western-Pomerania, Berlin, Brandenburg and Saxony Anhalt
Section Q 33
Determination of the licensing requirement under the KWG, ZAG and VAG as well as prosecution of unauthorised business (incl. Investment Act) in the federal states of North Rhine Westphalia, Hesse, Thuringia and Saxony
Section Q 34
Determination of the licensing requirement under the KWG, ZAG, VAG and KAGB as well as prosecution of unauthorised business in the federal states of Rhineland Palatinate, Saarland, Baden-Württemberg and Bavaria; coordination of cooperation with prosecuting authorities
Section Q 35
Inspections, searches and seizures of items (incl. related basic issues); determination of the licensing requirement under the KWG, ZAG and VAG as well as prosecution of unauthorised business conducted in Germany from abroad; exemptions pursuant to section 2 (4) KWG
Department Q RM
Cross-sectoral risk modelling
Section Q RM 1
Risk modelling as part of risk management and economic capital management
Section Q RM 2
Internal models – market risk
Section Q RM 3
Internal models – credit risk/IRBA, operational risk
Section Q RM 4
Internal models – insurance undertakings: basic issues and assessments relating to quantitative methods
Section Q RM 5
Internal models – insurance undertakings: basic issues (supervisory law) and assessments relating to quantitative methods
Department Z
Central services
Section Z 1
Budget
Section Z 2
Costs, fees, cost allocations
Section Z 3
Controlling, Cost and management accounting
Section Z 4
Personnel-related services
Section Z 5
Human resources
Section Z 6
Recruitment and staff training
Section Z 7
Facility-related services
Central procurement office
Central compliance office
Organisation and strategic personnel development
Notes:
Bonn office
Frankfurt office
Offices in Bonn and Frankfurt

2 BaFin bodies

2.1 Members of the Administrative Council

Representing Federal Ministries

Dr Thomas Steffen (Chair – BMF)
Dr Levin Holle (Deputy chair – BMF)
Corinna Westermann (BMF)
Christian Dobler (BMWi)
Erich Schaefer (BMJV)
Dr Rainer Metz (BMEL)

Representing the *Bundestag*

MdB Klaus-Peter Flosbach
MdB Bartholomäus Kalb
MdB Manfred Zöllmer
MdB Dr Jens Zimmermann
MdB Dr Axel Troost

Representing credit institutions

Georg Fahrenschon

Representing insurance undertakings

Dr Jörg von Fürstenwerth

Representing asset management companies

Thomas Richter

Representing the academic community

Prof. Isabel Schnabel
Prof. Brigitte Haar
Prof. Fred Wagner

As at March 2014

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
N. N.
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 chair)

Representing the Working Group on Occupational Retirement Provision – apa –

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

N. N.

Representing industry

Folkhart Olschowy (Wacker Chemie AG)

As at April 2014

2.3 Members of the Insurance Advisory Council

Dr Helmut Aden

Prof. Christian Armbrüster

Dr Alexander Barthel

Lars Gatschke

Ira Gloe-Semler

Prof. Catherine Grobosch

Norbert Heinen

Michael H. Heinz

Werner Hölzl

Sabine Krummenerl

Uwe Laue

Katharina Lawrence

Dr Ursula Lipowsky

Adelheid Marscheider

Dr Torsten Oletzky

Prof. Petra Pohlmann

Holger R. Rohde

Prof. Heinrich R. Schradin

Reinhold Schulte

Ilona Stumm

Prof. Manfred Wandt

Michael Wortberg

Dr Maximilian Zimmerer

Prof. Jochen Zimmermann

As at December 2013

2.4 Members of the Securities Council

Ministry of Finance and Economics of the State of Baden-Württemberg

Ministry of Economics, Infrastructure, Transport and Technology of the State of Bavaria

Berlin Senate Administration for 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

Authority for 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 of 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 Finance of the State of Schleswig-Holstein

Ministry of Finance of the State of Thuringia

As at March 2014

2.5 Members of the Consumer Advisory Council

Representing the academic community

Prof. Brigitte Haar (Deputy chair)
Prof. Kai-Oliver Knops
Prof. Udo Reifner

Representing consumer or investor protection organisations

Jella Benner-Heinacher
Stephan Kühnlenz
Dorothea Mohn (Chair)
Katharina Lawrence

Representing out-of-court dispute resolution entities

Wolfgang Arenhövel
Prof. Günter Hirsch
Dr Gerda Müller

Representing the Federal Ministry of Food, Agriculture and Consumer Protection[1]
(*Bundesministerium für Ernährung, Landwirtschaft und Verbraucherschutz***)**

Dr Erich Paetz

Representing trade unions

Christoph Hahn

As at June 2013

1 Since December 2013 Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz*)

3 Complaints statistics for individual undertakings

3.1 Explanatory notes on the statistics

For many years, BaFin has published complaints statistics in its annual report classified by insurance undertaking and class. The Higher Administrative Court in Berlin (*Oberverwaltungsgericht* – OVG) issued a ruling on 25 July 1995 (case ref.: OVG 8 B 16/94) ordering the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen* – BAV), one of BaFin's predecessors, to include this information.

The complaints statistics list how many complaints BaFin processed in full in 2013 for Insurance Supervision.

The statistics do not take into account whether the complaints processed are justified, and hence are not indicative of the quality of insurance business.

In order to provide an indicator of the volume of insurance business, the number of complaints that BaFin processed in full in 2013 is compared with the number of policies in the respective insurance class as at 31 December 2012. 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 written in the course of the year giving rise to the complaints is not adequately accounted for in the complaints statistics.

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 scale, 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 2012 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 in 2012	Complaints
1001	AACHENMüNCHENER LEB.	5,318,070	101
1006	ALLIANZ LEBEN	10,370,248	245
1007	ALTE LEIPZIGER LEBEN	1,204,132	21
1035	ARAG LEBEN	341,834	11
1303	ASSTEL LEBEN	305,288	6
1020	AXA LEBEN	1,681,903	76
1011	BARMENIA LEBEN	240,516	7
1028	BASLER LEBEN	757,368	23
1012	BASLER LEBEN (CH)	138,827	6
1013	BAYER. BEAMTEN LEBEN	263,992	10
1015	BAYERN-VERS.	1,811,328	22
1122	CONCORDIA LEBEN	141,067	1
1021	CONDOR LEBEN	214,972	3
1335	CONTINENTALE LV AG	640,954	8
1022	COSMOS LEBEN	1,405,437	27
1115	CREDIT LIFE AG	49,738	4
1146	DBV DEUTSCHE BEAMTEN	1,607,950	44
1023	DEBEKA LEBEN	3,471,422	50
1017	DELTA LLOYD LEBEN	412,677	17
1136	DEVK ALLG. LEBEN	796,667	19
1025	DEVK DT. EISENBAHN LV	674,841	2
1110	DIREKTE LEBEN	131,898	3
1180	DT. ÄRZTEVERSICHERUNG	204,072	5
1148	DT. LEBENSVERS.	456,092	5
1130	ERGO DIREKT LEBEN AG	1,176,373	32
1184	ERGO LEBEN AG	5,523,206	159
1107	EUROPA LEBEN	463,335	5
1310	FAMILIENFüRSORGE LV	268,529	6
1139	GENERALI LEBEN AG	4,832,821	136
1108	GOTHAER LEBEN AG	1,134,879	20
1040	HAMB. LEBEN	22,272	3
1312	HANNOVERSCHE LV AG	895,713	21
1114	HANSEMERKUR LEBEN	217,514	11
1033	HDI LEBEN AG	2,544,932	114
1158	HEIDELBERGER LV	428,436	21
1137	HELVETIA LEBEN	144,288	1
1055	HUK-COBURG LEBEN	708,658	18
1047	IDEAL LEBEN	554,668	5
1048	IDUNA VEREINIGTE LV	1,903,568	44
1330	INTER LEBENSVERS. AG	148,720	2
1119	INTERRISK LEBENSVERS.	91,271	1
1045	KARLSRUHER LV AG	105,782	1
1054	LANDESLEBENSHILFE	18,896	1
1062	LEBENSVERS. VON 1871	708,331	26
1112	LVM LEBEN	793,738	10
1198	MAMAX LEBEN	17,498	1
1109	MECKLENBURG. LEBEN	167,904	2
1064	MÜNCHEN. VEREIN LEBEN	145,776	4
1162	MYLIFE DEUTSCHLAND	113,835	1
1134	NEUE BAYER. BEAMTEN	100,599	1
1164	NEUE LEBEN LEBENSVERS	891,150	17
1147	NÜRNBG. LEBEN	2,906,707	103
1177	OECO CAPITAL LEBEN	34,924	1

! Please refer to the "Explanatory notes on the statistics" on page 206.

Reg. no.	Name of insurance undertaking	Number of life insurance policies in 2012	Complaints
1056	OEFF. LEBEN BERLIN	221,054	2
1207	OERA DRESDEN I.L.	n.a.	1
1194	PB LEBENSVERSICHERUNG	1,198,463	46
1123	PLUS LEBEN	98,373	1
1309	PROTEKTOR LV AG	133,870	15
1081	PROV. LEBEN HANNOVER	850,847	8
1083	PROV.NORDWEST LEBEN	1,760,498	33
1082	PROV.RHEINLAND LEBEN	1,354,428	16
1018	RHEINLAND LEBEN	103,130	1
1085	R+V LEBEN	63,574	2
1141	R+V LEBENSVERS. AG	4,195,801	43
1150	SAARLAND LEBEN	152,197	1
1157	SKANDIA LEBEN	336,460	22
1153	SPARK.-VERS.SACHS.LEB	517,419	7
1104	STUTTGARTER LEBEN	436,064	9
1089	SÜDDT.LEBEN	67,975	1
1091	SV SPARKASSENVERS.	1,729,914	28
1090	SWISS LIFE AG (CH)	867,055	32
1132	TARGO LEBEN AG	1,558,986	27
1092	UNIVERSA LEBEN	188,195	3
1314	VHV LEBENSVERSICHER.	14,653	2
1140	VICTORIA LEBEN	1,396,679	73
1099	VOLKSWOHL-BUND LEBEN	1,379,154	28
1151	VORSORGE LEBEN	160,501	6
1160	VPV LEBEN	930,275	27
1149	WGV-LEBEN	57,199	1
1005	WÜRTT. LEBEN	2,470,160	44
1103	WWK LEBEN	945,130	44
1138	ZURICH DTSCH. HEROLD	3,676,718	144

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.3 Health insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31. Dec. 2012	Complaints
4034	ALLIANZ PRIV.KV AG	2,524,929	111
4142	ALTE OLDENBURGER AG	161,476	4
4112	ARAG KRANKEN	512,249	19
4095	AXA KRANKEN	1,535,961	166
4042	BARMENIA KRANKEN	1,245,361	57
4134	BAYERISCHE BEAMTEN K	1,068,931	91
4004	CENTRAL KRANKEN	1,788,724	147
4001	CONTINENTALE KRANKEN	1,302,265	47
4028	DEBEKA KRANKEN	3,837,255	80
4131	DEVK KRANKENVERS.-AG	326,296	1
4044	DKV AG	4,444,653	185
4013	DT. RING KRANKEN	653,062	28
4121	ENVIVAS KRANKEN	376,434	5
4126	ERGO DIREKT KRANKEN	1,359,657	26
4053	FREIE ARZTKASSE	29,016	2
4119	GOTHAER KV AG	579,085	62
4043	HALLESCHE KRANKEN	635,179	35
4144	HANSEMERKUR KRANKEN_V	1,387,113	53
4122	HANSEMERKUR S.KRANKEN	5,205,495	5
4117	HUK-COBURG KRANKEN	953,960	42
4031	INTER KRANKEN	369,747	21
4011	LANDESKRANKENHILFE	392,069	28
4109	LVM KRANKEN	313,431	6
4123	MANNHEIMER KRANKEN	78,458	5
4037	MÜNCHEN.VEREIN KV	266,712	12
4125	NÜRNBG. KRANKEN	246,400	7
4143	PAX-FAMILIENF.KV AG	160,393	2
4116	R+V KRANKEN	627,013	8
4002	SIGNAL KRANKEN	1,974,110	43
4039	SÜDDEUTSCHE KRANKEN	625,101	3
4108	UNION KRANKENVERS.	1,083,672	36
4045	UNIVERSA KRANKEN	361,695	20
4139	WÜRTT. KRANKEN	217,407	3

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.4 Motor vehicle insurance

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31. Dec. 2012	Complaints
5342	AACHENMüNCHENER VERS.	2,087,020	12
5135	ADAC AUTOVERSICHERUNG	1,062,662	14
5312	ALLIANZ VERS.	13,530,879	158
5441	ALLSECUR DEUTSCHLAND	669,113	44
5405	ALTE LEIPZIGER VERS.	370,343	1
5397	ASSTEL SACH	199,839	25
5155	AXA EASY	n.a.	2
5515	AXA VERS.	4,817,797	43
5317	BARMENIA ALLG. VERS.	167,008	7
5633	BASLER SACH	437,085	7
5318	BASLER VERSICHERUNG (CH)	n.a.	1
5310	BAYER. BEAMTEN VERS.	241,204	5
5324	BAYER.VERS.VERB.AG	1,825,634	9
5098	BRUDERHILFE SACH.AG	397,782	3
5338	CONCORDIA VERS.	1,420,321	9
5340	CONTINENTALE SACHVERS	546,356	1
5552	COSMOS VERS.	655,064	3
5343	DA DEUTSCHE ALLG.VER.	1,328,990	40
5311	DBV DT. BEAMTEN-VERS.	728,308	8
5549	DEBEKA ALLGEMEINE	766,446	2
5513	DEVK ALLG. VERS.	3,597,922	35
5344	DEVK DT. EISENB. SACH	1,001,086	4
5055	DIRECT LINE	831,659	20
5562	ERGO DIREKT	n.a.	6
5472	ERGO VERSICHERUNG	2,464,109	28
5508	EUROPA VERSICHERUNG	485,572	10
5024	FEUERSOZIETÄT	160,499	11
5505	GARANTA VERS.	694,590	6
5473	GENERALI VERSICHERUNG	2,672,506	20
5858	GOTHAER ALLGEMEINE AG	1,254,519	16
5469	GVV-KOMMUNALVERS.	145,615	1
5585	GVV-PRIVATVERSICH.	229,986	1
5131	HANNOVERSCHE DIREKT	n.a.	5
5085	HDI VERSICHERUNG	3,636,451	64
5096	HDI-GERLING INDUSTRIE	1,021,827	9
5384	HELVETIA VERS. (CH)	324,286	3
5375	HUK-COBURG	7,004,321	44
5521	HUK-COBURG ALLG. VERS	6,791,690	60
5086	HUK24 AG	2,504,678	37
5401	ITZEHOER VERSICHERUNG	1,081,846	20
5078	JANITOS VERSICHERUNG	232,318	10
5058	KRAVAG-ALLGEMEINE	1,388,358	22
5080	KRAVAG-LOGISTIC	910,293	21
5402	LVM SACH	5,233,352	11
5084	MANNHEIMER AG HOLD	n.a.	10
5061	MANNHEIMER VERS.	222,322	54
5412	MECKLENBURG. VERS.	815,026	8
5426	NÜRNBG. ALLG.	168,255	1
5519	OPTIMA VERS.	157,387	3
5787	OVAG - OSTDT. VERS.	n.a.	21
5446	PROV.NORD BRANDKASSE	756,204	4
5095	PROV.RHEINLAND VERS.	1,340,654	5
5798	RHEINLAND VERS. AG	232,380	4

! Please refer to the “Explanatory notes on the statistics” on page 206.

Reg. no.	Name of insurance undertaking	Number of persons insured as at 31. Dec. 2012	Complaints
5438	R+V ALLGEMEINE VERS.	3,925,429	23
5137	R+V DIREKTVERSICHER.	216,531	23
5051	S DIREKTVERSICHERUNG	224,884	6
5773	SAARLAND FEUERVERS.	163,371	1
5690	SCHWARZMEER U. OSTSEE	n.a.	5
5448	SCHWEIZER NATION.VERS	77,333	2
5125	SIGNAL IDUNA ALLG.	1,070,684	10
5036	SV SPARK.VERSICHER.	833,370	5
5400	VGH LAND.BRAND.HAN.	1,977,836	4
5862	VHV ALLGEMEINE VERS.	4,076,644	68
5169	VOLKSWAGEN AUTO AG	n.a.	1
5484	VOLKSWOHL-BUND SACH	98,097	1
5093	WESTF.PROV.VERS.AG	1,381,333	4
5525	WGV-VERSICHERUNG	1,023,091	9
5479	WÜRTT. GEMEINDE-VERS.	989,372	1
5783	WÜRTT. VERS.	2,751,909	27
5476	WWK ALLGEMEINE VERS.	252,646	3

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.5 General liability insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5342	AACHENMüNCHENER VERS.	1,258,972	14
5370	ALLIANZ GLOBAL SE	2,473	2
5312	ALLIANZ VERS.	4,404,245	56
5405	ALTE LEIPZIGER VERS.	210,405	4
5455	ARAG ALLG. VERS.	21,151,564	5
5397	ASSTEL SACH	n.a.	4
5515	AXA VERS.	3,034,522	38
5792	BADEN-BADENER VERS.	n.a.	3
5633	BASLER SACH	276,031	2
5310	BAYER.BEAMTEN VERS.	n.a.	2
5324	BAYER.VERS.VERB.AG	1,075,226	3
5146	BGV-VERSICHERUNG AG	116,269	1
5098	BRUDERHILFE SACH.AG	218,675	1
5338	CONCORDIA VERS.	346,823	3
5340	CONTINENTALE SACHVERS	367,406	3
5311	DBV DT. BEAMTEN-VERS.	580,308	5
5343	DA DEUTSCHE ALLG.VER.	n.a.	1
5549	DEBEKA ALLGEMEINE	1,268,924	6
5513	DEVK ALLG. VERS.	1,134,385	8
5344	DEVK DT. EISENB. SACH	597,757	1
5129	DFV DEUTSCHE FAM.VERS	n.a.	1
5472	ERGO VERSICHERUNG	1,796,917	41
5024	FEUERSOZIETÄT	155,788	1
5473	GENERALI VERSICHERUNG	1,810,109	20
5858	GOTHAER ALLGEMEINE AG	1,336,886	16
5485	GRUNDEIGENTÜMER-VERS.	n.a.	1
5365	GVO GEGENSEITIGKEIT	n.a.	1
5469	GVV-KOMMUNALVERS.	2,892	3
5585	GVV-PRIVATVERSICH.	n.a.	1
5374	HAFTPFLICHTK.DARMST.	1.027.763	6
5085	HDI VERSICHERUNG	1.388.103	38
5096	HDI-GERLING INDUSTRIE	15.688	3
5384	HELVETIA VERS. (CH)	346.986	4
5375	HUK-COBURG	1.948.732	7
5521	HUK-COBURG ALLG. VERS	1.255.675	7
5573	IDEAL VERS.	n.a.	1
5546	INTER ALLG. VERS.	132,795	3
5078	JANITOS VERSICHERUNG	211,828	1
5402	LVM SACH	1,221,599	5
5061	MANNHEIMER VERS.	154,569	20
5412	MECKLENBURG. VERS.	275,988	4
5414	MÜNCHEN. VEREIN ALLG.	36,386	1
5426	NÜRNBG. ALLG.	324,334	5
5787	OVAG - OSTDT. VERS.	n.a.	4
5446	PROV.NORD BRANDKASSE	388,388	1
5095	PROV.RHEINLAND VERS.	827,601	4
5798	RHEINLAND VERS. AG	95,054	3
5121	RHION VERSICHERUNG	125,066	4
5438	R+V ALLGEMEINE VERS.	1,759,500	18
5448	SCHWEIZER NATION.VERS	n.a.	2
5125	SIGNAL IDUNA ALLG.	682,878	8
5036	SV SPARK.VERSICHER.	958,137	4
5463	UNIVERSA ALLG VERS.	n.a.	2

! Please refer to the “Explanatory notes on the statistics” on page 206.

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5042	VERSICHERUNGSK.BAYERN	16,086	3
5400	VGH LAND.BRAND.HAN.	731,764	4
5862	VHV ALLGEMEINE VERS.	1,087,929	12
5484	VOLKSWOHL-BUND SACH	133,436	3
5093	WESTF.PROV.VERS.AG	814,466	6
5479	WÜRTT. GEMEINDE-VERS.	274,557	3
5783	WÜRTT. VERS.	1,179,226	11
5476	WWK ALLGEMEINE VERS.	136,448	2

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.6 Accident insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5342	AACHENMüNCHENER VERS.	2,512,203	14
5498	ADAC - SCHUTZBRIEF VERS.	3,882,922	5
5312	ALLIANZ VERS.	4,387,177	36
5405	ALTE LEIPZIGER VERS.	74,993	1
5455	ARAG ALLG. VERS.	21,002,374	2
5515	AXA VERS.	774,386	13
5792	BADEN-BADENER VERS.	289,879	4
5633	BASLER SACH	133,031	1
5310	BAYER. BEAMTEN VERS.	119,578	4
5324	BAYER.VERS.VERB.AG	709,237	4
5552	COSMOS VERS.	186,531	2
5343	DA DEUTSCHE ALLG.VER.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	217,842	1
5549	DEBEKA ALLGEMEINE	1,867,359	3
5513	DEVK ALLG. VERS.	873,355	6
5350	DT. RING SACHVERS.	322,437	1
5562	ERGO DIREKT	273,701	1
5472	ERGO VERSICHERUNG	2,490,795	54
5473	GENERALI VERSICHERUNG	3,593,079	13
5858	GOTHAER ALLGEMEINE AG	713,086	6
5557	HÄGER VERS.VEREIN	n.a.	1
5501	HANSEMERKUR ALLG.	77,106	1
5085	HDI VERSICHERUNG	510,355	6
5512	HDI-GERLING FIRMEN	n.a.	1
5384	HELVETIA VERS. (CH)	123,463	1
5375	HUK-COBURG	977,880	1
5521	HUK-COBURG ALLG. VERS	539,177	1
5546	INTER ALLG. VERS.	86,229	1
5402	LVM SACH	908,277	2
5061	MANNHEIMER VERS.	71,657	3
5070	NECKERMANN VERS.	n.a.	2
5426	NÜRNBG. ALLG.	548,073	13
5017	OSTANGLER BRANDGILDE	n.a.	2
5074	PB VERSICHERUNG	n.a.	3
5147	PROTECT VERSICHERUNG	n.a.	1
5095	PROV.RHEINLAND VERS.	881,259	1
5583	PVAG POLIZEIVERS.	319,123	3
5798	RHEINLAND VERS.AG	n.a.	2
5438	R+V ALLGEMEINE VERS.	1,504,007	7
5125	SIGNAL IDUNA ALLG.	1,726,078	6
5586	STUTTGARTER VERS.	438,045	13
5790	TARGO VERSICHERUNG	112,755	3
5463	UNIVERSA ALLG.VERS.	n.a.	4
5400	VGH LAND.BRAND.HAN.	5,468,983	3
5862	VHV ALLGEMEINE VERS.	325,910	1
5484	VOLKSWOHL-BUND SACH	174,572	2
5093	WESTF.PROV.VERS.AG	909,366	1
5479	WÜRTT. GEMEINDE-VERS.	145,436	1
5783	WÜRTT. VERS.	730,476	4
5590	WÜRZBURGER VERSICHER.	n.a.	5
5476	WWK ALLGEMEINE VERS.	238,201	2

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.7 Household contents insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5342	AACHENMüNCHENER VERS.	896,392	12
5312	ALLIANZ VERS.	2,476,165	38
5405	ALTE LEIPZIGER VERS.	135,221	5
5068	AMMERLÄNDER VERS.	175,816	1
5455	ARAG ALLG. VERS.	166,489	1
5397	ASSTEL SACH	n.a.	3
5515	AXA VERS.	1,133,495	4
5317	BARMENIA ALLG. VERS.	n.a.	1
5633	BASLER SACH	206,457	1
5324	BAYER.VERS.VERB.AG	539,538	3
5310	BAYER. BEAMTEN VERS.	n.a.	2
5098	BRUDERHILFE SACH.AG	187,403	1
5339	CONDOR ALLG.VERS.	n.a.	1
5340	CONTINENTALE SACHVERS	184,968	1
5552	COSMOS VERS.	n.a.	1
5343	DA DEUTSCHE ALLG.VER.	n.a.	2
5311	DBV DT. BEAMTEN-VERS.	302,015	7
5549	DEBEKA ALLGEMEINE	756,680	2
5513	DEVK ALLG. VERS.	960,990	5
5328	DOCURA VVAG	n.a.	3
5472	ERGO VERSICHERUNG	1,139,852	22
5473	GENERALI VERSICHERUNG	1,356,431	12
5858	GOTHAER ALLGEMEINE AG	725,443	7
5469	GVV-KOMMUNALVERS.	n.a.	1
5374	HAFTPFLICHTK.DARMST.	n.a.	1
5085	HDI VERSICHERUNG	677,699	17
5384	HELVETIA VERS. (CH)	246,156	2
5375	HUK-COBURG	1,370,322	6
5521	HUK-COBURG ALLG. VERS	745,349	2
5086	HUK24 AG	189,388	6
5573	IDEAL VERS.	n.a.	1
5057	INTERLLOYD VERS.AG	142,982	2
5780	INTERRISK VERS.	147,783	1
5078	JANITOS VERSICHERUNG	109,526	10
5404	LBN	n.a.	1
5402	LVM SACH	732,885	1
5061	MANNHEIMER VERS.	73,374	6
5412	MECKLENBURG. VERS.	176,058	2
5426	NÜRNBG. ALLG.	158,461	5
5686	NÜRNBG.BEAMTEN ALLG.	n.a.	1
5015	NV VERSICHERUNGEN	n.a.	2
5017	OSTANGLER BRANDGILDE	n.a.	2
5446	PROV.NORD BRANDKASSE	288,237	3
5095	PROV.RHEINLAND VERS.	510,569	3
5583	PVAG POLIZEIVERS.	n.a.	2
5798	RHEINLAND VERS. AG	n.a.	2
5121	RHION VERSICHERUNG	n.a.	1
5438	R+V ALLGEMEINE VERS.	959,007	9
5125	SIGNAL IDUNA ALLG.	329,000	1
5781	SPARK.-VERS.SACHS.ALL	n.a.	3
5036	SV SPARK.VERSICHER.	461,052	3
5400	VGH LAND.BRAND.HAN.	479,057	2
5862	VHV ALLGEMEINE VERS.	326,510	2

! Please refer to the "Explanatory notes on the statistics" on page 206.

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5484	VOLKSWOHL-BUND SACH	n.a.	1
5461	VPV ALLGEMEINE VERS.	168,338	1
5093	WESTF.PROV.VERS.AG	2,353,160	3
5479	WÜRTT. GEMEINDE-VERS.	183,809	1
5783	WÜRTT. VERS.	756,420	7
5476	WWK ALLGEMEINE VERS.	n.a.	3

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.8 Residential building insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5342	AACHENMüNCHENER VERS.	361,976	15
5312	ALLIANZ VERS.	2,069,274	62
5405	ALTE LEIPZIGER VERS.	125,495	2
5455	ARAG ALLG. VERS.	n.a.	1
5515	AXA VERS.	684,882	31
5317	BARMENIA ALLG. VERS.	n.a.	1
5310	BAYER. BEAMTEN VERS.	n.a.	1
5319	BAYER. HAUSBESITZER	22,978	2
5043	BAYER.L-BRAND.VERS.AG	2,230,472	5
5324	BAYER.VERS.VERB.AG	678,709	8
5338	CONCORDIA VERS.	189,756	4
5339	CONDOR ALLG. VERS.	73,943	2
5552	COSMOS VERS.	n.a.	1
5311	DBV DT. BEAMTEN-VERS.	168,700	4
5549	DEBEKA ALLGEMEINE	235,847	4
5513	DEVK ALLG. VERS.	454,001	4
5472	ERGO VERSICHERUNG	536,519	36
5024	FEUERSOZIETÄT	85,848	2
5473	GENERALI VERSICHERUNG	591,147	24
5858	GOTHAER ALLGEMEINE AG	303,674	3
5485	GRUNDEIGENTÜMER-VERS.	71,698	1
5374	HAFTPFLICHTK.DARMST.	n.a.	1
5032	HAMB. FEUERKASSE	159,855	1
5085	HDI VERSICHERUNG	266,091	17
5384	HELVETIA VERS. (CH)	173,676	8
5126	HÜBENER VERSICHERUNG	n.a.	2
5375	HUK-COBURG	614,491	6
5521	HUK-COBURG ALLG. VERS	213,523	3
5086	HUK24 AG	n.a.	2
5546	INTER ALLG. VERS.	n.a.	2
5057	INTERLLOYD VERS.AG	51,139	1
5780	INTERRISK VERS.	67,594	1
5402	LVM SACH	540,746	9
5061	MANNHEIMER VERS.	58,156	6
5412	MECKLENBURG. VERS.	103,097	5
5014	NEUENDORFER BRAND-BAU	n.a.	1
5426	NÜRNBG. ALLG.	68,400	5
5017	OSTANGLER BRANDGILDE	n.a.	3
5446	PROV.NORD BRANDKASSE	314,623	4
5095	PROV.RHEINLAND VERS.	555,048	17
5583	PVAG POLIZEIVERS.	n.a.	1
5798	RHEINLAND VERS. AG	n.a.	1
5438	R+V ALLGEMEINE VERS.	989,028	29
5125	SIGNAL IDUNA ALLG.	155,660	2
5690	SCHWARZMEER U. OSTSEE	n.a.	1
5781	SPARK.-VERS.SACHS.ALL	33,507	1
5036	SV SPARK.VERSICHER.	1,965,500	30
5459	UELZENER ALLG. VERS.	n.a.	1
5463	UNIVERSA ALLG. VERS.	n.a.	1
5042	VERSICHERUNGSK.BAYERN	n.a.	2
5400	VGH LAND.BRAND.HAN.	471,394	4
5862	VHV ALLGEMEINE VERS.	114,051	3
5461	VPV ALLGEMEINE VERS.	65,657	2
5093	WESTF.PROV.VERS.AG	1,942,565	5
5525	WGV-VERSICHERUNG	70,082	1
5479	WÜRTT. GEMEINDE-VERS.	79,520	2
5783	WÜRTT. VERS.	453,089	11

! Please refer to the "Explanatory notes on the statistics" on page 206.

3.9 Legal expenses insurance

Reg. no.	Name of insurance undertaking	Number of insured risks as at 31 Dec. 2012	Complaints
5826	ADAC-RECHTSSCHUTZ	2,467,832	8
5809	ADVOCARD RS	1,532,719	38
5312	ALLIANZ VERS.	2,351,621	52
5405	ALTE LEIPZIGER VERS.	411,166	59
5455	ARAG ALLG. VERS.	n.a.	2
5800	ARAG SE	1,326,822	59
5801	AUXILIA RS	516,898	16
5838	BADISCHE RECHTSSCHUTZ	169,698	2
5310	BAYER. BEAMTEN VERS.	n.a.	5
5324	BAYER. VERS.VERB.AG	n.a.	1
5098	BRUDERHILFE SACH.AG	97,388	5
5831	CONCORDIA RS	410,410	8
5340	CONTINENTALE SACHVERS	100,920	1
5343	DA DEUTSCHE ALLG.VER.	n.a.	3
5802	D.A.S. ALLG. RS	2,682,984	48
5549	DEBEKA ALLGEMEINE	376,967	8
5803	DEURAG DT. RS	1,163,964	40
5513	DEVK ALLG. VERS.	n.a.	1
5829	DEVK RECHTSSCHUTZ	1,053,464	9
5129	DFV DEUTSCHE FAM.VERS	n.a.	1
5834	DMB RECHTSSCHUTZ	841,666	17
5096	HDI-GERLING INDUSTRIE	6,260	
5085	HDI VERSICHERUNG	n.a.	2
5818	HUK-COBURG RS	1,589,136	19
5086	HUK24 AG	96,299	3
5401	ITZEHOER VERSICHERUNG	n.a.	6
5078	JANITOS VERSICHERUNG	n.a.	1
5402	LVM SACH	729,319	6
5412	MECKLENBURG. VERS.	143,281	5
5805	NEUE RECHTSSCHUTZ	449,257	13
5426	NÜRNBERG: ALLG	n.a.	1
5813	OERAG RECHTSSCHUTZ	1,504,508	31
5095	PROV.RHEINLAND VERS.	n.a.	2
5807	ROLAND RECHTSSCHUTZ	1,770,890	57
5438	R+V ALLGEMEINE VERS.	717,722	14
5459	UELZENER ALLG. VERS.	n.a.	1
5400	VGH LAND.BRAND.HAN.	189,117	2
5525	WGV-VERSICHERUNG	428,381	17
5479	WÜRTT. GEMEINDE-VERS.	n.a.	4
5783	WÜRTT. VERS.	656,271	15

! Please refer to the “Explanatory notes on the statistics” on page 206.

3.10 Insurers based in the EEA

Reg. no.	Abbreviated name of insurance undertaking	Com-plaints
5902	ACE EUROPEAN (GB)	12
9019	ACE EUROP.GROUP (GB)	2
9053	ADMIRAL INSURANCE(GB)	1
9081	AETNA HEALTH (IRL)	1
5636	AGA INTERNATION. (F)	43
5163	AIG EUROPE LIMITED (GB)	14
5029	AIOI NISSAY (GB)	5
7265	ALLIANZ LIFE (L)	3
7671	ASPECTA ASSUR. (L)	2
7203	ATLANTICLUX (L)	8
5090	AXA CORPORATE S. (F)	1
1319	AXA LIFE EUR.LTD(IRL)	3
7611	BRAND NEW DAY (NL)	3
5145	BTA INSURANCE (LV)	2
7811	CACI LIFE LIM. (IRL)	1
7807	CACI NON-LIFE (IRL)	2
1300	CANADA LIFE (IRL)	7
7786	CANADA LIFE (IRL)	4
1182	CARDIF LEBEN (F)	5
5056	CARDIF VERS. (F)	19
5142	CHUBB INSUR. (GB)	3
7690	CIGNA LIFE INS. (B)	2
7453	CLERICAL MED.INV.(GB)	20
7724	CREDIT LIFE INT. (NL)	20
7985	CSS VERSICHERUNG (FL)	28
9033	DELTA LLOYD LEV. (NL)	1
7310	DKV LUXEMBOURG (L)	1
5048	DOMESTIC AND GEN.(GB)	8
1161	EQUITABLE LIFE (GB)	1
5115	EUROMAF SA (F)	1
7337	FILO DIRETTO (I)	1
7814	FRIENDS PROVID. (GB)	3
9146	FRIENDS LIFE COMP (GB)	1
7268	GENERALI VERS. AG (A)	3
7270	HANSARD EUROPE (IRL)	2
7214	HELVETIA VERS. (A)	1
7688	INORA LIFE (IRL)	1
5788	INTER PARTNER ASS.(B)	7
7956	INTER PARTNER (B)	3
7587	INTERN.INSU.COR.(NL)	4
9031	LIBERTY EURO.(IRL/E)	5
5592	LLOYD'S VERS. (GB)	2
5130	MAPFRE ASISTENC.(E)	6
1308	MEDIOLANUM INT. (IRL)	1
1323	MONUTA VERS. (NL)	1
7806	NEW TECHNOLOGY (IRL)	1
7897	NUCLEUS LIFE AG (FL)	1
7220	N.V. SCHADEVERZ. (NL)	1
7225	OBERÖSTERR. VERS. AG (A)	1
7723	PRISMALIFE AG (FL)	20
7455	PROBUS INSURANCE(IRL)	3
9147	PSA LIFE INS. (M)	1
7894	QUANTUM LEBEN AG(FL)	1

Reg. no.	Abbreviated name of insurance undertaking	Com-plaints
1317	R+V LUXEMB. LV (L)	4
7415	R+V LUXEMBOURG L (L)	2
9158	RCI INSURANCE (M)	2
7730	RIMAXX (NL)	18
9307	SANTANDER INS.LIFE (IRL)	6
7485	SOGECAP (F)	1
1320	STANDARD LIFE (GB)	4
7763	STONEBRIDGE (GB)	1
1328	SWISS LIFE PROD. (L)	1
5157	TELEFONICA INSURANCE (L)	4
9241	UK GENERAL INS. (IRL)	1
7308	UNIQA ÖSTERREICH (A)	1
1311	VDV LEBEN INT. (GR)	14
7456	VDV LEBEN INTERN.(GR)	6
7643	VIENNA-LIFE (FL)	3
7483	VORSORGE LUXEMB. (L)	9
5152	W.R. BERKLEY (GB)	7
5151	ZURICH INSURANCE(IRL)	104
7929	ZURICH INSURANCE PLC (IRL)	1

! Please refer to the “Explanatory notes on the statistics” on page 206.

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6 Abbreviations

A

ABS asset-backed security
ACIR actuarial corporate interest rate
ADR alternative dispute resolution
AFS *Ausschuss für Finanzstabilität* (German Financial Stability Commission)
AfW *Bundesverband Finanzdienstleistung e.V.* (Federal Financial Services Association)
AG *Aktiengesellschaft* (German stock corporation)
AGG *Allgemeines Gleichbehandlungsgesetz* (General Equal Treatment Act)
AIF alternative investment fund
AIFM alternative investment fund manager
AIFM-UmsG Act Implementing the AIFM Directive
AKIM *Arbeitskreis Interne Modelle* (Internal Models Working Group)
AMA Advanced Measurement Approach
AnlV *Anlageverordnung* (Investment Regulation)
AnsFuG *Anlegerschutz- und Funktionsverbesserungsgesetz* (Act to Increase Investor Protection and Improve the Functioning of the Capital Markets)
AnzV *Anzeigenverordnung* (Reports Regulation)
AT1 Additional Tier 1
AT *Allgemeiner Teil* (General Part)

B

B.A. *beperkte aansprakelijkheid* (limited liability company)
BA *Bankenaufsicht* (Banking Supervision)
BaFin *Bundesanstalt für Finanzdienstleistungsaufsicht* (Federal Financial Supervisory Authority)
BAV *Bundesaufsichtsamt für das Versicherungswesen* (Federal Insurance Supervisory Office)
BCBS Basel Committee on Banking Supervision
BCR basic capital requirements
BerPensV *Pensionsfondsberichterstattungsverordnung* (Pension Funds Reporting Regulation)
BerVersV *Versicherungsberichterstattungs-Verordnung* (Insurance Reporting Regulation)
BGBl. *Bundesgesetzblatt* (Federal Law Gazette)
BGebG *Bundesgebührengesetz* (Federal Fees Act)
BGH *Bundesgerichtshof* (Federal Court of Justice)
BI Banca d'Italia (Bank of Italy)
BMEL *Bundesministerium für Ernährung und Landwirtschaft* (Federal Ministry of Food and Agriculture)
BMF *Bundesministerium der Finanzen* (Federal Ministry of Finance)
BMJV *Bundesministerium der Justiz und für Verbraucherschutz* (Federal Ministry of Justice and Consumer Protection)
BMWi *Bundesministerium für Wirtschaft und Energie* (Federal Ministry for Economic Affairs and Energy)
BO branch office business
BoE Bank of England
BSA balance sheet assessment
BSC Banking Supervision Committee
BTS binding technical standards
BVerwG *Bundesverwaltungsgericht* (Federal Administrative Court)
BVR *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* (National Association of German Cooperative Banks)

C

CA comprehensive assessment
CBS cross-border provision of services

CCP central counterparty
CDO collateralised debt obligation
CDS credit default swap
CET1 Common Equity Tier 1
CFTC U.S. Commodity Futures Trading Commission
CLN credit-linked note
CLO collateralised loan obligation
CMBS commercial mortgage-backed security
CMG Crisis Management Group
Co. Company
ComFrame Common Framework for the Supervision of Internationally Active Insurance Groups
COREP common reporting
CPD continuing professional develpment
CRA credit rating agency
CRD Capital Requirements Directive
CRR Capital Requirements Regulation

D

DAV *Deutsche Aktuarvereinigung e.V.* (German Actuarial Association)
DAX *Deutscher Aktienindex*
DerivateV *Derivateverordnung* (Derivatives Regulation)
DK *Deutsche Kreditwirtschaft* (German Banking Industry Committee)
Dr Doctor
DSGV *Deutscher Sparkassen- und Giroverband* (German Savings Banks Association)
DVFA *Deutsche Vereinigung für Finanzanalyse und Asset Management* (Society of Investment Professionals in Germany)

E

e.g. for example
e.G. *eingetragene Genossenschaft* (registered cooperative society)
e.V. *eingetragener Verein* (registered association)
EAEG *Einlagensicherungs- und Anlegerentschädigungsgesetz* (Deposit Guarantee and Investor Compensation Act)
EBA European Banking Authority
EBF European Banking Federation
EBITDA earnings before interest, taxes, depreciation and amortisation
EC European Commission
ECB European Central Bank
ECJ European Court of Justice
EdW *Entschädigungseinrichtung der Wertpapierhandelsunternehmen* (Compensatory Fund of Securities Trading Companies)
EEA European Economic Area
EEX European Energy Exchange
EFSF European Financial Stability Facility
EIOPA European Insurance and Occupational Pensions Authority
EMIR European Market Infrastructure Regulation
e-money electronic money
ESA European Supervisory Authority
ESM European Stability Mechanism
ESMA European Securities and Markets Authority
ESRB European Systemic Risk Board
EU European Union
Euribor Euro Interbank Offered Rate

F

f., ff. and the following
FASB Financial Accounting Standards Board
FATF Financial Action Task Force
FBO foreign banking organization
FCA UK Financial Conduct Authority
FDIC Federal Deposit Insurance Corporation
FedBoard Board of Governors of the Federal Reserve System
FiCoD Financial Conglomerates Directive
FinDAG *Finanzdienstleistungsaufsichts-gesetz* (Act Establishing the Federal Financial Supervisory Authority)
FINREP financial reporting

FinStabG *Gesetz zur Überwachung der Finanzstabilität* (Financial Stability Act)
FIU Financial Intelligence Unit
FKAG *Finanzkonglomerate-Aufsichtsgesetz* (Supervision of Financial Conglomerates Act)
FkSolV *Finanzkonglomerate-Solvabilitäts-Verordnung* (Financial Conglomerates Solvency Regulation)
FLAOR forward-looking assessment of own risk
FMSA *Bundesanstalt für Finanzmarktstabilisierung* (Federal Agency for Financial Market Stabilisation)
FREP Financial Reporting Enforcement Panel
Frhr. *Freiherr*
FSA Financial Services Authority
FSAP Financial Sector Assessment Program
FSB Financial Stability Board

G

G20 The Group of Twenty
GDP gross domestic product
GDV *Gesamtverband der Deutschen Versicherungswirtschaft e.V.* (German Insurance Association)
GIZ *Gesellschaft für Internationale Zusammenarbeit* (Agency for International Cooperation)
GmbH & Co KG German limited partnership (*Kommanditgesellschaft*) with a GmbH as general partner
GmbH *Gesellschaft mit beschränkter Haftung* (German private limited company)
G-SIB global systemically important bank
G-SIFI global systemically important financial institution
G-SII global systemically important insurer
GwG *Geldwäschegesetz* (Money Laundering Act)

H

HBS holistic balance sheet
HessVGH *Hessischer Verwaltungsgerichtshof* (Higher Administrative Court in Hesse)
HGB *Handelsgesetzbuch* (Commercial Code)
HLA higher loss absorbency

I

IAASB International Auditing and Assurance Standards Board
IAIG internationally active insurance group
IAIS International Association of Insurance Supervisors
IAS International Accounting Standard
IASB International Accounting Standards Board
ICPs Insurance Core Principles
ICS insurance capital standard
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
ILS insurance-linked security
IMD Insurance Mediation Directive
IMF International Monetary Fund
Inc. incorporated company
InhKontrollV *Inhaberkontrollverordnung* (Holder Control Regulation)
InstitutsVergV *Institutsvergütungsverordnung* (Remuneration Regulation for Institutions)
INT International Policy/Affairs
InvG Investmentgesetz (Investment Act)
InvMaRisk *Mindestanforderungen an das Risikomanagement für Investmentgesellschaften* (Minimum Requirements for Risk Management in Investment Companies)
InvVerOV *Investment-Verhaltens- und Organisationsverordnung* (Regulation on the Rules of Conduct and Organisa-

	tional Rules pursuant to the Investment Act)
IORP	institution for occupational retirement provision
IOSCO	International Organization of Securities Commissions
IRBA	Internal Ratings-Based Approach
IT	information technology
ITS	Implementing Technical Standard
IVV	*Institutsvergütungsverordnung* (Remuneration Regulation for Institutions)

J

JST	joint supervisory team

K

KAG	*Kapitalanlagegesellschaft* (asset management company)
KAGB	*Kapitalanlagegesetzbuch* (Investment Code)
KapAusstV	*Kapitalausstattungsverordnung* (Capital Resources Regulation)
KAPrüfBV	*Kapitalanlage-Prüfungsberichte-Verordnung* (Investment Audit Reports Regulation)
KARBV	*Kapitalanlage-Rechnungslegungs- und -Bewertungsverordnung* (Investment Accounting and Valuation Regulation)
KAVerOV	*Kapitalanlage-Verhaltens- und -Organisationsverordnung* (Regulation on the Rules of Conduct and Organisational Rules Pursuant to the Investment Code)
KGaA	*Kommanditgesellschaft auf Aktien* (German partnership limited by shares)
KID	key information document
KomRI	Committee on Regulation and International Policy
KWG	*Kreditwesengesetz* (Banking Act)

L

LCR	liquidity coverage ratio
LIBOR	London Interbank Offered Rate
Ltd.	limited company
LTG	long-term guarantee
LTGA	long-term guarantees assessment

M

MaComp	*Mindestanforderungen an die Compliance* (Minimum Requirements for the Compliance Function)
MaRisk	*Mindestanforderungen an das Risikomanagement* (Minimum Requirements for Risk Management)
MaSan	*Mindestanforderungen an die Ausgestaltung von Sanierungsplänen* (Minimum Requirements for the Contents of Recovery Plans)
MdB	*Mitglied des Bundestages* (Member of the *Bundestag*)
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MoU	memorandum of understanding
MTF	multilateral trading facility

N

n.a.	not applicable
NAIC	National Association of Insurance Commissioners
no.	number
NPL	non-performing loan
NSFR	net stable funding ratio
NYSBD	New York State Banking Department

O

OCC	Office of the Comptroller of the Currency
ODR	online dispute resolution
OECD	Organisation for Economic Cooperation and Development
OIS	overnight index swap
OJ	Official Journal
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)

P

p.	page
PEP	politically exposed person
PfandBG	*Pfandbriefgesetz* (*Pfandbrief* Act)
Plc	public limited company
PNG	*Gesetz zur Neuausrichtung der Pflegeversicherung* (Long-term Care Reorientation Act)
PRIP	packaged retail investment product
Prof.	Professor
PrüfbV	*Prüfungsberichtsverordnung* (Audit Report Regulation)
PSVaG	*Pensions-Sicherungs-Verein VVaG*

Q

Q	quarter
QIS	quantitative impact study

R

RAP	Resolvability Assessment Process
RC	Risk Committee
RCAP	Regulatory Consistency Assessment Programme
RechVersV	*Verordnung über die Rechnungslegung von Versicherungsunternehm*en (Regulation on Insurance Accounting)
REIT	real estate investment trust
repo	repurchase agreement
RMBS	residential mortgage backed security
RückKapV	*Rückversicherungs-Kapital-ausstattungs-Verordnung* (Reinsurer Capital Resources Regulation)
RWA	risk-weighted asset

S

S II	Solvency II
S.A.	Société Anonyme
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
SecuRe Pay Forum	European Forum on the Security of Retail Payments
SEPA	Single Euro Payments Area
SIB	systemically important bank
SIE	Supervisory Intensity and Effectiveness group
SLAB	student loan asset-backed security
SME	small and medium-sized entity
SoFFin	*Sonderfonds Finanzmarkt-stabilisierung* (Financial Market Stabilisation Fund)
SolBerV	*Solvabilitäts-Bereinigungs-Verordnung* (Solvency Adjustment Regulation)
SolvV	*Solvabilitätsverordnung* (Solvency Regulation)
SRM	Single Resolution Mechanism
SRMP	systemic risk management plan
SROs	self-regulatory organisations
SSG	Senior Supervisors Group
SSM	Single Supervisory Mechanism
StGB	*Strafgesetzbuch* (Criminal Code)
StPO	*Strafprozessordnung* (Code of Criminal Procedure)

T

TFEU	Treaty on the Functioning of the European Union
TIBOR	Tokyo Interbank Offered Rate

U

ÜbschV	*Überschussverordnung* (Regulation on the Calculation and Distribution of Surplus in Health Insurance)
UCITS	undertakings for collective investment in transferable securities
UK	United Kingdom
UmsG	implementing act
US	United States
US$	US dollar
USA	United States of America

V

VA *Versicherungsaufsicht* (Insurance Supervision)

VAG *Versicherungsaufsichtsgesetz* (Insurance Supervision Act)

VaR value at risk

VerkProspG *Verkaufsprospektgesetz* (Prospectus Act)

VG *Verwaltungsgericht* (Administrative Court)

VGH *Verwaltungsgerichtshof* (Higher Administrative Court)

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)

VwKostG *Verwaltungskostengesetz* (Administrative Costs Act)

W

WA *Wertpapieraufsicht* (Securities Supervision)

WpDPV *Wertpapierdienstleistungs-Prüfungsverordnung* (Investment Services Examination Regulation)

WpHG *Wertpapierhandelsgesetz* (Securities Trading Act)

WpÜG *Wertpapiererwerbs- und Übernahmegesetz* (Securities Acquisition and Takeover Act)

Z

Z Central services

ZAG *Zahlungsdiensteaufsichtsgesetz* (Payment Services Supervision Act)

ZAGAnzV *ZAG-Anzeigenverordnung* (Reporting Regulation concerning the Payment Services Supervision Act)

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