BaFin

# 2015


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 the State Secretary

## Dr Thomas Steffen sets out his views

**Mr Steffen[1], nobody can predict with any certainty how long interest rates will remain so low. What conclusions do you draw for German life insurers?**

▶ Life insurers need to adjust to the possibility of low interest rates persisting for a long time yet. This means that they must take precautionary measures while they still have the opportunity to do so. Any insurers that do not take decisive action now will not be able to make up for it in the future. The regulatory framework has already been adapted to meet the challenges of the low interest rate environment. Changes which come to mind here include, for example, the introduction of the additional provision to the premium reserve (the *Zinszusatzreserve*, or ZZR) in 2011 and the Life Insurance Reform Act *(Lebensversicherungsreformgesetz)* of 2014. On the basis of these measures, undertakings and BaFin can operate better in the low interest rate environment. Policyholders rightly expect reliability when it comes to receiving their guaranteed benefits.

**Even though the ZZR is a sensible and effective instrument, it imposes a heavy burden on undertakings. Should it be calibrated differently?**

▶ The ZZR makes a significant contribution to ensuring that life insurers will continue to be able to pay out guaranteed benefits to policyholders in future. It is true that building it up requires an enormous effort on the part of undertakings. However, this is due to the fact that the risks arising from the low interest rate environment have to be countered effectively. For this reason, building up the ZZR as provided for is now a priority.

**The question of withstanding low interest rate periods also applies to banks and *Bausparkassen*. Are they adequately prepared?**

▶ The impact that low interest rates have on the earnings position of a bank depends primarily on its business model. If – as is the case with many small and medium-sized banks – the business model is heavily interest-reliant, there may be negative effects, in particular in the form of lower interest earnings. The persistently low level of interest rates therefore poses a challenge for small and

1 Dr Thomas Steffen is State Secretary at the Federal Ministry of Finance.

medium-sized banks in Germany. The impact of low interest rates on *Bausparkassen* is also considerable. The *Bauspar* business is heavily reliant on interest rates and the *Bausparkassen* Act *(Bausparkassengesetz)* limits the business opportunities of these institutions. In general, the banks and *Bausparkassen* in Germany are well capitalised. Nevertheless, it is essential that the banks and *Bausparkassen* address the challenges of the low interest rate environment, review their business policies or business models and adapt to the changed environment.

**Will the new Market in Financial Instruments Directive (MiFID II) strengthen the position of consumers?**

▶ MiFID II contains many provisions that will improve consumer protection. There will be stricter rules governing providers of financial services and issuers of financial instruments, transparency requirements are being stepped up, client disclosure requirements are being tightened and the organisational requirements for financial services providers are being expanded.

We have already transposed some of the provisions of MiFID II into German law ahead of schedule. For example, the rules governing fee-based advice have been incorporated into the Fee-Based Investment Advice Act *(Honoraranlageberatungsgesetz)*. The MiFID II rules on defining a target market for financial instruments and BaFin's product intervention rights have been implemented in the Retail Investor Protection Act *(Kleinanlegerschutz-gesetz)*. Other rules will be introduced with the transposition of MiFID II. These include more extensive disclosure requirements regarding the costs of financial instruments and an obligation to record investment advice provided over the telephone. Overall, persons using financial services will be better protected by MiFID II.

**Some of the MiFID II rules on consumer protection are very far-reaching. Do they ask too much of providers and might the branch structure be jeopardised?**

▶ The consumer protection provisions of MiFID II do indeed place high demands on providers of financial services. Nevertheless, I am convinced that providers will be able to fulfil these requirements. In this respect, however, there needs to be clarity very soon as to how, at the European level, the individual requirements will be fleshed out by Level 2 provisions.[2] Financial services providers must then be given sufficient time to adapt to the details of the new rules. The Federal Ministry of Finance is doing everything it can to ensure that this happens.

The Level 2 rules must not excessively burden the provision of financial services through branches. We will keep a close eye on this matter when assessing the Level 2 provisions which have yet to be finalised. Decisions on how specific financial services are provided in future will, however, still have to be taken by the institutions themselves.

**Are fintech companies making inroads into the business of long-established enterprises? Are they adequately regulated?**

▶ Fintech companies are starting up along the whole value chain of financial institutions with the services they offer. This does not necessarily mean, however, that they are replacing banks and other financial services providers. In point of fact, we are also observing close cooperation between banks and fintech companies, something which both sides benefit from at the end of the day. We must ensure that this development is sustainable. For this reason, the usual principle applies when it comes to regulation: same business, same risks, same rules. There can be no exceptions for fintech companies either.

**The national resolution authority, whose functions are currently held by the Financial Market Stabilisation Agency (*Bundesanstalt für Finanzmarktstabilisierung* – FMSA), is to become part of BaFin. What advantages do you expect will be gained from this?**

2 See Figure 2 "EU legislative process and ESAs" on page 67.

We were finally able to close the Financial Market Stabilisation Fund (*Finanzmarktstabilisierungsfonds* – SoFFin) to new applications at the end of 2015 once the financial crisis had been overcome. In addition, the Single Resolution Board assumed responsibility for the resolution and restructuring of non-viable systemically important banks at the beginning of 2016. This provided a good opportunity to initiate a reorganisation of the FMSA's functions by the beginning of 2018. The Federal Ministry of Finance expects the reorganisation to provide a long-term solution within a larger unit and this will also open up long-term opportunities for staff.

Last year the FMSA managed to build the German resolution authority into a highly effective unit within a very short space of time. In the second stage, we now want to move this resolution authority even closer to BaFin as envisaged in the Act Implementing the European Recovery and Resolution Directive *(Gesetz zur Umsetzung der europäischen Sanierungs- und Abwicklungsrichtlinie)*. Both sides will benefit from the pooling of know-how from the fields of supervision and resolution. In addition, we hope that the already good exchange of information between both areas will be enhanced even further. We intend to take advantage of the resulting synergy effects in order to further strengthen BaFin as an integrated financial supervisor. We will ensure the operational independence of the resolution authority required under EU law by taking appropriate organisational and personnel measures.

**Where do you see BaFin as an integrated financial supervisor in five years' time?**

▶ At the beginning of the year, a new structure was adopted, strengthening BaFin – in terms of its organisation as well – as an integrated financial supervisory authority which is responsible for all sectors of the financial market. A good example of this is collective consumer protection, which, as a separate department, now encompasses not only the protection of investors but also the protection of insurance policyholders and bank customers.

The new structure provides a foundation upon which BaFin will continue to be able to adapt successfully to changing conditions in the future. What comes to mind here is, of course, the ongoing European harmonisation of financial supervision. However, an ever-increasing role is also being played by the technological changes that are emerging from the digitisation of financial services and leading to new forms of interaction between customers and financial services providers. Fintech companies are one of the many examples. The impact of climate change and climate policy on financial market stability is also bound to become a further area of focus, a topic which is being discussed under the umbrella term of "green finance".

I am confident that BaFin, with its new set-up, will continue to contribute to financial market stability and consumer protection and be perceived as a highly efficient financial supervisory authority that is held in high regard both nationally and internationally.

**Mr Steffen, thank you for granting us this interview.**

# I Spotlights

## 1 Low interest rates

2015 again failed to bring about any change in interest rate levels, which have been extremely low for a number of years. This environment is increasingly weighing on companies operating in the financial sector.

### 1.1 Banks

Most banks currently have sufficient capital to survive this period of low interest rates. But earnings will deteriorate significantly if interest rates remain at these low levels – despite the positive economic conditions. Even a rise in interest rates would not solve the problems immediately. Banks that have focused heavily on maturity transformation, i.e. accepting short-term cash deposits and turning them into long-term loans, would only feel the effects after a considerable time lag. A sudden sharp rise in interest rates would even exacerbate their situation.

BaFin looks across the board at what the institutions under its direct supervision are doing to counteract these problems. Are they cutting costs? Are they interrogating their business models and thinking of ways to expand their non-interest-bearing business? Are banks offering their services on adequate terms and conditions? It is also important to find out whether they strengthen their capital in a timely manner. There are no one-size-fits-all solutions. One thing is certain, however: it would be irresponsible to wait and do nothing, because there can be no reliable predictions as to how long the low interest rates will persist.

As part of the supervisory review and evaluation process (SREP), BaFin will also examine whether the institutions under its direct supervision have set aside adequate own funds for all material risks and pay attention, in particular, to the interest rate risk in the banking book in this context. The reason is that Pillar I of the regulatory framework for banks does not currently specify general capital requirements for this risk. The SREP is a key component of Pillar II of this framework, and it is intended to allow the supervisory authority to get a comprehensive picture of internal risk allocation and management at banks (see info box on page 17).

### SREP harmonisation

Europe is currently engaged in efforts to give the supervisory review and evaluation process (SREP) a more robust structure and to harmonise it. The European Banking Authority (EBA) published guidelines to this end, which BaFin has now integrated into its supervisory processes and procedures for institutions under its direct supervision, i.e. the less significant institutions (LSIs). As for the new requirements relating to internal structures, controls and processes, these German institutions are not expected to face major adjustments, because they were already part of the Minimum Requirements for Risk Management (MaRisk). By contrast, other requirements of the EBA mean that the analysis will have to be conducted with a substantially more quantitative focus than in the past. A completely new requirement is that, as an outcome of the qualitative and quantitative review process, the competent supervisory authorities will have to specify in accordance with standard criteria what level of own funds they consider adequate for each individual credit institution. In Germany, this relates to almost 1,600 LSIs – a complex undertaking. It is therefore very much in BaFin's interest that the capital calculation process is transparent. In close consultation with the banking industry, it has already begun to develop concepts to set capital requirements. BaFin will use the three years it has been given by the EBA before making a final decision on how to shape the process for setting capital requirements. The consequences for banks' internal management must be considered alongside potential future requirements of the European Central Bank. The aim is to achieve a coherent view of a bank's risk situation and to determine adequate capital requirements.

BaFin will provide supervisory "man-to-man coverage" to institutions whose business activities depend heavily on interest rates while their interest rate exposure in the banking book is also very high. This means it will supervise them particularly closely, paying close attention to their capital planning, where banks have to explain how they intend to arrange solid cover for the interest rate risk in the banking book despite decreasing earnings prospects. In this context, BaFin will make sure that the institutions use hidden reserves to cover risks only once, not multiple times.

## 1.2 Bausparkassen

It is common knowledge by now that *Bausparkassen* are also struggling to cope with the persistently low interest rates. In order to generate adequate earnings in the long term, the sector will have to take countermeasures, for example by strengthening its capital base, cutting costs and introducing market-based tariffs across the board. The sector has already embarked on this arduous process, and BaFin is encouraging it to pursue it further. Through the recent reform of the German *Bausparkassen* Act *(Bausparkassengesetz),* legislators have removed some obstacles and made the process smoother. BaFin will continue to observe the development of individual *Bausparkassen* and supervise them closely.

## 1.3 Insurers

The low interest rates also continue to weigh on insurers, especially life insurers. The returns on their investments are falling continuously. In 2011, the *Zinszusatzreserve* was created as a tool to offset this trend. Since then, life insurers have been required to recognise additional provisions to provide for the persistently low interest rates and to ensure that they can fulfil the guarantees they have given to their policyholders. BaFin therefore does not question the purpose of the *Zinszusatzreserve* in principle.

However, interest rates have since declined further, and the *Zinszusatzreserve* continues to grow rapidly. In 2015 alone, insurers spent more than €10 billion on this reserve, taking the total provision to €32 billion as at the end of the year. Sharp increases are

also expected for the coming years. BaFin is observing this development, both at individual undertakings and across the sector as a whole. If the need arises, it will examine whether the *Zinszusatzreserve* has been adequately calibrated.

However, changes to the legal framework alone are not enough. Life insurers themselves have to do all it takes at an early stage so that they can meet their guarantee obligations. Market-consistent valuation under Solvency II reveals just what efforts are required in a low interest rate environment.

Although the new framework contains transitional measures, they only gain a bit more time rather than solve the problem. BaFin provides man-to-man coverage for undertakings whose performance raises doubts in the medium term. BaFin will also question life insurers about how they intend to ensure an adequate capital base without the transitional measures, which will end after 16 years at the latest.

What options are available to insurers? They can reduce their costs, for example, and think about reinsurance solutions. They can work on their product portfolio and develop new products with different guarantees. Some undertakings have discontinued the traditional guarantee products altogether (see info box "Maximum technical interest rate"). Some life insurers are considering a transfer of parts of their portfolio to run-off platforms for settlement. This is an option in principle, as long as the interests of policyholders are maintained.

### Maximum technical interest rate

The debate around new products is constantly intermingled with questions about the usefulness of the maximum technical interest rate. Two things have to be considered in this context: firstly, insurers can already offer new products without guarantees, or with lower or time-limited guarantees. Another factor is that the maximum technical interest rate only serves as a backstop – and only for products comprising guarantees. From BaFin's perspective, the maximum technical interest rate has fulfilled its purpose in the past decades, because it prevents undertakings from engaging in cut-throat competition over terms and conditions. BaFin will only be able to take a meaningful view on whether and to what extent the regulatory requirements of Solvency II will make the maximum technical interest rate redundant when it has had an opportunity to observe in practice the new framework, which entered into force at the beginning of 2016. In 2018, BaFin will reassess the maximum technical interest rate, as planned by the federal government.

## 2 Global systemically important financial institutions

Since the financial crisis, regulators have been dealing extensively with the issue of strengthening – but also of resolving – global systemically important financial institutions (G-SIFIs) of the different financial sectors. Further progress was made last year in dealing with G-SIFIs.

### 2.1 Banks

Orderly resolution, especially for global systemically important banks (G-SIBs), is a prerequisite for maintaining their critical functions, at least temporarily, in order to prevent contagion within the financial system and the real economy. To this end, the critical functions are separated from the non-critical functions, and the institution or bridge bank to which the critical functions are transferred

is then recapitalised. This has to be done quickly, however, in order to restore lost market confidence.

In addition to regulatory own funds, this requires sufficient capital so that the losses incurred can be absorbed and the bank or bridge bank can be recapitalised quickly. European legislators therefore created the minimum requirement for own funds and eligible liabilities (MREL), which applies to all institutions and had to be implemented by all EU member states by the beginning of 2016. Germany implemented the requirement, which is set out in the Bank Recovery and Resolution Directive (BRRD), at the end of 2014 by adopting the German Recovery and Resolution Act *(Sanierungs- und Abwicklungsgesetz)*.

To enable global systemically important banks to absorb losses more easily, the Financial Stability Board (FSB) additionally introduced a global minimum standard, the total loss-absorbing capacity (TLAC), which imposes even more stringent requirements on the quality of the eligible liabilities.

The MREL and the TLAC require institutions to maintain sufficient liabilities that could be rapidly written down or converted into equity in the event of the institution's failure. The Bank Recovery and Resolution Directive introduces a bail-in tool, which provides the option to convert liabilities into equity. But not all liabilities are equally suitable for bail-in, which has to be implemented with legal certainty within a very short space of time in order to create certainty for the markets. Moreover, the conversion must not in turn lead to new contamination and systemic risks. In practice, the implementation of bail-ins – for example of liabilities such as derivatives and structured bonds based on complex contracts, or of loans from other banks – within the time span that is realistically available is often beset with problems.

In order to make the bail-in tool suitable for practical application given these difficulties, the German Resolution Mechanism Act *(Abwicklungsmechanismusgesetz)*, which was adopted in 2015, will from 2017 onwards define a layer of debt instruments that can be bailed in quickly and with legal certainty and which pose a relatively low risk of contamination. This layer will be available as recoverable assets in the event of resolution, once all subordinated liabilities have been exhausted. In legal terms, this is done by introducing a special category of debt instruments for bank insolvencies, to which long-term, unsecured debt instruments, such as bonds, registered bonds and promissory note loans without derivative elements, have been assigned. Only after that will the resolution authority resort to those instruments for which it is considerably more difficult to assess the volume, value, contamination risk and legal feasibility of the bail-in. These new rules will simplify the resolution of banks considerably.

## 2.2 Insurers

The Financial Stability Board currently classifies nine primary insurers worldwide as global systemically important institutions. The International Association of Insurance Supervisors (IAIS) has developed capital requirements for these global systemically important insurers (G-SIIs). They consist of basic capital requirements (BCR) and a higher loss absorbency (HLA) requirement, which is calculated on the basis of the BCR. The insurers will have to comply with the capital requirements from 1 January 2019 onwards.

The BCR is an initial, relatively simple approach, which is factor-based and only has limited risk sensitivity. Unlike in bank regulation, the insurance sector did not previously have a global approach to determining capital requirements or own funds. The IAIS is currently developing a significantly more risk-sensitive insurance capital standard (ICS), which will apply to all internationally active insurance groups (IAIGs) and replace the BCR as the basis for calculating the HLA requirement. The HLA requirement is an extension of the BCR and focuses in particular on non-traditional insurance and non-insurance (NTNI) activities, which are of great importance for the systemic importance of insurance

undertakings. The IAIS finalised the HLA requirement at the end of 2015.

In 2015, the IAIS conducted a field test of the ICS with insurers. By the end of 2019, it intends to develop a version capable of implementation, incorporating the test results, among other inputs. Continuous further development is planned for the ICS even after that. There will be special emphasis on its risk sensitivity and calibration, the practicability of the specifications, and globally consistent application.

The IAIS's overarching goal is to create a comprehensive common framework of quantitative and qualitative requirements for major internationally active insurance groups: ComFrame (Common Framework). In addition to the ICS, this framework will also include governance, risk management and settlement rules.

## 2.3 Other financial institutions

The significance of the asset management sector has increased substantially in recent years. In 2015, the Financial Stability Board therefore took a closer look at the risks of this sector and examined it for structural flaws. The focus was on risks in liquidity transformation, the build-up of leverage, operational risk and guarantees for collateral in securities lending transactions. In the course of this year, the FSB is planning to formulate regulatory recommendations on the weak points identified. On the basis of these recommendations, it will then again turn its attention to the planned methods for identifying global systemically important non-bank non-insurance G-SIFIs (NBNI G-SIFIs), which include asset managers and investment funds as well as finance companies and investment services enterprises.

# 3 Fintech companies

BaFin deals in depth with the issue of fintech companies (see info box). Several hundred of these companies already exist in Germany. The question for BaFin is how it should approach this innovative market.

Banking Supervision, as well as Insurance and Securities Supervision are involved in this issue. As so often, striking the right balance is key: the challenge is not to stifle innovations by imposing too stringent requirements, while at the same time preventing fintech companies from outmanoeuvring supervisory principles or unmanageable risks from arising. The objective is to practice up-to-date supervision, which promptly and reliably responds to the needs of fintech companies despite the need for thorough oversight. This includes that matters relating to supervision are explained in such a way that they can be understood without involving a large legal department, that essential information can be accessed online and that specialised experts are available for queries.

### Fintech companies

Fintech companies are generally young, innovative companies that use technology-based systems to provide specialised and particularly customer-focused financial services. They cover a very broad spectrum of different business models, ranging from technology-based payment methods and innovative online banking enhancements, through crowdfunding and automated financial advice down to virtual currencies. In the insurance sector, start-ups now frequently maintain an Internet presence in the form of comparison services platforms or as insurance intermediaries offering specific services.

Whether, and from what level, regulation is to be applied is a political decision. Legislators can create regulatory freedom for fintech companies. In some cases they have already done so, for example in the German Retail Investor Protection Act *(Kleinanlegerschutzgesetz)*, which exempts crowdfunding platforms for smaller projects from the obligation to publish a prospectus. But of course even the business models of fintech companies must be compatible with regulatory requirements and consumer protection. Fintech companies engaged in activities that require authorisation have to comply with the same requirements as established institutions and are subject to adequate, i.e. risk-based supervision. The critical factors are what business they transact and what risks they incur in the process.

## 4 Insurers – new Solvency II regime

After a two-year preparation period, Solvency II entered into force on 1 January 2016. The new risk-based European supervisory regime was implemented in Germany by reforming the Insurance Supervision Act *(Versicherungs-aufsichtsgesetz)*. Solvency II represents a paradigm shift for the risk and capital management of insurance undertakings, combined, among other things, with further strengthening of consumer protection.

2015 was therefore the home stretch – for the insurers as well as for BaFin and the European Commission. The Commission adopted a comprehensive package of implementing technical standards on Solvency II, which had been developed by the European Insurance and Occupational Pensions Authority (EIOPA). The standards, which are binding on supervisory authorities and undertakings, support the practical implementation of the new rules. They deal with, among other aspects, the approval processes for various application procedures for internal models, the calculation of the solvency capital requirement (SCR) using a standard formula, the process for determining capital add-ons and the formats for filing reports to the supervisory authority.

EIOPA in turn published in 2015 its guidelines on Solvency II in all the official languages of the EU member states. The guidelines supplement the implementing technical standards and relate to all three pillars of the new supervisory regime. BaFin has translated the explanatory texts accompanying the guidelines into German. In addition, it published a number of supplementary interpretative decisions on the application of the quantitative requirements under Solvency II as well as information on the undertakings' own risk and solvency assessment (ORSA), on risk management, on the actuarial function and on outsourcing.

A key element of Solvency II is the calculation of a risk-based solvency capital requirement. The undertakings can do this by using either a standard formula or an internal model that maps their individual risk profile, although BaFin has to approve internal models beforehand. It started this process in April 2015 and since 1 January 2016, four reinsurers, 12 property insurers, three health insurers and three life insurers have been authorised to use internal models to calculate their SCR. In addition, five German insurance groups use (partial) internal models to calculate group solvency. BaFin will make decisions on further applications in 2016. In addition, there are model extensions and changes, for which the undertakings will also have to seek approval from BaFin.

One of EIOPA's priorities in 2016 is to harmonise the supervision of internal models further. To this end, EIOPA will conduct benchmark studies together with the national supervisory authorities, for example on the calibration of market risk models. In addition, it is planning to develop suitable quantitative tools that will allow continuous performance testing of the models

used. BaFin is involved in these projects. It will also continue to monitor undertakings closely to prevent them from abusing internal models, for example by unduly reducing regulatory capital requirements with certain calibrations.

## 5 Banks – supervision, resolution and deposit guarantee

Last but not least, 2015 was a critical year for the new supervision of eurozone banks, which was launched in November 2014, marking the first pillar of the European banking union. The objective was to coordinate and establish cooperation between the German banking supervision, the European Central Bank (ECB) and the supervisory authorities of the other eurozone countries. This objective has been met. The good news overall is that the Single Supervisory Mechanism (SSM) is working, even though there are a few instances where it is not yet running entirely smoothly.

One of the core objectives of the new European supervisory regime is to harmonise the supervisory standards and practices of the 19 eurozone countries – a useful and necessary undertaking. The ECB develops its standards in conjunction with the national supervisory authorities. For BaFin, which represents Germany and is a voting member of the Supervisory Board of the SSM, the European motto, "United in diversity", applies in this context. Although it would be wrong to treat all special national provisions as cast in stone, certain national characteristics are important for the respective financial culture and therefore worth preserving. BaFin aims to find European solutions that are in line with the principle that the same regulatory treatment should only be applied to issues that are the same. This would also take the diversity of the German banking sector into account.

So far, the SSM has pursued a supervisory approach that is based on indicators to a far greater extent than was customary in Germany. Although this improves comparability between institutions, good supervision has to prove its worth by looking at the detail: it will always need a qualitative component to assess and weigh up each individual case, because reality is not model perfect. The SSM, too, will therefore have to find the right balance of quantitative and qualitative supervision.

An issue closely related to the supervision of eurozone banks is the resolution of banks, which continued to be a focal point in 2015, not only at the European level, where the second pillar of the banking union, the European Single Resolution Board, started its activities under the management of former BaFin President Dr Elke König at the beginning of 2016. At the end of 2015, the Federal Ministry of Finance announced that the area of responsibility of the National Resolution Authority (*Nationale Abwicklungsbehörde* – NAB), which is currently assigned to the Federal Agency for Financial Market Stabilisation (*Bundesanstalt für Finanzmarktstabilisierung* – FMSA), would be integrated into BaFin, as provided for in the Recovery and Resolution Act *(Sanierungs- und Abwicklungsgesetz)*. The provisions of this Act ensure that the resolution activities are operationally independent from ongoing banking supervision, while allowing the necessary close cooperation. Each side can benefit from the know-how of the other and from simplified information flows. Implementation is planned by the beginning of 2018.

The European Commission presented its plans for a European deposit guarantee scheme in November 2015. BaFin has taken a critical position, believing that the commission's proposal is giving the wrong incentives: the risks, which continue to have strong national characteristics, will be redistributed among the other member states. Instead, the highest priority should be given to further reducing

the banking risks in the EU. This applies to implementing the banking union measures agreed already and applying them effectively. In addition to implementing the Bank Recovery and Resolution Directive and the Deposit Guarantee Directive in all member states, it will be necessary to demonstrate that the Single Resolution Mechanism (SRM) is fully functional. Another essential requirement is to take further measures to reduce the risks arising to states from banks and to banks from states. In particular, further risk reductions will have to be initiated: it will be necessary, for example, to strengthen and consistently apply the bail-in principle by introducing an adequate and legally binding bail-in buffer (MREL) of at least 8% for SRM banks and to reduce the sovereign risks to bank balance sheets, especially the revision of the regulatory treatment of government bonds.

# 6 Consumer protection

## 6.1 Retail Investor Protection Act

The Retail Investor Protection Act *(Kleinanlegerschutzgesetz)* entered into force in July 2015. It has anchored collective consumer protection explicitly as an overarching supervisory objective of BaFin and is intended to improve consumer protection by making the offerings of the unregulated capital market more transparent. There have been cases in the past where investors lost a lot of money as a result of investments in this segment. Despite the information provided in the associated prospectuses, the risks their investments were exposed to had not been clear to many retail investors. In some cases, they also became victims of fraud.

Among other things, the Retail Investor Protection Act extended the obligation to publish a prospectus for certain types of investment – for example for profit participation loans and subordinated loans as well as for investments that are economically equivalent to financial investments, which have already been subject to the prospectus requirement –, closing loopholes in the process that had previously made it more difficult for investors to assess the risks of certain investments correctly. Their providers also have to meet additional information and disclosure requirements and adhere to minimum terms. This will help investors to make a better assessment of the integrity and prospects for success of investments and thus make an informed and risk-aware decision. That said, investors remain responsible for their own decisions: if a risk materialises, they have to deal with the consequences. In addition, investors must bear in mind that providers and issuers of investments within the meaning of the Capital Investment Act *(Vermögensanlagengesetz)* will still not be supervised by BaFin. Before a public offer, they are only required to prepare a prospectus, which they have to submit to BaFin for approval, and to publish it. Prospectus law is therefore only intended to create full transparency for investors. It can neither prevent individual providers from engaging in criminal conduct nor replace the investor's own responsibility in assessing the risk and return of an investment.

Where the investor's ability to assess the risk and return seems under threat or a proper assessment seems hardly feasible at all, the Act has given BaFin additional powers in collective consumer protection: it can, for example, restrict or even prohibit the distribution of certain products, if they raise considerable concerns about investor protection or pose a risk to the stability or integrity of the financial system. BaFin can review the financial statements of companies on the unregulated capital market and publish on its website information about measures it has taken against market participants in order to warn investors. In order to discharge its new consumer protection mandate as effectively as possible,

BaFin at the beginning of 2016 established a new department based in both Bonn and Frankfurt, which deals with issues relevant to consumer protection in all financial sectors across different locations.

## 6.2 First Financial Markets Amendment Act

On 6 January 2016, the Federal Cabinet adopted another component of its programme to improve consumer protection: the government draft of a First Financial Markets Amendment Act *(Erstes Finanzmarktnovellierungsgesetz)*. Similar to many national provisions applicable to the financial markets, this Act will also mainly serve to adapt the legal framework to new European requirements intended to strengthen the integrity and transparency of the capital markets and improve investor protection. The new European requirements are laid down in the Market Abuse Directive, the Market Abuse Regulation, the Central Securities Depositories Regulation and the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs Regulation).

The Act is expected to be adopted in the first half of 2016. Because of the different application dates of the European requirements, its provisions will enter into force in stages. The European Markets in Financial Instruments Directive II (MiFID II) and the associated Markets in Financial Instruments Regulation (MiFIR), however, are to be implemented in a Second Financial Markets Amendment Act *(Zweites Finanzmarktnovellierungsgesetz)*, because these two pieces of legislation are only expected to be applicable from the beginning of 2018, one year later than originally planned.

## 6.3 Conduct regulation – striking the right balance

Conduct of business rules, transparency and documentation requirements, rules on product development and distribution and more besides: conduct regulation has been continuously expanded in recent years, and further regulation is planned. Such requirements are appropriate and important for creating fair conditions on the financial markets and protecting investors and consumers. For BaFin, the rules of conduct regulation are as much a foundation of its supervisory work as those associated with prudential regulation on the basis of financial statements.

But conduct regulation must not overshoot the mark. Investor protection must not lead to a situation where advice on securities is no longer provided, or is only provided selectively so it is de facto only available to wealthy clients. Retail investors and consumers need special protection because they are not in as strong a position as providers and professional investors. But, as with any kind of regulation, it is important to strike the right balance when implementing conduct regulation. If there is excessive red tape, it will ultimately impact on the delivery of financial products, and therefore on those the regulation seeks to protect: the customers.

# 7 Timeline of important events in 2015

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| **January** | ▸ Important implementing rules for the new European insurance supervision regime, **Solvency II**, enter into force.<br>▸ The **Swiss National Bank** abandons the minimum exchange rate of 1.20 francs per euro. The franc's value appreciates sharply for a period.<br>▸ The European Central Bank (ECB) extends its bond-buying programme to include eurozone **government bonds**, increasing the monthly target to €60 billion until September 2016.<br>▸ The leftist Syriza party wins parliamentary elections in **Greece** and announces its intention to renegotiate the terms of the European rescue package.<br>▸ The **German Recovery and Resolution Act**, which transposes the European Bank Recovery and Resolution Directive, enters into force. In the event a bank fails, the owners and creditors must be first to bear losses before a resolution fund financed by the banking industry can step in in exceptional cases. The Act also nominates the Financial Market Stabilisation Agency (FMSA) as national resolution authority. |
| **February** | ▸ **Portugal** plans the early repayment of emergency loans granted by the International Monetary Fund (IMF). **Ireland**, too, has begun the partial repayment of its IMF loan ahead of maturity.<br>▸ The European Financial Stability Facility (EFSF) programme for **Greece** is extended by four months to the end of June. |
| **March** | ▸ The International Organization of Securities Commissions (IOSCO) publishes a revised code of conduct for **rating agencies**.<br>▸ **Düsseldorfer Hypothekenbank** is taken over by the private, voluntary Deposit Protection Fund of the Association of German Banks as part of a private-sector transaction. The institution suffered large losses on bonds of the Austrian Heta Asset Resolution AG, which had been set up to liquidate the non-performing part of Hypo Alpe Adria, which was nationalised in 2009.<br>▸ The **financial watchdog** starts its activities. It is assigned to the Federation of German Consumer Organisations and its role is to make its findings from observing the financial market available, in particular to BaFin.<br>▸ The EBA puts out for consultation a proposal to ensure a robust and transparent framework for the internal ratings-based approach (**IRB approach**). |
| **April** | ▸ The new **Insurance Supervision Act**, which transposes the Solvency II Directive into national law, is promulgated. The effective date for the new supervisory regime is 1 January 2016.<br>▸ The German stock index, **DAX**, passes the 12,300 point mark, reaching an all-time high. At the same time, the yield on the 10-year **Bund** temporarily falls to a record low of 0.08%. |
| **May** | ▸ BaFin declares loans permissible that are originated for the account of **alternative investment funds** (AIFs) for which the German Investment Code specifies no or hardly any product requirements.<br>▸ BaFin and Deutsche Bundesbank survey German **credit institutions** on their earnings situation and resilience in the **low interest rate environment**. |

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| **June** | ▸ The EFSF programme for **Greece**, which was extended in February, expires. Loans of more than €1.54 billion due to the IMF are not repaid. The Greek government imposes restrictions on the movement of capital and temporarily closes banks and stock exchanges.<br>▸ In **China**, prices on the domestic stock exchanges collapse when the speculative bubble bursts. |
| **July** | ▸ BaFin presents the findings of an impact study of German **life insurers**, according to which they will be able to manage the switch to the new capital requirements under Solvency II.<br>▸ The **Retail Investor Protection Act** enters into force. It is aimed at improving the protection of investors on the unregulated capital market. The Act expands the regulation of this market, adds to the transparency and disclosure requirements of providers, strengthens BaFin's powers and anchors collective consumer protection as a supervisory objective of BaFin.<br>▸ The **German Deposit Guarantee Act** is promulgated. In a compensation event, all depositors in Germany will be entitled to compensation of up to €100,000 and in some cases of up to €500,000. In addition, shorter payout periods apply and cooperation among the European deposit guarantee schemes has been improved.<br>▸ In a referendum, Greeks reject the creditors' reform conditions for the granting of a new rescue package. Nevertheless, **Greece** applies for further financial aid from the European Stability Mechanism (ESM).<br>▸ IOSCO and the Basel Committee on Banking Supervision (BCBS) publish criteria for simple, transparent and comparable securitisations. They are intended to help the sector to develop these types of securitisations and make it easier for investors to meet due diligence requirements.<br>▸ pbb **Deutsche Pfandbriefbank AG** is listed on the stock exchange. It was the core bank of the Hypo Real Estate Group, which was nationalised under emergency circumstances in 2009. |
| **August** | ▸ The Eurogroup reaches agreement with **Greece** on a third rescue package – with conditions attached – from ESM funds totalling up to €86 billion and a term of three years.<br>▸ **China** allows the renminbi to depreciate against the US dollar (US$). This is followed by a brief period of turbulence on the forex markets.<br>▸ The highly indebted **Ukraine** negotiates a haircut of 20% with Western creditors. The agreement is one of the conditions for an IMF loan of US$40 billion. |
| **September** | ▸ On the basis of the Deposit Guarantee Directive, the EBA publishes two sets of guidelines expanding the rules for calculating contributions to the **deposit guarantee schemes**.<br>▸ Following a public consultation process on a corresponding Green Paper in the spring, the European Commission adopts an action plan for the **Capital Markets Union**, which is aimed at creating a European internal market for capital.<br>▸ The European Commission publishes two draft regulations aimed at creating a consistent framework for simple, standard and transparent **securitisations** and for other securitisations; they are also intended to implement the securitisation framework of the BCBS dated December 2014. |

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| **October** | ▸ The federal government publishes a draft of the First **Financial Markets Amendment Act**, which is intended to transpose a number of new European provisions into German law, in particular relating to market abuse. Since the application of the revised Markets in Financial Instruments Directive II (MiFID II) and the associated Regulation has been delayed by one year, these pieces of legislation will only be implemented in a Second Financial Markets Amendment Act.<br>▸ The ECB estimates the capital shortfall of the four systemically important **Greek banks** under its direct supervision at a total of €14.4 billion.<br>▸ The European Commission agrees the restructuring of **HSH Nordbank** with the federal states of Hamburg and Schleswig-Holstein. Most of the legacy liabilities are transferred to the shareholders. The remaining operating company is to be privatised or put into resolution within two years of the formal decision.<br>▸ As a result of the introduction of the **liquidity coverage ratio** (LCR), a consistent, binding minimum standard has been set in Europe. In 2015, an LCR ratio of 60% has to be met. This will increase progressively to 100% by 2018. |
| **November** | ▸ The Act Implementing the **Transparency Directive Amending Directive** enters into force. It leads to changes to the reporting of significant voting right percentages and imposes stricter sanctions on violations of transparency requirements. In addition, it includes the obligation to pay compensation in the event of delisting and abolishes the obligation to publish interim management statements.<br>▸ The Financial Stability Board (FSB) publishes the final standard for **total loss-absorbing capacity** (TLAC) for global systemically important banks.<br>▸ The G20 states adopt a capital add-on for **global systemically important insurers** (G-SIIs): higher loss absorbency (HLA). Together with the basic capital requirements (BCR) adopted in 2014, the HLA will form the basis for calculating the capital requirements for G-SIIs from 2019.<br>▸ **Greece's** Hellenic Financial Stability Fund (HFSF) receives €5.4 billion from the ESM for recapitalising the banks. Some of the capital shortfall is covered by private investors.<br>▸ **Terror attacks** in Paris and the war in Syria indicate increased geopolitical risk, but hardly have any effect on the financial markets.<br>▸ **Russia** has to provide support to the ailing state development bank, VEB.<br>▸ The *Bundesrat* and *Bundestag* adopt the **Resolution Mechanism Act**, which brings the German Recovery and Resolution Act in line with the European Single Resolution Mechanism (SRM) and implements the European rules on the bank levy.<br>▸ The EBA publishes the results of the **2015 transparency exercise**, in which 105 banking groups (including 20 German institutions) from 20 EU countries and from Norway participated. The purpose of the exercise was, among other things, to make information on capital resources, credit and market risks, sovereign exposures and leverage ratios transparent. |

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| **December** | ▸ The **US Federal Reserve** increases interest rates for the first time in almost a decade, by a quarter of a percentage point to a range between 0.25 and 0.5%.<br>▸ The ECB extends its **bond-buying programme** to March 2017 and lowers its rate for the deposit facility from -0.2% to -0.3%.<br>▸ The **Portuguese bank** Banif is put into resolution using tax funds and parts of it are sold to the major Spanish bank Santander.<br>▸ The **price of crude** oil drops to a seven-year low.<br>▸ The Economic and Financial Affairs Council (ECOFIN) largely confirms the European Commission's proposed regulations for **securitisations**, but also suggests a number of significant amendments and clarifications. |

# II Integrated financial services supervision

## 1 Macroeconomic environment

There was plenty to worry financial market participants in 2015: the persistent loose monetary policy of the central banks, weak growth in various key emerging economies[1], doubts whether Greece would remain in the European Monetary Union and geopolitical tensions. In January, the European Central Bank expanded its bond-buying programme to include government bonds, increasing the monthly target volume to €60 billion.[2] On the money and capital markets, interest rates – already at extraordinarily low levels – continued to decline. For example, the yield on the 10-year Bund briefly fell to below 0.08%[3] in April 2015 – a new historic low. For shorter maturities, yields turned negative throughout.[4] After a sharp move in the opposite direction, which only lasted about two months, however, the low interest rate environment re-established itself[5] and the investment crisis deteriorated even further. In many segments of the financial market, the risk premiums were so low in 2015 that it seemed increasingly doubtful whether they were an adequate reflection of the actual risks. If asset prices increase across a broad range and investors systematically underestimate the risks incurred, this may pose a major threat to financial stability. The crucial test comes as soon as the leading central banks abandon their extremely loose monetary policies and interest rates normalise. The US Federal Reserve took a tentative step in this direction in December 2015, increasing interest rates for the first time in almost a decade.[6]

Geopolitical risks also continued to increase. The conflict between Russia and Ukraine remained unresolved in 2015. The war in Syria, which triggered a massive wave of refugees, and the terror attacks in Paris shook Europe to its core. In addition, economic performance

1 See International Monetary Fund (IMF), World Economic Outlook Database.

2 European Central Bank (ECB), press release dated 22 January 2015.

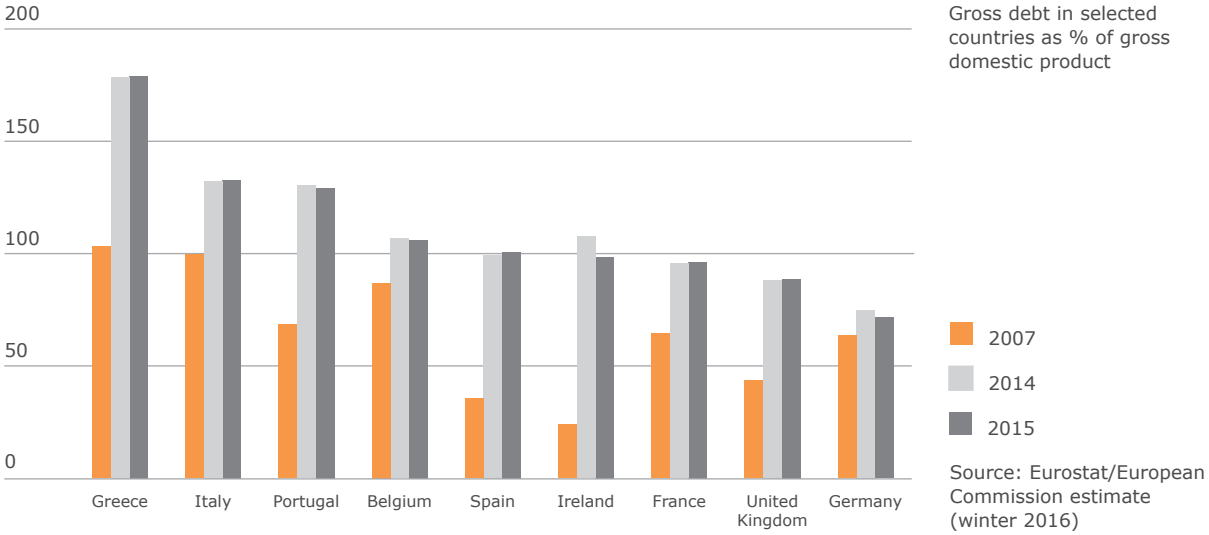
3 See Bloomberg.

4 See Bloomberg.

5 See Bloomberg.

6 See federalreserve.gov/monetarypolicy/policy-normalization.htm.

**Figure 1** Sovereign debt ratios in Europe




nosedived in key emerging economies.[7] China's growth prospects deteriorated and its domestic stock exchanges collapsed in the summer when the speculative bubble burst.[8] Driven not least by a decline in demand from China, combined with abundant supplies, commodity prices fell sharply. Although dollar-denominated crude oil prices, which had already fallen by more than half in the second half of 2014, recovered somewhat in the spring, they subsequently resumed their downward trend. Towards the end of 2015, they were similar to prices last seen seven years before – the last low reached after the start of the financial crisis.[9] The collapse in commodity prices weighed especially on Russia, already under pressure from sanctions imposed in response to the Ukraine conflict, and Brazil, which was dealing with political problems at home. Both countries were in a deep recession in 2015.[10]

The European sovereign debt crisis deteriorated when the new Greek government refused at the beginning of the year to meet the tough conditions imposed by its lenders.[11] The second rescue package, which had been due to expire, was extended by four months to the end of June 2015.[12] The negotiations initially failed to produce any agreement.[13] Greece defaulted on the International Monetary Fund (IMF)[14] and the ECB curtailed the emergency liquidity support for the Greek banking system.[15] In order to prevent a run on the banks, the Greek government closed the credit institutions and imposed restrictions on the movement of capital. The situation calmed down only when another rescue package of €86 billion, to be parcelled out over three years, was resolved.[16] This turbulence did not directly lead to any contamination for other countries, which had thus far made better progress in dealing with the crisis.[17]

Although the third aid package for Greece made the European sovereign debt crisis recede into the background, the underlying problems remained. In the eurozone, the ratio of debt

7 See IMF, World Economic Outlook Database.

8 See Thomson Reuters, Bloomberg.

9 See Thomson Reuters, Bloomberg.

10 See IMF, World Economic Outlook Database.

11 See European Commission, Second Economic Adjustment Programme for Greece.

12 European Financial Stability Facility (EFSF), press release dated 27 February 2015.

13 See Bank of Greece, Act of cabinet having the effect of law, Bank holiday of short duration, 28 June 2015.

14 IMF, press release no. 15/310 dated 30 June 2015.

15 ECB, press release dated 28 June 2015.

16 Eurogroup statement on the ESM programme for Greece, 14 August 2015.

17 See Thomson Reuters, Bloomberg.

to total economic output declined by one percentage point to 93.5% in 2015, but most of this decrease was attributable to Germany. There was also visible progress in Ireland. In contrast, most other countries failed to reduce their debt levels to any significant extent. Increasingly, government efforts to consolidate their national budgets were beginning to falter. In particular the crisis-hit countries failed to untangle the close ties between the government and the banks to any appreciable extent. Elections changed the party landscape in a number of countries in such a way that it was difficult to form a government and the political situation became more unstable.[18] Overall, this increased the political risk in the eurozone.

Germany's economic recovery continued in 2015, with real gross domestic product (GDP) expanding by 1.7%.[21] Private consumption replaced exports as the main growth driver,[22] supported by residential construction and the continuing decline in crude oil prices.[23] The number of company insolvencies decreased for the sixth year in succession.[24] Unemployment remained at a very low level by historical standards.[25] Employment reached highs never seen before[26], and real incomes rose significantly.[27] The robust economic conditions benefited the German financial sector, which saw fewer credit defaults and rising customer demand for investments, insurance and loans.

# 2 Financial stability

## 2.1 Non-bank non-insurance global systemically important financial institutions

At the end of July 2015, the Financial Stability Board (FSB) announced that work on the framework for non-bank non-insurance global systemically important financial institutions (NBNI G-SIFIs) would be postponed until the FSB has passed a binding resolution on new asset management mandates. The work set in train in March 2015 will allow the FSB and the International Organization of Securities Commissions (IOSCO) to gather additional insights into potential systemic risks associated with asset management activities. This will thus make it possible to put the assessment methodology for NBNI-G-SIFIs on a more solid basis.[19]

When work on the framework for NBNI-G-SIFIs resumes, it will focus on aspects not previously addressed in the context of market-wide regulation.[20]

## 2.2 Macroprudential instruments

In the past, whenever exaggerated activity on property markets coincided with excessive credit extension and inappropriately relaxed lending standards, this repeatedly threatened the financial stability in many countries. Based on this experience and in view of years of significant price rises for residential property in Germany, the Financial Stability Committee (FSC, see info box on page 33) analysed and assessed during its work in 2015 the risks that could arise from the property market for the German financial system. In this process, the Committee came to the conclusion that there are excessive valuations in isolated cases, especially

18 See European Central Bank, MFI statistics.

19 For details on the new mandates, see 3.1.

20 See chapter I.2.

21 Federal Statistical Office, press release 56 dated 23 February 2016.

22 See Federal Statistical Office, national account system.

23 See Federal Statistical Office, national account system.

24 Federal Statistical Office, subject-matter series 2, series 4.1.

25 Federal Statistical Office, Federal Employment Office *(Bundesagentur für Arbeit)*, labour market statistics.

26 Federal Statistical Office, press release 1 dated 4 January 2016.

27 Federal Statistical Office, press release 35 dated 4 February 2016.

### Financial Stability Committee

The Financial Stability Committee (FSC) comprises representatives from BaFin, the Federal Ministry of Finance and the Deutsche Bundesbank, 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 of banking and insurance supervision regularly attend the meetings.

The FSC provides a framework for the cooperation between BaFin, the Deutsche Bundesbank and the federal government. The FSC 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 FSC 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. Other tasks the Committee fulfils include discussing the handling of warnings and recommendations issued by the European Systemic Risk Board (ESRB), on which the FSC has been modelled.

In addition, the FSC 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 FSC 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 FSC issue corresponding warnings and recommend measures to avoid the danger.

in a number of urban centres, but they are not severe at this stage. The FSC did not identify any indications of destabilising interaction between lending and property price trends in Germany, so it did not see any need for urgent action either.

BaFin can exert an early influence on risks arising from real estate loans by adjusting the regulatory capital requirements. However, in the FSC's view, these tools are not adequate to ensure that conceivable systemic risk arising from residential property financing can be countered sufficiently and effectively. In June 2015, the Committee therefore argued in favour of the precautionary creation of the legal basis for additional macroprudential tools to regulate residential mortgage loans that apply directly when new loans are issued. For this reason, the FSC recommended that the federal government authorise BaFin to impose certain restrictions on lenders in relation to granting loans secured by mortgages for the construction or purchase of residential property. The aim of the extended toolbox is to enable BaFin to take flexible, preventive action as soon as there is an imminent threat to financial stability.

Macroeconomic procyclical factors may also impact on financial stability – especially if there is no longer a healthy relationship between credit growth and general economic development and excessive debt financing encourages the formation of speculative bubbles. The creation of an additional capital buffer in times of excessive credit growth is aimed at enabling credit institutions to increase their capacity to absorb losses in order to be better equipped for potential market corrections. At the same time, this countercyclical capital buffer tends to dampen credit extension. In case of crisis, a credit crunch can be prevented by using up the buffer, thus ensuring credit is available to the economy at all times.

As at 1 January 2016, BaFin for the first time specified the domestic countercyclical capital buffer requirement that all credit institutions have to satisfy in addition to the general capital requirements.[28] The most important indicator

28 For information on the countercyclical capital buffer, see chapter III 2.1.

used in the assessment is the extent to which the loans to GDP ratio varies from its long-term trend. At the end of 2015, the indicators used did not point to excessive lending in Germany.

BaFin therefore set the countercyclical capital buffer at 0%. It will in future review the indicators on a quarterly basis and adjust the buffer rate if necessary.

# 3 Market-based financing

## 3.1 Shadow banks

The FSB and the standard-setting bodies have now adopted a number of regulatory recommendations in order to migrate the shadow banking sector into a sustainable market-based financing system. In the area of securities financing transactions, the FSB successfully closed another loophole in November 2015, thus concluding the current round of regulation.

It completed the framework for minimum haircuts for non-centrally cleared securities financing transactions and published it in full in November 2015.[29] The framework is an important part of the FSB's regulatory recommendations aimed at mitigating the risks of the shadow banking sector. It is intended to prevent excessive leverage from building outside the banking system, because, in case of a crisis, this could exacerbate the situation.

The framework firstly contains qualitative standards for the calculation methods used by market participants and secondly specifies minimum haircuts for non-centrally cleared securities financing transactions. Financing backed by government bonds is exempted from the regulations.

Following consultations, the framework was supplemented in 2015 by adding regulatory proposals aimed at transactions between non-bank financial institutions, such as insurance undertakings and investment funds.

This area may in future also be subject to minimum haircuts; the national competent authorities (NCAs) will have to estimate and assess the size of the sector and the materiality of these types of transactions on a case-by-case basis. This is to ensure that all shadow banking activities are captured and a level playing field is created for all participants.

Most of the regulatory recommendations have meanwhile been adopted and the focus is increasingly shifting towards implementation. To ensure that the measures are implemented on a globally consistent basis and any inconsistencies can be identified, the FSB and IOSCO conducted the first peer reviews last year. The focus was on the regulatory recommendations for money market funds, securitisations and other shadow banking entities. As implementation at the national level continues, further peer reviews have been commissioned.

A new focus of attention is the asset management mandates adopted in March 2015. The FSB thus recognises the increased importance of the sector. Driven by the search for yields, which has acquired a new urgency due to the persistent low interest rate environment, more and more funds have flowed into less liquid asset classes. At the same time, liquidity has decreased in parts of the secondary markets because stricter regulation has curtailed the market making function of institutions. It must therefore be assumed that risks will increase, especially once the monetary policies of central banks return to normal. In a first step, until September 2015, the FSB dealt with economic risk associated with asset management. One of the key demands of the FSB is that investment funds perform adequate stress tests.

29 Transforming Shadow Banking into Resilient Market-based Finance, Regulatory framework for haircuts on non-centrally cleared securities financing transactions; available at www.fsb.org.

In a second step, the FSB is examining the structural weaknesses of the asset management sector. The focus areas are liquidity risk, leverage, operational risk and activities in connection with securities lending transactions.

In addition, the FSB is investigating the risk exposure of pension and sovereign wealth funds. Concrete regulatory proposals are expected by the end of 2016.

## 3.2 Focus

### Capital Markets Union, quo vadis?

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The Capital Markets Union has the ambitious goal of making the markets more efficient in order to stimulate investment in Europe and, consequently, employment and growth. At the end of September 2015, the European Commission underpinned this goal by publishing an action plan[30] comprising a total of 33 measures. The Commission aims above all at more involvement of institutional and private investors in the long-term financing of companies and infrastructure projects. Also, in addition to the traditional loan financing provided by banks, it wants to promote capital-market-based financing instruments to a greater extent and drive the standardisation of credit information. Ultimately, the plans are aimed at creating a single EU-internal market for capital.

#### Prudence and proportion

From Germany's perspective, there is no reason not to proactively strive for more efficient capital markets, although prudence and proportion should be applied in this process. We are not under the same kind of pressure as with the creation of the banking union. The Commission's pragmatic approach of implementing the different measures in stages by 2019 is therefore correct. Each individual step towards the Capital Markets Union must be based on careful analysis.

Moreover, from the perspective of an integrated financial market supervisor such as BaFin, a good balance ought to be established for all measures between stimulating economic growth and ensuring secure and stable markets – in the sense of adequate but not necessarily fully harmonised regulation. National regimes and structures should be retained if they have proven themselves and already fulfil their (financing) function effectively.

#### Revival of the securitisation market

A key measure of the Capital Markets Union is the revival of the securitisation market in Europe, which has been more or less idle since the financial crisis. The future European regulatory framework for securitisations[31] is intended to encourage securitisation activity that is useful for banks and investors in equal measure. This would give banks new financing options, from which small and medium-sized enterprises could benefit. The investor base would be enlarged, risks would be diversified, and investments in European securitisation positions – including from third countries – would be made easier by a more consistent, more closely integrated regulatory framework.

It is therefore intended to introduce criteria for simple, transparent and standardised

30 The action plan is available at http://ec.europa.eu.

31 For details on this framework, see chapter III 1.2.2.

(STS) securitisation by way of a cross-sectoral securitisation regulation. STS securitisation should then be subject to adequate supervision. For these types of securitisations, lower regulatory capital requirements would apply to banks, i.e. a distinction would be made between STS and other securitisations. Similar arrangements are to be put in place for insurers. From a German point of view, asset-backed commercial paper (ABCP) programmes for short-term securitisations and some synthetic securitisation positions should also be included in the STS regime, because they, too, expand the banks' financing options.

### Learning from the past

In designing the European securitisation regime, the EU absolutely has to heed the lessons of the financial crisis. For example, non-securitised and securitised exposures must be subject to the same sound and well-defined credit-granting principles, and risk retention must be mandatory for all securitisations in order to prevent a repeat of the originate-to-distribute model, which was one of the reasons for the 2007/2008 financial crisis. In addition, institutional investors should get easy access to all relevant information to facilitate their due diligence. Investors must not repeat the old mistakes from before the financial crisis by blindly trusting the rating agencies.

Form a German point of view, strict STS criteria with stringent requirements for preferential treatment are key to a sustainable securitisation regime. It is also important that both originators and investors are able to ascertain whether the STS criteria have been met. To this end, these criteria must be as clear as possible and appropriate transparency requirements must be imposed. In cases of doubt, a small number of supervisory authorities with clear responsibilities should ideally make fast and final decisions in order to create legal certainty. According to the European Commission's proposals, the supervisory architecture for European securitisations is so complex that the process may in some cases involve more than 100 supervisory authorities.

### New Prospectus Regulation has potential to ensure more effective regime

Another example where efficiency and safety have to go hand-in-hand is the draft proposal for a new Prospectus Regulation. To make it easier for companies to raise equity and debt capital on the European capital markets, the regime is to be made leaner with lower costs incurred. To this end, the Commission is primarily planning to simplify the documentation and speed up the process. For example, issuers would be able to reuse the information they have to publish in any case for admission to trading on a regulated market for drawing up their prospectus. The annual financial report supplemented by additional prospectus information could then also be part of the prospectus document. For any issue, only a description of the securities and, if necessary, a summary would have to be produced. The authorities would be required to assess this information in an accelerated procedure of only five working days. For subsequent issues, companies already listed on the regulated market would only be required to submit a minimum of information.

Moreover, according to the draft proposal, the exemptions from the prospectus requirement for smaller issues with lower capital requirements would be expanded. The costs for small and medium-sized enterprises with a market capitalisation of up to €200 million would be reduced by implementing a simplified regime. At the same time, investor protection would be improved by making prospectus summaries more concise, and risk weighting would be made more transparent and clearer for investors. In this respect, a balance has to be achieved between maintaining adequate investor protection and transparency levels and making IPOs and the associated costs significantly more attractive for larger medium-sized companies and young high-tech enterprises. Cross-border investment in the capital market can only be increased if there is adequate access to reliable information on issuers and their issues.

### Increasing the attractiveness of European venture capital funds makes sense

The situation is similar for plans to make EuVECA[32] and EuSEF[33] funds more attractive for management companies and investors, thus making more venture capital and private equity available to European companies. The idea is to give also larger fund managers the opportunity to launch these funds and to market them throughout Europe. It has also been suggested that the investment threshold should be lowered to give more investors access to these funds and thus win more investor funds from all over Europe and make them available to the real economy more efficiently. Other considerations include suggestions to reduce registration fees and to extend the list of assets these funds are allowed to acquire. Adequate investor protection must be ensured in this context, too. Moreover, competition between EuVECA and EuSEF funds with other alternative investment funds (AIFs) must not be unduly influenced.

### Analysing the regulatory impact

In all of this, it is important to analyse in detail the impact of European financial market regulation. Such a process will no doubt identify excessive regulatory burdens, duplication, unintended side effects and interference, inconsistencies and gaps. In particular following the adoption of the major projects of financial market regulation, such as the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR), Solvency II, the Markets in Financial Instruments Directive II (MiFID II) and the European Market Infrastructure Regulation (EMIR), this seems necessary to achieve effective, consistent and adequate regulation. Appropriate regulation also means that proportionality must be kept in mind.

### Benefits must be greater than costs and risks

For the Capital Markets Union to be accepted and successful in the long run, it is important in BaFin's view that the benefits of each individual measure of the action plan are greater than the associated costs and risks. For example, if there were plans to force all small and medium-sized entities in the EU to reveal their financial and credit data in a standardised format in a European database, this would drive up costs significantly – even for those entities that do not want or need access to the capital market. In Germany, this applies to many companies happy with the financing provided by their regular regional bank. The important role that banks play in financing Europe's economy should not be called into question.

The specific proposals for the Capital Markets Union should ideally underpin financial stability, but in any case refrain from undermining it by giving the wrong incentives or allowing regulatory arbitrage. A particular example that springs to mind in this context is adequate European regulation of loan origination funds which should be subject to strict risk management requirements[34] – also with a view to the risks posed by loan participation funds.[35] The growing importance of different types of loan funds for financing the real economy in Europe underlines how important it is to debate harmonised minimum standards.

As mentioned in the introduction, well-established and -working structures and good practices should not be abandoned. On the contrary, they should be used as inspiration for new requirements so that effective markets in some countries are not put at risk by the planned harmonisation. This applies to German *Pfandbrief* law, for example.[36] Likewise, fair competition must be maintained between the different types and sources of financing. On the other hand, adequate investor protection must be guaranteed. In particular, retail clients must not be lured towards riskier capital investments without giving them adequate information. The Capital Markets Union should aim to make the financial markets and capital allocation more

32 European Venture Capital Funds.

33 Social Entrepreneurship Funds.

34 For details on loan funds, see chapter V 1.6.

35 In contrast to loan origination funds which actively grant loans, these are fund investments in existing company loans. They often pay higher interest because they are not rated "investment grade".

36 For details on *Pfandbrief* law, see chapter III 1.9.

efficient, but also more secure. In short: we say yes to the Capital Markets Union, but only in combination with investor protection and financial stability.

# 4 Digitalisation

## 4.1 Fintech companies

### 4.1.1 Overview of authorisation requirements

#### Payment systems

Consumers can pay for goods and services using cash or bank money, by credit transfer or direct debit or in various systems based on modern technology. For example, electronic money, or e-money, can be transferred via the Internet, or mobile devices can be used to make contactless payments at the point of sale.

Depending on the type of payment system, providers have to meet different supervisory requirements. BaFin assesses each individual case on the basis of the contracts used by the provider to establish whether the authorisation requirement under the German Payment Services Supervision Act *(Zahlungsdiensteaufsichtsgesetz)* applies. The providers also have to observe and comply with the provisions of the German Banking Act *(Kreditwesengesetz)*, the Payment Services Supervision Act and the German Money Laundering Act *(Geldwäschegesetz)*.

#### Crowdfunding

Crowdfunding is used by providers to persuade investors to participate in ventures. Special platforms are available for this purpose. By pooling supply and demand, participations are often subscribed quickly. There are four models for these platforms: donation-based and reward-based crowdfunding (crowdsponsoring), credit-based crowdfunding (crowdlending), and crowdinvesting, where funders hope to generate a return. The projects cannot always be clearly assigned to one of the four basic models. BaFin's main focus is on crowdlending and crowdinvesting.

The supervisory requirements depend on the individual case concerned. For example, authorisation requirements under the Banking Act and the Payment Services Supervision Act may apply. In addition, there may be an obligation to publish a prospectus in accordance with the German Capital Investment Act *(Vermögensanlagengesetz)* or the German Securities Prospectus Act *(Wertpapierprospektgesetz)*.

#### Virtual currencies

Digital units of account based on a decentralised network are most commonly referred to as virtual currencies (VCs). Examples include bitcoins or litecoins. VCs are based on the idea of extra-governmental substitute currencies. New currency units are created using predetermined computing processes within a peer-to-peer computer network. The users manage VCs with their private and public key pairs to authenticate transactions within the network. There is no central body that monitors the transactions or balances. Existing VCs and all transactions can be viewed in a central file, the blockchain.

BaFin has classified bitcoins as financial instruments in the form of units of account in accordance with the Banking Act. This classification applies in principle to all VCs.

### Blockchain

Financial market projects in which decentralised networks authenticate and manage other transactions and assets are conceivable in principle. This means that the issuance of shares or the transactions entered into for this purpose could also be implemented by way of a blockchain. Since the network does not have an "operator" in the traditional sense, the authorisation requirement has to be assessed by taking into account whether network participants provide services requiring authorisation for other parties. In future, however, existing institutions will also be able to use blockchain technology in the provision of their services.

### Signal following

In social trading, the operators of special platforms manage public portfolios for signal providers in order to make their trading activities visible. Customers can link their own portfolios to these reference portfolios: in this way, trade decisions taken by the signal provider are automatically also implemented for their own account. The signal provider is, as a rule, attributed to the platform, which complements the provider's activity by executing concrete customer orders and acting as the promoter of the business model. This means that the platform normally provides at least portfolio management within the meaning of the Banking Act.

## 4.1.2 Opinion

### Felix Hufeld on fintech companies

"Panta rhei – everything flows." The Greek philosopher Heraclitus already knew this. The phrase "everything flows" is also an apt description of the environment in which BaFin operates. It is in a state of continual change. Currently, the issue of digitalisation is at the top of the agenda. In the public's perception, fintech companies have become the epitome of this digitalisation. These mostly very young companies provide services that are either completely new or have in the past only been offered by banks, insurers or investment services enterprises.

What should we make of this development? One fact is that, when considered on the basis of fundamental market principles, fintech companies increase the diversity of the market for financial services providers. It is a proof of a well-functioning financial system if young enterprises can enter the market with new ideas and find acceptance there.

**Felix Hufeld**

was Chief Executive Director of Insurance and Pension Funds Supervision until February 2015. He has been President of BaFin since March 2015.

### Regulatory rules of play

Another question is how we deal with fintech companies from a supervisory and a regulatory perspective. What are the regulatory rules that they will have to play by? This question can only be answered if we consider the business they (want to) conduct. Regulation must not be used to protect established companies by creating market barriers to newcomers, nor should it give the latter preferential treatment, at least not permanently. Regulation is a network of rules and requirements intended to protect the integrity and stability of Germany as a financial

centre. Depending on the business model, these rules and requirements also apply to fintech companies, which then require an authorisation to conduct business from BaFin and are subject to its ongoing supervision.[37]

To the extent that they are subject to regulation, the young enterprises are expected to be just as flexible as the well-established major players in the industry. If the legal requirements change, fintech companies will also have to weather these changes. Payment services providers wanting to add value by offering their customers easy-to-use payment processing applications are a good example. Through the interplay of three new sets of rules, some of which still have to be implemented, the market may now face significant changes. The SEPA Regulation[38] and the Regulation on interchange fees for card-based payment transactions[39] have already had an impact; the amendments to the Payment Services Directive[40] will also have a significant effect on the operating conditions of all involved payment services providers. All affected companies – fintechs and established entities alike – must embrace the changes in payment transactions.

It therefore clearly takes some effort to meet regulatory requirements, especially for companies approaching the issue not as financial services providers, but initially as IT companies. On the other hand, fintech companies in particular regard supervision as an opportunity to optimise their management processes and workflows.

37 See interview with State Secretary Dr Thomas Steffen on page 12.

38 Regulation (EU) No 260/2012, OJ EU L 94/22. It entered into force on 31 March 2012. SEPA stands for "Single Euro Payment Area".

39 Regulation (EU) 2015/751, OJ EU L 123/1. The Regulation applies as from 8 June 2015 – with the exception of Articles 3, 4, 6 and 12, which entered into force on 9 December 2015, and Articles 7, 8, 9 and 10, which will be effective from 9 June 2016.

40 Directive (EU) 2015/2366, OJ EU L 337/35. The amendments entered into force on 12 January 2016. The Directive must be transposed into national law by 13 January 2018.

## Authorities also move with the times

BaFin is responsible for implementing regulation and for putting – and keeping – financial market developments on the right track through sustained and at the same time up-to-date supervision. In this process, it has to hold up the mirror to itself and decide what it means to be up-to-date in the age of digitalisation.

It takes a certain amount of flexibility. BaFin must become attuned to the needs of fintech companies and has every intention of doing so. If it expects fintech companies to fulfil regulatory requirements, it must in turn formulate them in a clear and comprehensive manner. Even before they commence their business activities, the founders of fintech companies have to be aware of the regulatory requirements they may face. This knowledge will make it all the easier to meet them. And this is where BaFin is called upon. It has to present these requirements with the addressees in mind, i.e. online, for example, even before the first personal interaction between BaFin and the entrepreneur takes place. In addition, BaFin aims to engage in modern, service-based communication with the entrepreneurs. It is self-evident that the speed of change in the fintech market requires certain response times from BaFin. However, the quality of the responses – for example to enquiries regarding authorisation requirements – must not be adversely affected by the entrepreneurs' time expectations. The fintech market is fast-moving and hotly contested. BaFin knows that. Yet, to be able to give a correct answer, it has to understand each business model individually and ascertain how it should be classified in accordance with current regulatory requirements.

## No sandbox at BaFin

To encourage economic development, it is occasionally suggested that fintech companies should be offered a sandbox in which selected start-ups can test their business models under more relaxed supervisory standards.

It ought to be made clear in this context that BaFin has no mandate to stimulate the

economy and it would be violating its legal duties if it were to implement "supervision light" for fintech companies. This incidentally applies to the supervision of all companies, irrespective of the lifecycle they are in. What is more, the sandbox model holds potential for conflict: measures that promote businesses do not necessarily serve consumers as a whole, whom BaFin has to protect.[41] What BaFin can do, however, in order to stay in the picture: it can drop in from time to time on sandboxes set up by other parties – i.e. places that promote innovation – and provide some initial guidance on regulatory issues.

### Scaled-down regulatory and supervisory requirements

One aspect is often left out of account in this context: regulatory requirements can be scaled down – including in German supervisory laws: the Banking Act *(Kreditwesengesetz)*, for example, does not require every business model to have a full banking licence. BaFin can also grant authorisations for selected banking activities and financial services. Although a company holding this type of licence is then restricted in terms of its business activity, the list of requirements it has to meet is also scaled down accordingly.

True, some rules cannot be changed, but wherever the legislators have only specified an outline, BaFin makes its requirements on companies dependent on risk and the complexity of their business in order to reflect the principle of proportionality.

41 See 5.1 and 5.2.

### Catalytic effect of fintech companies

BaFin focuses on fintech companies not only as (possible) objects of supervision. It also pays much attention to the changes they trigger in their environment. These young companies not only embody digital progress, they also trigger this progress all around them. There are signs that they will act as catalysts, driving the process of digitalisation, automation and personalisation in the long term. The services offered by fintech companies are also changing consumers' expectations from the established companies. Moreover, the new providers are a driving force for process efficiency. All of this can have an impact on the product and service offering, sources of income and business models of the other financial services providers. The established companies will have to face this development. In some cases, their response is already evident: they are cooperating with fintech companies or replicating their ideas in their own systems. No matter which path they choose, BaFin remains in close contact with all the companies under its supervision and adapts its interpretation of regulatory requirements to the ongoing changes – but without diluting these requirements.

The fintech phenomenon also has a major impact on consumers, of course. The many ways in which products and services can be presented online or on mobile devices may give them significant additional benefits, but also pose new threats. Consumers need to find out for themselves what opportunities and risks an offering may hold, and this also applies to those proposed by fintech companies. For BaFin, new questions may arise under its collective consumer protection mandate. "Panta rhei – everything flows."

## 4.2 Cyber risk

### 4.2.1 Banks

Cyberspace threats continued to worsen around the world in 2015. Attackers are exploiting weaknesses with ever increasing speed, using more and more sophisticated methods. At the same time, the supervised companies depend on IT infrastructures to an ever greater extent, as technological penetration increases and information technology and business processes become more and more interlinked. Virtually any IT system can be accessed via the Internet these days. One of the consequences is that significant value adding processes also become vulnerable to attacks from cyberspace.

In view of this trend, BaFin again paid close attention to a range of issues relating to cyber risk in 2015 (see info box "Dialogue on IT supervision"). In this process, it concentrated on regular analysis of the current threat situation, provided information to and raised awareness among the supervised institutions and worked on the regulatory aspects of the problem in national and international working groups. In addition, it dealt to an increasing extent with relevant aspects of cyber security during audits of the banking business.

To be able to assess the current threat situation, BaFin continuously analyses all available news reports and warnings and shares information on them with other relevant authorities. One of the outcomes was a representative ad-hoc survey conducted in February 2015 in response to news breaking at the time that a large number of unprotected databases with live corporate data were openly accessible via the Internet. Yet the survey revealed that German banks were not at risk in this regard.

An important regulatory project in 2015 was the fine-tuning of the "Minimum Requirements for the Security of Internet Payments" (*"Mindestanforderungen an die Sicherheit von Internetzahlungen"* – MaSI[42]), which transpose the "Guidelines on the security of internet payments" of the European Banking Authority (EBA) into German law. One of the new requirements of the MaSI Circular of May 2015 is that serious incidents relating to payment security must be reported to BaFin.

An analysis of the findings of IT security audits in the banking business shows that in 2015 the focus was on issues such as protection needs analyses, the IT strategy process, user authorisation procedures, contingency plans and the management and monitoring of individual data processing.

BaFin is aware that the threat from cyber criminals is intensifying. For this reason, it will set out its supervisory requirements for the IT security of the supervised companies more specifically in future.

**Dialogue on IT supervision**

BaFin hosted the information event entitled "IT supervision at banks" for the third time in 2015. The event, which attracted some 400 delegates, made another significant contribution to the dialogue with the banking and IT industry. Representatives from banks, industry associations, IT service providers, audit and consulting firms took advantage of the opportunity to get information from BaFin on, among other topics, the work results and priority areas of IT supervision.

### 4.2.2 Insurers

#### 4.2.2.1 Cyber risks in insurance undertakings

Cyber risk is becoming an increasingly urgent issue for insurers as well. The undertakings are developing and implementing appropriate measures. In addition, Solvency II, the new European insurance regulatory regime, and its implementation in the German Insurance Supervision Act *(Versicherungsaufsichtsgesetz)*, creates the legal basis for requiring them to guarantee the security of their systems

42 BaFin Circular 4/2015 BA 57-K 3142-2013/0017.

and data. BaFin monitors the undertakings' compliance with these requirements.

#### 4.2.2.2 Cyber policies

The insurance industry has reacted to the threats from cyberspace by launching specific cyber policies. This relatively new type of policy can be used to insure against IT and cyber risk exposures in private, commercial and industrial environments. Measured in terms of premium income and sums insured, its market volume is only small at present – although the trend is rising. Currently, the US market dominates the global volume of these types of products by far. From BaFin's point of view, the biggest challenge facing undertakings selling these insurance products is to set risk-adequate premiums. This is because the expected claims expenditures in the commercial and industrial area are not normally high-frequency claims. These products therefore have to be embedded in adequate control structures to prevent potentially incorrect assessments from escalating into a threat to the insurance undertakings concerned. A working group of the International Association of Insurance Supervisors (IAIS) is currently trying to get an initial global overview of the market for such insurance products. BaFin is also involved in this initiative.

# 5 Consumer protection

## 5.1 Opinion

### Elisabeth Roegele on the objectives and strategies of collective consumer protection

BaFin has an obligation to protect collective consumer interests (see info box "Collective consumer protection" on page 44). It fulfils this obligation alongside its other legal responsibilities in banking, insurance and securities supervision. Consumer protection is of the same importance as the supervision of companies and markets.

**Elisabeth Roegele**

has been Chief Executive Director of Securities Supervision/Asset Management at BaFin since May 2015.

#### Consumer protection and notion of the consumer

BaFin intends to meet the objective of consumer protection by ensuring an adequate degree of protection collectively for all consumers.

Consumer protection is intended to strengthen consumers' ability to act under their own responsibility. Consumers should not be told what to do, but given support. BaFin can intervene where they are unable to protect themselves or where there are considerable general doubts about collective consumer protection.

The diversity of issues around consumer protection covers the full extent of the financial and capital markets, including their products and services. They include, for example, payment transactions, lending, savings schemes, structured deposits, insurance and

### Collective consumer protection

An important aspect of BaFin's work is collective consumer protection, i.e. the protection of consumers as an overall group. This legal mandate differs from the approach of individual consumer protection, which considers individual consumers and their particular circumstances. Individual consumers who feel their rights have been infringed and who want to enforce their individual claims can approach ombudsmen, dispute resolution entities or the regular courts.

Individual cases can, however, provide information about more wide-ranging violations of consumer protection law which BaFin then pursues, for example if a consumer complains to BaFin about a company. It therefore examines each individual case for specific indications of flaws in a company's organisation that may impact on collective consumer interests. If that is the case, BaFin is called on to investigate further and intervene if violations of consumer protection law are found in order to safeguard the interests of all consumers.

The way companies comply with civil-law protections and court rulings is another example of the collective dimension of consumer protection, such as the kind of protection assigned to BaFin.[43] Here, too, BaFin has to identify whether it is an isolated case or a structural flaw. BaFin assesses whether, in their activities, companies generally observe highest-instance case law on civil-law standards serving consumer protection.

financial instruments. Generally, the selling activities of the companies operating in this product landscape are an important topic of consumer protection.

BaFin bases its work on a differentiated notion of the consumer. Primarily, consumers should be given the opportunity to take their own informed and risk-aware decisions in favour of or against products and services on the financial and capital markets. In this context, a sensible balance between protection on the one hand and consumer responsibility on the other must be maintained. BaFin wants to support consumers according to their needs in order to enable them to take decisions under their own responsibility on the basis of the information and knowledge required for this purpose – even though the service or product provider is usually ahead in terms of knowledge.

If this balance is at risk and it is consequently more difficult for consumers to take decisions under their own responsibility, BaFin has supervisory instruments to maintain or restore that balance.

## Supervisory instruments

Consumer protection supervision ties in with conduct regulation and is aimed at identifying and eliminating violations of consumer protection law. Conduct regulation comprises all the rules the supervised companies have to comply with when they provide services to customers. This area of supervision is just as important as prudential supervision. It will continue to gain importance as a result of European provisions that are about to be adopted – for example the guidelines of the European Supervisory Authorities on complaints handling and processing and future developments brought about by the Markets in Financial Instruments Directive II (MiFID II)[44] and the Markets in Financial Instruments Regulation (MiFIR).[45]

Supervision of compliance with rules of conduct has to be approached with moderation in order to safeguard consumer interests. For example, investor protection must not lead to a scenario where consumers cannot get any or only limited

43 See 5.2.

44 Directive 2014/65/EU, OJ EU L 173/349.

45 Regulation (EU) No 600/2014, OJ EU L 173/84.

services, because companies discontinue their offerings as a way of dealing with regulation. As far as possible, protection should not be forced on consumers against their will. Consumer protection must not be turned into its opposite.

Consumers will only be able to take their own decisions if transparency prevails and products and services are easy to understand. Transparency is above all enhanced through rules on customer information. Examples include the new key information document for investment products, which provides assistance to consumers for packaged retail and insurance-based investment products in accordance with the Regulation on Key Information Documents for Packaged Retail and Insurance-Based Investment Products (PRIIPs Regulation).[46] For investments in securities, for example, transparent cost structures provide key input to the decision process.

Transparency is the first step towards investor information and therefore forms part of sales supervision. Where transparency is not enough and the balance needs to be restored to ensure consumers can take their own decisions, the supervisory instruments available to BaFin even include the right of intervention. BaFin can restrict or altogether prohibit the sale of products or certain sales practices.[47]

### Consumer information

As a prerequisite for allowing consumers to determine their own actions, they have to know about financial and capital market products and the services provided by companies.

In many cases, consumers face fundamental decisions requiring a choice between an insurance, savings or investment product. In this situation, an overview of the product range on the financial and capital markets is often more helpful than large amounts of detail. For example, BaFin informs consumers on its website, in the BaFinJournal[48], in the Annual Report, in brochures, at trade fairs and at events about product categories and the risks associated with them to give them some guidance for selecting a product or service. BaFin continues to enhance its existing range of offerings. To produce consumer information that is appropriate for its users, BaFin needs to know about the problems consumers have.

### Customer complaints

By analysing customer complaints, BaFin gets an idea of the problems faced by consumers. Consumers complain to BaFin about banks, insurers, investment services enterprises and product issuers.

Although BaFin cannot protect individual consumers (see info box "Collective consumer protection" on page 44), an individual's submission may be relevant for a large number of consumers. This is why the insights BaFin gains from customer complaints are so important. They are the starting point for identifying violations of consumer protection law. For example, complaints paint a picture of how insurers handle claims or what fees are charged by banks – issues that are directly relevant to consumers. If there are frequent complaints about certain matters, this could be an indication of a major issue.

### Consumer trend analyses

Events on the financial and capital markets influence consumer behaviour and vice versa. To be able to assess these reciprocal effects and their potential impact on consumers, BaFin identifies and analyses trends relevant to consumers, using internal and external information and data. Consumer trend analyses may also be based on queries to companies in order to investigate certain products or their sales. The results of such analyses may trigger specific probes to expand the information on certain issues. The insights gained in this way help to identify and assess existing or emerging risks and to counter violations of consumer protection law.

46 Regulation (EU) No. 1286/2014, OJ EU L 352/1.

47 See 5.2.

48 Only available in German.

### International perspective

Consumer protection is not a purely national, but also a European and global concern for BaFin. BaFin uses its involvement in various international committees, working groups and forums to enhance consumer protection standards also across national borders. Where cross-border financial services are concerned, BaFin aims to ensure consistent levels of protection for all consumers.

### Integrated supervision as starting point

Within BaFin, consumer protection is a supervisory objective that spans all directorates. The competences in banking, insurance and securities supervision must be networked horizontally so that findings and measures can be coordinated efficiently and effectively.

In this context, BaFin can make use of its advantage of being organised as an integrated supervisor. There has to be an exchange of findings made in prudential supervision and conduct supervision and the right balance has to be found. For example, a company with structural deficiencies in the treatment of consumers should also be monitored for any organisational deficiencies. This kind of exchange of prudential and conduct-supervisory aspects is most likely to be successful in an integrated structure, where both areas of supervision, and thus both perspectives, are represented.

BaFin has also responded to the growing importance of collective consumer protection by implementing organisational changes. As from the end of 2015/beginning of 2016, it has created a new consumer protection department, which is part of the Securities Supervision Directorate. The fact that this unit has operations at both of BaFin's locations, Bonn and Frankfurt, is a reflection of its responsibility profile, which spans all directorates. As a central unit, the consumer protection department is responsible for tasks associated with collective consumer protection – from consumer information and consumer trend analysis through complaints handling down to conduct supervision and product intervention.

Thus, BaFin's organisational setup is now also well prepared for the task of collective consumer protection.[49]

49 For details on BaFin's reorganisation, see chapter VI 2.

## 5.2 Retail Investor Protection Act

BaFin has always been committed to collective consumer protection, whose significance has continued to increase in recent years.[50] Collective consumer protection means that BaFin has an obligation to ensure the protection of consumers as an overall group, i.e. it works exclusively in the public interest. This means BaFin cannot intervene to enforce the rights of individual consumers – no matter whether they relate to civil or public law (see info box "Collective consumer protection" on page 44).

Through the Retail Investor Protection Act *(Kleinanlegerschutzgesetz)*, German legislators have anchored collective consumer protection as a supervisory objective of BaFin in the German Act Establishing the Federal Financial Supervisory Authority (*Finanz-dienstleistungsaufsichtsgesetz* – FinDAG).[51] In addition, section 4 (1a) sentence 2 of the FinDAG contains a new basis of authorisation, which gives BaFin the right to enforce the measures required for consumer protection vis-à-vis the supervised companies in all supervisory areas. This means BaFin can issue any orders that are

50 For information on BaFin's objectives and strategies in collective consumer protection, see 5.1.

51 Section 4 (1a) of the FinDAG.

suitable and necessary to prevent or eliminate irregularities relating to consumer protection, if general clarification seems appropriate in the interest of consumer protection. By the same token, this enables BaFin to take civil-law protections, court judgments or rulings of the highest court into account in its supervisory activities to an even greater extent.

It is most commonly general terms and conditions, the failure to implement rulings of the highest court or general business practices that adversely affect collective consumer interests. Many aspects play a role in this regard, such as the transparency of a financial product, how it is sold, the general terms and conditions, contracts and how consultations are documented.

Furthermore, section 4 (1a) sentence 3 of the FinDAG stipulates for all areas how "violation of law" is to be defined for the purpose of consumer protection. The provision therefore determines consistently for all supervisory areas involved, i.e. the areas of banking, insurance and securities supervision, when BaFin can take action. According to this provision, a violation of law exists if a significant, permanent or repeated infringement of a consumer protection law has been identified whose nature or extent can threaten or adversely affect the interests of not only individual consumers. In order to detect violations of law with regard to collective consumer protection, BaFin will be able to access not only its own sources of information from operational supervision and from complaints received, but also inputs provided by the newly created financial watchdog.[52]

52 See 5.5.

## 5.3 Focus

### Product intervention: paradigm shift in securities supervision

Authors: Dr Thorsten Becker, Christian Bock and Dr Chan-Jae Yoo, Consumer Protection Department

The provisions of the German Securities Trading Act *(Wertpapierhandelsgesetz)* have always been based on the principle of protecting the interests of customers. A large number of supervisory law regulations in the area of securities trading, for example, are intended to create transparency and ensure that price-relevant information is dealt with in the same way. Key aspects here include, for instance, the prohibition on insider trading and ad-hoc disclosures. The regulations have in common that they are centred around the customer or investor. More recently, this principle has been condensed into a legislative commitment to investor protection that goes beyond the mere protection of interests in terms of both content and methodology.

The product intervention powers provide a particularly clear example of how this paradigm shift has manifested itself.

#### Legislative background

Product intervention powers have been integrated through the German Retail Investor Protection Act *(Kleinanlegerschutzgesetz)*[53] by inserting the new provision, section 4b, into the Securities Trading Act. In this way, legislators have not only responded to domestic incidents in the area of capital investments, but also adopted European legislation early: through the

53 German Retail Investor Protection Act *(Kleinanlegerschutzgesetz)* of 3 July 2015, Federal Law Gazette 2015 I no. 28, page 1114 ff.

### Changes resulting from MiFIR

Although the contents of the provisions will largely remain the same when the Markets in Financial Instruments Regulation (MiFIR) enters into force[54], replacing section 4b of the Securities Trading Act, some changes may possibly arise from the transition to European procedural law: when MiFIR enters into force, the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA), which will be responsible for structured deposits, will acquire their own powers of intervention.[55] They will be able to use these powers, if the national authorities fail to take product intervention measures or ESMA or the EBA think the measures taken are inadequate. ESMA and the EBA will also get a control function: national authorities will have to notify both the competent authorities of other affected member states and ESMA or the EBA in advance of any proposed interventions. Whichever of the two European authorities is responsible will determine whether the national intervention is justified and proportionate, and issue an opinion. Although the national authorities are not obliged to follow this opinion, they have to publish a notice explaining their reasons for not doing so (comply-or-explain principle). In addition, delegated acts of the European Commission to clarify aspects of MiFIR may result in changes to the scope of the product intervention powers. The Commission will have to specify the criteria and factors to be taken into account in determining whether the conditions necessary to intervene are present, i.e. whether there is considerable doubt about investor protection or there are other threats. The first drafts of this standard were expected in spring 2016.[57] It is to come into effect together with MiFIR.

European Markets in Financial Instruments Regulation (MiFIR)[56], consistent product intervention powers are to be introduced for all EU member states. The European Regulation will apply directly. The provisions of 4b of the Securities Trading Act are based on the wording of the European legislation and serve to bridge the time period until the European law takes effect (see info box "Changes resulting from MiFIR").

## New tools in the aftermath of the crisis

In processing the experience gained during the crisis, legislators have already taken action in a number of cases in recent years, introducing several tools to improve investor protection. Examples that stand out include the obligation to keep records of investment advice meetings (investment advice minutes), the obligation to provide certain information documents (product information sheets) and far-reaching requirements on the staff deployed in providing investment advice (employee and complaints register). Not only has the supervision of investment advice intensified since these provisions entered into force, the form it takes has also changed. These changes were necessary, given that the financial crisis had shown how susceptible to fluctuations in confidence and at the same time prone to errors this particular type of investment service is. Moreover, given the risks, the fact that retail customers frequently use investment advice services also justifies the increased level of regulation in this area.

## Protection does not end here

Yet investors may suffer losses, even if the investment advice process was followed correctly. Also, especially complex products, particularly aggressive advertising or a product range that is difficult to oversee raise concerns about investor protection. These kinds of constellations, which may be found outside of regulated investment advice, therefore led to

54 The effective date had not been determined at the time of going to press.

55 The European Insurance and Occupational Pensions Authority (EIOPA) will be given similar powers for insurance-based investment products on the basis of the PRIIPs Regulation.

56 Regulation (EU) No 600/2014, OJ EU L 173/84.

57 They were not available at the time of going to press.

questions as to what other models legislators would provide in order to further increase investor protection.

### New tool: product intervention

By inserting section 4b into the amended version of the Securities Trading Act through the Retail Investor Protection Act, legislators have handed product intervention to BaFin as a new tool. This makes it possible for BaFin to intervene in order to counter the damaging impact of a financial product or particular financial conduct. The new provisions are critically different in one respect: unlike the previous investor protection regime, BaFin can use the new powers irrespective of the type of intermediation. Instead, the decisive criterion is the loss potential. The explanatory memorandum for the Retail Investor Protection Act specifically mentions BaFin's powers to restrict or prohibit the marketing or distribution of certain products, especially if they are complex, in order to protect investors from aggressive advertising and the sale of products that are difficult to oversee.[58]

### Product and conduct intervention

The new powers provide for different ways in which intervention may play out. For example, BaFin can intervene in the marketing, distribution or selling of a specific financial instrument or structured deposit (product intervention in the narrower sense). It can, however, also intervene in certain types of financial activities or financial practice. This relates not necessarily to a specific product, but for example to aggressive advertising for a product, i.e. conduct (conduct intervention). In both scenarios, it is possible for BaFin to impose restrictions and prohibitions even before marketing, distribution or selling activities commence. In principle, this means that BaFin can intervene anywhere along the value chain, a fact that underscores the preventive nature of the new provisions.

### Requirements

The Act describes four scenarios that may justify intervention by BaFin:

- The product or conduct gives rise to significant investor protection concerns.
- The product or conduct poses a threat to the orderly functioning and integrity of financial markets or commodity markets.
- The product or conduct poses a risk to the stability of the whole or part of the financial system in at least one EU member state.
- A derivative has a detrimental effect on the price formation in the underlying markets.

These scenarios show that a broad scope has been defined. The provisions are not focused on any particular addressee either. A product intervention measure may target not only individuals and supervised investment services enterprises, but also independent financial intermediaries or direct sales of financial instruments and structured deposits by issuers, for example. It is up to BaFin to decide in each individual case whether to limit the measures to individual participants or – by way of a general administrative act – issue them for an unspecified group of addressees.

### Challenges

The provisions leave room for interpretation in order to cover as many different constellations that could potentially harm investors as possible. Although this initial situation seems to make things easy for BaFin, there is also potential for conflict when the provisions are applied to specific situations. Because of the large number of indefinite legal terms they contain, a challenge faced by BaFin is to apply the provisions with legal certainty. The intended direction is of critical importance here: when assessing individual cases, BaFin has to take guidance especially from the purpose and objective of the provisions. BaFin also considers the provisions to be an authorisation to take preventive action. Indications in favour are not only the possibility to intervene during the early stages of a product cycle, but above all also the wording, which suggests particularly clearly its nature of a threat-prevention standard.

58 Recommendation for a decision and report of the Finance Committee of the Bundestag on the draft Retail Investor Protection Act, Bundestag printed paper 18/4708, page 1.

To be able to exercise its product intervention mandate without having to rely on discoveries by chance, it is also key for BaFin to perform market observation in as much detail as possible. In order to adequately fulfil its prevention mandate, BaFin not only has to obtain timely knowledge of the issues, but also conduct comprehensive, risk-based investigations.

### Outlook

By introducing product intervention powers, German legislators have closed a loophole in the law relevant to investor protection. This decision has been given special importance because legislators have thus strengthened the significance of collective consumer protection by making it an explicit part of supervisory activity in the German Act Establishing the Federal Financial Supervisory Authority *(Finanzdienstleistungsaufsichtsgesetz)*.[59] The entry into force of the product intervention powers follows the definition of collective consumer protection as a new supervisory objective. BaFin now has to flesh out these new powers so that the provisions can be used for their intended purpose.

At the same time, it has to be borne in mind that, as described earlier, the German legislators have anticipated the EU's provisions to be set out in MiFIR. It is expected that, at the latest when the planned European product intervention regulations become effective, the European Supervisory Authorities will come forward with clarifications or implementing acts. It can be anticipated as well that the European Commission will also respond to fundamental questions or define the criteria for interpretative purposes, for example (see info box "Changes resulting from MiFIR" on page 48). The scene is therefore set for further changes. Since the German product intervention law is based on the model set out in MiFIR, the two legal texts are expected to share a lot of common ground in terms of content. The current provisions in the Securities Trading Act should therefore at least also be seen as a precursor of the future European intervention regime.

59 Section 4 (1) of the Act Establishing the Federal Financial Supervisory Authority *(Finanzdienstleistungsaufsichtsgesetz)*.

## 5.4 Consumer Advisory Council

In its commitment to financial consumer protection, BaFin pursues the objective to further intensify the exchange of information with the participants involved. The non-public meetings of the Consumer Advisory Council *(Verbraucherbeirat)* are an efficient forum for such exchanges; two such meetings were held in 2015. BaFin's Consumer Advisory Council was established in 2013. Section 8a of the FinDAG provides the statutory basis for the Council. The Advisory Council advises BaFin on its collective consumer protection responsibilities by analysing consumer trends and reporting on these activities to BaFin's Executive Board. The Consumer Advisory Council can submit fundamental opinions on the procedures by which BaFin issues regulations and administrative provisions, where these are relevant to consumer protection. The Council can also advise BaFin on the opinions the latter submits during the legislative procedure.

The 12 members of the Council are appointed by the Federal Ministry of Finance. Council members are drawn from the fields of academia, consumer or investor protection organisations, out-of-court dispute resolution entities, trade unions, as well as the Federal Ministry of Justice and Consumer Protection. The Council is chaired by Dorothea Mohn of the Federation of German Consumer Organisations (*Verbraucherzentrale Bundesverband e.V.* – vzbv).

**Financial markets watchdog**

Although the financial markets watchdog is centrally coordinated by the vzbv, it makes its findings on the basis of the information passed on by the 16 regional consumer advice centres (*Verbraucherzentrale* – VZ). Five specialised consumer advice centres are responsible for observation, statistical analysis and for conducting in-depth investigations of sub-markets: VZ Baden-Württemberg for investments/retirement provisions, VZ Bremen for real estate financing, VZ Hamburg for insurance, VZ Hessen for the unregulated capital market and VZ Sachsen for banking services and consumer loans.

## 5.5 Financial markets watchdog

The financial watchdog, also known as financial markets watchdog, started its activities in spring 2015. It is centrally coordinated by the Federation of German Consumer Organisations (*Verbraucherzentrale Bundesverband e.V.* – vzbv).

The financial markets watchdog is responsible for observing and analysing the financial markets from the consumers' perspective (see info box) so it can help to detect possible undesirable developments on the market at an early stage. Although the financial markets watchdog does not have any sovereign powers, it can publish its findings and also submit them to BaFin, which will study them, in particular to ascertain whether there has been a violation of law. BaFin has agreed to cooperate with the vzbv and the financial markets watchdog in a coordinated manner so that the watchdog's findings can be analysed with maximum efficiency.

The financial markets watchdog is supported by a 23-member advisory panel, to which BaFin belongs as an observer.

## 5.6 Deposit Guarantee

### 5.6.1 Focus

#### New Deposit Guarantee Act now in force

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The German Deposit Guarantee Act *(Einlagensicherungsgesetz)* entered into force on 3 July 2015. Through this Act, the harmonised provisions of the new European Directive on Deposit Guarantee Schemes[60] have been transposed into German law. The Deposit Guarantee Act replaces the German Deposit Guarantee and Investor Compensation Act *(Einlagensicherungs- und Anlegerentschädigungsgesetz)*. Investor protection is now covered separately by the German Investor Compensation Act *(Anlegerentschädigungsgesetz)*, although the content has not changed.

60 See 2014 Annual Report, pages 19, 51 ff.

### Overview

The German deposit guarantee structure has largely been retained. It continues to consist of the two statutory compensation schemes, Compensation Scheme of German Banks (*Entschädigungseinrichtung deutscher Banken GmbH* – EdB) and Compensation Scheme of the Association of German Public Sector Banks (*Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH* – EdÖ) as well as the schemes safeguarding the viability of institutions 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). The voluntary Deposit Protection Funds (*Einlagensicherungsfonds* – ESF) of the private and public-sector banks will also continue to exist. Now, however, they have to indicate expressly the extent of their protection and make depositors aware that they do not grant depositors any legal right to compensation. In accordance with the European provisions, the institutional protection schemes of the DSGV and BVR are no longer partially exempt from the regulatory regime of the Deposit Guarantee Act, but have to guarantee the compensation claims in the same way as the other deposit guarantee schemes and build up the corresponding funds to this end in accordance with the provisions of the Deposit Guarantee Act. In addition, all deposit guarantee schemes will have to have set aside funds equivalent to at least 0.8% of the covered deposits in 2024.

### Legal entitlement

The Deposit Guarantee Act gives each depositor a legal entitlement to compensation of up to €100,000 for their covered deposits. For the first six months after deposited amounts have been credited, the compensation entitlement may even increase to up to €500,000. The condition is that the deposit was related to certain life events, such as the sale of privately owned property, marriage or redundancy pay.[61]

Deposits denominated in foreign currency are also covered, although the compensation is paid in euros. In addition, starting on 1 June 2016, the Act reduces the period within which the compensation has to be paid out to the depositors from 20 to seven days from the date on which the compensation event was determined. The affected depositors will generally not have to apply for the compensation any more: the deposit guarantee scheme will contact them of its own accord. Only investors wishing to claim more than €100,000 will have to convince the deposit guarantee scheme separately and in writing, providing evidence of the facts that justify their claim.

To ensure that the depositors know about their entitlement to compensation and know who their contact is in the event of a claim, the deposit-taking credit institutions will in future have to inform their customers in writing of their rights, using a template specified by law. They have to do this when an account is opened and periodically once a year.

### Target funding levels of the deposit guarantee schemes

To this end, the deposit guarantee schemes have to set aside available funds equivalent to 0.8% of the covered deposits by 2024, collected through contributions from the institutions that belong to the respective scheme. The Deposit Guarantee Act specifies detailed rules for this process. It allows the institutions to make up a maximum of 30% of the contributions by way of irrevocable payment commitments.

However, according to the applicable guidelines of the European Banking Authority (EBA; see info box on "EBA guidelines on payment commitments" on page 53), the payment commitments may only be taken into consideration if they are fully collateralised and the collateral is at the disposal of the guarantee scheme and is unencumbered by any third-party rights. The collateral must consist of low-risk assets.

61 This list is not exhaustive.

### EBA guidelines on payment commitments

With its guidelines on payment commitments[62] under the European Directive on Deposit Guarantee Schemes, the European Banking Authority (EBA) has issued consistent Europe-wide rules on the conditions for payment commitments that the institutions can use instead of cash in order to make up the funds to be set aside. Institutions that make use of the option to provide 30% of their annual contributions to the deposit guarantee schemes in payment commitments have to enter into a payment commitment agreement with these schemes. For the payment commitments of a credit institution to be authorised, the securities accordingly have to be fully collateralised in favour of the respective deposit guarantee scheme, the collateral must consist of low-risk debt securities, be available to the deposit guarantee scheme at any time and must be unencumbered by third-party rights.

If a credit institution fails to meet its obligation to make the cash contributions when due, a so-called disposal or termination event occurs. The deposit guarantee scheme may then dispose of the debt securities. To ensure that the collateral generates adequate proceeds from disposal, haircuts have to be applied.

## Risk-weighted contributions

In accordance with the Deposit Guarantee Act, the compensation schemes levy annual contributions, one-time payments and, if necessary, special contributions and special payments on the institutions assigned to them in order to reach their target capital base and be able to fund compensation events. The contributions are levied on the basis of risk in accordance with the EBA's guidelines on methods for calculating contributions to deposit guarantee schemes (see info box on "EBA guidelines on calculating contributions" on page 54).

Details of how the contributions are calculated for the statutory compensation schemes are set out in the German Compensation Scheme Funding Regulation *(Entschädigungseinrichtungs-Finanzierungsverordnung)* of 5 January 2016.[63] For the officially recognised institutional protection schemes, they are laid down in their statutes. In this way, the compensation or support risk of each institution is to be measured and assigned to a particular contribution category. The higher the compensation risk, the higher the institution's individual contribution, which is primarily determined on the basis of the amount of covered deposits of the institution concerned. In addition, the ceilings for special contributions within one accounting year have been redefined. Special contributions are levied when the compensation scheme's available funds are not sufficient to fund a compensation event. Generally, a maximum of 0.5% of the covered deposits can be levied on the institutions annually as special contributions. In exceptional circumstances, a deposit guarantee scheme can, with BaFin's consent, also demand higher special contributions in order to safeguard the compensation scheme's ability to function.

## Cross-border compensation events

Depositor protection has also been improved for cross-border compensation events. Since the Deposit Guarantee Act entered into force, the process has been handled by the compensation scheme of the host country. This means that affected German customers will no longer themselves have to approach the guarantee scheme in the home country of the foreign institution. They can turn to the deposit guarantee scheme in Germany instead.

However, the compensation scheme of this institution's home country must provide to the scheme of the host country, i.e. Germany, the financial resources it needs for the compensation before any payout. To facilitate

62 EBA/GL/2015/09.

63 Federal Law Gazette I, page 9. See 5.6.2.

### EBA guidelines on calculating contributions

The EBA has developed guidelines on methods for calculating contributions to deposit guarantee schemes (EBA/GL/2015/10) on the basis of the Directive on Deposit Guarantee Schemes. Among other things, the guidelines specify a calculation formula, although the formula can be expanded. The guidelines also stipulate that 75% of the total aggregate weight is based on mandatory categories with predefined indicators, while 25% can be allocated according to – in some cases flexible – criteria in order to meet specific national requirements.

Through its guidelines, the EBA aims to establish a system in which a higher contribution is paid by deposit-taking credit institutions whose business model entails an increased risk of a compensation event occurring or would result in an especially high charge for the deposit guarantee schemes in such a case.

effective cooperation among the deposit guarantee schemes in the European Economic Area, the German deposit guarantee schemes have to enter into cooperation agreements with the schemes of other European countries. The EBA published guidelines on this in February 2016.[64] BaFin has appointed the Compensation Scheme of German Banks as the competent domestic deposit guarantee scheme that would have to conduct the compensation process of a foreign EEA branch operating in Germany.

## Act makes stress tests compulsory

Another requirement laid down by the Deposit Guarantee Act for the first time is the performance of stress tests to test the resilience and viability of the deposit guarantee schemes. Deposit guarantee schemes have to subject their systems to a stress test at least every three years. The first test must be conducted by no later than 3 July 2017. The results of the national stress tests must be received by the EBA by no later than 3 July 2019. To this end, the EBA is currently working on guidelines, which are expected to be adopted and published by May 2016.[65] Based on the results of the national stress tests, the EBA will conduct peer reviews by no later than 3 July 2020.

## Institutional protection

In 2015, BaFin recognised the guarantee scheme of the Savings Banks Finance Group *(Sparkassen-Finanzgruppe)* and the guarantee scheme of the National Association of German Cooperative Banks, *BVR Institutssicherung GmbH*, as deposit guarantee schemes. Institutional protection schemes are associations of several credit institutions that have entered into a mutual liability agreement. Their main function is to avert or remedy imminent or existing economic difficulties at the member credit institutions in order to prevent insolvencies. In this way, customer funds are already protected indirectly. In addition, in the event that support for an institution fails, the guarantee schemes of the BVR and the DSGV now also have to guarantee individual depositors the same entitlement to compensation as the statutory compensation scheme. The provisions of the Deposit Guarantee Act now also apply to the organisation, funding and allocation of resources of these officially recognised institutional protection schemes.

In principle, the protection schemes of the DSGV and the BVR may continue to take measures to avert threats to the continued existence of member institutions, especially to ensure their liquidity and solvency. However, a time limit and some restrictions have been imposed on their scope to take actions. If a resolution measure under the German Recovery and Resolution Act *(Sanierungs- und Abwicklungsgesetz)* has already been implemented, there can be no support by the protection scheme.

64 See 5.6.3.

65 See 5.6.3.

### More supervisory powers for BaFin

All new legal requirements are subject to oversight by BaFin. For example, BaFin now also monitors whether the deposit guarantee schemes reach the required target capital base. And since the protection schemes of the DSGV and the BVR were officially recognised, BaFin now also has full oversight responsibility over these schemes.

### Summary

The Deposit Guarantee Act improves investor protection and strengthens the role of banking supervision. The obligation to set aside a target funding level will improve the financial resources of guarantee schemes, and their resilience will be tested regularly. The fact that the entitlement to compensation in a general amount of €100,000 is now anchored in law also strengthens the position of depositors. Moreover, the deposit guarantee schemes now have to meet additional information requirements, and this will also benefit the depositors.

## 5.6.2 German Financing Regulation for EdB and EdÖ

On the basis of the German Deposit Guarantee Act *(Einlagensicherungsgesetz)*, the Federal Ministry of Finance on 5 January 2016 issued the German Regulation on the Financing of the Compensation Scheme of German Banks and the Compensation Scheme of the Association of German Public Sector Banks *(Verordnung über die Finanzierung der Entschädigungseinrichtung deutscher Banken GmbH (EdB) und der Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH (EdÖ))*. The Regulation replaces the previously separate contribution calculation regulations for the Compensation Scheme of German Banks and the Compensation Scheme of the Association of German Public Sector Banks. It thus implements the EBA's European guidelines on payment commitments[66] and on methods for calculating contributions to deposit guarantee schemes[67] for the statutory compensation schemes.

In detail, it regulates the financing of the compensation schemes and sets out further provisions for contribution assessment methods, the calculation and levying of contributions and payment commitments. Payment commitments are permitted to supplement cash contributions to a limited extent. They may only be taken into account if they are fully collateralised and the collateral is available to the guarantee scheme. The collateral must consist of low-risk debt securities and must be unencumbered by third-party rights.

In accordance with the provisions of the Deposit Guarantee Act, the compensation schemes levy annual contributions, one-time payments, special contributions and special payments on the institutions assigned to them. The annual contributions must be paid until a target capital base of 0.8% of the covered deposits of the CRR[68] credit institutions[69] assigned to a compensation scheme has been reached. The contributions are expected to reach the target capital base by 3 July 2024. The annual contributions are assessed in accordance with section 19 of the Deposit Guarantee Act and the methods specified in the EBA guidelines.[70] A risk-based determination of the contributions

66 EBA/GL/2015/09.

67 EBA/GL/2015/10.

68 Capital Requirements Regulation (CRR).

69 Credit institutions that also fall under the narrower definitions of credit institution under EU law in accordance with Article 4(1) no. 1 of the CRR are referred to as CRR credit institutions in the German Banking Act. See also chapter III 3.1.

70 EBA/GL/2015/10.

is made for all CRR credit institutions, using a standard calculation formula. Adjusted calculation factors for determining the aggregate risk weighting for the Compensation Scheme of German Banks and the Compensation Scheme of the Association of German Public Sector Banks take account of the different composition and risk structure of the individual groups of institutions.

The compensation schemes are now allowed to accept up to one third of the target capital base by way of payment commitments. Payment commitments are a novel financial instrument entered into on the basis of a public-law contract; they replace contribution notices. The CRR credit institutions must secure the obligations with financial collateral.

### 5.6.3 EBA guidelines

The new European Deposit Guarantee Schemes Directive[71] entered into force on 2 July 2014. It stipulates that the European Banking Authority (EBA) will develop guidelines for cross-border cooperation among the deposit guarantee schemes in the EU and for stress tests on these schemes.

#### Cooperation agreements

In February 2016, the EBA published guidelines[72] on cross-border cooperation between deposit guarantee schemes in the European Union. The guidelines set out the rules for cooperation between deposit guarantee schemes. They require the deposit guarantee scheme of the home member state to provide the necessary information and funds to the deposit guarantee scheme of the host member state; the payout is then made by the deposit guarantee scheme of the host state. To facilitate and regulate cooperation between them, deposit guarantee schemes in the European Union have to enter into written cooperation agreements and then inform the EBA about them. Previously, payouts of compensation claims were made directly by the deposit guarantee schemes of the home member state. The cooperation agreements specify not only how cross-border compensation events are to be handled, but also regulate the transfer of funds if a credit institution switches to another deposit guarantee scheme as well as the lending arrangements under deposit guarantee schemes permitted in some EU member states. This type of lending is not permitted in Germany.

#### Stress tests

The Directive on Deposit Guarantee Schemes also stipulates that stress tests must be performed every three years to test the resilience of the deposit guarantee schemes.

To this end, the EBA has drafted guidelines for stress testing deposit guarantee schemes, which it is expected to publish by the end of May. They contain different scenarios with which the resilience of the deposit guarantee schemes in the EU can be tested. They include, among other things, compensation scenarios, resolution scenarios, tests of financial capacity and default prevention scenarios.

The EBA will use the results of the first national stress tests stipulated by EU law to conduct quinquennial peer reviews, starting no later than 3 July 2020. The results of the stress tests to be performed at the national level must be received by the EBA by no later than 3 July.

### 5.6.4 Conclusion of the Phoenix proceedings

In 2015, a final conclusion was reached in the compensation proceedings in the Phoenix Kapitaldienst GmbH case. BaFin had determined the existence of a compensation event on 15 March 2005. As a consequence, the Compensatory Fund of Securities Trading Companies (*Entschädigungseinrichtung der Wertpapierhandelsunternehmen* – EdW), which had only been established in 1998 and had only low fund levels available at the time, faced claims by Phoenix investors eventually totalling around €260 million. To ensure that the member institutions of the EdW were able to fund this compensation event, the legal provisions underlying the calculation of the contributions

71 Directive 2014/49/EU, OJ EU L 173/149.

72 EBA/GL/2016/02.

had to be extensively revised. Since the first task in 2005 was to bridge the funding gap, EdW raised two loans from the Federal Republic of Germany. These loans were repaid from 2010 onwards by levying special payments on the assigned institutions.

The processing of the compensation payments was largely completed by 2012. In total, around 71,000 individual decisions had to be taken for creditors from 40 countries. Once satisfied, the individual claims for which compensation was paid passed to EdW by law. Accordingly, in June 2015, the insolvency administrator paid out €103.4 million to EdW. This corresponds to a repayment rate of 36.3% of the claims transferred, plus the costs incurred by EdW. As a result of these payouts, it will be possible to repay the federal loans within the next two years at the latest.

## 5.7 Mortgage credit agreements

The European Mortgage Credit Directive (MCD) of 4 February 2014[73] is intended to ensure the best possible protection when consumers take out a mortgage. To this end, the Directive contains a number of obligations that apply to mortgage credits granted to consumers who wish to acquire or maintain a residential property. For this purpose, the MCD harmonises, for example, requirements on

- advertising,
- (pre)contractual information,
- creditworthiness assessment,
- the right of withdrawal or the reflection period,
- credits denominated in foreign currencies,
- mortgage advice and intermediation,
- rules regarding expertise and remuneration at lenders,
- intermediaries and employees.

The MCD also harmonises the supervisory requirements. This also includes cooperation of the competent authorities.

German legislators transposed the MCD into national law on 11 March 2016.[74] To this end, they revised a large number of provisions that had previously applied to consumer loans and consumer mortgage credits. The process affected primarily the German Civil Code *(Bürgerliches Gesetzbuch)* and the Introductory Act to the Civil Code *(Einführungsgesetz zum BGB)*. However, further amendments can also be found in the Industrial Code *(Gewerbeordnung)*, the Regulation on Price Indications *(Preisangabenverordnung)*, the Banking Act (*Kreditwesengesetz* – KWG), the Remuneration Regulation for Institutions *(Institutsvergütungsverordnung)*, the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG) as well as the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG).

In accordance with section 491 (1) of the Civil Code, the term "consumer credit agreement" will in future be the collective term for all types of consumer loans. It covers both general consumer credit agreements, which fall under the Consumer Credit Directive, and consumer credit agreements relating to residential immovable property, to which the MCD applies.

The amendments to the KWG and the VAG are of particular supervisory relevance, especially those in the newly inserted section 18a of the KWG and those in section 15a of the VAG, which in turn refers to section 18a of the KWG.

A total of 11 subsections of section 18a of the KWG contain banking supervisory requirements that have to be met when granting a consumer loan for immovable property. For example, section 18a of the KWG now specifically stipulates that no loan agreement may be entered into, if assessing the customer's creditworthiness reveals that they are not creditworthy. The supervisory amendments to the KWG are in part identical to the amendments to the Civil Code, for example in relation to the assessment of the customer's creditworthiness.

73 Directive 2014/17/EU, OJ EU L 60/34.

74 Federal Law Gazette I no. 12, page 396.

In addition, in the implementation of the MCD, legislators for the first time set out specifically – in section 18a (6) of the KWG – that the staff involved in granting consumer loans for immovable property must have adequate knowledge and competence in relation to designing and offering consumer loans for immovable property and for acting as intermediaries and entering into such loan agreements. Moreover, the new section 18a (7) of the KWG lays down in law that both internal and external appraisers conducting property valuations during the loan underwriting process are professionally competent and sufficiently independent from the loan underwriting process so that they can provide an impartial and objective valuation.

Amendments to the Remuneration Regulation for Institutions and the Insurance Supervision Act are additionally intended to ensure that there are no financial incentives to act against the interests of consumers during the lending process. For example, the remuneration of the employees and insurance intermediaries must not be contingent on sales targets or on the number or proportion of applications accepted. Further amendments to the German Industrial Code impose additional requirements also on credit intermediaries.

## 5.8 Consumer complaints and enquiries

### 5.8.1 Credit institutions and financial services providers

In 2015, BaFin processed a total of 5,890 submissions relating to credit and financial services institutions (previous year: 7,144), of which 5,636 were complaints and 254 general enquiries. The figure includes 49 cases where BaFin issued statements to the Petitions Committee of the Bundestag (the lower house of the German parliament). In addition, BaFin received 63 information requests about former banks, and especially their legal successors. The complaints were upheld in 845 cases, including one petition.

The complaints submitted in 2015 again concerned virtually the full range of products and services offered by the supervised institutions. But BaFin was also approached about various problems relating to account management, the execution of credit transfers, or queries about the processing of deceaseds' estates. The complaints repeatedly related to the termination of long-term savings accounts or real estate financing. However, most of the submissions received by BaFin concerned issues that drew a lot of attention in the public and in the media, such as the termination of *Bauspar* contracts and the question of when loan handling charges are not permitted.

**Table 1** Complaints by group of institutions

| Group of institutions | Total number of submissions |
|---|---|
| Private commercial banks | 3,389 |
| Savings banks | 709 |
| Public-sector banks | 136 |
| Cooperative banks | 604 |
| Mortgage banks | 14 |
| *Bausparkassen* | 371 |
| Financial services providers (e.g. leasing and factoring companies, etc.) | 405 |
| Foreign banks | 262 |

#### Loan handling charges

In 2015, a large number of complaints again related to handling charges levied by credit and financial services institutions on consumer credit agreements. In 2014, the German Federal Court of Justice *(Bundesgerichtshof)* had declared that handling charges cannot be levied on loans.[75] At the same time, the judges had ruled that all customers could claim back loan handling charges they had wrongly been required to pay in the past ten years.[76]

75 Judgements dated 13 May 2014, case ref.: XI ZR 405/12 and XI ZR 170/13.

76 Judgements dated 28 October 2015, case ref.: XI ZR 348/13 and XI ZR 17/14.

In almost all cases, consumers complained in their submissions that the institutions had failed to process their claims for repayment in a timely or appropriate manner.

The significant number of demands for repayment at the end of 2014 posed a major challenge for all institutions. BaFin found that the institutions handled them very differently. A number of institutions sent out interim notifications shortly after receiving the refund claims and also did not invoke the statute of limitations, even if the claims had already become time-barred. By contrast, other institutions took several months before issuing an initial response. The processing times until the claims were actually paid out also varied widely. Some customers received the refunds of the charges within a few weeks, while many others had to wait several months.

Given the large number of repayment demands, longer processing times and even processing backlogs were to be expected. Nevertheless, BaFin would in several cases have welcomed a more customer-friendly approach in the interest of consumers, given that the refund claims became time-barred at the end of 2014. BaFin believes that, if the institutions had sent out confirmations of receipt and further information on how the claims were progressing, they could have avoided unnecessary queries or complaints as well as dissatisfaction on the part of many customers.

However, consumer complaints were not limited to problems with refunds of handling charges they had wrongly been required to pay. Many bank customers also asked BaFin to investigate whether they could also claim refunds of the handling charges levied on their commercial or development loans. In the decisions of 13 May 2014 referred to above, the BGH had ruled only that pre-formulated clauses relating to handling charges in consumer loan agreements were not permissible.

However, as described above, BaFin cannot act in the interest of individual customers by examining their contract documents. It only acts in the public interest and is not authorised to give legal advice. As far as is known, there are other cases pending before the BGH in connection with loan handling charges. It remains to be seen what the outcome will be. Affected customers should follow reports published in the media or seek advice from a lawyer or a consumer organisation.

### Termination of *Bauspar* contracts

Because of the continuing phase of low interest rates on the capital market, there was again an increased incidence of *Bausparkassen* terminating older *Bauspar* contracts in 2015. This mostly affected those contracts where the agreed savings target had already been reached or even exceeded, i.e. over-saved *Bauspar* contracts, as well as contracts that had been eligible for allocation for more than ten years.

A number of consumers objected to these terminations in their submissions to BaFin, asking the supervisory authority to force the *Bausparkassen* to withdraw the terminations.

However, both arbitration proposals made by the ombudspersons of the building societies and various court judgments confirmed that the institutions had acted within their rights when they terminated the over-saved *Bauspar* contracts. The reason most commonly cited in these cases is the purpose of *Bauspar* plans, which is for the saver to obtain the right to a *Bauspar* loan at a favourable interest rate by accumulating a minimum savings amount. If, however, the *Bauspar* contract has a credit balance equal to or in excess of the savings target, the customer is no longer entitled to having a *Bauspar* loan disbursed. However, this also means that the original purpose of the *Bauspar* contract cannot be achieved.

When terminating *Bauspar* contracts that have been eligible for allocation for more than ten years, *Bausparkassen* refer to the termination rights for loan agreements under the BGB, which they believe are also applicable to *Bauspar* contracts. They regard *Bauspar* contracts as mutual loan agreements within the meaning of section 488 of the BGB, under

which the *Bauspar* customer is the lender and the *Bausparkasse* the borrower during the savings phase. *Bausparkassen* claim the right to ordinary termination in accordance with section 489 (1) no. 2 of the BGB, which allows the *Bausparkasse* as borrower to terminate the loan "in any case at the end of ten years after complete receipt". *Bausparkassen* consider the dispatch of the allocation notice as confirmation of complete receipt of the loan from the *Bauspar* customer.

There is controversy in both the literature and court rulings about whether *Bausparkassen* may terminate *Bauspar* contracts by invoking the right to ordinary termination in accordance with section 489 (1) no. 2 of the BGB. Although a number of lower-court judgments have so far been made on this controversial issue, they have not yet resulted in a consistent assessment of the legal situation.

#### Selected cases

A bank financed the property of one of its customers. Although he sold the property during the term of the loan, the loan was initially continued. Both sides had agreed that, instead of the property, a pledged account balance in the appropriate amount would now be available to the bank as security. However, when the customer wanted to terminate the loan agreement before maturity, the bank demanded the payment of an early repayment penalty.

In accordance with section 490 (2) of the BGB, a bank has the right to levy an early repayment penalty, if the customer terminates a fixed-rate, fixed-term loan secured by a mortgage before maturity. But since in this case the bank had substituted the security, the loan was not secured by a mortgage. This meant that the loan could be repaid in accordance with section 489 (1) no. 2 of the BGB without compensation to the bank. In a similar case, the Higher Regional Court in Stuttgart *(Oberlandesgericht Stuttgart)*[77] had confirmed this.

77 9 U 21/07 dated 25 July 2007.

Following BaFin's intervention, the bank refrained from levying an early repayment penalty.

#### Notification by way of direct debit

Another case involved a complaint from a customer who used online banking. He had instructed two electronic bank transfers. But the bank had changed the online banking software, which resulted in several bank transfer instructions being lost and not being executed before the account entries were made. This also affected the two bank transfer instructions of this particular customer. Although the credit institution noticed that the instructions had not been carried out, it was unable to fully reconstruct them and wanted to inform the customers affected promptly.

It did so by initiating two direct debits for €0.01 each, using the transaction reference to notify the customer that his bank transfer instructions had not been executed. The bank reversed the debits on the customer's account on the same day. It had no legal basis for collecting the direct debits.

BaFin objected to the way in which the bank had chosen to transfer information by using the direct debit system without any direct debit authorisation. The credit institution promised in its response that in future it would no longer inform its customers in this way.

### 5.8.2 Investment and management companies

The investment business supervision section received a total of 107 enquiries and complaints from consumers in 2015.

They related to fund liquidations, among other issues. For example, there were doubts about the amount of liquidation proceeds, the calculation of payouts, the suspension of unit redemption, mergers or adherence to the defined investment strategy. There were also enquiries about possible deficits incurred by management or the portfolio manager, compliance with information requirements and

**Table 2** Submissions received by insurance class (since 2008)

| Year | Life | Motor | Health | Accident | Liability | Legal expenses | Building/ household | Other classes | Other com-plaints* |
|---|---|---|---|---|---|---|---|---|---|
| 2015 | 2,113 | 1,778 | 1,267 | 294 | 505 | 722 | 740 | 769 | 1,558 |
| 2014 | 2,802 | 1,822 | 1,545 | 379 | 622 | 675 | 890 | 780 | 1,624 |
| 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 |

* Wrong address, brokers, etc.

the accuracy of key investor information and other sales documents. Many consumers also approached BaFin with problems relating to the performance of investment funds, fund management costs, data protection and the termination of investments in closed-ended retail alternative investment funds (AIFs).

BaFin followed up on the information in each individual case. It requested further explanations from the complainants where necessary and asked the supervised companies to comment. However, this rarely resulted in the need for BaFin to take further supervisory measures.

### 5.8.3 Insurance undertakings

#### 5.8.3.1 Complaint figures

In 2015, BaFin processed fewer submissions, finalising 9,746, compared with 11,139 submissions in the previous year. The submissions received comprised 7,843 complaints (see Table 3 "Main reasons for complaints in 2015"), 410 general enquiries not based on a complaint and 84 petitions, which BaFin received via the Bundestag or the Federal Ministry of Finance. In addition, BaFin received 1,409 submissions for which it was not the competent authority.

In relation to the total number of submissions, the complainants were successful in 26.6% of the proceedings (previous year: 28.1%), while 58.9% of the submissions proved unfounded and, in 14.5% of the cases, BaFin was not the competent authority. If only the proceedings for which BaFin is the competent authority are taken into account, the success ratio was 31.1%.

**Table 3** Main reasons for complaints in 2015

| Reason | Number |
|---|---|
| Claims handling/delays | 1,364 |
| Amount of insurance payment | 1,014 |
| Coverage issues | 972 |
| Termination | 747 |
| Advertising/advice/application processing | 499 |
| Contractual amendments/extensions | 467 |
| Tariff issues/no-claims classes | 439 |
| Premium payments, dunning | 387 |
| Changes and adjustments to premiums | 329 |
| Processing quality or duration of complaints processing | 317 |

#### 5.8.3.2 Selected cases

##### Cancellation of direct debit arrangements

A policyholder had taken out occupational disability insurance and agreed with the insurance undertaking that it would collect the premiums by direct debit.

After two debits had been returned unpaid, the direct debit arrangements were cancelled.

However, the insurer failed to inform the policyholder, who was in arrears with his premium payments as a result and failed to settle them despite several reminders. The insurance undertaking responded by terminating the policy, claiming that it had not been necessary to inform the policyholder that the direct debit arrangements had been cancelled. However, in another case, the Higher Regional Court in Oldenburg *(Oberlandesgericht Oldenburg)* had already ruled that the insurer must notify the policyholder specifically if the direct debit arrangements are cancelled.

BaFin confronted the insurance undertaking with this judgement. The insurer subsequently conceded and reinstated the policy with retroactive effect. It also promised that it would inform its policyholders in future in all relevant cases when direct debit arrangements are cancelled.

### Incorrect administrative costs quoted in product information sheet

In a product information sheet for a pension insurance contract, a life insurer had inadvertently underquoted the administrative costs. When it noticed the error, it subsequently sent a corrected information sheet to the policyholders affected, detailing the administrative costs calculated at a higher amount. In this letter, the undertaking also advised its customers about the option to cancel their insurance policies.

However, one policyholder believed that she only had to pay the administrative costs quoted in the product information sheet. The undertaking countered that the product information sheet had not been part of the contract terms and the insurer therefore had the right to demand the higher administrative costs. BaFin did not hold the same legal opinion, since the policy documents referred to the product information sheet in several instances. Following several exchanges of correspondence, the insurer confirmed to BaFin that it would continue all policies at the costs quoted in the product information sheet and inform its customers accordingly.

### Obligation to contract under the basic tariff

A statutory health insurance customer met the requirements allowing him to switch to the private health insurance system, and he entered into an insurance contract with a private provider. But the insurer soon contested the contract successfully, because the policyholder had violated pre-contractual disclosure requirements. However, the customer was not able to return to the statutory health insurance system, because his income exceeded the compulsory insurance threshold.

In order to regain private health insurance cover, the complainant therefore turned to another private insurer, but this undertaking held the view that the customer did not fulfil the requirements for admission, even under the basic tariff. It argued that, since the first insurance contract entered into in the private health insurance system had been contested, he had to be considered a member of the statutory health insurance undertaking that had last insured him and he would be required to get cover there.

In BaFin's view, however, the second insurer had an obligation to enter into a contract under the basic tariff in this case. BaFin pointed this out to the insurance undertaking, which eventually conceded and insured the customer under the basic tariff.

### Reimbursement of medical costs incurred abroad

Another complainant was planning to undergo medical treatment abroad, in Switzerland. His German insurer responded by informing him that for planned medical treatment to be carried out abroad that did not add medical value, benefits could only be paid up to the cost level normally covered in Germany. But the person concerned was not happy with that.

The applicable terms and conditions of tariffs granted insurance cover throughout Europe; however, in relation to treatment elected to be performed abroad that does not add medical value, the undertaking invoked the policyholder's duty to minimise losses. This

duty is based on the general legal principle of economic efficiency and, on the strength of section 194 (1) in conjunction with section 82 of the German Insurance Contract Act *(Versicherungsvertragsgesetz)*, applies specifically also to private health insurance. BaFin could therefore not make any legal objection to the insurer's willingness only to reimburse the costs that would have been incurred for similar treatment in Germany, with reference to the duty to minimise losses.

There had been similar complaints about this issue in the past and further confusion could therefore be expected. BaFin therefore advised the undertaking to expand the insurance terms and conditions of the tariff concerned by pointing out explicitly that the amount to be reimbursed could be reduced in the case of such treatments. The insurer implemented this suggestion.

#### Failure to announce premium increase

A policyholder complained to BaFin about a 25-percent increase in premiums for his residential building insurance. During the complaint proceedings it was noted that the insurance undertaking had informed the customer of the increase on the premium invoice but, in contravention of legal requirements, not of his special termination right in this case.

However, in accordance with section 40 (1) of the Insurance Contract Act, policyholders faced with a premium increase have the right, under certain circumstances, to terminate the contract within one month of receiving the insurer's notification – but not before the date on which the increase becomes effective.

The undertaking admitted its mistake to BaFin and undertook to write to the 5,100 policyholders affected to grant them the special termination right retrospectively.

### 5.8.4 Securities transactions

In 2015, BaFin received fewer complaints about securities transactions than in the previous year. A total of 581 complaints related to credit and financial services institutions (previous year: 628). In addition, there were 281 written enquiries by investors (previous year: 379).

Since 2014, there has been an increased number of complaints about financial services institutions domiciled in Cyprus offering cross-border services to customers in Germany. Most customers complained about the way orders had been executed, about losses, delayed payouts of funds belonging to customers after the contractual relationship had been terminated and about misleading customer information.

As a result of the Swiss National Bank's decision in January 2015 to abolish the minimum euro exchange rate, BaFin also received many complaints about CFD providers. Because of the collapse in the exchange rate, a number of retail customers faced high margin calls. In addition to handling the complaints in the usual way, BaFin also responded to them by arranging a meeting with representatives of CFD providers.

### 5.8.5 Consumer helpline

Citizens can call BaFin's consumer helpline at +49 (0) 228 299 70 299, a service they again used frequently in 2015: in November 2015, BaFin received the 200,000th call since the helpline was launched in 2006.

In 2015, advisers dealt with 22,586 queries on financial market topics (previous year: 22,539). Of these, 36% related to the insurance sector and 48% to the banking sector. 9% of calls concerned securities supervision.

The queries submitted by consumers varied widely. Most queries in the area of banking related to the decision by the German Federal Court of Justice *(Bundesgerichtshof)* on handling charges for consumer loans, the limitation period and ways of making claims against the respective credit institutions. The callers also asked for information about rules for the amount of account management fees and interest on overdrafts. Questions on securities

supervision focused primarily on the providers' obligation to give advice and the informational value of the securities prospectuses. As in the previous year, the insurance enquiries related in particular to the total sums paid out under life insurance policies, given the current interest rate policies of the central banks. But some callers also spoke about problems with tariff changes and premium adjustments at private health insurers.

In addition, many of the people calling the consumer helpline asked for information about the different options for submitting complaints to BaFin. The helpline staff told them which authority was competent to handle their queries and also informed them about the progress of ongoing complaint proceedings. Many enquiries also related to dispute resolution options.

## 5.9 Dispute resolution

### New rules on alternative dispute resolution to be extended to the financial sector

In December 2015, the federal government resolved new dispute resolution rules in order to implement the European Alternative Dispute Resolution Directive.[78] The new legal framework is intended to give all consumers the option to settle disputes with financial services providers out of court, in principle without incurring any costs. Consumers still have access to the courts and no consumer will be forced to accept the arbitration proposal. The law will largely retain the proven infrastructure of dispute resolution entities in Germany's financial sector (see info box "Meeting of ombudsmen").

Another important aspect of the regulations is that the dispute resolution entities provide information on their procedures on their websites. They also have to enable complaints to be submitted online. The providers of financial products are in turn obliged to make consumers aware that they can approach the competent dispute resolution entity in cases of dispute. They have to provide this information in their general terms and conditions, on their websites and in particular when they receive complaints.

78 Directive 2013/11/EU, OJ EU L 165/63.

**Meeting of ombudspersons**

On 17 September 2015, BaFin hosted another meeting of representatives of the financial sector's dispute resolution entities in Bonn. These annual meetings provide a forum for delegates to exchange information on similarities and differences in dispute resolution relating to financial issues in Germany. At the meeting of dispute resolution entities, held for the fourth time, the delegates discussed the government judiciary's views on out-of-court dispute settlement with, among others, Bettina Limperg, the President of the Federal Court of Justice. BaFin will invite the dispute resolution entities to another meeting in 2016. One of the topics to be discussed among the dispute resolution entities will be their initial experience with the new German Consumer Dispute Resolution Act *(Verbraucherstreitbeilegungsgesetz)*, which will have entered into force by then. Another topic will be the future internet platform for online dispute resolution on the basis of the Online Dispute Resolution Regulation[79], which is currently being tested by the European Commission.

## 5.10 International developments

### 5.10.1 Product design and sales

Based on the principles of the Joint Committee of the three European Supervisory Authorities (ESAs) on product oversight and governance (POG) dating from 2013[80], the three ESAs – the European Banking Authority (EBA), its insurance industry counterpart, the European Insurance and Occupational Pensions

79 Directive 2013/524/EU, OJ EU L 165/1.

80 Joint Committee, "Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes".

Authority (EIOPA), and the European Securities and Markets Authority (ESMA) – have developed guidelines.

### EBA

In July 2015, the EBA adopted Guidelines on Product Oversight and Governance Arrangements.[81]

The national competent authorities (NCAs) are required to implement the Guidelines by 3 January 2017. They specify requirements for both manufacturers and distributors of banking products, such as mortgages.

The NCAs have a choice as to the way in which they introduce the requirements for distributors: the NCAs must either require the manufacturers to enforce the requirements with the distributors, or the competent NCA for credit intermediaries supervises the distributors directly.

The POG guidelines apply to all products brought to the market after the implementation date of the guidelines as well as to existing products that are significantly changed after the implementation date.

The aim is to give better protection to customers by including their requirements in the product development process and ongoing product monitoring. The guidelines are intended to contribute, right at the start of product development, to avoiding inappropriate product designs and incentives to missell. Moreover, the guidelines are aimed at making supervisory practice of the member states more consistent.

### ESMA

When the Markets in Financial Instruments Directive (MiFID) was amended, the fundamental political decisions were codified in legal terms in the form of an EU Directive at Level I of the European legislative process (see Figure 2 "EU legislative process and ESAs" on page 67). The European Commission will have to expand on these decisions further at Level II on the basis of ESMA's preparations. BaFin is also represented on the highest decision-making body, the Board of Supervisors, and at the working level.

On 19 December 2014, ESMA published its technical advice for delegated acts of the European Commission. The Commission in turn uses this advice to develop its own standards – the delegated acts – similar to regulations under German law. The Commission is expected to present its draft in the second quarter of 2016. At this stage, the European Council and Parliament can still raise objections and thus try to get changes incorporated.

New rules on product design and sales are an important new aspect of the EU Commission's delegated acts on MiFID II. These rules set out the product development requirements in accordance with Article 16(3) and Article 24(1) and (2) of MiFID II. Product manufacturers and providers of financial services will in future have to establish a product development process and integrate it into their control processes and reporting lines. A check is required to determine for which group of investors a particular product is suitable and for which target market a product can be approved. In particular, the potential customers in this target market will have to be able to understand the risks and costs associated with a product. The development of a product will have to incorporate scenario analyses that test the products in different market scenarios in order to establish whether they are compatible with the interests of the potential investors. Products will also have to be monitored and tested after the sale. Suitable measures should be taken if any adverse effects on investors are identified.

The sales function will be fully included in the product development process and will have to set up its own development process, similar to the product manufacturer's. The product manufacturer will be obliged to supply suitable information to the sales function, which in turn has to make its own arrangements in this process to ensure that the information provided by the manufacturer can be used and understood.

81 EBA/GL/2015/18, Guidelines on Product Oversight and Governance Arrangements (POG).

EIOPA

From the end of October 2015 to the end of January 2016, EIOPA put POG guidelines up for consultation[82], which are to be adopted at the beginning of April 2016 and are expected to be published in summer 2016. The EIOPA POG guidelines are only a preparatory document and therefore also include content that is to be set out in POG regulatory standards as part of the implementation of the Insurance Distribution Directive (IDD).[83] They specify requirements for managing and monitoring product development, manufacture and distribution processes by an undertaking as well as for sales activities by a distributor with the aim of improving consumer protection. The preparatory EIOPA POG guidelines are intended to be used as non-binding guidance by undertakings, distributors and supervisors. In Germany, the POG provisions will only enter into legal force in the insurance sector when the IDD is implemented.

### 5.10.2 Product information

The 145-page consultation paper on the technical standards for the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs)[84] was published on 11 November 2015. The standards take into account the consultation results of the general discussion paper from November 2014 and another technical discussion paper from May 2015; they also incorporate the analysis of the qualitative consumer study. In addition to the proposed technical standards, the consultation paper also contained a number of unresolved questions, which clearly showed that further substantive work had to be done on the standards before the deadline for submission to the European Commission at the end of March 2016. In particular the technical requirements for the indicators, i.e. risk and total cost, and performance required clearer details as to how the requirements were to be met by undertakings and supervisors. BaFin was involved in drafting the regulatory technical standards. BaFin is particularly interested not only in ensuring that consumers are well informed, but also that all PRIIPs products are presented in a balanced way and that the requirements on manufacturers of PRIIPs key information documents (KIDs) are clearly worded and can be implemented in practice. The 2016 work programme of the Joint Committee of the European Supervisory Authorities also includes plans to develop PRIIPs guidelines, and BaFin will also be involved in this process.

# 6 International supervision

## 6.1 Powers of the ESAs

The three European Supervisory Authorities (ESAs) are part of the European System of Financial Supervision (ESFS, see info box on page 67); alongside the national competent authorities – and the Single Supervisory Mechanism (SSM) in banking supervision – they are responsible for supervising institutions and markets.

The ESAs primarily play a regulatory role: their purpose is to promote the harmonisation of financial supervision and a shared supervisory culture in Europe and in this process ensure that supervisory regulations are applied consistently throughout the European internal market. In order to achieve that, the EBA, EIOPA and ESMA can, within the limits they have been set by the European guidelines of the individual financial sectors, draft specific and binding regulatory and implementing technical standards. The European Commission subsequently enacts these standards as a regulation or decision so they can then be applied in the member states directly (see

82 Consultation Paper on the proposal for preparatory Guidelines on product oversight & governance arrangements by insurance undertakings and insurance distributors; available at https://eiopa.europa.eu.

83 See chapter IV 1.5.1.

84 Regulation (EU) No 1286/2014, OJ EU L 352/1.

### European System of Financial Supervision

The three European Supervisory Authorities (ESAs) became operational at the start of 2011: the London-based European Banking Authority (EBA), its insurance industry counterpart, the European Insurance and Occupational Pensions Authority (EIOPA), which is located in Frankfurt, and the European Securities and Markets Authority (ESMA) in Paris. The European Systemic Risk Board (ESRB) started work shortly before then, at the end of 2010. Together, the ESAs and the ESRB form the European System of Financial Supervision (ESFS). The ESFS aims to harmonise supervisory practice in Europe and strengthen the coordination between macroprudential analysis and microprudential supervision.

info box "EU legislative process and ESAs"). In addition, the ESAs can issue guidelines and recommendations that are not legally binding; in those cases, the national supervisors or the SSM have to provide reasons if they do not comply with them.

Moreover, under certain narrowly defined circumstances, the three authorities have direct powers of intervention, which they can use on the national supervisors or the SSM and the supervised institutions and market participants. These powers can be invoked, for example, if competent supervisory authorities fail to apply EU law or apply it incorrectly, when settling disputes between supervisory authorities or in crisis situations. However, direct intervention is only possible after following a strict escalation process.

Only ESMA has direct supervisory powers in addition to its regulatory responsibilities; these powers can be exercised over credit rating agencies (CRAs) and trade repositories (TRs). In addition, ESMA maintains a central repository in which it collates and publishes information on the past performance of credit rating agencies and on credit ratings.

At the European level, all fundamental decisions are taken by the respective Board of Supervisors (BoS) of the EBA, EIOPA or ESMA. Voting members of these Boards are the heads of the national competent authorities, and this ensures that the expertise of the national authorities is incorporated into the ESAs' decisions. Raimund Röseler, Chief Executive Director of Banking Supervision at BaFin, is a member of the EBA BoS. Dr Frank Grund, BaFin's Chief Executive Director of Insurance and Pension Funds Supervision, belongs to the EIOPA BoS and Elisabeth Roegele, Chief

**Figure 2** EU legislative process and ESAs

Executive Director of Securities Supervision/ Asset Management, represents BaFin on the ESMA BoS.

### Bundestag resolution on efficient enhancement of EU financial supervision

The ESA Regulations require the European Commission, every three years, to submit to the European Parliament and the Council a general report on the operations of the authorities and the procedures laid down in the Regulations. The Commission presented its first report in August 2014.[85] The report stated: "In the first three years since the start of their work, the ESAs have carried out remarkable ground work and begun to perform the roles assigned to them of improving supervisory convergence and coherence."

But it also highlighted shortcomings that need to be addressed. This is also the aim of a Bundestag resolution entitled "Efficient enhancements to the European System of Financial Supervision" of 18 February 2016. The Bundestag resolution calls for, among other things, greater consideration than in the past for the principle of proportionality by the European Supervisory Authorities. Smaller, lower-risk institutions, in particular cooperative banks and savings banks, for example, should not be overburdened by regulatory processes.

Likewise, BaFin President Felix Hufeld had stressed the importance of the principle of proportionality on previous occasions. For example, in his address at the BaFin Annual Press Conference in 2015, he said with reference to European banking supervision that close attention needed to be paid to the appropriateness of administrative requirements, especially in the case of the less significant institutions (LSIs). "The guiding principle that we feel bound by as BaFin is not maximalism but proportionality."

The Bundestag resolution also calls for the application of strict budgetary discipline in order to prevent the cost of supervision in Europe from spiralling out of control. Control over the ESAs as stipulated in EU legislation should be exercised rigorously by the bodies authorised to do so – especially the European Commission and the European Parliament.

## 6.2 Bilateral and multilateral cooperation

BaFin continued to extend its relationships with supervisory authorities outside the euro area in 2015.[86] For example, there were a number of cross-sectoral meetings and projects, including with supervisory authorities in Serbia, Albania, Azerbaijan, Vietnam, Egypt, South Korea, Ukraine and China. Exchange visits helped BaFin above all to intensify the cooperation with the Chinese supervisory authorities. The Bundesbank was also involved in or provided support for some of these initiatives.

BaFin, with support from the *Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH*, also hosted a study visit by the National Securities and Stock Market Commission of Ukraine (NSSMC). The one-week event, in which *Deutsche Börse* also took part, focused mainly on issues related to market abuse.

BaFin is a founding member of the European Supervisor Education Initiative (ESE Initiative). Under this banner, three cross-sectoral seminars were held in 2015 on the following topics: supervisory colleges (in cooperation with EIOPA), financial conglomerates (in cooperation with the Federal Ministry of Finance) and consumer protection. The seminars are organised by all member states to promote further training provided by supervisors for supervisors throughout Europe.

### Anti-money laundering

In 2015, BaFin organised various meetings with the supervisory authorities responsible for combatting money laundering in other countries,

85 See 2014 Annual Report, page 41 f.

86 In 2015, BaFin again negotiated with a number of supervisory authorities about entering into memoranda of understanding (MoUs). No new such memorandum had been signed by the end of the year. For details of the MoUs signed by the end of 2014, see the 2014 Annual Report, pages 42 and 272.

including Finland, Liechtenstein, Austria and Italy. For BaFin, cooperation with foreign supervisory authorities is a key component of an effective regime against money laundering in the financial sector. For this reason, BaFin also provided extensive support for an initiative of the Dutch Central Bank (*De Nederlandsche Bank* – DNB). This initiative is intended to improve cooperation among EU authorities responsible for combatting money laundering and the financing of terrorism at banks. BaFin also took part in a workshop on this issue, which was hosted in London by DNB jointly with the EBA.

# 7 Financial market integrity

## 7.1 Authorisation requirements

As part of its responsibilities, BaFin examines whether investment and retirement savings offerings require authorisation under the laws whose observance it is responsible for supervising. Due to the nature of transactions subject to authorisation, providers may only carry on such business if they have the necessary authorisation. If, however, companies undertake activities without authorisation, BaFin launches an investigation against them. It can in such cases enforce supervisory measures to ensure that the companies comply with the authorisation requirement and apply for the appropriate authorisation. In this process, BaFin cooperates closely with the criminal prosecution authorities, exchanging information with them, coordinating the approach and acting jointly with them.

Anyone intending to offer investments on the financial market is free to submit the plans for their business ventures to BaFin and seek its opinion on whether these activities potentially require authorisation. This gives the provider legal certainty as to whether the ventures are subject to authorisation under the Banking Act *(Kreditwesengesetz)*, the Insurance Supervision Act *(Versicherungsaufsichtsgesetz)*, the Payment Services Supervision Act *(Zahlungsdiensteaufsichtsgesetz)* or the Investment Code *(Kapitalanlagegesetzbuch)*.

In 2015, BaFin received 918 requests to examine whether an authorisation was required for business ventures (previous year: 988). By the end of the year, BaFin finished dealing with 1,092 such requests (previous year: 738).

### 7.1.1 Second Payment Services Directive

The revised Directive on Payment Services in the Internal Market[87] was published in the Official Journal of the European Union on 23 December 2015. The member states must transpose the new Directive into national law by 13 January 2018.[88] The old Directive[89] on Payment Services dating from 2007 will be repealed at that time.

The reformed Directive further develops the European internal market for electronic payments. Existing requirements will be adapted to, among other things, the technical developments of innovative online and mobile payment systems. At the same time, it will strengthen consumer protection by imposing information and liability requirements.

The new Payment Services Directive also contains rules for the authorisation requirement: a new list of payment services[90] has been included. Where there are specific exclusions[91], their scope is specified.

The digitalised payment business will no longer be classified as payment service, but it does not merely cease to exist. Depending on the nature of the services, they may instead meet the criteria of one of the other payment services.

87 Directive 2015/2366/EU, OJ EU L 337/35.

88 Articles 114 and 115.

89 Directive 2007/64/EC, OJ EC L 319/1.

90 Annex I with Article 3 (4).

91 Article 3.

The payment authentication business will be expanded as a category of payment service. The new Directive will now also recognise service providers that provide payment initiation or account information services.

These activities, which are in all cases based on online banking solutions provided by the credit institutions, are now recognised as payment services. These service providers use the Internet to transfer data records between customers and credit institutions without themselves entering into possession of client funds at any time.

For example, customers can initiate a credit transfer at a payment initiation service when shopping in a merchant's online shop. Account information services give customers online access to processed information about their account balances at different credit institutions.

Where the new Directive provides details of the scope of specific exclusions, they relate to, among other things, the requirements for payment instruments with limited application as well as to the arrangements for certain payment transactions by providers of electronic communication networks or services that do not exceed defined thresholds.

## 7.2 Exemption from the authorisation requirement

Companies in the financial sector have the option to apply for exemption from the authorisation requirement and other supervisory requirements. However, a prerequisite is that the activity concerned does not require supervision because of its nature. As a rule, exemption is possible if the activity is carried out in association with or as a "by-product" of a principal activity that is not subject to authorisation, and it is only a low-level auxiliary or ancillary transaction compared to this principal activity. BaFin exempted a total of 13 companies from supervision for the first time in 2015 (previous year: nine). At the end of the year, a total of 349 institutions were exempt from the authorisation requirement, as the nature of their business means that they do not require supervision.

In principle, the exemption option is also available for foreign providers that want to start operations on the German market from abroad. However, a mandatory condition of exemption in Germany is that the providers are subject to equivalent supervision in their respective home country. In 2015, BaFin granted exemption to nine foreign companies (previous year: four).

## 7.3 Illegal investment schemes

The fight against illegal investment schemes is essential for safeguarding the integrity of Germany as a financial centre. It is at the same time an integral part of investor protection. Illegal investment schemes comprise banking, financial services, investment and insurance businesses, as well as payment services operated by providers that do not have the required authorisation. The players involved in illegal investment schemes are therefore by their nature not subject to any government regulation. It can therefore not be assured that they meet the personal, professional or financial requirements for operating such businesses. Legislators have given BaFin extensive powers of investigation and intervention that compare favourably by international standards. It is therefore able to uncover and combat unauthorised business activities. Where the facts justify such an assumption or it has already been established that business subject to authorisation is carried on or provided without authorisation, BaFin can demand information and documents on all business matters. Its powers include the ability to have the business premises of suspect companies searched by its investigators and to have relevant documents confiscated. If a suspicion is confirmed, BaFin can order the provider to stop its illegal activities immediately and to unwind the unauthorised transactions. In addition, it can issue instructions, impose coercive fines and, if necessary, even appoint a suitable liquidator.

In 2015, BaFin initiated a total of 750 new investigations (previous year: 696) and

concluded 669 other proceedings (previous year: 625). During its investigations, BaFin issued formal requests for information and the submission of documents to companies or individuals in 58 cases (previous year: 68). It imposed coercive fines in 23 cases (previous year: 29).

As part of its investigations into unauthorised business operations, BaFin's investigators carried out nine searches of premises and on-site inspections (previous year: seven).

In total, BaFin issued prohibition orders in 12 cases in the year under review (previous year: 18). It had to issue formal liquidation orders in 32 cases (previous year: 34) because the parties concerned refused to discontinue their activities subject to authorisation. A liquidator had to be appointed in eight cases (previous year: 17).

A total of 52 companies and individuals against whom BaFin had taken formal measures in 2015 filed objections (previous year: 59). BaFin completed 44 objection proceedings (previous year: 52), 27 of them on the basis of objection notices (previous year: 31). A number of affected parties appealed to the administrative courts to contest the supervisory actions.

The judges across all levels ruled in a total of 25 cases (previous year: 36), handing down 22 judgements or orders in favour of BaFin (previous year: 30). In two cases the courts ruled in favour of the affected parties (previous year: six).

# 8 Financial accounting and reporting

On 18 December 2015, the Basel Committee on Banking Supervision (BCBS) published the final version of the "Guidance on Credit Risk and Accounting for Expected Credit Losses". It is a revised version of the paper entitled "Sound Credit Risk Assessment and Valuation of Loans" dating from 2006, also referred to as SCRAVL guidance. The new guidance is intended to help banks implement IFRS 9[92] to a high standard of quality. The International Accounting Standards Board (IASB) published this standard in July 2014.

The revised standard replaces IAS 39[93] and also sets out new requirements for the classification and measurement of financial assets. The most salient new feature of IFRS 9 is the transition from an incurred-loss to an expected-loss model. Under the previous incurred-loss model, losses were only reported once they had actually been incurred; the new model of risk provisioning also takes expected credit losses into account in the calculation of the provision for credit risk. Since the SCRAVL guidance was based on the incurred-loss model, the transition to an expected-loss model (ECL model) meant that the document had to be revised. The new standard is expected to enter into force on 1 January 2018. The European Commission's endorsement process for implementing the standard in European law has been initiated.

## FASB model

The US Financial Accounting Standards Board (FASB) anticipates presenting the final version of its CECL-based model (current expected credit loss model) for recognising allowances during the first half of 2016. Based on the drafts prepared by the FASB to date, the possibility of full convergence of the two models can already be ruled out. While the FASB's impairment model considers only the lifetime expected loss without exception, the IASB has opted for a three-stage approach.

92 The abbreviation IFRS stands for International Financial Reporting Standard.

93 The abbreviation IAS stands for International Accounting Standard.

By default, all financial instruments are assigned to stage 1 following initial recognition. The 12-month expected credit losses are determined for these instruments. If there is a significant increase in credit risk, an allowance equivalent to the lifetime expected credit loss is recognised at stage 2 over the lifetime of the financial instruments on the basis of the portfolio value. If a credit event has occurred where the debtors can no longer meet the claims against them or there is objective evidence of impairment (incurred loss), the affected financial instruments are allocated to stage 3. Here, the allowance also takes the lifetime expected credit loss into account, but, unlike stage 2, this is based on the individual instrument.

The BIS's guidance consists of a main section, which applies irrespective of the accounting system being used, and an IFRS-specific appendix. The main section is structured around 11 principles, which provide basic guidance on how expected loss models are to be applied. This includes in particular a call to take adequate account of forward-looking information and macro-economic factors as well as to document the processes to determine the expected losses in an appropriate manner.

### Requirements of the BIS guidance

The appendix to the guidance sets out specific requirements relating to the implementation of the expected credit loss model of IFRS 9. For BaFin, the fact that IFRS 9 allows numerous discretionary options is significant. In particular, there are many subjective elements for the transition from stage 1 to stage 2. In addition, the new standards make a number of simplifying assumptions for users. For example, IFRS 9 permits, among other things, using only information that is available "without undue cost and effort"[94] in the calculation of the provision for credit risk. In addition, for instruments with a low risk of default at the reporting date – an external investment-grade rating is given as an example – it is not necessary to assess the increase in the risk of default. The purpose of the BIS's guidance is to ensure a high level of quality when interpreting the scope for discretion and the simplifying assumptions of the standards. Given that, due to the nature of their business, banks with global operations in particular are able to meet the requirements and provide the requisite information without undue cost and effort, the guidance limits the application of certain simplification options in the banking sector compared with IFRS 9.

Even if the guidance sets forth extensive requirements, it emphasises that it does not intend to create new accounting standards or to contradict the requirements of IFRS 9. It also states that all requirements are subject to the principle of proportionality, meaning that not all institutions are expected to implement it to the same level of quality. The contents have been agreed with the standard setters, the IASB and the FASB.

94 See IFRS 9; 5.5.17.

# 9 Risk modelling

## 9.1 Focus

### Internal models in banking supervision

Author: Ottmar Bongers, BaFin Division for Internal Models Credit Institutions: CCP, Counterparty Risk, Economic Capital

Opinions of the role of internal models at banks have changed since the Basel Framework was enhanced in response to the 2007/2008 financial crisis. As a result of Basel 2.5, their significance in calculating capital requirements was strengthened further in order to close regulatory gaps. After that, the debate about reforms of the regulatory framework was guided by objectives such as simplicity and comparability. Internal models were increasingly regarded as a source of unnecessary complexity and blamed for the fact the same risks lead to different capital requirements from bank to bank.[95] The Task Force on Simplicity and Comparability of the Basel Committee on Banking Supervision (BCBC) was tasked with bringing clarity.

When the public debate of internal models had calmed downed in the course of 2015 and no publications were forthcoming at first, there came a point when questions about what would happen next to internal models were raised more loudly.

This article reports on the latest developments. It also ventures a look ahead to 2016, which promises to be a critical year for many of these developments.

#### Models in the Basel framework

In November 2015, the Basel Committee published a report on progress with reforms of the supervisory framework in the aftermath of the financial crisis.[96] Key aspects are:

- development of new, more risk-based standardised approaches for credit, market and operational risk and the minimum capital requirements based on them,
- a more standardised framework for market risk (fundamental review of the trading book),
- calibration of the leverage ratio,
- disclosure requirements to improve comparability of banks,
- continued analysis of the drivers of excessive variability of risk-weighted assets (RWA),
- restrictions on the use of internal models to calculate capital requirements.

Many of the activities, some of which are at an advanced stage already, are aimed at reducing unwarranted variability in RWA and thus improve the comparability of banks. The BCBS has set itself the target of completing these reforms by the end of 2016. But some variables still need to be defined to this end:

- Should restrictions be imposed on the input parameters and/or outputs of internal models?
- What is the level of restrictions on input parameters for internal models?
- To what amounts and at what aggregation levels will model-based results be limited in relation to the standardised approach?
- What are the concrete features and level of the leverage ratio?
- For which risks/portfolios will the use of internal models be prohibited altogether?

A tight schedule will be needed for consultations, impact analyses and for

95 The phenomenon is referred to as "excessive variability in capital requirements".

96 The report is available at http://www.bis.org.

incorporating the results produced into the proposals, if the reforms are to be finalised by the end of 2016. Although BaFin representatives are involved at every level of this process, it is difficult to make an interim assessment, because any reading of the results depends to a large extent on the answers to the above questions.

### No sacrificing of objectives

The fact is that internal models fulfilling the (current) regulatory requirements help to meet key objectives of the Basel framework:

- calculation of capital requirements in relation to the risks incurred,
- strengthening of a bank's risk management function by making appropriate use of risk-sensitive control variables,
- management responsibility for
  - regular risk analysis,
  - comprehensive validation of the models and of the quality of the underlying data, processes and risk reports,
  - enhancement of the models and thus
  - ensuring that the models deliver the output expected of them,
- pressure on the quality of data, processes, internal models and risk reports as a result of using them in the banks' internal management (use test).

These objectives still continue to apply. When spelling out details of the reforms, the supervisors will therefore have to make sure that the objectives are not sacrificed in favour of achieving supposed simplification or comparability. That would be too high a price to pay. Especially during the final phase of the reforms in 2016, BaFin's representatives will therefore continue to work in the Basel committees and working groups for a revised framework that both meets the above objectives and leads to a reduction in excessive variability in capital requirements, thus helping to improve comparability between banks.

The reformed framework will restrict the use of internal models in those areas where a bank has neither sufficient historical data nor quantifiable in-house expertise as a basis for modelling. This is expected to affect those models that have been difficult or impossible to validate in the past. If the exclusion criteria are applied correctly, the reforms could contribute to increasing the acceptance of the internal models that will continue to be approved by supervisors.

### Focus on model validation

For models to gain acceptance, the quality of comprehensive model validation in banks is of key importance. Validation is not limited to merely examining the risk measurement methods used. In addition to other aspects, it also includes a critical assessment of data and process quality, the model assumptions and parameters and the ability to use the model output in the context of risk management. The validation also provides answers to questions about whether the models fulfil their purpose, what risks they fail to cover and what enhancement measures the institutions need to take as a result.

Floors on input parameters should only be used to limit excessively optimistic estimates and ensure that the risk sensitivity of adequately estimated parameters is not negatively impacted. The floors imposed on model-based outputs by standardised procedures must not lead to a situation where banks with complex risk profiles are tempted into using unsuitable standardised approaches. This could undermine fundamental original objectives of the Basel framework. For the same reasons, the leverage ratio should also retain its function as a backstop to avoid extremes. It can supplement, but not replace, risk-sensitive control variables.

Many banks will not need to use internal models as they will continue to determine their capital requirements on the basis of standardised approaches. It is therefore encouraging that these approaches are being enhanced as well, are more closely based on risk and are becoming more meaningful as a result. In this process, it is important to bear in mind that standardised approaches, too, are models that are specified by the supervisory authority. If

they are too crudely or wrongly calibrated, they will not have the right risk-sensitive effect. This may lead to inappropriate incentives or have an adverse effect on inter-institutional comparability. For this reason, regulators must meet their responsibility to validate and enhance standardised approaches on a regular basis.

### Benchmark comparisons among banks

The Basel Committee and the European Banking Authority (EBA) have conducted benchmark comparisons of RWA calculations for a number of years. The comparisons of market and credit risk in low-default portfolios have corroborated the above calls for better comparability, while at the same time creating a significant incentive to reform the framework. In 2015, two Basel working groups (the Supervision and Implementation Group Trading Book – SIG TB, and the Supervision and Implementation Group Banking Book – SIG BB) continued their work, conducting benchmark comparisons of counterparty risk[97] and credit risk in higher-default (retail, SME[98]) portfolios.

Unlike the benchmark comparisons of low-default portfolios, this process did not compare the RWA results for large exposures that are included in the portfolios of several banks and thus allow comparison. Instead, the benchmark comparisons for retail and SME loans aim to compare estimates of the probability of default (PD), loss given default (LGD) and exposure at default (EAD) against the realised values observable in prior time periods (backtesting). If backtesting confirms good forecasting quality for two banks even though their RWAs differ, it can be assumed that this is due to different portfolio risks and therefore intentional.

The SIG BB study[99], which was published on 1 April 2016, confirms a close correlation between estimated and realised probabilities of default for the participating banks during the period of observation, i.e. good backtesting results. The assessment of the forecast quality for LGD and EAD, by contrast, produced a more modest result, because not all time series observed are long enough to contain complete credit cycles. It is therefore not yet possible to draw general conclusions.

### Pillar I and II models

Unlike Pillar I of the Basel Framework, there are only few detailed specifications for Pillar II, and for good reason. The requirements there are formulated as principles. The banks are responsible for identifying their risks, measuring them with suitable methods and for managing them through effective processes. During the supervisory review and evaluation process (SREP), the supervisory authority assesses these bank-internal approaches, in particular the capital requirements determined by a bank using the internal capital adequacy assessment process (ICAAP).[100] In order to harmonise the supervisory approach in Europe, the EBA published guidelines in this regard[101] at the end of 2014; these guidelines have been applicable since 1 January 2016. In this area, too, the methods for calculating economic capital, which often use model-based methods, are a particular focal point for the supervisory authority in addition to assessments of the business model, governance, control processes and liquidity management. Comparisons between Pillar I and Pillar II results, at least at the level of individual risk types, the benchmarking of stress test results or the juxtaposition of figures for comparable banks can help supervisors in this evaluation and in determining total capital requirements.

Quantitative benchmark comparisons are also gaining in importance for Pillar II models. Here, supervisors can compare the methods, assumptions, outputs and model validation for determining the economic capital of different banks, perform their own comparative calculations or compare the risk indicators determined by a bank using different methods. It is not enough to merely point to

97 Available at https://www.bis.org.

98 Small and medium-sized enterprises.

99 Available at https://www.bis.org.

100 See chapter III 1.1.2.

101 EBA/GL/2014/13 of 19 December 2014.

the differences in methods between Pillar I and Pillar II or between regulatory and bank-internal stress tests. Comparative analysis of regulatory and economic capital for individual risk types and the parallel assessment of stress test results performed by a bank during ICAAP and by the supervisory authority during SREP can be very demanding. By the same token, it can produce valuable insights for determining capital requirements. Especially given the trend towards greater standardisation of Pillar I, the significance of Pillar II models is set to increase.

### Model supervision in the SSM

The way internal models are used has changed since the Single Supervisory Mechanism (SSM) was launched in November 2014. But model supervision practice has also changed since then. Since the launch of the SSM, the model experts of the ECB and the national supervisory authorities have made much progress with the harmonisation of model supervision:

- A standardised process for approving internal models and adjustments to these models has been implemented.
- Similar to other audits and reviews, model reviews at significant institutions are planned and conducted as part of SSM-wide processes, increasingly with mixed teams of auditors from different countries.
- Ongoing supervision of internal models now follows standard procedures.
- A large number of joint working groups have helped to further intensify cooperation among the model experts of the ECB and the national supervisory authorities.

This cooperation has resulted in the targeted review of internal models (TRIM) project, which was approved by the Supervisory Board of the SSM on 16 December 2015. The objectives of this project, which has initially been planned for a three-year period, include:

- harmonising supervisory practice relating to selected aspects where the national supervisory authorities had previously held different interpretations of supervisory law or made different use of national options,
- reducing excessive non-risk-based RWA variability,
- continuing to expand powerful SSM model supervision,
- ensuring that supervisory approval of internal models remains recognised as a seal of quality for high standards under the SSM regime.

### Summary

The above outline gives an idea of how internal model practice is set to develop. However, it will only be possible to assess its future role once the regulatory and supervisory activities planned for 2016 have been completed.

# 9.2 Focus

## Internal models in insurance supervision

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The insurance industry and supervisors had put in more than ten years of preparation, when Solvency II was finally implemented on 1 January 2016. A key element of the new European solvency regime is that insurers now have to calculate their solvency capital requirement (SCR) on the basis of risk.[102] To do so, they can use a standard formula[103] or a (partial[104]) internal model, for which they require prior approval from the supervisory authority.[105]

Internal models offer companies the opportunity to model their individual risk profiles in a more appropriate manner than the standard formula and in accordance with the internal perspective on the risks and how they are managed. What is more, insurers can use risk measurement, a key element of the undertaking's own risk management process, to calculate the SCR.

### Pre-application phase

Expecting that Solvency II would already be implemented in 2012, BaFin, together with interested insurance groups, started preparations for the review and approval of model applications in 2008. The idea was that BaFin would start early to acquire as much knowledge as possible of the respective internal models in order to be able to assess whether the insurers would meet the Solvency II requirements for internal models. The undertakings, too, were to benefit from these preparations: they were to be given – albeit informal – feedback on their internal models and thus on the progress with implementing the requirements.

The implementation of Solvency II was subsequently delayed twice in order to make fundamental additions to the framework – especially in relation to the treatment of business models with long-term guarantees. The undertakings responded by adjusting their internal models on several occasions to reflect the changed requirements.

In 2015 all was finally set: from the beginning of April onwards, BaFin accepted and approved several applications for the use of internal models. Since the beginning of 2016, five reinsurers, 16 property insurers, four health insurers and seven life insurers have been authorised to use internal models to calculate the SCR under BaFin's supervision. In addition, five German insurance groups use internal models to calculate group solvency. BaFin will make decisions on further applications in 2016.[106]

### Key issues

The following three issues dominated the constructive dialogue between undertakings and BaFin during the preparations as well as in the actual application phase:

102 See e.g. chapter IV 1.1.1.

103 On application, the supervisory authority can also authorise the use of undertaking-specific parameters.

104 "Partial" means that some risk premiums continue to be calculated using the standard formula or an insurance group's internal model does not model the risks of all its entities.

105 For details on internal models, see also chapter IV 1.3.6.

106 For details on the application process, see chapter IV 1.3.6.

### Stochastic cash flow projection models

During the preparation phase, BaFin dealt extensively with models known as stochastic cash flow projection models, which are used by life and health insurers to calculate the technical provisions under Solvency II, which are in turn used as the basis for determining the SCR. Since individual components of these very complex models, such as assumptions about future policyholder behaviour, are of major significance for the level of the SCR, BaFin has decided to consider the risk-relevant components of a stochastic cash flow projection model part of the internal model. The national European supervisory authorities are still discussing how these models should be treated from a supervisory perspective, but they all recognise their key significance for the SCR.

Whatever the outcome, BaFin will in future also examine the stochastic cash flow projection models of undertakings that use the standard formula.

### Risks from government bonds

Another point for discussion: in accordance with section 116 (1) of the German Insurance Supervision Act *(Versicherungsaufsichtsgesetz)*, internal models must cover all material risks. In BaFin's view, this also includes the spread and default risks of government bonds, because these types of exposures normally represent a significant proportion of the respective investment portfolios and therefore have to receive special risk management attention. Spread risk in this regard refers to changes in own funds due to potential changes in spreads of individual government bond yields as compared with the corresponding risk-free interest rate. Under certain conditions, the standard formula assumes an expansion of spreads of zero basis points for these types of exposures.

BaFin's position is in agreement with the "Opinion on the preparation for Internal Model applications" published by the European Insurance and Occupational Pensions Authority (EIOPA) in April 2015. All German insurance undertakings whose model approval comprises spread and credit risk modelling, must ensure that risks arising from government bonds are backed by capital.

### Model validation

Model validation was another frequently discussed issue. The management board is responsible for ensuring that the individual components of internal models as well as the model as a whole are adequately validated, safeguarding the quality of the underlying data and processes. It does so by implementing a suitable validation process. The legal requirements for model validation are laid down in section 120 of the Insurance Supervision Act in conjunction with Articles 241 and 242 of Solvency II Delegated Regulation 2015/35.[107] Through an effective validation process, the undertaking makes the strengths and weaknesses of a model transparent both to its own decision makers and to BaFin, thus supplementing the use test required under section 115 of the Insurance Supervision Act. The validation process – in combination with an appropriate reporting system – is the starting point for enhancing an internal model and may in certain circumstances trigger future model changes, which will be subject to approval.

The validation process is an elementary part of any review of an application for model approval. BaFin noted significant improvements in the course of the pre-application phase. At the start of the pre-application phase, the validation activities of the individual insurers were not very well developed, but over the years the undertakings recognised the need for enhancement and subsequently developed specific validation activities and embedded them in a validation process. BaFin expects further improvements in this regard in the coming years. Validation ultimately helps to assess inherent model uncertainty and in this way strengthens the undertakings' and BaFin's confidence in the internal model.

### Next steps

If, as a result of the validation, an undertaking finds that a model that has already been

107 OJ EU [L 12/1].

approved will no longer meet the requirements in the long term, or can no longer adequately capture the risks because of business policy decisions – for example, the introduction of new insurance products or the launch of activities in new markets –, the undertaking is required to change the model. BaFin has to approve these changes in advance, provided certain quantitative or qualitative criteria of the policy for model changes as required under section 11 (2) of the Insurance Supervision Act have been met.

For 2016, BaFin expects not only that pending application processes will be finalised, but also that it will receive the first applications for model extensions and changes. A model extension describes one of the following situations:

- the scope of entities included in a group model is expanded or
- an approved internal model is used not only to calculate group solvency, but also the (solo) SCR of an individual entity from the date of approval or
- the scope of the modelled risks is extended.

Undertakings may conceivably also submit new applications for approval of an internal model.

### Further harmonisation at European level

EIOPA will focus on further harmonising the supervision of internal models in 2016. Firstly, all approved internal models are to meet standardised requirements in Europe. Secondly, appropriate quantitative tools are to be developed to support the authorities in the ongoing supervision of internal models.

To bring about further harmonisation, EIOPA and the national supervisory authorities will conduct benchmark studies, for example on calibration of market risk models in general or on taking account of risks from government bonds in particular. EIOPA combines the development of appropriate supervisory tools under the heading "Internal Model On-Going Appropriateness Indicators (IMOGAPI)". They are to enable supervisors to test the performance of the models used and detect any abnormalities. Initial results of these activities are not expected before the end of 2016.

### Ongoing supervision by BaFin

BaFin is involved in these activities and also conducts its own investigations in this regard. Thus, BaFin regularly checks in accordance with section 294 (5) of the Insurance Supervision Act whether insurance undertakings that use internal models for calculating the SCR comply with the provisions of sections 111 to 121 of the Act at all times. The examinations, which form part of ongoing model supervision, are intended to prevent potential abuse of internal models as far as possible. Such abuse may manifest itself, for example, in a preference for certain modelling approaches or in attempts to reduce regulatory capital requirements most of the time. In 2016, BaFin will therefore start analysing the latest validation reports and discussing them with the undertakings.

### Summary

In summary, it should be noted that the internal models will by no means disappear from the insurers' and BaFin's radar once the first approvals have been granted. They will remain part of day-to-day supervision. In addition, together with other national supervisory authorities and EIOPA, BaFin is committed to establishing harmonised model supervision in Europe.

# 10 Money laundering prevention

## 10.1 FATF guidance

In October 2015, the Financial Action Task Force (FATF) issued guidance for effective supervision and enforcement in the financial sector, with special consideration for a risk-based approach.[108] This guidance was created by a separate working group in which BaFin was also involved.

Among other things, the document lists four examples of supervision models that are considered appropriate, including the kind of integrated financial services supervision practiced in Germany. The aspects highlighted in particular in this context include the benefits of a dedicated combined anti-money laundering unit within an integrated supervisor, such as the one at BaFin: on the one hand, it has proximity to solvency supervision, while on the other it has the expertise to supervise activities relating to anti-money laundering and countering financing of terrorism. Overall, the guidance presents the key aspects of effective supervision. It emphasises how important close cooperation between supervisory authorities and criminal justice authorities is – as practiced in Germany for years – in performing this task.

## 10.2 Anti-Money Laundering Directive

After more than two years of negotiations, European legislators completed their work on the Fourth Anti-Money Laundering Directive. The Directive[109] was published in the Official Journal on 5 June 2015. Member states now have until 26 June 2017 to transpose the new provisions into national law.

By adopting the Fourth Anti-Money Laundering Directive, the EU is tightening up its fight against money laundering. The Directive is at the same time a demonstration of the European legislators' resolve to take even more rigorous measures against money laundering and terrorism financing. Another objective pursued by the EU is to align the national regulations to a greater extent. The main reason for the amendment was the fact that the European AML/CTF regulations had to be adapted to the revised recommendations of the Financial Action Task Force (FATF) dating from 2012.

### Risk-based approach

It is important to note that the Fourth Anti-Money Laundering Directive confirms and reinforces the risk-based approach to combatting money laundering and terrorism financing and is thus directly consistent with the approach taken in the Third Anti-Money Laundering Directive.[110] Where the Third Anti-Money Laundering Directive had contained a list of predefined situations with lower or increased risk of money laundering, the new version requires the obliged entities to review each individual business relationship and transaction for its specific risk of abuse for the purpose of money laundering.

Since the risk-based approach requires fact-based decision making processes to be in place, the European Commission, the member states and the obliged entities are encouraged to identify and assess the inherent risks for this purpose. The Directive also has three annexes which for the first time specify factors and criteria the obliged entities have to take into account in assessing the risks of money laundering and terrorism financing. It also describes the risk-based supervision requirements the competent authorities have to meet.

### Sanctions

Furthermore, the new Directive specifies in greater detail than before how the member states have to punish violations of the anti-money laundering regulations. It requires effective, proportionate and dissuasive administrative sanctions and measures in national law for failure to respect

108 Guidance for a risk-based approach: "effective supervision and enforcement by AML/CFT supervisors of the financial sector and law enforcement."

109 Regulation (EU) 849/2015, OJ EU L 141/73.

110 Directive 2005/60/EC, OJ EU L 309/15.

the national provisions adopted by a member state to implement the Directive. Accordingly, administrative sanctions and measures must be put in place at least for serious, repeated or systematic breaches of the different key anti-money laundering requirements.

In addition to a large number of material changes for obliged entities, for example in connection with politically exposed persons, due diligence requirements for e-money products or group-wide safeguards, the Directive additionally sets out a new type of duty of cooperation for customers. This means that all legal persons will in future be obliged to obtain and retain accurate, up-to-date information about who acts as beneficial owner for them and about the nature and extent of the beneficial ownership. Each member state has to collect this information in a central register. No decision has been taken yet on the specific design of such a register in Germany.

## 10.3 Funds Transfers Regulation

In parallel with the Fourth Anti-Money Laundering Directive, the European institutions agreed on a new directly applicable Regulation on Information Accompanying Transfers of Funds. The new Funds Transfers Regulation[111] has been in force since 25 June 2015, but will only become effective in combination with the Fourth Anti-Money Laundering Directive. The aim of the Funds Transfers Regulation is to be able to fully trace back funds transfers. This is to prevent and detect money laundering and terrorism financing and to facilitate the corresponding investigations.

The most important change of the new Funds Transfers Regulation specifies that the obliged payment service providers now have to accompany transfers of funds not only with information on the payer but also on the payee. Intermediary payment service providers will in future also have certain verification obligations to ensure that the required information is complete. Where necessary, they have to take risk-adequate decisions for determining what measures to take, for example to reject or suspend a transfer of funds.

The new Regulation also clarifies that transfers of funds within the meaning of the Regulation also include those transfers where the same payment service provider acts for both the payer and the payee. This confirms the legal situation in Germany, which has been applied for some time already.

## 10.4 Consultation on the ESA Guidelines

On 21 October 2015, the three European Supervisory Authorities, EBA, ESMA and EIOPA, published two draft joint guidelines setting out details of the Fourth Anti-Money Laundering Directive for a three-month consultation process; the deliberations continue, taking the consultation results into account.

One of the guidelines regulates the simplified and the enhanced customer due diligence process as well as the circumstances that financial institutions should weigh up when assessing the risk of money laundering and terrorism financing for an individual business relationship or an occasional financial transaction. It also contains specific recommendations for the different obliged entities and for different products. BaFin co-chaired the preparatory working group.

Another set of guidelines relates to the features of a risk-based approach to AML and CFT supervision, which the national competent authorities are to use as guidance. BaFin has been using a corresponding risk classification system for institutions for many years. BaFin was also actively involved in the development of these draft guidelines.

Although the ESAs' guidelines are not binding European law, the parties concerned have to explain to the European Supervisory Authorities why they do not comply (comply-or-explain principle).

111 Regulation (EU) 2015/847, OJ EU No 141/1.

### 10.5 BaFin warning on Bosnia-Herzegovina

In its Circular 2/2015 dated 13 February 2015, BaFin issued information about a statement of the standing MONEYVAL committee of the Council of Europe. The committee had conducted an assessment of the extent to which the member states complied with the international AML/CFT standards. According to the committee's findings, there are still deficiencies in the anti-money laundering/combating the financing of terrorism regime in Bosnia and Herzegovina. In Circular 6/2015 dated 10 July 2015, BaFin also informed the obliged entities under its supervision that the country was being more closely investigated by FATF's International Cooperation Review Group (ICRG) and that there were deficiencies with regard to key FATF recommendations. BaFin pointed out that this should be taken into account adequately when assessing the country risks relating to the prevention of money laundering and terrorism financing.

Bosnia and Herzegovina's progress with combatting money laundering and terrorism financing is being monitored by the Europe/Eurasia Regional Review Group (ERRG) of the FATF. BaFin co-chairs this group and coordinates and prepares its meetings.[112]

112 For information on the simplified access to basic payment accounts for refugees, see chapter III.

## 11 Freedom of Information Act

### 11.1 Focus

#### Freedom of Information Act

Author: Markus Heine, BaFin Division for Advice and Legal Remedies under the KWG and VAG, IFG Policy Issues and Coordination

In 2015, the Administrative Court *(Verwaltungsgericht)* of Frankfurt am Main ruled for the first time that IFG class action was not permissible because of legal abuse. A German law firm had filed requests for more than 1,000 individuals under the German Freedom of Information Act (*Informationsfreiheitsgesetz* – IFG).[113] The requests involved identical submissions from different individuals. The requests for information related to several insolvent credit institutions and other companies that have been in liquidation, in some cases for several years. The firm had pointed out repeatedly that it needed the information to prepare for state liability action against the Federal Republic of Germany and against the Federal Ministry of Finance and BaFin. In these case constellations, BaFin believes that a single submission is sufficient to gain access to the information, if other requirements are also met.

At the end of 2015, the Administrative Court of Frankfurt am Main ruled that a part of the class action proceedings were not permissible because there was no legitimate interest to take legal action (see info box on page 83).

The court accused the plaintiffs of legal abuse. However, the abuse had not been committed by the plaintiffs themselves, but by their counsel. This is similar to indirect perpetration (see info box on page 83).

113 See 2014 Annual Report, page 81 et seq.

### Grounds of the judgement

In the two judgements of 10 November 2015[114] and the consolidated judgement of 1 December 2015[115], the Administrative Court commented in clear terms on the phenomenon of IFG class action proceedings for the first time. As for the matter of legal abuse, the court explained that the actions were not permissible because the plaintiffs had no legitimate interest to take legal action. There was no such legitimate interest if winning the case would have no legal or substantive benefit. The main purpose of the IFG was to oversee the public administration and to uncover any irregularities. That had not been the intention with the proceedings on which the ruling had to be handed down. There was no private interest in the information either, because any state liability actions had no chance of success. The reason was firstly that, in accordance with section 4 (4) of the German Act Establishing the Federal Financial Supervisory Authority (*Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht* – FinDAG), claims for damages cannot be filed against the state, because BaFin only acts in the public interest. Secondly, a state liability claim, if such a thing existed, would be time-barred already after three years in accordance with section 195 of the German Civil Code (*Bürgerliches Gesetzbuch* – BGB).

### Court as a money-printing machine

The court explained that the counsel had "raised objectively false and completely unrealistic ideas and expectations" among his clients, as a result of which they had let him "exploit" them. The purpose of the action was evidently only to generate fee income, which is why the counsel did not admit a public test case. The counsel's interpretation of the limitation period was "so far removed from what is legally acceptable that criminal relevance was the only reasonable conclusion". The court felt it had been abused as a "money-printing machine", saying that a "more glaring case of legal abuse could hardly be imagined". The plaintiffs have to accept the blame for the conduct of their counsel.

The court therefore rejected the actions already for formal reasons. However, it also commented on the substance of the case (substantive legal review) and concluded that, even if there was legitimate interest to take legal action in this case, the actions would have to be dismissed for substantive legal reasons. In this regard, it referred primarily to the decision of the Court of Justice of the European Union (CJEU) of 12 November 2014 and to judgements of the Administrative Court of Hesse *(Hessischer*

**§ Legitimate interest to take legal action *(Rechtsschutzbedürfnis)***

In general terms, legitimate interest to take legal action is a prerequisite for admitting legal proceedings. It constitutes the legitimate interest of a party whose rights have been infringed to turn to the courts in order to obtain legal protection. There is no legitimate interest to take legal action if the intended outcome can be reached more simply, more cheaply, or as a matter of course without seeking legal remedy, or if proceedings are brought before a court frivolously (unnecessarily) or for improper motives.

**§ Indirect perpetration *(mittelbare Täterschaft)***

The term "indirect perpetration" originally comes from the area of criminal law. Among other things, it covers case constellations where, seen objectively, an individual commits a criminal offence without actually realising this. In most cases, such an individual does not act with intent or acts with an excuse. The person behind the crime, by contrast, is fully aware of the situation and uses this individual as his or her tool. The individual committing the crime (indirectly) is exempt from punishment, but the person behind the criminal act is punished.

114 Case refs: 7 K 2707/15 and 7 K 2940/15.

115 Case ref: 7 K 4713/14.

### Appeal and review in court proceedings

In an appeal, the Higher Administrative Court *(Oberverwaltungsgericht)* reviews the judgement handed down to establish whether it is correct in relation to all factual findings and all legal norms applied.

Review proceedings, by contrast, do not involve the investigation of facts. The only checks performed are whether the judgement is based on the violation of legal norms.

Leave to appeal and to petition for review are normally granted by the court that handed down the judgement. If leave is not given, the party seeking this legal remedy has to recite the reasons it believes exist for granting it to the next higher court. This court then decides independently whether the recited reasons do in fact apply. If leave to appeal is granted, the proceedings continue in the appellate court.

*Verwaltungsgerichtshof)* of 11 March 2015[116], which implemented the CJEU's decision for the first time.[117]

Since the plaintiffs lost the case, they have to bear the – not inconsiderable – costs of the proceedings. The court pointed out that, according to its sense of justice, it would be right for the counsel to bear the costs, because it had caused the legal abuse. There was, however, no legal basis for this.

Leave to use the legal remedies of appeal and review (see info box) against the judgements was not granted. Some of the judgements are already final. At the time of going to press, no decision had been made on the applications filed for leave to appeal.

116 Case refs: 6 A 329/13, 6 A 330/13 and 6 A 1071/13.

117 For information on the judgements, see 2014 Annual Report, page 81 et seq.

## Federal Administrative Court submits further questions to the CJEU

At the end of 2015, the Federal Administrative Court *(Bundesverwaltungsgericht)* had to deal with two older IFG review cases relating to Phoenix Kapitaldienst GmbH. The proceedings had initially been suspended for an extended period pending the expected decision of the CJEU of 12 November 2014.[118]

At the oral hearing on 22 October 2015, the court made it clear that further questions about the interpretation of the Markets in Financial Instruments Directive I[119] would have to be put to the CJEU, because its judgement of 12 November had not provided sufficient clarity on these issues. For this reason, on the basis of the resolutions of 4 November 2015[120], both cases were again suspended and submitted to the Court of Justice of the European Union for further clarification by way of a preliminary ruling procedure in accordance with Article 267 of the Treaty on the Functioning of the European Union (TFEU).

In essence, the CJEU has been asked to clarify

- whether the term "confidential information" within the meaning of Article 54 of the Markets in Financial Instruments Directive I covers all company-related information that the supervised company has submitted to the supervisory authority, irrespective of other requirements, and
- whether all statements made by the supervisory authority contained in the files, including its correspondence with other bodies, are covered by supervisory secrecy as a sub-category of professional secrecy within the meaning of Article 54 of this directive.

In addition, the Federal Administrative Court has asked for clarification of whether the term "confidential information" within the meaning of Article 54 of the Markets in Financial Instruments Directive I should be interpreted in such a way that the classification

118 Case ref.: C-140/13.

119 Directive 2004/39/EC, OJ EU L 145/1.

120 Case refs: 7 C 3.14 and 7 C 4.14.

of company-related information transmitted by the supervisory authority as a protectable business secret or other protectable information depends solely on the time the information was transmitted to the supervisory authority.

If the answer to the above question is no, the question then is whether there can be a rebuttable presumption that after a certain period of time has elapsed – a period of five years has been mooted – the company-related information has lost economic value and therefore does not represent a protectable secret, and whether this also applies to BaFin's supervisory professional secrecy.

Depending on the response of the CJEU, the Higher Administrative Court of Hesse in Kassel will again make a decision on the above-mentioned cases, or a final decision will be made by the Federal Administrative Court. Until then, there can be no legal certainty about dealing with the IFG. It is currently not clear when a final decision can be expected.

## 11.2 Submissions in 2015

Due to more recent case law of the Administrative Court of Frankfurt am Main, which is the competent court of first instance, the number of initial submissions relating to the Banking Supervision directorate declined sharply in 2015 compared with the previous year (see Table 4 "IFG statistics 2015").[121] By contrast, further IFG mass request proceedings relating to securities supervision had to be dealt with in 2015. These proceedings were also the reason for the large number of objection proceedings. These mass proceedings were also initiated by a single law firm, which has committed itself to investor protection. Over 700 applicants are represented in this case. They are litigating for access to one and the same information, but not for individual access to this information. Although many actions have been rejected due to legal abuse – in some cases in final decisions – the total number of proceedings pending against BaFin at all instances remains very high. This is due to the considerable number of new actions filed.

**Table 4** IFG statistics 2015

| Super-visory area | Number of new submissions in 2015 | Application withdrawn | Access to information granted | Access to information partially denied | Access to information denied | Objection filed | Appeal lodged | Total number of pending proceedings |
|---|---|---|---|---|---|---|---|---|
| BA* | 291 | | | 496 | 2 | 676 | 420 | 1,268 |
| VA* | 3 | | 1 | | 2 | 1 | 1 | 1 |
| WA* | 720 | 7 | 19 | 641 | 53 | 400 | 69 | 76 |
| QIV* | 70 | 6 | 1 | 2 | 6 | 2 | 1 | 2 |
| **Total** | **1,084** | **13** | **21** | **1,139** | **63** | **1,079** | **491** | **1,347** |

* BA = banking supervision, VA = insurance supervision, WA = securities supervision, QIV = cross-sectoral issues.
The figures are based on BaFin's organisational structure before the reorganisation at the beginning of 2016.[122]

121 For information on the prior-year figures, see 2014 Annual Report, page 84.

122 For details on BaFin's new structure, see chapter VI 2.

# III Supervision of banks, financial services providers and payment institutions

## 1 Bases of supervision

### 1.1 One year of European banking supervision

The first year of the Single Supervisory Mechanism (SSM) under the leadership of the European Central Bank (ECB) is over (see info box "European banking supervision in the SSM", page 87). It is already apparent that the core idea behind the SSM has been successfully realised in practice: the integrated supervision of eurozone banks by the national competent authorities (NCAs) and the ECB.[1]

However, in order to be able to function successfully over the long term, the SSM must still take action in one or two areas. For example, there is still room for improvement in the collaboration with the national authorities, especially with regard to the exchange of information and consultation between participants. The new authority must also develop uniform administrative practices. From the German point of view, at least, this implies at the same time a paradigm shift in the approach to supervision. The latter is more focused on quantitative methods than was the case in Germany in the past. An additional factor is that the need for communication and consultation between all participating supervisory institutions is very important.

#### Best practice

The guiding principle of ECB banking supervision shows the way forward: The SSM's objective is to bring together the best national supervisory practices in a single framework. This is intended to ensure that all member states comply with the standardised regulatory regime and the most important supervisory principles and practices. Is not intended that there should be any preferential treatment, either for large institutions or for particular banking groups or smaller SSM banks.

A complicating factor is that inevitably it is not only harmonised legislation – such as the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR) – that is relevant here. Many legal provisions, such as company law and accounting rules, are not harmonised at European level. The national

1 See 2014 Annual Report, page 86 ff., page 89 ff.

### European banking supervision in the SSM

On 4 November 2014, the Single Supervisory Mechanism for banks in the eurozone (SSM) started its work.[2] Since that date, significant institutions or groups of institutions (SIs) have been subject to direct supervision by the SSM. These currently comprise 129 banks or banking groups, including 22 German groups (see Table 11 "German institutions under direct supervision by the SSM", page 136).[3] The less significant institutions (LSIs) are supervised by the SSM indirectly; they are therefore subject to national supervision as before.

The defining feature of European supervision is that the European Central Bank (ECB) and the national competent authorities (NCAs) carry out their supervisory responsibilities jointly and work closely together. This close collaboration is the result of Article 6 of the SSM Regulation, which states that the ECB "shall carry out its tasks within a single supervisory mechanism composed of the ECB and national competent authorities". It further states that "both the ECB and national competent authorities shall be subject to a duty of cooperation in good faith, and an obligation to exchange information". Hence the SSM is a supervisory alliance led by the ECB.

The ECB's Governing Council functions as the supreme decision-making body of the SSM. However, the Supervisory Board was created at the ECB to plan and exercise supervisory activities. BaFin in the person of its President Felix Hufeld represents Germany on this Board as a voting member. The Board prepares all supervisory decisions and presents them to the Governing Council for resolution. The non-objection procedure applies: The Governing Council may only accept or reject the Supervisory Board's resolution proposals; it may not amend them. If the Governing Council does not reject a proposed resolution within ten working days, it is deemed accepted.

supervisors in the Joint Supervisory Teams (JSTs) are faced with the considerable challenge of clarifying these areas of law that are not harmonised. Ultimately, they must reconcile the SSM's objective of treating all institutions equally with an acceptance of specific national differences.

### 1.1.1 Harmonisation of options and discretions

Since November 2014, the ECB has supervised significant institutions (SIs) in the eurozone directly. For this purpose, it uses directly applicable European Union law, such as the CRR. In the case of legislative acts that must be transposed into national law, such as the CRD IV, it applies the national implementation; in German law, that is essentially the Banking Act *(Kreditwesengesetz)*.

The CRR and CRD IV contain a range of options and discretions. These provisions either allow member states or the competent authorities the option of choosing between two or more alternative approaches or, on the other hand, they grant them scope for discretion when making decisions in individual cases. If member states make use of the options and discretions, the ECB is bound by the respective national implementation. Where these rights are granted to a supervisory authority, however, the ECB exercises the options and discretions within its area of competence independently and on its own responsibility.

Against this background, the ECB initially examined around 120 of these options and discretions, together with their practical relevance and the administrative practice to date in the member states, in the context of

2 In principle, the non-eurozone EU countries may also join the SSM.

3 The current list of all significant institutions subject to direct SSM supervision is available at the following link: https://www.bankingsupervision.europa.eu. The significant German institutions under direct SSM supervision are listed under 3.3.1 in Table 11. The 22 groups comprise 67 individual institutions.

a wide-ranging project in collaboration with representatives of the national competent authorities (NCAs). It also developed its own SSM positions on this subject.

The ECB has published a regulation and a guideline as the result of this work. The regulation will come into effect on 1 October 2016. Both documents were available for public consultation between 11 November and 16 December 2015; in addition, a public hearing took place on 11 December 2015. The ECB Regulation covers the exercise of general options by the European Central Bank. This relates to provisions in European Union law which allow the competent authorities the option of choosing between a number of approaches for regulating a particular matter. However, the option chosen is then binding for all institutions. Examples of such matters include decisions on how quickly the transition to the new own funds regime under Basel III should proceed, and the preferential treatment in principle of certain claims in the context of the large exposures regime. In view of the general applicability of supervisory decisions of this nature, the legal form of a directly applicable binding ECB Regulation was chosen to implement them. The draft of the ECB Guides, on the other hand, deals with provisions requiring a decision to be made in the particular case. The intention is to establish supplementary criteria in the ECB Guides, specifying the statutory requirements in more detail to ensure that they are applied uniformly by the ECB. The ECB Guides are not legally binding, however. Above all, their purpose is also to standardise the procedures adopted by participants in the SSM and at the same time to contribute to the clarity of formulation of the criteria for decision-making, especially with respect to the credit institutions under supervision.

## 1.1.2 Focus

### SREP: a holistic approach to risk assessment for banks

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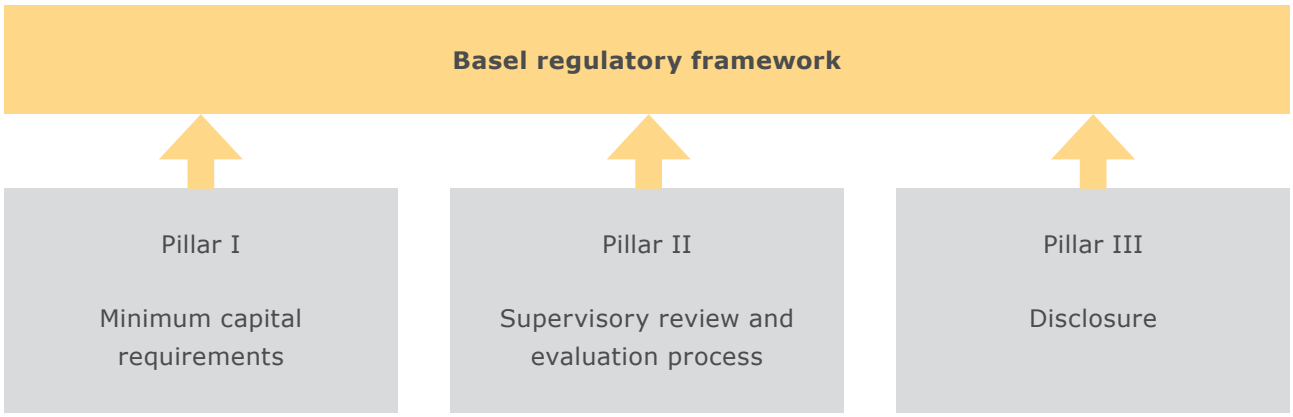
The three-pillar model has been a core principle of the Basel Framework since Basel II[4]. This covers the supervisory rules relating to capital requirements (Pillar I), the supervisory review and evaluation process (SREP) relating to internal risks, structures and processes (Pillar II) and disclosure requirements (Pillar III) to improve market discipline (see Figure 3 "Basel regulatory framework", page 89).

The objective of the SREP under Pillar II is for supervisors to gain a comprehensive understanding of banks' internal risk allocation and management, and to be in a position to assess the adequacy of an institution's capital and liquidity – over and above the requirements of Pillar I.

4 Basel II was published in June 2004 and entered into force at the end of 2006. The European Union implemented Basel II in June 2006 through the Banking Directive (2006/48/EC) and the Capital Adequacy Directive (2006/49/EC). Basel III was published at the end of 2010. This includes Basel II and further amendments subsequently published by the Basel Committee on Banking Supervision. Basel III was implemented in the EU through the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR).

**Figure 3** Basel regulatory framework




## Insight into decision-making processes

For more than a decade, supervisory authorities have been addressing the exact form that Pillar II should take. Since the Basel requirements are far from comprehensive in this regard, supervisors worldwide have developed different concepts ranging from stringent general requirements to very flexible regulations that are heavily geared to the situation of the individual institutions. To date in Germany, the concepts have tended towards the second category. Until now, the primary focus has inclined towards a more qualitative approach that offered institutions substantial leeway, particularly with respect to the Internal Capital Adequacy Assessment Process (ICAAP), which is part of the SREP. Two concepts have prevailed to date: one balance-sheet-based (going concern approach) and one on a present value basis (gone concern approach). While large institutions in particular follow the latter approach, the balance-sheet-based approach is primarily used by small and medium-sized banks to achieve the greatest possible balance between internal management and supervisory requirements. This also enables the supervisors to gain a greater insight into the banks' decision-making processes.

The process of responding to the 2007/2008 financial crisis brought flaws in the banking system to light; these showed that supervisors must increasingly address internal processes and adequately account for and assess all of the risks relevant to the institutions. Pillar II, i.e. the SREP, rapidly gained significance. Regulations were tightened and – at least in Europe – were simultaneously aimed at better coordinating the very different approaches pursued by supervisors. The preliminary endpoint in structuring and harmonising the SREP are the guidelines issued by the European Banking Authority (EBA) on 19 December 2014.[5]

## Requirements of the EBA guidelines

The EBA guidelines contain requirements relating to the key aspects of a comprehensive SREP. Supervisory authorities were given a deadline of February 2015 to state whether they would comply with the guidelines from 1 January 2016 onward. BaFin undertook towards the EBA to integrate the guidelines into its supervisory processes and procedures from 2016 onward, and to align its current procedures for the development of institution-specific risk profiles with the EBA requirements.

In accordance with the guidelines, the key elements of the SREP include regular monitoring of the risk situation using quantitative key indicators, business model analysis – dealing in particular with the sustainability of earnings potential to generate equity – and examination of the adequacy of a bank's internal structures, processes, controls and risk management (corporate governance).

5 EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP).

Business model analysis does not mean that certain business models are prescribed. However, a comparison of the competitive situation does help to analyse the extent to which an institution's business strategy is viable and stable in the long term. While these aspects are not completely new, they do require a significantly more quantitative approach than the methods previously employed by the German supervisors. Therefore it is also fitting that a further element of the SREP is to assess the material risk types: the credit risk, market risk, operational risk and interest rate risk in the banking book. The EBA expects supervisors to analyse the severity of each risk type on a quantitative basis, and to address issues surrounding the risk management system and internal controls. This will always be governed by proportionality and materiality. In Germany, the requirements relating to internal structures, controls and processes are already sufficiently familiar from the Minimum Requirements for Risk Management (MaRisk)[6], and are also already included in the preparation of a risk profile. Consequently, institutions that are already well positioned in this area also have a very good foundation for the SREP.

By contrast, the EBA's requirements for establishing an adequate level of own funds and liquidity resources as a result of the SREP are new. While the liquidity resources are an EBA option, the banks' specific determination of an adequate level of own funds is a mandatory requirement that must be implemented from 2016 onward.

### Setting capital requirements as a core element of the SREP

The most significant implementation requirement arises from the EBA's expectation that national supervisory authorities will determine what they believe to be an adequate overall own funds requirement level for all credit institutions as a result of the SREP. The German supervisors, like other authorities, have refrained from doing so to date. This part of the SREP guidelines therefore presents the greatest challenge from a supervisory point of view.

German supervisors gained their initial experience in 2014 and 2015 with the European Central Bank's SREP for the 22 significant German groups of institutions that are directly supervised under the Single Supervisory Mechanism (SSM). The SREP for the almost 1,600 institutions in Germany that are not directly subject to SSM supervision takes this to a new level. For this reason, the supervisors have a considerable interest in developing a transparent process for setting own funds requirements. At the same time, the preliminary work carried out by the institutions, in particular regarding use of the ICAAP, should be taken into appropriate consideration. This is also necessary since for the EBA guidelines, a bank's ICAAP forms a key foundation for setting capital requirements. For the ICAAP, the institutions were given an initial deadline of 31 December 2015 to submit notifications under the Financial and Internal Capital Adequacy Information Regulation *(Finanz- und Risikotragfähigkeitsinformationenverordnung)*.

As a consequence, key milestones for the determination of capital requirements under the SREP have already been reached. On closer examination, what initially appeared relatively easy to implement at national level is turning out to be a complex undertaking. Since only few requirements for the design of an ICAAP have been established to date, the banks' corresponding disclosures and underlying parameters are highly varied and, in cases where doubt arises, incomparable. In addition, the EBA provides for a certain approach (known as Pillar I plus) to calculate capital requirements. On the one hand, this means that capital requirements are no longer set on a holistic basis, but are determined separately for each risk type. On the other – and this is the crucial aspect – the Pillar I capital is taken as given, and SREP capital is determined as an add-on to this Pillar I capital. To date, the German approach permitted the capital requirement to be completely recalculated under the ICAAP, with the observance of Pillar I requirements constituting an implicit auxiliary condition. Although the EBA approach creates a direct link between Pillar I and the results of

6 See 1.4 for more information on the MaRisk.

the assessment under Pillar II, at the same time it considerably reduces the leeway available to individual banks in using the ICAAP.

### ECB pursuing further harmonisation

In dialogue with the banking industry, BaFin has begun to develop concepts for setting capital requirements that are initially aimed at enabling the institutions' existing approaches to be taken into consideration. A first information event was held in October 2015, with a further event in the pipeline. BaFin intends to continue this exchange of information in the MaRisk expert panel.

Since this overall process is complex and the potential consequences for banks' internal management must be considered, it is already obvious that problem-solving approaches will continue to be developed. In addition, the ECB has made clear its interest in harmonising the SREPs in the eurozone, meaning that ECB requirements will also have to be taken into consideration in the medium term. However, this is a process marked by interdependencies.

Since the German supervisors are responsible for smaller institutions that are not directly subject to ECB supervision, the ECB has an interest in sharing in the experiences gained from this process. As a result, the SREP approaches initially developed at national level have the opportunity to find their way into the overarching concept. It requires time, as well as the courage to find new approaches, to gain a coherent view of a bank's risk situation and the resulting capital requirements. For this reason, German supervisors will take advantage of the three-year period granted by the EBA before the SREP has been completed for all institutions.

## 1.1.3 Work in the JSTs

The ECB supervises the significant institutions (SIs) directly. The Joint Supervisory Teams (JSTs), in which BaFin employees work alongside supervisors from the entire eurozone and the ECB, represent the central instrument for supervision in the SSM. Every significant banking group within the eurozone is supervised by a dedicated supervisory team, which is headed up in turn by a member of the ECB staff (JST coordinator) working together with the sub-coordinators of the NCAs. The number of supervisors in the JSTs reflects the size and complexity of the banking groups under supervision. The teams carry out the ongoing supervision of the institutions, on the one hand, and are also responsible for implementing decisions of the SSM Supervisory Board, which submits draft decisions to the ECB's Governing Council as the highest decision-making body in the SSM. BaFin represents Germany as a voting member of the Supervisory Board.

The network nature of the SSM with all the interconnections in its decision-making processes is especially clear in the Joint Supervisory Teams: While in the past responsibility for banking supervision was solely a matter for national supervisors, supervisors from the ECB and the authorities of other countries are now represented in the JSTs. In the first place, this bringing together of different supervisory cultures and experiences enriches the new European supervisory regime. This is because it enables existing approaches to supervision to be critically examined and continuously advanced as part of a collective process. At the same time, however, this diversity has created the need to spend great effort on coordination and consultation in the initial phase of the new supervisory regime, especially with respect to the division of responsibilities between the participating institutions and the new decision-making levels. One of the challenges for collaboration in the future consists of improving the synchronisation

and alignment of the steps taken by the individual participants. Some information flows must also become more established.

Notwithstanding this, the supervisory team members rapidly learned to work together in an atmosphere of trust. At the same time, it can be observed – not least on the basis of the experiences obtained – that the supervisory processes are becoming ever more closely harmonised. This therefore provides confirmation, a good year after the start of the SSM, that the JSTs are fulfilling their promise as a means of achieving the objective of intrusive and fair supervision in the SSM.

### 1.1.4 Supervisory methods and standards

#### Supervision of less significant institutions

In contrast to the supervision of significant institutions (SIs), the direct supervision of the less significant institutions or groups of institutions (LSIs) continues in principle to be the responsibility of individual NCAs. Here too, regular and wide-ranging exchange of information represents a key foundation for ensuring that collaboration in the SSM is based on trust.

Common procedures constitute the exception to this direct supervision by the national authorities. Responsibility for these procedures rests with the ECB in the case of all institutions, irrespective of whether they are significant or less significant. Examples of common procedures are the granting of authorisations to conduct business operations, the withdrawal of such authorisations, holder control procedures[7] and passporting. This includes procedures regulating the right of establishment and the freedom to provide services.[8] However, the NCA remains the point of contact for the institutions, and the body to which the relevant notifications must be given, for the common procedures as well.

But European supervision also has consequences for the LSIs going beyond these common procedures. It is true that the ECB supervises these banks only on an indirect basis. But because the SSM standardises the various national supervisory practices for these institutions as well, it automatically ensures that supervision in all the SSM countries conforms to common standards.

The ECB is developing common regulatory standards for this purpose in close cooperation with the NCAs. BaFin is involved in these activities in the SSM, since its staff are helping to shape the standard setting process in the ECB's working groups. Its supervision of around 1,600 less significant institutions (see Table 10 "Number of banks by group of institutions", page 130) means that BaFin is the NCA with the greatest expertise in supervising this group of institutions. The best practices are determined jointly on the basis of an initial assessment so that they can then be developed further in an appropriate manner. Any national peculiarities are taken into consideration in this process. The SSM also provides an opportunity to place the national institutions in an international context by means of cross-border analyses of the LSIs going beyond national boundaries. This process allows potential undesirable systemic developments to be identified at an early stage.

In 2015, the work focused initially on the supervisory planning process. In addition, the identification and assessment of risk as part of the Supervisory Review and Evaluation Process (SREP) were, and continue to be, of crucial importance. Business model analysis represents a significant component of the SREP. The basis for this evaluation is provided by the SREP Guidelines issued by the European Banking Authority (EBA). The supervisory implications of institutional protection schemes for LSIs and the requirements for recovery plans were also current priority areas in the development of standards for this group of institutions.

7 For changes in the Regulation on Notifications in Accordance with Section 2c of the German Banking Act and Section 104 of the German Insurance Supervision Act (Holder Control Regulation) *(Inhaberkontrollverordnung)*, see 1.2.4.

8 Articles 11 to 17 of Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 (SSM Framework Regulation).

## Fit and proper assessment

The SSM has transferred certain tasks to the ECB that were previously the responsibility of the NCAs. One of those tasks consists of assessing the professional qualifications and expertise of newly appointed management board members and members of administrative and supervisory bodies of the German SIs, as well as their trustworthiness and their ability to dedicate sufficient time to performing their functions. Responsibility for the German LSIs, on the other hand, remains with BaFin in this respect. The ECB carries out the evaluation for the SIs in the form of a fit and proper assessment. The legal basis for this assessment process for SIs and LSIs is provided by the relevant national legislation implementing, in particular, the requirements of the Capital Requirements Directive CRD IV. In Germany, this means sections 25c and 25d of the Banking Act, on which BaFin published guidance notices at the beginning of 2016.[9]

BaFin is therefore involved with the SIs and LSIs. As before, the institutions submit notifications of newly appointed management board members and members of administrative and supervisory bodies both to BaFin and to the Deutsche Bundesbank. BaFin then informs the ECB of the notifications concerning SIs and involves the JSTs. The Supervisory Board of the SSM makes a decision on the professional qualifications of the relevant parties on the basis of recommendations made beforehand by the JSTs. BaFin is helping to form internal fit and proper guidelines for the ECB in the SSM. The objective of the guidelines is to ensure that participants in the SSM adopt uniform procedures.

## Reporting

On 14 April 2014[10], the European Commission adopted the technical standard with regard to supervisory reporting of institutions which is directly binding, thus making a significant contribution to the harmonisation of European reporting practices. The centrepiece of this regulation are the COREP[11] and FINREP[12] tabular formats. COREP specifies the reporting formats for the banking supervisory own funds and own funds requirements of Pillar 1 of the regulatory framework. FINREP in turn establishes requirements for the uniform reporting of financial data which reproduce the balance sheet and profit and loss account in significantly greater detail. However, FINREP is primarily based on IFRS[13] consolidated financial statements. The technical standard on reporting requirements therefore essentially limits the application of FINREP to those groups of institutions which prepare IFRS financial statements.

On 17 March 2015, the ECB issued a reporting regulation[14] requiring harmonised banking supervisory financial information reports for all credit institutions in the eurozone. The regulation covers reports for individual institutions and groups which must be submitted on the basis of the FINREP tables. This means that the ECB has significantly expanded the scope of application of the technical standard. Under the transitional provisions, the large majority of German institutions will have to submit the reports for the first time as of June 2017. Institutions with total assets of up to €3 billion are only required to report a small portion of the contents of the FINREP tables.

The large majority of institutions in Germany prepare their financial statements in accordance with the German Commercial Code (*Handelsgesetzbuch* – HGB). They are therefore faced with the challenge of having to submit FINREP reports based on the IFRS measurement categories of International Financial Reporting

9 See 1.10.

10 See Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council.

11 Common Reporting.

12 Financial Reporting.

13 International Financial Reporting Standards.

14 Regulation (EU) 2015/534 of the European Central Bank of 17 March 2015 on reporting of supervisory financial information (ECB/2015/13).

Standards. In order to assist the affected institutions in managing this task, BaFin has already set up a working group of banks, industry associations and auditors at this early stage. The objective is to develop a common understanding of how the contents of the reports by HGB users should be structured, without at the same time altering HGB valuation principles. BaFin has conducted intensive discussions on its findings with the ECB, which has welcomed this constructive contribution. The expectation is that the consensus achieved by HGB users in response to this initiative by BaFin will form the basis for their FINREP reports.

## 1.2 Work on the European and global framework

### 1.2.1 Standardised approaches versus internal models

The Basel Committee on Banking Supervision (BCBS) is currently revising the regulatory framework for risk-weighted assets (RWAs). The central issue here is the future of internal models used by banks to enable them to calculate their capital requirements.[15] A major objective of the exercise is that the capital requirements calculated by different institutions for a given portfolio should be at similar levels.[16] To achieve this, it is intended to require all institutions to determine their capital requirements using the standardised approaches for the respective risk types, i.e. in accordance with specific regulatory provisions. Where an institution employs an internal model, it is intended that the standardised approach should establish a floor for the capital requirements. The objective is also that the standardised approaches should replace internal models entirely in some cases. Against this background, the Basel Committee is currently revising the standardised approaches for credit risk, market risk and operational risk. The Committee's aim is to make the standardised approaches simpler and therefore more comparable, while at the same time preserving the greatest possible risk sensitivity. To achieve this, the Committee initially analysed weak points and then worked out possible courses of action, within the frame of requirements of the G20 and the Financial Stability Board (FSB). Where possible, the Committee derived new standardised approaches – with the simplifications necessary – from the structure of internal models, standardised definitions and reduced the number of national discretions.

The Basel Committee expects to complete the majority of this work during the course of 2016. BaFin welcomes a higher degree of risk sensitivity in the standardised approaches. However, institutions must continue to manage their risks using their own risk assessment processes. BaFin therefore also welcomes the fact that internal models may continue to be used for determining own capital requirements in accordance with Pillar 1, at least in those cases where, for example, they offer the supervisors significant advantages for the assessment of the institutions' solvency as a result of the institutions' better access to data. To the extent possible, therefore, information on the potential implications of the proposals is being gathered by means of consultation exercises and quantitative impact studies. This information will be taken into consideration in the decisions on the calibration of the various approaches and of floors, in particular. In the final analysis, the overall capital requirements should not be significantly higher than the amounts under the Basel III requirements.

15 See chapter II 9.1.

16 This objective is also referred to as reducing RWA variability.

## 1.2.2 Focus

### Securitisations in the banking book

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According to the plans developed by the Basel Committee on Banking Supervision (BCBS), the treatment of securitisation positions held in the banking book should be more risk-sensitive and appropriate than was previously the case, but simpler to use. In addition, it should be more transparent and thus more comparable. The BCBS intends to achieve this by amending the securitisation framework. The Revisions to the Securitisation Framework were published in December 2014 after almost five years of negotiations. The revised standards are planned for application from 2018 onward. The specific intention is to streamline application of the framework, including through a simplified hierarchy of approaches to determining risk weights, the number of which has also been significantly reduced. An additional aim is to reduce cliff effects, where, for instance, only slight reductions in ratings produce a considerable increase in capital requirements. Another key point is to increase the international comparability of the securitisation positions held by banks in the banking book.

The new standards will also significantly increase the capital requirements for many securitisation positions, since the BCBS has calibrated the new approaches using more conservative assumptions based on experience gained in the recent financial crisis. Moreover, additional risks relevant to securitisation have been taken into consideration in the interests of enhanced risk sensitivity, such as tranche maturity and correlations of positions within a securitisation portfolio.

In the European Union, the aim is for the new Basel securitisation framework to be implemented through the planned regulation amending the CRR.[17]

#### Criticism addressed

During the consultation process organised by the BCBS on the revisions, a number of respondents criticised the fact that the new securitisation standards would have to apply to all securitisation positions without distinction, including those that had not themselves generated increased losses during the crisis. They argued that during the crisis, losses were primarily incurred due to securitisations based on US sub-prime residential mortgages, not by investors in comparable European securitisations.

#### Simplifications at global level

The BCBS addressed the criticism before publication of the new securitisation framework and launched a review into whether criteria could be formulated for the differentiated treatment of certain securitisation positions. A joint task force[18] set up by the BCBS and the International Organization of Securities Commissions (IOSCO) developed criteria that provide for the identification of simple, transparent and comparable (STC) securitisations. It limited itself to traditional securitisations, i.e. those that include the legal transfer of the underlying asset (true sale asset-backed securities). Subsequent to this work, which it completed in July 2014, the task force was commissioned to review similar criteria for asset-backed commercial paper (ABCP) programmes. However, this was not

17 The Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV) implement Basel III in the European Union.

18 Task Force on Securitisation Markets (TFSM).

designed to cover synthetic securitisations. Here, risk is transferred via guarantees or agreements similar to guarantees and/or via financial collateral that is pledged or transferred as collateral.

As soon as it had published its new securitisation standards in December 2014, the BCBS announced a review of whether it would be reasonable to integrate the task force's STC criteria into the new securitisation standards and give preferential treatment to securitisations that meet these criteria. In its consultation paper, "Capital treatment for simple, transparent and comparable securitisations" dated 10 November 2015, the BCBS proposes a reduction in capital requirements for all tranches of traditional securitisations (with the exception of ABCPs) that meet both the STC criteria and certain additional requirements relating to credit risk. The consultation paper only gives a range of possible values in response to the issue of how far this reduction should go. The BCBS's intention is to determine this following evaluation of the quantitative impact study (QIS), conducted in parallel. The consultation on the proposal ended on 5 February 2016. All work (including ABCP) is planned for completion by the end of 2016.

### Simplifications at European level

The topic of securitisation is also on the agenda at European level. In response to a call for advice from the European Commission, on 7 July 2015 the European Banking Authority (EBA) recommended the creation of a European framework for the identification and differentiated (in effect preferential) treatment of simple, standardised and transparent (SST) securitisations.[19] In addition to detailed criteria for SST securitisations, the recommendation also contains specific preferential risk weights for this type of securitisation, namely on the basis of the new Basel securitisation framework. The EBA's objective is to ensure risk-based treatment through clearly formulated minimum requirements for the simplicity, standardisation and transparency of the securitisation concerned, and with regard to the credit quality of the underlying exposures. The aim is that preferential treatment with regard to capital requirements will only be given to securitisations where this is empirically justified. The SST criteria are based on the STC criteria developed by the BCBS and IOSCO task force, and largely coincide with these. However, in addition to SST criteria for traditional securitisations, the EBA recommendation also covers exposures to ABCP programmes.

By contrast, synthetic securitisation positions were not included in the EBA recommendation since developing specific criteria and justifying differentiated treatment for this type of transaction required separate analysis based on their specific nature and market circumstances.

### EU securitisation framework planned

The EBA recommendations form the basis for the drafts of a cross-sectoral securitisation regulation (STS regulation) and the regulation amending the CRR (discussed above), which the European Commission published on 30 September 2015. These regulations form a securitisation framework and lay the first major foundation for the planned Capital Markets Union (CMU), which is aimed at creating fully integrated capital markets in the EU by the end of 2019.[20] The objective of the European securitisation framework is to develop a sustainable European securitisation market and to revitalise this segment, which has been dormant since the financial crisis. The focus is on securitisation activities that make equal sense for banks and investors, and that create new investment opportunities for institutional investors. For the real economy, the aim is to generate additional sources of funding primarily for small and medium-sized enterprises (SMEs).

### Regulation amending the CRR

The planned regulation amending the CRR is aimed at implementing the revised Basel securitisation standards in Europe, and contains

19 Report on Qualifying Securitisation.

20 See chapter II 3.2.

the EBA recommendations on preferential treatment with regard to regulatory capital requirements for STS securitisation positions. However, there are also plans to permit the preferential treatment of certain synthetic securitisation positions under narrowly defined circumstances to promote the financing of SMEs. Preferential treatment will only apply to the senior tranches of synthetic securitisation transactions retained by the originator institution. In addition, at least 80% of the securitised portfolio must comprise exposures to SMEs. The synthetic risk transfer must be guaranteed, and the public-sector guarantor or counter-guarantor must be 0% risk-weighted under the Credit Risk Standardised Approach (CRSA).

The EBA supports the limited preferential treatment of certain synthetic securitisation positions in its Report on Synthetic Securitisation dated 18 December 2015. The analysis and observations supported the corresponding preferential treatment of the senior tranches of SME portfolios retained by the originator, while there was insufficient justification to extend this to other synthetic securitisation positions. For these reasons, the EBA recommended that the European Commission revise the STS criteria and establish specific criteria for preferential treatment to take adequate account of synthetic securitisations. In addition, the EBA advised the European Commission to consider expanding the preferential treatment for fully cash-funded structures to private, i.e. non-public sector guarantors.

### Securitisation regulation

By contrast, the cross-sectoral securitisation regulation is designed to apply to all securitisations and aims to standardise due diligence for investors, risk retention requirements for originators, sponsors or original lenders, and transparency obligations for originators, sponsors and securitisation special purpose entities (SSPEs). In addition, it defines STS criteria for the traditional securitisations and ABCP programmes eligible for preferential treatment; the aim is for compliance with these to be subject to appropriate supervision.

### ECOFIN comments in record time

The Economic and Financial Affairs Council (ECOFIN) commented on the European Commission draft at its meeting on 8 December 2015, after only nine weeks of discussion. It approved the European Commission's proposals in principle, but resolved clarifications and revisions on some points. For example, in the securitisation regulation ECOFIN intends among other things to ensure a more explicit definition of the criteria for STS securitisations – i.e. those for which simplifications are planned – and to provide a clearer distinction between securitisations and specialised lending. In addition, the intention is to ensure that originators, sponsors and original lenders can mandate an independent supervised third party to review whether the STS criteria have been met. However, the plan is for credit rating agencies to be excluded from this review function.

ECOFIN also intends to require that all originators, sponsors and original lenders comply with established and clear lending criteria for securitised and non-securitised exposures. In addition, in order to avoid costly duplication, it proposes replacing Article 8b[21] of the third Credit Rating Regulation with the provisions of Article 5 of the planned securitisation regulation. In accordance with the wishes of ECOFIN and with support from the EBA, the European Commission also plans to issue a report specifying whether certain synthetic securitisations can be included in the STS regime. In addition, ECOFIN's proposal provides more specific details of the supervisory tasks of the national supervisory authorities, their cooperation and (joint) decision-making. It also introduces a wide range of technical clarifications and amendments.

Regarding the amendments to the CRR, ECOFIN made it clear how the internal assessment approach (IAA) fits in the hierarchy of

21 Regulation (EU) No 462/2013, OJ EU L 146/1.

approaches. It intends to significantly limit the opportunity available in certain cases for the calculation of own funds to deviate from the Basel hierarchy. In addition, it intends to provide originators with the opportunity (analogous to the Basel securitisation framework) to include the value adjustments that they recognise for securitised exposures in the exposure value of securitisation positions requiring application of a 1,250% risk weight. Finally, ECOFIN clarified the relationship between the remaining maturity of a securitisation position and its seniority, and proposed a simplified method of determining risk weights for market value hedges that are included in the securitisation waterfall. Negotiations with the European Parliament had not yet begun at the time of going to press.

### 1.2.3 Revision of the trading book rules

The Basel Committee on Banking Supervision has carried out a fundamental review of its trading book capital standards and published its new standard on the minimum capital requirements for market risk[22] on 14 January 2016. With respect to the internal models approach, particularly conservative capital requirements will apply in future to risks where insufficient objective market data is available to create a robust model. The standardised approach is provided with a common methodological basis – graduated standard deviations for changes in portfolio value. In future, all institutions will have to calculate the standardised approach on an ongoing basis. This will enable supervisors to derive information on the composition of institutions' trading portfolios based on common specified sensitivities. They will therefore be in a position to make their own estimates of the institutions' profits and losses in specific risk scenarios, for example, and to obtain the information they need without creating unrest in the market.

### 1.2.4 Holder Control Regulation

With the entry into force of the CRD IV Implementing Act on 1 January 2014, the definition of "significant holding" in section 1 (9) of the Banking Act has changed. While this was previously governed – in the context of the transposition of EU directives – by national regulations, section 1 (9) sentence 1 of the Banking Act now refers to the definition of "qualifying holding" in Article 4(1)(36) of the CRR. Under those provisions, an indirect holding may still qualify as significant even if it is not held via one or more subsidiaries or similar relationships. BaFin used the adjustment required to the Holder Control Regulation *(Inhaberkontrollverordnung)* as an opportunity to simplify a number of provisions. For example, it made the notification requirements for intragroup restructurings more flexible and at the same time introduced simplified requirements for financial services providers. Acquirers of significant holdings in banks or insurance undertakings will now also submit their certificates of good conduct and extracts from the Central Trade and Industry Register to BaFin themselves.

### 1.2.5 Liquidity coverage ratio

Since 1 October 2015, the liquidity coverage ratio (LCR) has applied as the minimum requirement of Pillar 1 for credit institutions in the European Union. In order to allow institutions to make the necessary adjustments in stages, the initial minimum requirement in 2015 was 60%, increasing to 100% by 2018. The EU Commission has yet to decide whether CRR investment firms will also be required to apply the LCR.

22 Minimum Capital Requirements for Market Risk, http://www.bis.org.

In Germany, investment firms are currently still exempt from the requirement to report and comply with the liquidity coverage ratio. The introduction of the ratio is a direct response to the financial crisis, in the course of which a systemic liquidity crisis was apparent. The build-up of a reserve of highly liquid assets required by the regulatory authorities is intended to put institutions in a position whereby they can withstand an idiosyncratic and/or systemic liquidity crisis for at least one month independently of support from the central bank. Accordingly, the time horizon to which the LCR applies is 30 days. The standard adopted by the Basel Committee on Banking Supervision in January 2013 was implemented in the EU by means of a delegated regulation of the Brussels Commission.[23] This enabled numerous European specificities to be brought in at the same time. BaFin, for example, made efforts to ensure that the regulation takes into account the particular characteristics of the German banking sector. For instance, *Pfandbriefe* receive special treatment and banking network liquidity is recognised, at least to some extent.

### 1.2.6 Structural liquidity ratio

The LCR, which focuses on a short-term stress scenario, is complemented by the net stable funding ratio (NSFR), a structural indicator with a longer term horizon. BaFin was also involved in the development of this standard in the Basel Committee. The Basel Committee issued its recommendations for the NSFR in October 2014 and published the associated disclosure standards in June 2015. The standards are expected to be implemented by 1 January 2018.

Minimum requirements for the relationship between available and required stable funding available to the institution on a long-term basis are intended to prevent excessive maturity transformation in the future. In particular, the intention is to restrict the practice which came to light during the financial crisis whereby banks fund long-term assets with low liquidity using very short-term capital market securities. Nevertheless, maturity transformation remains possible to a considerable degree since, for example, the indicator takes into account the historical stability of retail deposits. These stable deposits are thus able to cover the funding requirements for residential building loans or loans to small and medium enterprises. The most recent work on the NSFR has concentrated on appropriate backing for the derivatives business using long-term funding.

The European Commission is expected to circulate a proposal for related legislation implementing the Basel Committee's NSFR recommendations in the European Union by the end of 2016. It will base its proposal on the report on the impact and calibration of the NSFR in Europe presented by the EBA at the end of 2015. In the report, the EBA argues that the introduction of the NSFR should adhere closely to the Basel guidelines.

### 1.2.7 Leverage ratio

A revised method of calculating the leverage ratio came into effect with Commission Delegated Regulation (EU) 2015/62 on 18 January 2015. The implementing standard on reporting, which has been amended accordingly and sets out the revised method of calculation, is awaiting the Commission's decision. Until it comes into effect, institutions are expected to continue to report their leverage ratios on the basis of the original version of Article 429 of the CRR, applying the implementing regulation currently in force. The implementing regulation, which sets out the details of the disclosure requirement for the leverage ratio which came into force on 1 January 2015, was published in the Official Journal of the EU in February 2016.[24]

The leverage ratio was conceived as a simple, non-risk-sensitive addition to the risk-sensitive capital requirements and has been an integral component of the supervisory reporting regime in the EU since 2014. Banks have been

23 Commission Delegated Regulation (EU) 2015/61, OJ EU L 11/1.

24 Implementing Regulation (EU) 2016/200, OJ EU L 39/5.

required to disclose it since 1 January 2015. The EBA's project team on the leverage ratio began its work in January 2015 with the aim of considering the possible introduction of the leverage ratio as a compulsory Pillar 1 requirement. The project team is preparing a report on the impact and effectiveness of the leverage ratio which has a provisional publication date of June 2016. On the basis of the report, the European Commission is expected to circulate proposed legislation for the introduction of a mandatory minimum leverage ratio by the end of 2016.

In parallel to this, corresponding review exercises are under way in Basel. They are intended to result in a recommendation by the Basel Committee on Banking Supervision in 2016 on the design of a minimum leverage ratio. The concluding revisions that the Committee intends to make to the framework of the leverage ratio prior to a final decision will be put out for consultation in the second quarter of 2016. The recommendation would then be applicable from 2018 onward.

### 1.2.8 Global systemically important banks: Review of methodology

The framework for the identification of global systemically important banks (G-SIBs) and for the determination of the capital add-on for such institutions published by the Basel Committee in July 2013 provides for a regular review of the methodology used to assess them. In 2015, therefore, the Committee continued its work in the context of the first three-year review. Among other topics, it considered the extent to which the indicators and weightings currently in use are adequate. The Committee also subjected the cap on the substitutability category introduced in 2013 to critical examination. Under the current timetable, the first three-year review will be completed in 2017.

### 1.2.9 Corporate governance

The Basel Committee also revised the corporate governance principles applying to banks and published them in July 2015. The objective of these principles is to ensure that banks have efficient internal management and organisational structures.

The Committee's revision work focused on strengthening risk management in the broader sense. In particular, it set out in greater detail the allocation of responsibilities between the individual business units, the risk management teams and the internal audit and compliance functions (three lines of defence).

The Committee also formulated a more precise definition of the monitoring role of supervisory bodies. Furthermore, it emphasised the fact that supervisory and management bodies collectively should have the necessary technical qualifications. This was backed up by the requirement for individual members of those bodies to devote sufficient time to discharging their responsibilities.

In addition, the Committee stressed the importance of an appropriate risk culture. It also expressed the view that a good system of remuneration with an adequate incentive scheme was indispensable. In this connection, it also indicated the importance of a code of conduct or code of ethics whereby every bank can set standards for the actions of its own employees it wishes to encourage or discourage, respectively.

The revision of the corporate governance principles is especially important for states outside the EU, since European legislation already complies with these principles to a very great extent. Nevertheless, there will be further adjustments in the European Union as well.

### 1.2.10 Government bonds

In 2015, the Basel Committee also began the process of reviewing the regulatory treatment of government bonds. This new initiative forms part of the Committee's reform agenda resulting from the financial and sovereign debt crisis. At the present time, the Committee is engaged in discussions on the various options

available with regard to a possible revision of the existing framework. There are two central approaches to reform: on the one hand, modification of the risk weighting and, on the other, the introduction of a large exposure limit for exposures to sovereign borrowers.

Germany is in favour of an appropriate revision of the regulatory treatment of government bonds. A complete decoupling of the nexus between sovereign borrowers and banks can only be achieved by means of appropriate regulatory treatment of loans to government bodies, although the current definition of government bodies is very broad. Its meaning covers national and regional governments, local authorities and public-sector entities. Suggested proposals for reform will also be presented to the wider public in the form of a consultation process at the beginning of 2017.

## 1.3 Restructuring

### 1.3.1 Overview

BaFin uses the term restructuring to encompass a whole range of initiatives with similar objectives that were introduced as a consequence of the financial crisis in 2008. They are intended to provide the impetus for solutions to the "too big to fail" problem. The aim is to strengthen the resilience of major banking networks and banks operating on an international scale or to have the option of allowing them to enter orderly insolvency proceedings in the event of financial difficulties, avoiding the need to rescue them using public funds.

In order to solve this problem, the Financial Stability Board (FSB), the Basel Committee and European and national legislators have developed standards that have been incorporated in the supervisory practices of the SSM and of BaFin. In 2015, the focus was on the identification of financial institutions posing a potential systemic risk (*potenziell systemgefährdende Institute* – PSIs), the establishment of higher capital requirements for global and domestic systemically important banks, recovery and resolution planning and, finally, structural measures for banks.

Financial institutions posing a potential systemic risk include all institutions already identified as global and other systemically important institutions, and those which are unable to take advantage of simplified obligations or the exempting provisions for the purposes of recovery planning. Financial institutions posing a potential systemic risk are important for a number of reasons: If the situation of such institutions becomes critical, this could trigger a threat to the whole system in certain circumstances. The legislation therefore imposes a variety of additional regulatory requirements which these institutions must comply with.

#### EBA guidelines

In collaboration with the national competent authorities, the EBA has developed two sets of guidelines on the systemic importance of institutions that were due to be implemented nationally in 2015. The first set of EBA guidelines is intended to enable national systemically important banks to be identified. The latter must – in the same way as the global systemically important banks (G-SIBs) for which the FSB developed the criteria – meet higher capital requirements. This serves the purpose of reducing the potential impact of the greater systemic risks to which they give rise. The second set of EBA guidelines provides the basis for identifying other financial institutions posing a potential systemic risk. All of the guidelines – including a further set issued by the Financial Stability Board – deal with comparable matters and use similar criteria and indicators. BaFin has therefore decided jointly with the Deutsche Bundesbank to consolidate all three sets of guidelines in the methodology for the identification of financial institutions posing a potential systemic risk.

#### Improved recovery planning

Recovery planning also increases the institutions' resilience, in addition to more stringent capital requirements. BaFin has revised the "Minimum Requirements for

the Contents of Recovery Plans" (*Mindestanforderungen an die Ausgestaltung von Sanierungsplänen* – MaSan)[25], since in 2015 the EBA, among other initiatives, developed guidelines relating to scenarios and indicators that must be observed at national level. Furthermore, since 2015 all institutions have been required to draw up recovery plans and implement them in their business organisation on the basis of the Recovery and Resolution Act *(Sanierungs- und Abwicklungsgesetz)*. Financial institutions that do not pose a potential systemic risk may take advantage of simplified obligations or exempting provisions. The revised MaSan also deal with the specific contents of simplified recovery plans.[26] To enable the recovery plans to be evaluated in the JSTs, the SSM is also developing its own assessment benchmarks which BaFin is helping to design. Partly for this purpose and also for the assessment benchmark for qualitative requirements affecting the recovery plans of comparable institutions, BaFin is gaining significant knowledge from the annual benchmark comparisons of the recovery plans. The result is an overall improvement in the quality of recovery planning.

### Loss-absorption in resolutions

The Federal Agency for Financial Market Stabilisation (*Bundesanstalt für Finanzmarktstabilisierung* – FMSA) has responsibility for the institutions' resolution planning. The area of responsibility of the National Resolution Authority (*Nationale Abwicklungsbehörde* – NAB), which currently forms part of the FMSA, is intended to be integrated into BaFin as an independent operating entity.[27] In order to bring the experience of the supervisory authority into the resolution planning function, various duties of cooperation are planned for BaFin. In 2015, BaFin collaborated on initiatives of the FSB aimed at removing impediments to resolution: progress was made in particular on the recognition of legislative acts in foreign countries and the suspension of termination rights for financial instruments. In addition, BaFin took the lead in setting standards relating to the absorption of losses and recapitalisation in the event of resolution. Basel III tightened the own funds requirements for banks so that they have adequate funds at their disposal to absorb unforeseen losses in their normal business operations (going concern). If these resources have been used up, however, the resolution of the institution is likely. The FSB addressed the issue of how institutions can maintain sufficient resources in order to absorb all losses and be adequately recapitalised. The FSB presented its answer at the meeting of the G20 on 15 and 16 November 2015: It submitted a proposal for a standard on loss-absorption and recapitalisation in the event of resolution (total loss-absorbing capacity – TLAC) which the G20 approved.[28]

### Standards and guidelines on the Bank Recovery and Resolution Directive

In 2015, the EBA completed the regulatory technical standards and guidelines provided for by the Bank Recovery and Resolution Directive (BRRD). BaFin collaborated on the development of these standards and guidelines in the relevant EBA working groups. The EBA began this work in 2012 since a total of around 40 technical standards and guidelines had to be produced. They address further aspects of issues relating to recovery and resolution such as, for example, the requirements for the contents of recovery and resolution plans and a more detailed description of the criteria used to establish a threat to an institution's continued existence. They also include the criteria used to set the minimum requirement for own funds and eligible liabilities (MREL). The intention of the European Commission is to combine all of the regulatory technical standards provided for by the BRRD in one document and at the same time to issue it as a delegated regulation.

25 Circular 3/2014 (BA).

26 See 1.3.6.

27 See I.5.

28 Financial Stability Board, "Principles on Loss-Absorbing and Recapitalisation Capacity of G-SIBs in Resolution – Total Loss-Absorbing Capacity (TLAC) Term Sheet" dated 09 November 2015. See also chapter I 2.

### Banking structural reform

2015 also recorded progress in the field of the structural reform of banks. At the European level, the Council established a general approach to the European Commission's proposal for a regulation on banking structural reform. Now the European Parliament must agree on a common position on the Commission's proposal before a European regulation can be adopted. The German legislature had already decided on its own rules for the structural reform of banks in 2013 in the form of the Ringfencing Act *(Abschirmungsgesetz)*.[29] The central objective of both initiatives is to protect customers' deposits against potential risks from other activities in which the bank is engaged. Under the Ringfencing Act, institutions within its scope had to carry out a risk analysis by the end of 2015 in order to identify their potentially risky business activities, which must in principle be terminated or separated by 1 July 2016. In order to assist the institutions affected with their risk analysis, BaFin has issued interpretive guidance on the Ringfencing Act. This provides the institutions in question with reliable indications of how to properly implement the requirements of the legislation.

## 1.3.2 Determination of financial institutions posing a potential systemic risk

In 2015, BaFin together with the Deutsche Bundesbank identified a total of 37 institutions in Germany as financial institutions posing a potential systemic risk (*potenziell systemgefährdende Institute* – PSIs) within the meaning of section 20 (1) of the Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz* – SAG). An institution is regarded as posing a potential systemic risk if it is either a global systemically important institution (G-SII) or an other systemically important institution (O-SII), or if the relevant institution does not meet the criteria allowing it to apply the simplified obligations for its recovery plan set out in section 19 (2) of the SAG. Of the 37 German financial institutions posing a potential systemic risk, 16 are other systemically important institutions (O-SIIs), while one is a global systemically important institution.

The methodology used for identifying G-SIIs is set out definitively in Delegated Regulation (EU) No 1222/2014[30] of the European Commission. The procedure is consistent with the Basel Committee's valuation method for assessing the systemic importance of an institution for the global financial market which is applicable worldwide. It is based on the five criteria of size, interconnectedness, substitutability, complexity and cross-border activity.

### Identification of O-SIIs

BaFin and the Deutsche Bundesbank have jointly developed a methodology for identifying the other systemically important institutions which conforms to international and national requirements. The methodology is based on the criteria set out in section 10g (2) of the Banking Act, taking into account the provisions of the EBA guidelines relating to the criteria for the assessment of other systemically important financial institutions.[31] This joint methodology comprises two stages. The first stage applies a standardised scoring model prescribed by the EBA, with mandatory indicators for the size, interconnectedness, complexity and substitutability categories. The second stage, national supervisory discretion, consists of an expansion of the first-stage scoring model at national level and an expert opinion. By exercising this national discretion, BaFin and the Deutsche Bundesbank intend to ensure that the particular features of the German banking sector are taken into account adequately in the process of identifying other systemically important institutions.

29 Act on Ringfencing and on Recovery and Resolution Planning for Credit Institutions and Financial Groups *(Gesetz zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten und Finanzgruppen)* of 7 August 2013, Federal Law Gazette I no. 47, page 3090. See 1.3.3.

30 Commission Delegated Regulation (EU) 1222/2014, OJ EU L 330/27.

31 European Banking Authority, Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs), EBA/GL/2014/10 of 16 December 2014.

### No simplified obligations

Those institutions which are not permitted to apply simplified obligations for the recovery plan are identified using the criteria set out in section 19 (2) of the SAG. The procedure also observes the EBA guidelines on the application of simplified obligations.[32] The decision as to whether simplified obligations are sufficient for the recovery plans ultimately depends on whether the relevant financial institution poses a potential systemic risk. Accordingly, many of the indicators used in the guidelines on the application of simplified obligations and the guidelines relating to the criteria for the assessment of other systemically important institutions are identical. The scoring model for the identification of other systemically important institutions already incorporates the criteria of size, interconnectedness and complexity from the EBA guidelines on the application of simplified obligations. It is therefore also suitable in principle for determining those institutions which are not permitted to apply simplified obligations.

The scoring model for the identification of other systemically important institutions therefore already represents a consistent and coherent procedure for preselecting those institutions which BaFin cannot allow to apply simplified obligations. For this purpose, a threshold value is specified for the overall score. If the threshold is exceeded, the assumption can be made that the institution's failure and resolution in insolvency proceedings will have a significant negative impact on the financial markets, on other institutions, on their funding or on the economy as a whole. Further assessment is not necessary for these institutions. Those institutions for which the application of simplified obligations is not already ruled out on the basis of the results of the scoring model, are assessed by BaFin by means of a qualitative analysis.

This analysis includes the following criteria from the EBA guidelines on the application of simplified obligations in its evaluation: the risk profile of the institution, its legal status, the nature of its business activities, its ownership/shareholding structure, its legal form and its membership of an institutional protection scheme or other cooperative mutual solidarity systems in accordance with Article 113(7) of the CRR.[33]

To enable it to arrive at its overall opinion in the qualitative analysis, the supervisor must also take into account the circumstances of the particular case. Simplified obligations are only permissible if BaFin comes to the conclusion that the institution's failure and resolution in insolvency proceedings would not have a significant negative impact on the financial markets, on other institutions, on their funding or on the economy as a whole. Unless this is the case in all respects, the institution is identified as a financial institution posing a potential systemic risk (PSI). BaFin and the Deutsche Bundesbank have consolidated these three sets of guidelines into a PSI methodology.

### O-SII or PSI

The specific regulatory requirements depend on whether an institution is assessed as an other systemically important institution (O-SII) or as an other institution posing a potential systemic risk (PSI). At the end of 2015, in consultation with the Deutsche Bundesbank, BaFin for the first time classified 16 institutions domiciled in Germany as other systemically important institutions within the meaning of section 10g (2) of the Banking Act. These institutions must maintain an additional institution-specific capital buffer consisting of Common Equity Tier 1 capital (O-SII buffer) amounting to up to 2% of the total risk exposure amount on a consolidated basis. The level of the institution-specific capital buffer depends on the degree of systemic importance associated with the relevant institution. The prescribed capital buffers must be maintained from 1 January 2017 onward to the extent of 25% of the O-SII buffer. They will be increased proportionally to 100% of the O-SII buffer by 1 January 2020 (phase-in). In addition to the O-SII

32 EBA/GL/2015/16.

33 Regulation (EU) No 575/2013, OJ EU L 176/1.

buffer, O-SIIs are subject to further regulatory requirements such as, for example, those relating to risk data aggregation capabilities and the procedures for risk reporting as prescribed by document BCBS 239.[34] Both other systemically important institutions and all other financial institutions posing a potential systemic risk have to comply with additional supervisory obligations. In accordance with section 20 (1) sentence 2 of the SAG, for example, institutions posing a potential systemic risk cannot be exempted from the obligation to prepare a recovery plan. They are also not permitted to take advantage of simplified obligations within the meaning of section 19 of the SAG. In addition, the Banking Act contains specific provisions for financial institutions posing a potential systemic risk which limit the number of directorships that management board members and members of the administrative or supervisory bodies are allowed to hold. Further specific rules are derived, for example, from the Remuneration Ordinance for Institutions (*Institutsvergütungsverordnung* – InstitutsVergV). Under section 17 of the InstitutsVergV, financial institutions posing a potential systemic risk must be treated as "significant institutions", which are therefore subject to particular requirements relating to their remuneration systems. Furthermore, institutions of that type must comply with shorter reporting intervals in accordance with section 12 of the Financial and Internal Capital Adequacy Information Regulation *(Finanz- und Risikotragfähigkeitsinformationen-verordnung)*.

34 Basel Committee on Banking Supervision, "Principles for effective risk data aggregation and risk reporting", January 2013.

## 1.3.3 Focus

### Ringfencing Act

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Ringfencing the deposit and credit business of large banks from certain risk activities, primarily from proprietary trading in financial instruments, represents a further contribution to solving the "too big to fail" problem. Such ringfencing regulations, i.e. the separation of commercial and investment banking, reduce institutions' complexity and are aimed at making it easier for them to be resolved. They are also designed to prevent banks above a certain size from experiencing financial difficulties due to losses in the investment business, and to prevent these speculative losses from jeopardising customer deposits. Ultimately, banks should not use deposits to finance speculative, high-risk strategies without an appropriate risk premium. Risk-adjusted pricing reduces the incentive to take inappropriately high risks.

German legislators have already introduced ringfencing regulations in Article 2 of the Ringfencing Act[35], which entered into force on 31 January 2014.

#### Prohibited business

The Ringfencing Act introduces a wide range of prohibitions into the Banking Act *(Kreditwesengesetz)*. They relate to proprietary

35 Act on Ringfencing and on Recovery and Resolution Planning for Credit Institutions and Financial Groups (*Gesetz zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten und Finanzgruppen*) of 7 August 2013, Federal Law Gazette I, page 3090.

business, credit and guarantee business with certain hedge funds, EU AIFs[36] and foreign alternative investment funds, as well as high-frequency trading if this is not conducted as market making.

The terms "proprietary business" and "proprietary trading" tie in to the categories applied in supervisory practice. It must be noted that proprietary business is prohibited regardless of its actual inherent risk. The narrow definitions in accordance with section 1 (1) sentence 2 no. 2 of the Banking Act (credit business) and section 1 (1) sentence 2 no. 8 of the Banking Act (guarantee business) must be referenced to determine what is understood by prohibited credit and guarantee business with alternative investment funds. Credit and guarantee business with AIFs is included if it involves a considerable degree of leverage.

There is no prohibition on business to hedge transactions with customers, the institution's interest rate, exchange rate or liquidity management, or the acquisition or disposal of long-term equity investments.

### Scope of the Ringfencing Act

The Ringfencing Act applies to undertakings that must be classified as part of a group of institutions, a financial holding group or a mixed financial holding group in accordance with section 10a of the Banking Act. This includes CRR credit institutions[37] and undertakings that are members of the same group as CRR credit institutions whose trading activities and total assets reach certain thresholds. The thresholds assigned to trading activities do not therefore correspond to the scope of prohibited business. The prohibition does not apply to smaller credit institutions that conduct prohibited business below the thresholds.

### Termination or transfer of prohibited business

The CRR credit institutions and undertakings covered by the provisions of the Ringfencing Act must identify their prohibited business within six months by way of a risk analysis. Within twelve months, they must either terminate this business or transfer it to a financial trading institution. The financial trading institution must be an economically, organisationally and legally independent undertaking.

The transitional provisions provide for initial application of the requirements on 1 July 2015. Credit institutions were therefore required to identify the business covered by the prohibition by 31 December 2015. They must either terminate this business or transfer it to a financial trading institution by 1 July 2016. In addition, from 1 July 2016 BaFin can order the discontinuation or transfer of further business – in particular market making (caseby-case authorisation). Conducting prohibited business is punishable by imprisonment or a fine.

### Interpretive guidance on the Ringfencing Act

The institutions concerned raised a number of fundamental questions before the Ringfencing Act entered into force. As a result, BaFin and the Deutsche Bundesbank developed interpretive guidance aimed at providing the credit institutions with reference on how to carry out the risk analysis and how to implement the subsequent compliance process to be able to identify prohibited business. It also provides the prosecuting authorities with guidance on how to assess facts from a legal viewpoint.

The institutions affected by the Ringfencing Act were given the opportunity to submit comments to BaFin by 29 January 2016.

### International approaches

The Ringfencing Act implements the concept of intragroup ringfencing, and hence retains the benefits of the universal banking model. This approach differs from that of a group-wide prohibition. For example, the ringfencing

36 AIF stands for alternative investment fund. The Directive on Alternative Investment Fund Managers (Directive 2011/61/EU, OJ L 174/1) defines an EU AIF as an AIF which is authorised or registered in a member state under the applicable national law, or an AIF which is not authorised or registered in a member state, but has its registered office and/or head office in a member state.

37 The term "CRR credit institution" is defined in section 1 (3d) of the Banking Act. The name is derived from the Capital Requirements Regulation (CRR) and replaces the term "deposit-taking credit institution".

regulations in the United States, introduced through the Glass-Steagall Act of 1933, required a strict separation between commercial banks (that conducted deposit and credit business) and investment banks. Today, the Volcker Rule, named after former Federal Reserve chairman Paul Volcker, is in force in the United States and forms a core element of the Dodd-Frank Act.

The Dodd-Frank Act prohibits depositary institutions, their holding companies, subsidiaries and affiliates – irrespective of their size – from engaging in business that is classified as particularly high-risk. In addition, the Dodd-Frank Act provides for stringent reporting and compliance rules, but without reintroducing the strict separation of commercial and investment banks under the Glass-Steagall Act.

In the United Kingdom, the Independent Commission on Banking (ICB), chaired by well-known economist Sir John Vickers, recommended ringfencing retail banking and banking services relevant to the economy. Retail deposit, lending and payment services are spun off into an independent company that can remain part of a banking group. The ICB's proposals were introduced in the Financial Services (Banking Reform) Act 2013.

### Liikanen Report

In 2012, the European Commission established a high-level expert group chaired by Erkki Liikanen, governor of the Bank of Finland (the Liikanen Group). It was tasked with developing recommendations aimed at establishing a safe, stable and efficient banking system serving the needs of citizens, the EU economy and the internal market. The group published a report in October 2012 (the Liikanen Report) that recommended separating proprietary trading activities and other high-risk trading from the ordinary activities of a deposit-taking credit institution into various business units.

### European Commission proposal for a regulation on structural reform

The European Commission addressed the recommendations of the Liikanen Group in its proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions (Banking Structural Reforms – BSR) of 29 January 2014. The Economic and Financial Affairs Council agreed a joint position (negotiating stance) of the Council of the European Union on the Commission's proposal on 19 June 2015. The commencement of negotiations on the final version of the BSR regulation is planned once the European Parliament has agreed on a position.

### Draft BSR regulation and the Ringfencing Act

Some provisions of the draft BSR regulation differ from those of the Ringfencing Act. For instance, 11 credit institutions are expected to be subject to the Ringfencing Act. By contrast, an impact study by the European Commission's Joint Research Centre indicates that just eight institutions will be affected by the draft BSR regulation. The European Commission's draft regulation covers systemically important credit institutions and credit institutions with total assets in excess of €30 billion, or trading activities of at least €70 billion or 10% of their total assets.

A further difference is that, under the Ringfencing Act, the supervisory authority decides on a case-by-case basis whether to order the discontinuation or transfer of further business, and has scope for discretion in making its decision. By contrast, in certain cases the draft BSR regulation requires that supervisory authorities demand the transfer of other activities to a separate financial trading institution.

### Summary

Although the draft BSR regulation and the Ringfencing Act are comparable in their fundamental orientation, their specific provisions are not consistent. Even after the European Council and European Parliament have agreed on a final regulation, it is anticipated that this will not correspond to the provisions of the German Ringfencing Act. This is expected to pose particular challenges for German institutions that are already

subject to the Ringfencing Act. However, the proposed European regulation on structural reform creates a level playing field for all credit institutions in the single market, and avoids regulatory arbitrage and regulatory competition.

### 1.3.4 Recovery planning

In 2015, BaFin evaluated the recovery plans of more than 30 credit institutions. This involved the supervisory authority examining, among other things, whether the plans submitted complied with the requirements of the EU Bank Recovery and Resolution Directive, as specified in detail by the relevant regulatory standards and guidelines of the EBA as well as the Recovery and Resolution Act, and whether they were capable of achieving the objectives of the recovery planning process. The objective of recovery planning is to enable institutions to manage crises on their own without the need for the supervisory authority to step in. Options that institutions can take in the event of a recovery therefore represent some of the core elements of any recovery plan. The institutions are also

#### Initial results of the 2015 benchmark comparison[38]

The principal areas of focus for the 2015 benchmark comparison were the recovery options and indicators and the crisis scenarios of the recovery plans evaluated. The institutions are required to present appropriate recovery options for the purpose of strengthening their financial positions in their recovery plans. A total of more than 300 recovery options were outlined in the plans submitted relating, for example, to capital, liquidity and risk reduction. Options considered to be appropriate by the institutions included, in particular, the sale of shareholdings, capital increases by the owner or third parties and the disposal of other assets. The institutions must also analyse in detail potential significant obstacles to the recovery options in their recovery plans. A few institutions presented these obstacles and possible approaches to overcoming them in detail in the 2015 benchmark comparison. But the majority of institutions restricted themselves to a simple listing of general headings.

The benchmark comparison showed that there is still room for improvement in the description of the financial impact of the recovery options employed in the various crisis scenarios – including, among other aspects, the documentation of the quantitative assessments presented. The same goes for the timeframes for implementation assumed by the institutions, which were too optimistic in many cases.

The picture that emerged from the recovery indicators was as follows: The institutions typically rely on the CET1 ratio, the total capital ratio and the leverage ratio as capital indicators; the liquidity coverage ratio is generally preferred as the recovery indicator for liquidity. Some of the new recovery indicators included in the EBA guidelines on recovery indicators[39], however, such as return on assets, stock price variation, the cost of wholesale funding, the coverage ratio and CDS of sovereigns, were used very little, if at all.

38 The results of a comprehensive evaluation of the benchmark comparison were not yet available at the time of going to print.

39 Guidelines on the minimum list of qualitative and quantitative recovery plan indicators.

required to establish indicators which allow them, in the event of a crisis, to take appropriate early measures to restore their long-term financial viability. In addition, they must carry out a stress analysis as part of the recovery plan, which must include both serious idiosyncratic stress scenarios and those affecting the market as a whole, as well as sudden developments and those arising over a longer period of time.

In order to consistently improve the quality of recovery planning and at the same time ensure that a uniform assessment benchmark is established for comparable institutions, BaFin together with the Deutsche Bundesbank undertakes an annual benchmark comparison of the recovery plans submitted. The benchmark comparison carried out in 2015 (see info box "Initial results of the 2015 benchmark comparison", page 108) also focused in particular on the revised regulatory requirements for the indicators used, recovery options and the stress scenarios presented. In addition, the current benchmark comparison featured a significant increase in the level of detail compared with the previous year.

### 1.3.5 Supervisory involvement in resolution planning

#### Total loss-absorbing capacity

The FSB has developed a minimum standard (Total Loss-Absorbing Capacity – TLAC) to ensure that global systemically important banks (G-SIBs) are in a better position to absorb losses. BaFin was closely involved in designing the standard. It is intended to ensure that sufficient appropriate liabilities are available to credit institutions in the event of resolution that can be converted into equity (bail-in). It consists of the minimum capital requirements under Basel III and an additional gone-concern loss-absorbing and recapitalisation potential. The G20 approved the final version of the TLAC standard in November 2015. The standard must now still be implemented into EU law.

In accordance with G20 provisions, global systemically important banks must maintain a TLAC of at least 16% of risk-weighted assets and at least 6% of the Basel III leverage ratio as from 1 January 2019. The national competent authorities may also stipulate higher requirements in individual cases. From 1 January 2022, the minimum requirements will increase to 18% of risk-weighted assets and 6.75% of the leverage ratio. All instruments forming part of Basel III minimum capital, i.e. Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Tier 2 (AT2), can be counted towards the TLAC. This also applies to subordinated liabilities with a minimum remaining term to maturity of one year that do not contain derivative elements. The legal implementation of this G20 requirement in the European Union will also have to clarify the relationship between the TLAC and the minimum requirement for own funds and eligible liabilities (MREL, see info box "MREL"), prescribed by the Bank Recovery and Resolution Directive.

**MREL**

An orderly resolution requires adequate capital – in addition to regulatory own funds. The European Union has therefore created a minimum requirement for own funds and eligible liabilities (MREL) in the Bank Recovery and Resolution Directive. The MREL came into effect at the beginning of 2016 and applies to all institutions. Germany implemented the provisions at the end of 2014 in the context of the Recovery and Resolution Act. Similarly to the TLAC, the MREL requires institutions to maintain adequate liabilities that could be rapidly written down or converted into equity in the event of the institution's failure.

#### Bank insolvency – change in ranking of debts

The TLAC standard essentially has two objectives: that institutions have adequate potential to absorb losses and recapitalise themselves, and that the competent authority can make use of this potential in the event of a resolution and do so without significant legal

risks. In such situations, it is crucially important that measures taken by the resolution authority are credible in order to avoid conflict. In this respect, a significant challenge is posed by the principle firmly established in the European recovery and resolution regime that no creditor may be placed in a worse position in a resolution than would be the case in normal insolvency proceedings (no creditor worse off – NCWO).

A change in the statutory ranking of claims in the insolvency of financial institutions will reduce the legal risks. At the same time, it will improve the ability of institutions to achieve a resolution. BaFin collaborated closely on this change. As a result of the Resolution Mechanism Act *(Abwicklungsmechanismusgesetz)*, claims arising from long-term, unsecured instruments will be satisfied after all other non-subordinated claims, but before subordinated debt and equity from 1 January 2017. An institution's liabilities arising from these debt instruments will also be highly suitable for a bail-in. It can therefore be expected that, in the event of the resolution of an institution, they will be used for a bail-in before other non-subordinated liabilities that are less useful for this purpose. The latter include, for example, liabilities with derivative elements or demand deposits of major companies in the real economy. It would be too complicated to convert these into equity at short notice or would involve contamination risks.

### Recovery and resolution of financial market infrastructures

Financial market infrastructures (FMIs) such as central counterparties (CCPs) make the financial markets more efficient. On the other hand, however, they are particularly exposed to accumulations of risks. As a result, their failure can entail far-reaching consequences for financial stability.

In 2015, therefore, the Financial Stability Board, the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO), with assistance from BaFin, prepared a joint programme for further work on the regulation of central counterparties. The focus is on the resilience of CCPs, but also on their recovery and resolution.

A substantial part of the work programme consists of developing standards for the improved resolvability of central counterparties. Two international working groups at the FSB, in which BaFin is also represented, are dedicated to this topic. A third group is analysing the networking of central counterparties. The FSB's cross-border crisis management group for FMIs is using these findings, analysing the impediments which arise to the resolution of central counterparties and, if necessary, developing standards with the aim of improving their resolvability.

### ISDA Resolution Stay Protocol

In 2014, a total of 18 global systemically important institutions signed a supplementary protocol to the Master Agreement of the International Swaps and Derivatives Association (ISDA) which makes it significantly easier to deal with derivatives in the event of a resolution (see info box "ISDA Master Agreement"). As a result of signing the ISDA Resolution Stay Protocol, the institutions mutually recognise situations in which foreign resolution regimes of the relevant counterparties provide for termination rights to be suspended and this is

**ISDA Master Agreement**

The "Master Agreement" of the International Swaps and Derivatives Association (ISDA) is a standard contractual framework for derivatives trading which lays down the fundamental obligations of the trading parties for all individual transactions. This voluntary agreement is supported by annexes and supplements, as well as other materials. Supplementary protocols expand the provisions of the agreement for signatories entering into transactions with each other under the agreement.

ordered by the respective foreign resolution authority. This affects institutions' termination rights arising from derivatives contracts under the ISDA Master Agreement. Since 2015, contracts under standard agreements for repo and secured lending transactions have also fallen within the scope of the protocol. BaFin closely followed and provided assistance to the negotiations on the extension of the protocol – as it did in 2014. The group of signatories is intended to be expanded further in 2016 to include additional institutions as well as asset managers and hedge funds.

At the same time, section 60a of the Resolution Mechanism Act, as an accompanying regulatory measure, has introduced a new regulation into the Recovery and Resolution Act. It provides that from 1 January 2016 institutions must require their counterparties to recognise the provisions of the German resolution regime relating to the suspension of termination rights, if they enter into financial contracts with them which are subject to the laws of a non-EU state or if the counterparty is domiciled in a non-EU state.

### 1.3.6 Outlook: Minimum Requirements for the Contents of Recovery Plans

The preparation of recovery plans for financial institutions posing a potential systemic risk has been mandatory in Germany since 2012. The Recovery and Resolution Act, which has been in force since 1 January 2015, implements the provisions of the European Bank Recovery and Resolution Directive and extends the obligation to prepare recovery plans to all institutions. The requirements for the contents of recovery plans are also derived from the guidelines of the EBA on scenarios and indicators in recovery plans, and from a regulatory technical standard which the European Commission is expected to issue at the beginning of 2016.

Until the Recovery and Resolution Act came into effect at the beginning of 2015, the requirements for the contents of recovery plans were set out in section 47 ff. of the KWG and in the "Minimum Requirements for the Contents of Recovery Plans". However, in the light of the new provisions of the Bank Recovery and Resolution Directive and of the EBA, the requirements in that circular are no longer up-to-date.

The Resolution Mechanism Act has newly introduced section 21a (1) of the Recovery and Resolution Act. This empowers the Federal Ministry of Finance to formulate minimum requirements for the contents of recovery plans in a legal regulation. The purpose of the regulation is to implement the EBA guidelines on scenarios and indicators in recovery plans into German law. In addition, the regulation will also include a description of the contents of simplified requirements for recovery plans. The basis for these simplified requirements is that the SAG allows the possibility of permitting financial institutions that do not pose a potential systemic risk to comply with simplified obligations for the purposes of recovery planning. In accordance with section 20 of the Recovery and Resolution Act, the supervisory authority may exempt institutions from the obligation to prepare a recovery plan, if they belong to an institutional protection scheme and do not pose a potential systemic risk.[40] In cases of this nature, the institutional protection scheme is responsible for preparing a recovery plan for the institutions covered by the exemption. The power to issue the regulation extends to the application, the preconditions for the exemptions and the requirements for the contents of such recovery plans.

40 See 1.3.2.

## 1.4 Focus

### Revised version of the MaRisk

Author: Markus Hofer, BaFin Division for SREP, Remuneration Schemes and Operational Risk

BaFin and the Bundesbank jointly developed proposed amendments to the Minimum Requirements for Risk Management (MaRisk) in 2015 and put these out for consultation on 18 February 2016. The draft circular was discussed by the MaRisk expert committee, which is made up of supervisory experts and experts from practice.

Among other things, the amendments focus on transposing the Basel Committee on Banking Supervision (BCBS) requirements on risk data aggregation and risk reporting[41] into German supervisory practice. There is a need for subsequent supervisory improvement with regard to the resulting requirements for IT system efficiency. The supervisors also addressed the topic of "risk culture in banking" and expanded the MaRisk as appropriate. There have been several international initiatives in this field in the recent past, for example by the Financial Stability Board (FSB). BaFin and the Bundesbank have tied in to these initiatives with their supplements to the MaRisk. In addition, the supervisors focused on expanding the requirements for outsourcing, which constitute a further major issue as part of the revision.

#### Outsourcing

The supervisors used the increasing number of doubts and questions surrounding the requirements for outsourcing as an opportunity to make several clarifications and supplements in module AT 9[42] of the MaRisk. Their explicit objective was to provide a closer definition of the boundaries for outsourcing, in particular in the control areas of risk control, compliance and internal audit. It will therefore no longer be possible to fully outsource the risk control function in the future. The other key control areas – the compliance function and internal audit – can only be fully outsourced at small institutions with very limited resources. In addition, the supervisors will require centralised outsourcing management in the future, which will have to be established at least by institutions with extensive outsourcing solutions.

Other adjustments to outsourcing are also being proposed, although these mainly deal with clarifications to existing requirements such as those relating to sub-outsourcing, the differentiation between outsourcing and external procurement or on dealing with the involuntary termination of outsourcing.

#### Expansion of risk data aggregation capabilities

The new module AT 4.3.4 of the MaRisk implements the BCBS requirements discussed above and is primarily intended to improve the IT infrastructure of large and complex institutions, namely by enabling an up-to-date and exact aggregation of risks on the most automated basis possible. The new module is aimed exclusively at these large and complex institutions. The objective is to provide decision-makers at these banks with decision-relevant data and information concerning internal reporting, enabling them to respond rapidly to changes in the institution's risk situation and its economic environment. The expansion of risk data aggregation capabilities and the associated need to modify IT systems will require some effort on the part of the institutions concerned. However, this should considerably improve reporting and make it available in a more timely manner.

41 Principles for effective risk data aggregation and risk reporting (BCBS 239).

42 General part.

### Principle of proportionality emphasised

With regard to reporting, the supervisors have combined the existing reporting requirements in the new module BT 3[43] and have expanded these to include further aspects from the Basel Committee paper. The new module is aimed at all institutions, but makes it clear that the way they implement it must be proportional. Since most of the requirements are already familiar from the current version of the MaRisk and were introduced many years ago, it is not expected that this point will result in an excessive burden for the majority of institutions.

### Appropriate risk culture

The development, advancement and integration of an appropriate risk culture within the institution, which in the future will be required from an institution's management in AT 3, is effectively an expansion of existing requirements. These already aim for an institution to operate strictly within the risk appetite defined by the management board. Although an appropriate risk culture is already established in the existing requirements, in essence it goes further. The real purpose is to promote conscious analysis of risk in the institution's day-to-day business and to firmly anchor this risk assessment in its corporate culture. The aim is therefore to create an awareness of risk at all levels of the institution, which shapes the everyday thought and action of all employees. Among other things, this requires the initiation of a critical dialogue on risk-relevant topics within an institution, which should be fostered by the respective management level. It also includes a clear commitment on the part of the management board and all employees to observe the defined value system and code of practice (in some circumstances still to be developed) in order to avoid situations in which the institution and its employees break the law or act in an ethically questionable manner.

### Publication of the final version and entry into force

The consultation on the revised version of the MaRisk is nearing completion, and the final version of the new circular is expected in the summer.[44] Although the new MaRisk will enter into force upon publication, BaFin will provide sufficient transitional periods for application of the new requirements, as it has always done. Detailed information was not available at the time of going to press, however this will be provided in the letter accompanying the final version of the MaRisk.

43 Special part.

44 Copy deadline: 31 March 2016.

## 1.5 Minimum Requirements for the Security of Internet Payments

### Improved consumer protection for internet payments

On 5 May 2015, BaFin published its "Minimum Requirements for the Security of Internet Payments" (*Mindestanforderungen an die Sicherheit von Internetzahlungen* – MaSI).[45]

BaFin's first draft was very closely based on the text of the EBA guidelines on the security of internet payments.[46] Nevertheless, it also included a number of revisions to reflect the specific circumstances of the German banking sector. In the course of the consultation exercise, however, the banking industry expressed the desire to use a word-for-

45 Circular 4/2015 (BA), www.bafin.de/dok/6166312.

46 Consultation 02/2015 – Minimum Requirements for the Security of Internet Payments, www.bafin.de/dok/5877574.

word translation of the EBA guidelines. BaFin complied with this request, in consultation with the Federal Ministry of Finance, in order to ensure that German banks receive the same treatment as other European institutions.

The MaSI came into effect at the date of their publication on BaFin's website. In order to allow the institutions affected sufficient time for their implementation, however, compliance with the MaSI was not required until from 5 November 2015 onwards.

The legal basis for the minimum requirements is section 7b (1) sentence 4 of the Banking Act. BaFin's purpose in issuing the circular, with respect to secure payments on the internet, was to bridge the period until the revised European Payment Services Directive of 25 November 2015[47] is legally implemented. The directive will define the strict security requirements in future for initiating and processing electronic payments. At the same time, it will regulate providers of payment initiation and account information services.

The MaSI are aimed at payment services providers within the meaning of the Payment Services Supervision Act *(Zahlungsdienste-aufsichtsgesetz)*. Their purpose is to counteract fraud in payment transactions and to reinforce consumers' confidence in internet payment services. Inevitably, data security is a major concern. The MaSI therefore cover significant security aspects of payment transactions, namely the governance and risk management systems of payment services providers as well as the monitoring, review and documentation of payment transactions on the internet.

A new feature is that, under the minimum requirements, the banking industry must immediately report serious incidents in connection with payment security to BaFin, the Bundesbank and the competent data protection authority. For this purpose, BaFin has provided the institutions with both a form on its website[48] and a functional e-mail address.[49] BaFin specifically recommends that a secure e-mail function is used to submit the form. It is already intended to change over to an electronic reporting procedure as part of the implementation of the revised Payment Services Directive.

Following the publication of the MaSI, BaFin received a large number of inquiries relating to their interpretation. Since 30 October 2015, it has therefore provided assistance in the form of a list of frequently asked questions together with the related answers on its website.[50] This list is revised and brought up to date at irregular intervals.

47 Directive (EU) 2015/2366, OJ EU L 337/35.

48 www.bafin.de/dok/6957532.

49 Zahlungssicherheitsvorfall-Meldung@bafin.de.

50 www.bafin.de/dok/6951840.

# 1.6 Focus

## Amendments to the *Bausparkassen* Act and the *Bausparkassen* Regulation

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German legislators introduced comprehensive reforms to the *Bausparkassen* Act *(Bausparkassengesetz)* and the *Bausparkassen* Regulation *(Bausparkassenverordnung)* at the end of 2015. The last amendments on a comparable scale took place in 1990. For example, the responsibilities for supervising *Bausparkassen* were aligned with the European rules (see the info box), the management of collective risk was revised and new requirements were introduced that are designed to safeguard and strengthen the financial performance of *Bausparkassen*. In addition, *Bausparkassen* are now permitted to conduct business that was previously prohibited. Under certain conditions, for example, they may issue mortgage *Pfandbriefe* and, starting in 2017, they may also invest their distributable funds in equities to a limited extent.

### *Bausparkassen*

The *Bausparkassen* Act and *Bausparkassen* Regulation contain special regulations for *Bausparkassen*. *Bausparkassen* are credit institutions, whose business objective is to accept *Bauspar* deposits *(Bauspareinlagen)* from *Bauspar* customers *(Bausparer)* and to grant Bauspar loans *(Bauspardarlehen)* from these aggregate savings to *Bauspar* customers for residential economic measures. Pursuant to the *Bausparkassen* Act, only *Bausparkassen* are authorised to conduct this aforementioned *Bauspar* business *(Bauspargeschäft)*. Apart from the *Bauspar* business, they may only conduct certain other transactions related to residential business ("principle of speciality"). All *Bauspar* customers of a *Bausparkasse* are members of a special-purpose savings collective *(Kollektiv)*.

### A changed environment

The environment for *Bausparkassen* has changed significantly since the last comprehensive revision of the *Bausparkassen* Act in 1990 (the Act originally dates from 1972), such as the key legal framework for the supervision of *Bausparkassen*. For example, the Banking Act *(Kreditwesengesetz)* has been amended several times and two key European regulations have been adopted: the Capital Requirements Regulation (CRR) to implement Basel III and the Single Supervisory Mechanism (SSM) Regulation.

The past 25 years have also seen *Bausparkassen* being increasingly integrated into group structures. This brings with it a fundamental risk that third parties could influence the risk management of *Bausparkassen* and could be motivated by interests that run counter to those of the special-purpose savings collective.

### Persistently low interest rates

In addition, the persistently low level of interest rates on the capital markets is currently negatively impacting the income of *Bausparkassen*. This is due in particular to the fact that the interest rates on *Bauspar* deposits and loans remain fixed over the entire term of the contract, in accordance with the standard terms and conditions, which the existing *Bauspar* contracts are currently based on. The existing high-interest *Bauspar* tariffs *(Bauspartarife)* continue to bear interest at rates that are significantly greater than current market rates. Many customers with older contracts therefore prefer to take out a low-interest mortgage, forgoing disbursement of their deposits and/or opting not to take out a relatively high-interest *Bauspar* loan. This in

turn results in a situation where, for some time now, *Bauspar* deposits have been less and less likely to be invested in *Bauspar* loans. This is reducing industry-wide investment levels, i.e. the ratio of *Bauspar* loans to *Bauspar* deposits. However, *Bauspar* loans are a major source of income for *Bausparkassen*. The options available to *Bausparkassen* for reacting to this situation are limited by the legal restrictions on the permitted scope of business activities. It is not possible to predict at the moment how long capital market interest rates will remain low.

### Amendments to the *Bausparkassen* Act

Legislators reacted to the changing environment with the Second Amendment Act to the *Bausparkassen* Act, dated 21 December 2015[51], which entered into force a few days later on 29 December.

In order to improve the financial performance of *Bausparkassen*[52], it provides for example new opportunities for them to expand their credit business for residential economic measures (see info box on "*Bausparkassen* loans"). In accordance with the new legislation, under certain conditions (section 6 (1) no. 2 of the *Bausparkassen* Act) *Bausparkassen* can now use the allocation assets for "other building loans" (see info box). Institutions were previously permitted to grant other building loans, but without access to the allocation assets.

The permitted aggregate limit for other building loans was increased from 75 to 100 per cent of the *Bauspar*, prefinancing and bridging loans (section 4 (2) of the *Bausparkassen* Act).

*Bausparkassen* can now make loans up to the mortgage lending value to finance owner-occupied residential property (section 7 (1) sentence 4). Previously, the lending limit was 80% of the mortgage lending value.

#### ***Bausparkassen* loans**

*Bausparkassen* are permitted to grant the following loans:

- *Bauspar* loans,
- loans that are used for prefinancing or bridge financing of performances by the *Bausparkasse* on *Bauspar* contracts of its *Bauspar* customers (prefinancing and bridging loans), and
- other loans for residential economic measures (other building loans).

#### **Allocation assets**

The allocation assets consists of the *Bauspar* deposits, the funds that have been added for granting *Bauspar* loans and the technical security reserve *(Fonds zur bauspartechnischen Absicherung)* (see below), net of the aggregate amount of *Bauspar* loans granted. The allocation assets may only be used for a specific purpose (section 6 (1) of the *Bausparkassen* Act).

With this amendment, legislators intend to expand the opportunities for *Bausparkassen* to finance owner-occupied residential property. It could also create incentives for greater take-up of *Bauspar* loans. The lending limit is also being increased in order to allow *Bausparkassen* to strengthen their core business.[53]

### *Pfandbrief* business

*Bausparkassen* can now issue mortgage *Pfandbriefe* for specific purposes in accordance with the German *Pfandbrief* Act *(Pfandbriefgesetz)* (section 4 (1) no. 5c of the *Bausparkassen* Act), in particular to grant loans for residential economic measures. This is

51 Federal Law Gazette I, page 2399.

52 See the grounds for the government draft of a Second Amendment Act to the *Bausparkassen* Act, Bundestag publication 18/6418, page 29.

53 See the recommendation and report of the Finance Committee of the Bundestag on the government draft of a Second Amendment Act to the *Bausparkassen* Act, Bundestag publication 18/6903, page 36.

something they were previously prohibited from doing. The new regulations are designed to give *Bausparkassen* a relatively economical option to obtain funding.[54]

### Technical security reserve

The regulations governing the "technical security reserve" (*Fonds zur bauspartechnischen Absicherung* – FbtA) have also changed. The technical security reserve was established as part of the reform of the *Bausparkassen* Act in 1990. It is an off-line item that all *Bausparkassen* must establish under certain conditions in order to protect the interests of the *Bauspar* customers. As previously defined, it served to ensure that *Bauspar* loans could be allocated sufficiently quickly also in times when collective liquidity was scarce because of a lack of new *Bauspar* deposits.

In its new form, the reserve no longer only safeguards that the waiting times between the start of the *Bauspar* contract and its allocation are guaranteed to be uniform and as short as possible, but also safeguards the collective induced interest spread that is required to ensure the sustainable operation of the *Bauspar* business (see info box).

*Bausparkassen* can now use the technical security reserve to safeguard the collective induced income. According to the explanatory memorandum, this expansion in the purpose of the technical security reserve is designed to enable *Bausparkassen* to use it to offset negative effects on income in the current low interest rate environment.[55]

### Expanded investment opportunities

Another first is that starting on 1 January 2017, *Bausparkassen* can also use distributable funds to invest in equities (section 4 (3) sentence 1 nos. 7 and 8, as well as section 19 (5a) of the *Bausparkassen* Act). Investments in equities are limited to a maximum of five per cent of the allocation assets, and a maximum of 0.2 per cent of the allocation assets may be invested in the shares of any one company. These amounts also include indirect investments in equities through investment fund units.

The reform is designed to expand the opportunities for *Bausparkassen* to diversify the investment of their distributable funds. The statutory caps on the new forms of investment are aimed at minimising the risks of investing in shares – with regard to both investment volumes and risk concentration.[56]

### Other changes

The revision of the German *Bausparkassen* Act has seen other changes as well:

- The requirements specific to the *Bauspar* business that a company must satisfy before the supervisory authority can grant it permission to operate the *Bauspar* business were expanded (section 2 of the *Bausparkassen* Act).
- Another new feature is that certain control agreements under which a *Bausparkasse* is the controlled entity – meaning that it is subject to management by another person – are expressly prohibited (section 2a of the *Bausparkassen* Act).

**Collective induced interest spread**

The collective induced interest spread is the ratio of the collective induced interest surplus to the annual average balance of *Bauspar* deposits. The collective induced interest surplus is the total income from *Bauspar* loans plus income from *Bauspar* deposits not invested in *Bauspar* loans, less the interest expense on *Bauspar* deposits.

54 Grounds for the government draft of a Second Amendment Act to the *Bausparkassen* Act, Bundestag publication 18/6418, page 29.

55 Grounds for the government draft of a Second Amendment Act to the *Bausparkassen* Act, Bundestag publication 18/6418, page 30.

56 See the recommendation and report of the Finance Committee of the Bundestag on the government draft of a Second Amendment Act to the *Bausparkassen* Act, Bundestag publication 18/6903, page 35.

- Also, the responsibilities for supervising *Bausparkassen* were aligned with EU rules such as the Capital Requirements Regulation (CRR) and the SSM Regulation (section 3 (1) sentence 1, in conjunction with section 1 (9) of the *Bausparkassen* Act).
- In addition, the reporting requirement in the form of collective management reports that was already standard administrative practice is now explicitly codified in law (section 3 (5) of the *Bausparkassen* Act).
- A further amendment concerns third parties that receive assets from *Bausparkassen* as settlement of claims under occupational pension schemes, where these assets exclusively serve the fulfilment of post-employment benefit obligations. Under certain conditions, these third parties such as group companies are now no longer subject to the investment restrictions for *Bausparkassen*. However, the assets must be invested in the safest and most profitable manner with consideration to the nature and duration of the post-employment benefit obligations. Care has to be taken to ensure that the investments are suitably spread and diversified, and safeguards must be in place to ensure that sufficient liquidity is available to settle the liabilities (section 4 (3a) of the *Bausparkassen* Act). This is primarily designed to enable *Bausparkassen* to participate in group occupational retirement solutions, which provide for types of investment extending beyond the list of investments permitted for *Bausparkassen*.[57]
- The revision also contains new rules for risk management specific to the *Bauspar* business. In particular, *Bausparkassen* now have to use simulation models specifically for the *Bauspar* business and must have them validated by an auditor (section 8 of the *Bausparkassen* Act).
- New regulations have also been introduced for the resolution of *Bausparkassen*, taking into consideration the specific characteristics of the *Bauspar* business (section 16 of the *Bausparkassen* Act).

### German *Bausparkassen* Regulation

The revision of the German *Bausparkassen* Act also required the German *Bausparkassen* Regulation to be overhauled. The new version of the *Bausparkassen* Regulation[58] dated 29 December 2015[59] replaced the previous version of the *Bausparkassen* Regulation. In particular, it contains detailed provisions on the most recent new requirements introduced by the German *Bausparkassen* Act, especially risk management, management of the special-purpose savings collective and the design of the *Bauspar* tariffs.

### Summary

The reform of the *Bausparkassen* Act reinforces the principle of speciality for *Bausparkassen* and introduces regulations aimed at further safeguarding against the risks of the *Bauspar* business. It also provides institutions with new opportunities to strengthen their earning power. It rests with the *Bausparkassen* in particular to make appropriate use of these opportunities in the future. The wide range of new provisions – such as those relating to risk management and allocation requirements specific to the *Bauspar* business – largely corresponds to what was previously standard administrative practice and had already been proven in the past.

57 See the recommendation and report of the Finance Committee of the Bundestag on the government draft of a Second Amendment Act to the *Bausparkassen* Act, Bundestag publication 18/6903, page 32.

58 The grounds to the *Bausparkassen* Regulation is available at www.bafin.de/dok/7548392.

59 Federal Law Gazette I, page 2576.

## 1.7 Payment Accounts Directive

The implementation of the European Payment Accounts Directive[60] creates new responsibilities for BaFin in the area of consumer protection. It is the intention of the Payment Accounts Directive that all consumers who are legally resident in the European Union – including persons with no fixed address, asylum seekers and persons who are not granted a residence permit, but whose expulsion is impossible for legal or factual reasons – have the right to a payment account with basic features. The change represents a reaction by the European legislature to the fact that it is essential to have such an account today to be able to participate in economic and social life, whether to receive payments of wages or to rent a flat. The directive also contains various provisions intended to improve the transparency of fees in the market for payment accounts and to make it easier to switch providers. The directive is to be transposed into national law by all EU member states by 18 September 2016.

### Payment Accounts Act

In order to implement the directive, the Bundestag resolved a new Payment Accounts Act *(Zahlungskontogesetz)* on 25 February 2016. The legislation provides that in future BaFin shall monitor compliance with the provisions of the act by the credit and payment institutions. In particular, consumers who are denied from opening a payment account with basic features will be able to initiate special administrative proceedings with the supervisory authority. BaFin will then consider whether the credit institution can rely on one of the reasons

### BaFin has simplified access to basic accounts for refugees

Refugees in Germany are able to open a basic account even before the Payment Accounts Implementation Act *(Zahlungskontenumsetzungsgesetz)* comes into effect. In accordance with guidelines issued by the Federal Ministry of Finance, BaFin, among other things, has relaxed the existing provisions relating to personal identification under money laundering legislation on a transitional basis for this purpose. Refugees are therefore able to open a basic account even if they cannot produce documentation which satisfies the passport and identity card requirements set out in section 4 (4) no. 1 of the Money Laundering Act *(Geldwäschegesetz)*. These transitional provisions will continue to apply until a regulation on identity verification in accordance with section 4 (4) sentence 2 of the Money Laundering Act comes into force, which is expected to be during the course of 2016. The regulation is expected to authorise the use of documents for identification purposes going beyond those referred to in section 4 (4) no. 1 of the Money Laundering Act.

Until then, a basic account may be opened using documents which bear the letterhead and seal of a German foreigners authority; contain the details relating to identity required by section 4 (3) no. 1 of the Money Laundering Act, i.e. name, place and date of birth, nationality and address; include a photograph and are signed by the official in charge at the foreigners authority. Where banks open such accounts for refugees on the basis of documents that meet these criteria, BaFin will not raise any objections from the point of view of supervisory regulations.

Refugees need a current account to be able to participate in general economic life. Moreover, the use of bank accounts for financial transactions enables flows of cash to be monitored and therefore creates an impediment to money laundering. However, many refugees do not have the usual identity documentation required to open an account and prescribed by the Money Laundering Act, and were therefore unable to open an account until now.[61]

60 Directive 2014/92/EU, OJ EU L 257/214.

61 See 2.2.

for refusal envisaged in the legislation. If that is not the case, the draft legislation gives BaFin the power to order a basic account to be opened at the relevant credit institution (see info box "BaFin has simplified access to basic accounts for refugees", page 119).

## 1.8 Regulation on interchange fees

The European regulation on interchange fees for card-based payment transactions[62] has created further new responsibilities for BaFin. The objective of the regulation is to lower these fees for credit and debit card payments and to achieve greater transparency and more competition with respect to these methods of payment. Interchange fees are normally charged by the payment services provider of the company receiving the card payment to the cardholder's payment services provider. These fees have already been the subject of antitrust proceedings in the past. The caps for interchange fees specified in the regulation – a maximum of 0.3% of the value of the transaction for credit-card payments and 0.2% for payments using debit cards – are intended to create legal certainty for all participants from now on. By means of an amendment of section 25g (1) no. 4 of the Banking Act and section 22 (5) sentence 1 of the Payment Services Supervision Act, the German legislature has given BaFin the task of monitoring compliance with the regulation by the credit and payment institutions. In November 2015, BaFin published a key points document issued by the BMF on this subject[63] in order to clarify a number of issues on the application of the regulation to the German girocard system, i.e. payment using an EC card and PIN.

## 1.9 Covered bonds

On 30 September 2015, the European Commission published a consultation document[64] containing possible proposals for regulating the treatment of covered bonds in the EU. The paper envisages a potential need for harmonisation, since in the peak phases of the financial markets and sovereign debt crisis, the capital market spreads for covered bonds from a number of member states diverged. The Commission concludes from this that the capital market does not have confidence in the effectiveness of the protection mechanisms for holders of covered bonds established in accordance with national legal standards.

In particular, the document asks whether Europe-wide harmonisation of the regulations on covered bonds – to date they have been regulated at national level – would create advantages for the supply of credit to the real economy. The matters under consideration by the Commission cover many areas: They range from a simple recommendation to the member states to implement the best practice recommendations of the EBA contained in its report on "EU Covered Bond Frameworks and Capital Treatment", to a proposal to expand on the nucleus of a definition of covered bonds currently regulated, in particular, in Article 52(4) of the UCITS Directive[65] and on which numerous supervisory special treatment provisions are based, right through to the development of a standard, Europe-wide legal framework. Any such European legal framework would then replace or complement ("29th regime") the respective existing national regulatory frameworks – in Germany in particular, therefore, the *Pfandbrief* Act *(Pfandbriefgesetz)*.

From BaFin's point of view, however, there is no need for an impetus from European legislation to guarantee the quality of the German *Pfandbrief* Act. On the other hand, a principles-based approach to the detailed development of the existing minimum requirements for covered bonds receiving special regulatory treatment would be helpful – both for reasons of financial stability and in the light of the

62 Regulation (EU) 2015/751, OJ EU L 123/1.

63 www.bafin.de/dok/6970682.

64 "Consultation Document Covered Bonds in the European Union", http://ec.europa.eu.

65 Directive (EU) 2014/91, OJ EU L 257/186. UCITS stands for "undertakings for collective investment in transferable securities".

numerous simplified regulatory requirements for covered bonds as well as the rather vague criteria contained in Article 52(4) of the UCITS Directive. Such an approach would only affect the *Pfandbrief* Act indirectly and would also leave open the option of formulating stricter requirements in the *Pfandbrief* Act than the minimum requirements that would then have to be met to qualify for special regulatory treatment. In contrast, the prospect of preparing a standard, EU-wide legal framework for covered bonds does not seem very promising – especially given the close link with insolvency law, which has not been harmonised.

### *Pfandbrief* Act

The content of the *Pfandbrief* Act was amended in 2015 by Article 5 of the Resolution Mechanism Act dated 2 November 2015[66]: It now includes an additional requirement for coverage by short-term exposures to institutions of credit quality step 2 that does not impact risk weightings. It therefore reflects Article 129(1)(c) of the Capital Requirements Regulation (CRR). In addition, section 20 (2a) of the *Pfandbrief* Act now contains a practice-based provision for the coverage of public-sector *Pfandbriefe* by export credit financings due from borrowers domiciled outside the EU or by exposures that are covered by export credit insurers domiciled outside the EU.

It is assumed within the EU that insolvency proceedings relating to the assets of a *Pfandbrief* bank – in accordance with the provisions of the European directive on the reorganisation and winding-up of credit institutions[67] – fall under the scope of German law. The preferential right in an insolvency of *Pfandbrief* holders to the cover assets entered in the cover register established in the *Pfandbrief* Act can therefore be assumed to apply. In the past, this preferential right in an insolvency had to be explicitly guaranteed in the case of claims against borrowers or guarantors domiciled outside the EU, such as by creating a trust arrangement in the third country that continues to apply in the event of insolvency, since it is conceivable that there might be individual insolvency proceedings under foreign law directed at the assets of the *Pfandbrief* bank. Now, in response to the needs of the *Pfandbrief* banks, the option of a claim for financial compensation in the event of the withdrawal of the claim has been added as an equivalent to the only previously permissible method, namely guaranteeing the *Pfandbrief* holders' preferential right to the claim in the third country. Specifically, individual export credit insurers offer coverage giving an undertaking to the *Pfandbrief* operations of the insolvent *Pfandbrief* bank to also pay compensation in the event of financial loss from such withdrawals.

### Annual audit of *Pfandbrief* banks

Article 13 of the Resolution Mechanism Act has revised the schedule of obligations for auditors relating to *Pfandbrief* law in particular in section 51 ff. of the Audit Report Regulation *(Prüfungsberichtsverordnung)*. For example, it is made clear that the annual auditor of *Pfandbrief* banks must always report on compliance with the organisational requirements under *Pfandbrief* law and that risk orientation must reflect the respective class of *Pfandbriefe*. This clarification is in no way intended to supersede the established practice of only reporting later on changes during the reporting period. Also, the organisational requirements under *Pfandbrief* law have now been consolidated and set out systematically in section 52 of the Audit Report Regulation. At the same time, collations of *Pfandbrief*-related data have been removed from the Audit Report Regulation, since a reporting regulation at a later date based on section 27a (2) of the *Pfandbrief* Act seems to be a more appropriate measure.

## 1.10 Members of supervisory and management boards

On 4 January 2016, BaFin published new editions of its guidance notices on management board members pursuant to the Banking Act (*Kreditwesengesetz* – KWG), the Payment Services Supervision Act (*Zahlungsdienste-aufsichtsgesetz* – ZAG) and the German

66 Federal Law Gazette I, page 1864.

67 Directive 2001/24/EC, OJ EC L 125/15.

Investment Code (*Kapitalanlagegesetzbuch* – KAGB)[68] and on members of administrative and supervisory bodies in accordance with the KWG and the KAGB.[69]

The guidance notices, now in their second and third editions, respectively, are concerned with the supervisory requirements for the qualifications and reliability of management board members and members of administrative and supervisory bodies, and the related notifications required to be submitted in accordance with the KWG, the ZAG and the KAGB.

The European provisions of CRD IV, transposed into German law by the KWG (sections 25c and 25d of the KWG), have resulted in significant revisions to the supervisory requirements relating to management board members and members of administrative and supervisory bodies within the scope of the KWG. For example, the KWG requires members of such bodies to devote sufficient time to their responsibilities. When management board members or members of administrative and supervisory bodies are appointed, the members must therefore provide BaFin with an overview of their time commitments in relation to all of their activities and positions. In addition, the limitations of positions to which members of such bodies are subject have changed. BaFin must be informed of every position, but not all positions count towards the maximum number. A series of diagrams is intended to illustrate the large number of related rules that have to be observed.

A separate section of the guidance notice on members of administrative and supervisory bodies in accordance with the KWG and KAGB addresses the requirements imposed by the KWG on the creation of committees of administrative and supervisory bodies.

A new feature of the guidance notice on management board members is that the substantive requirements relating to members of management boards under the KWG are now also explained. Practical experience represents a significant component of the requirement for professional qualification. In the opinion of BaFin, anyone managing a credit institution must have experience in the lending business, among other things.

Explanations of the supervisory requirements for management board members and members of administrative and supervisory bodies that fall within the scope of the KAGB, which came into force in 2013, are published for the first time in both guidance notices.

The statutory requirements for management board members of undertakings within the scope of the ZAG have not changed since the first edition of the guidance notice on management board members. The guidance notice also explains for the first time the substantive requirements for management board members under the ZAG.

Further changes were made to the contents of the section describing the notification procedures under the KWG, the ZAG and the KAGB. For example, BaFin makes it clear that it generally allows a period of four weeks for compliance with the obligation to submit a notification without delay.

The forms to be used which are attached to both guidance notices are another new development. For example, the information required by BaFin to assess the reliability, limitations of positions and available time of a member of such bodies is contained in a single form that can be filled out online. The familiar checklists intended as an aid to those making notifications are available as before in their updated form.

68 www.bafin.de/dok/7507680.

69 www.bafin.de/dok/7510172.

# 2 Preventive supervision

## 2.1 Countercyclical capital buffer

In mid-December 2015, BaFin stipulated a countercyclical capital buffer for Germany for the first time (see info box "The countercyclical capital buffer"), with effect as of 1 January 2016. The amount of the buffer is currently 0%, because the indicators examined showed no signs of excessive lending in Germany.

### Institution-specific buffers

Institutions must factor the relevant value for Germany into their calculations for the institution-specific countercyclical capital buffer, applying it to the total significant credit risk exposures in Germany. In addition to the domestic countercyclical capital buffer, German institutions must also take into account foreign countercyclical capital buffers from countries in which they are invested. Thus, the institutions themselves must calculate their individual institution-specific countercyclical capital buffer. This is calculated as the weighted average of the values of those states in which the institution holds significant credit risk exposures. Significant credit risk exposures include all credit risk exposures specified in section 36 of the Solvency Regulation *(Solvabilitätsverordnung)*, i.e., all exposures to the private sector. The institution-specific countercyclical capital buffer must then be applied to the total risk exposure amount pursuant to Article 92(3) of the Capital Requirements Regulation (CRR) and maintained as Common Equity Tier 1 capital.

BaFin conducts a quarterly review of whether the value applicable in Germany is still appropriate in view of the risk situation and development of credit at that time. It bases its review on analyses and data provided by the Deutsche Bundesbank. The European Central Bank is involved in the decision-making process

**The countercyclical capital buffer**

The countercyclical capital buffer (CCB) is a macroprudential instrument of banking supervision.[70] It is intended to counteract the risk of excessive credit growth in the banking sector. The idea behind the buffer is that in times of excessive credit growth, banks are required to build up an additional capital buffer. This buffer generally increases the loss-absorbing capacity of banks. The buffer is explicitly permitted to be used up in times of crisis and used to mitigate losses. As a result, it should be possible to avoid the creation of a credit crunch. The legal bases for the buffer are set out in Articles 130 and 135 to 140 of the Capital Requirements Directive IV (CRD IV), which has been transposed into German law by virtue of section 10d of the German Banking Act *(Kreditwesengesetz)* in conjunction with section 64r of the Banking Act.

The CCB usually amounts to between 0 and 2.5% and can be set in 0.25 percentage-point increments. If necessary, BaFin can also stipulate a value in excess of 2.5%. The decision about the level of the buffer is based on an analysis of a variety of factors. The development of the credit-to-GDP gap, i.e., the deviation in the ratio of lending to gross domestic product from the long-term trend, plays a decisive role. The additional capital requirements of the countercyclical capital buffer have been applicable since 1 January 2016. In the ramp-up phase, the institution-specific countercyclical capital buffer amounts to a maximum of 0.625% in 2016, 1.25% in 2017 and 1.875% in 2018. Beginning on 1 January 2019, the requirements must be met in full.

70 On macroprudential instruments, see also chapter II 2.2.

through the Single Supervisory Mechanism (SSM). BaFin also takes into account the recommendations of the Financial Stability Committee (*Ausschuss für Finanzstabilität* – AFS), in which the Federal Ministry of Finance and the Deutsche Bundesbank are represented in addition to BaFin.

## 2.2 Risk classification

### 2.2.1 Credit institutions

Together with the Deutsche Bundesbank, BaFin prepares a risk profile for each institution that it supervises directly, i.e. for the less significant institutions (LSIs, see info box "ECB risk profiles for SIs"). It updates this profile on an ongoing basis.

BaFin bases the intensity of its supervisory activities on this individual risk profile. In order to generate the risk profile, it utilises the report on the audit of the annual financial statements assessed by the Deutsche Bundesbank together with up-to-date risk analyses and the knowledge gained from special audits and requests for information.

On the basis of the risk profile, BaFin carries out a risk classification of the institutions according to their quality and systemic importance. The supervisory authority uses the "quality" criterion to assess the extent and complexity of the risks and, as additional factors, whether an institution's organisation and risk management systems are structured appropriately. By evaluating the systemic importance, BaFin estimates the effect that a hypothetical failure of the institution could have on the financial sector as a whole. The factors assessed in making this estimation are size, the intensity of interbank relationships and the degree of business interconnectedness with foreign countries.

The numbers in the risk matrix (see Table 5) represent solely the results of the risk classification of less significant institutions. They are therefore not comparable with the results recorded in previous years. The absence of the significant institutions also explains why only 0.2% of the institutions are now classified as having high systemic importance. The figure for the prior year was 2.5%. An

#### ECB risk profiles for SIs

With the introduction of the Single Supervisory Mechanism (SSM), the ECB assumed responsibility for the direct supervision of the significant institutions (SIs) and therefore also for their risk classification. The ECB has developed its own methodology for this purpose which differs from the procedure adopted by the German supervisors. The methodology subdivides the significant institutions into five clusters. The allocation of an institution to one of the clusters is based on criteria such as external ratings, total assets, geographical diversification, interconnectedness within the financial system and other indicators of complexity.

**Table 5** Risk classification results of LSIs in 2015

| Institutions in % | | Quality of the institution | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Systemic importance | High | 0 | 0 | 0.2 | 0 | 0.2 |
| | Medium | 3.8 | 5.6 | 1.9 | 0.3 | 11.6 |
| | Low | 32.4 | 44.4 | 10.0 | 1.4 | 88.2 |
| | **Total** | **36.2** | **50.0** | **12.1** | **1.7** | **100** |

encouraging outcome was that it was possible to allocate more than 86% of the less significant institutions to the A and B quality bands. The situation of the less significant institutions was therefore stable in 2015 as in the previous years.

### 2.2.2 Financial services institutions

BaFin's risk classification covered a total of 758 financial services institutions in 2015 (see Table 6 "Risk classification results of financial services institutions in 2015"). In the previous year, it carried out a risk classification of 754 institutions.

## 2.3 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. The supervisory authority ensures that the enterprises and individuals being supervised comply with the legal requirements that exist for this purpose. These requirements on institutions result primarily from the German Money Laundering Act *(Geldwäschegesetz)* and the German Banking Act *(Kreditwesengesetz)* and are intended to ensure transparency in business relationships and financial transactions using a risk-based approach. Parties subject to the provisions must meet customer due diligence requirements, for example. These include identifying the client and, if different, the beneficial owner as well as verifying the background to the business relationship and carrying out continual monitoring wherever possible. 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.

### 2.3.1 Correspondent bank relationships often inadequately reviewed and monitored

In BaFin's opinion, credit institutions should pay closer attention to their correspondent banking activities. This is because correspondent banks are frequently used as a circuitous method of disguising payments into offshore locations. The facilitation of pass-through payments via their own banks does not relieve credit institutions of their obligation to monitor and investigate these payment flows using appropriate systems. In the event of abnormalities, it may ultimately be necessary, in addition to reporting suspicious transactions, to disengage from critical relationships or to withdraw support for payments into problematic regions. Some banks have already taken appropriate measures in this business area.

**Table 6** Risk classification results of financial services institutions in 2015

| Institutions in % | | Quality of the institution | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Systemic importance | High | | | | | |
| | Medium | 13.1 | 16.8 | 2.4 | 0.4 | 32.7 |
| | Low | 25,0 | 36 | 5.7 | 0.6 | 67.3 |
| | **Total** | **38.1** | **52.8** | **8.1** | **1,0** | **100** |

### 2.3.2 Group-wide implementation in need of improvement

BaFin carried out a total of 32 special audits of credit institutions, securities trading banks and branches of banks from the EU area in the past year. The audits involved inspecting each bank's entire system for the prevention of money laundering. This resulted in certain findings, such as in relation to the reporting of suspicious transactions: Some banks are still having problems in making these reports without undue delay as required by the Money Laundering Act. BaFin also ascertained a need for improvement in the group-wide implementation of measures to counteract money-laundering, especially at banks with international operations. It is apparent in repeated cases that the high German standards for the prevention of money laundering are not being uniformly implemented and observed throughout the business as a whole.

### 2.3.3 Banks increase use of online identification

BaFin's circular "Suspicious transaction report in accordance with sections 11, 14 of the GwG"[71] allows credit institutions to offer their customers the option of video identification. More and more banks are making use of this simple method of identification from home. However, banks have found that this simplified procedure has also resulted in customers opening an account quickly but then not using it at all. Some banks have discontinued this procedure after a test period.

### 2.3.4 Revised version of the Payment Services Directive

On 23 December 2015, the revised version of the Payment Services Directive was published in the Official Journal of the EU.[72] The German legislators now have time until 13 January 2018 to transpose the new version of the directive into national law.[73] The definition of payment services is expanded to include payment initiation services and account information services, which were not previously subject to supervision. The revised version also grants these services access to accounts run by other institutions. The new version was used for clarifications and some extensions or limitations with respect to exclusions from the scope of the directive and the acquiring of payment transactions. In addition, a particular objective of the new regulations is to require payments services providers to put in place adequate security measures for electronic payments. These increased requirements have also been reflected in the conditions for authorisation that must be satisfied by payment services providers under the German Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – ZAG), i.e. payment and e-money institutions. All institutions already operating in this sector must either comply with the stricter obligations by 31 July 2018 or cease their activities.

### 2.3.5 Audit of payment agents

In 2015, a total of 90 payment institutions domiciled in another member state of the EU or in another signatory state to the Agreement on the European Economic Area indicated that they would also like to provide payment services – in the majority of cases, money-remittance services – in Germany. As at 31 December 2015, 5,618 registered agents within the meaning of section 1 (7) of the ZAG were operating on behalf of these payment institutions. BaFin is responsible for supervising these payment agents in accordance with the provisions of money laundering legislation. However, due to the lack of statutory notification and submission requirements, as before, the only method available to it of acquiring the information and knowledge necessary to discharge its responsibilities is the conduct of audits on the basis of the Payment Services Supervision Act.

#### Money laundering requirements inadequately implemented

In 2015, BaFin ordered a total of 212 audits of payment agents on the basis of section 26 (4)

71 Circular 1/2014 (GW).

72 Directive (EU) 2015/2366, OJ EU L 337/35.

73 See 1.5.

of the ZAG in conjunction with section 14 (1) sentence 2 of the ZAG. The inspections focused on those agents acting for more than one payment institution at the same time. However, it was actually possible to carry out only 55 of the 212 audits ordered.

One of the shortcomings with which BaFin is repeatedly confronted when auditing the payment agents relates, as in the past, to the registers maintained by the home supervisory authorities of the payment institutions in question, because only too often the entries are not up to date. That was why 63 of the planned audits of payment agents alone could not take place, as the agents affected, despite the existence of an entry in the relevant register, were not active or no longer active or, in some cases, had never been active at the address given. 91 audits could not be conducted for other reasons, mainly due to the absence of the payment agent.

In the case of the agents who formed the focus of the audit activities in 2015, who are selected, monitored and trained by several principals, BaFin also repeatedly found that compliance with the money laundering requirements is inadequate. This was particularly the case for the obligations to keep records and retain them. This finding is also reflected in the continuing large number of proceedings against payment agents under the Act on Breaches of Administrative Regulations *(Ordnungswidrigkeitengesetz)*.

Nevertheless, the audits of payment agents already subject to supervision by BaFin with respect to money laundering requirements for other reasons revealed a certain degree of improvement: This group was significantly more conscientious in complying with its obligations.

The number of suspicious transaction reports pursuant to sections 14 and 11 of the Money Laundering Act also remained at a high level – despite a small decline – with 181 reports. In 2014, there were 201 reports of suspicious transactions.

As in previous years, BaFin again found in 2015 that numerous payment agents are implementing their obligations under money laundering legislation inadequately. This is also indicated by the continuing high level of proceedings against payment agents under the Act on Breaches of Administrative Regulations. At the same time, it was also clear that many payment agents have been reminded of their obligations by the imposition of a fine and have now significantly improved their compliance with the money laundering requirements. The improvements were especially noticeable in the areas of research, monitoring and the systems for reporting suspicious transactions.

#### Money-remittance services

BaFin issued a total of 17 prohibition orders in 2015 as a result of the unauthorised provision of money-remittance services. Five of these were based on findings made at on-site inspections pursuant to section 5 (2) of the ZAG. Eight prohibition orders were related to the illegal smuggling of foreigners. The recipients of the prohibition orders had organised the financial side of the smuggling activities. Their function was to accept the fees paid to the smugglers in cash and then to transfer them on to ringleaders and other parties involved, disguising the origin of the payments. Given that there is no let-up in the inflow of refugees from regions in crisis, a decline in cases of this nature is not to be expected. BaFin co-operates very closely with the criminal prosecution authorities in this area.

### 2.3.6 Administrative fines

In 2015, BaFin initiated a total of 94 proceedings pursuant to the Act on Breaches of Administrative Regulations (*Ordnungswidrigkeitengesetz* – OWiG) against institutions or their responsible persons. They related to breaches of provisions of the Money Laundering Act, the Payment Services Supervision Act and the Banking Act that are punishable by a fine and were initiated against payment agents, credit institutions, insurance undertakings, payment institutions and institutions engaged in finance leasing and/or factoring.

66 of the 94 proceedings initiated related to agents within the meaning of section 1 (7) of the ZAG. Of those 66 proceedings and the administrative fine proceedings pending from previous years, a total of 24 cases were finally concluded with an administrative order imposing a fine, three of them at a preliminary hearing following a permissible appeal and two others after a decision by the Local Court *(Amtsgericht)*. Two of the administrative fine proceedings against payment agents are currently the subject of a preliminary hearing following a permissible appeal. Nine others were concluded using the warning procedure in accordance with section 56 of the OWiG since, once the investigations were complete, the offences established were still able to be classified as insignificant.

A further eight proceedings ended with a discontinuation pursuant to section 47 (1) of the OWiG, while another four proceedings concluded with a discontinuation in accordance with section 46 (1) of the OWiG. A discontinuation generally arises if a permanent impediment to the proceedings arises, such as the dissolution of a company or the death of one of the parties to the proceedings.

BaFin had to initiate a further 28 proceedings pursuant to the Act on Breaches of Administrative Regulations as a result of breaches of provisions of the Money Laundering Act, the Payment Services Supervision Act and the Banking Act that are punishable by a fine against credit institutions, insurance undertakings, payment institutions and institutions engaged in finance leasing and/or factoring, and in some cases also against their responsible persons. A total of eleven of those proceedings and of the administrative fine proceedings still pending from previous years were able to be finally closed – four of them as the result of a decision by the Local Court, namely a judgment or order, and two others by an order of the Higher Regional Court *(Oberlandesgericht)* in Frankfurt am Main following an appeal. In these proceedings, the court of first instance upheld BaFin's administrative order imposing a fine together with the findings established; on appeal, however, the order imposing a fine was cancelled. Two further proceedings are currentlythe subject of a preliminary hearing following a permissible appeal. Nine of eleven proceedings were discontinued for legal reasons and two on factual grounds. Twelve proceedings were able to be terminated by consolidating them with proceedings still pending.[74] Another six proceedings were finally concluded, having previously been transferred to the local public prosecutor's office pursuant to section 42 (1) of the OWiG and taken over by the latter in accordance with section 42 (2) of the OWiG.

In 2015, BaFin imposed fines amounting in total to €40,053,078.50 as a result of breaches of the supervisory laws referred to above, in some cases also in conjunction with section 130 of the OWiG, that are punishable by a fine.

# 3 Institutional supervision

## 3.1 Authorised institutions

The Banking Act *(Kreditwesengesetz)* and the Payment Services Supervision Act *(Zahlungsdiensteaufsichtsgesetz)* divide the institutions supervised by BaFin into credit institutions, financial services institutions, payment institutions and e-money institutions, depending on the nature of the businesses in which they are engaged.

74 Section 46 (1) of the OWiG in conjunction with section 2 ff. of the Code of Criminal Procedure *(Strafprozessordnung)*.

A credit institution is defined as an undertaking which conducts at least one of the banking businesses described in detail in section 1 (1) of the Banking Act commercially or on a scale which requires commercially organised business operations. The banking businesses include the deposit business and credit business, but also specific securities-related activities such as principal broking services and the safe custody business. As at 31 December 2015, a total of 1,724 legally independent credit institutions domiciled in Germany were authorised. This includes German credit institutions that are subsidiaries of foreign banks. To these are added credit institutions domiciled in foreign countries operating a branch in Germany. In addition, 47 housing enterprises with savings schemes are authorised (see Table 7 "Overview of the credit institutions supervised by BaFin").

**Table 7** Overview of the credit institutions supervised by BaFin

| | | |
|---|---|---|
| CRR credit institutions | | 1,665 |
| | of which SIs | 67 |
| | of which LSIs | 1,598 |
| Securities trading banks | | 26 |
| Other credit institutions | | 33 |
| **Total credit institutions** | | **1,724*** |
| **Housing enterprises with savings schemes** | | **47** |

* Two of these credit institutions provide financial market infrastructures and are therefore supervised by BaFin's Securities Supervision Directorate.

Credit institutions that also fall under the narrower definition of a credit institution under EU law in accordance with Article 4(1)(1) of the Capital Requirements Regulation (CRR) are referred to as CRR credit institutions in the German Banking Act.[75] They are now supervised in the context of the SSM either directly by the ECB as significant institutions (SIs) or by BaFin together with the Deutsche Bundesbank as less significant institutions (LSIs). While securities trading banks or other credit institutions are not CRR institutions, they nevertheless fall within the German definition of a credit institution.

Financial services institutions are undertakings which provide financial services within the meaning of section 1 (1a) of the Banking Act commercially or on a scale which requires commercially organised business operations, but which are not credit institutions. The services offered may consist, for example, of investment advice, portfolio management or finance leasing. BaFin distinguishes between those financial services institutions engaged solely in factoring or leasing, the so-called Group V, and those (also) providing other financial services, Groups I to IV (see Table 8 "Overview of the financial services institutions supervised by BaFin").

**Table 8** Overview of the financial services institutions supervised by BaFin

| | |
|---|---|
| Financial services institutions in Groups I to IV | 674 |
| Financial services institutions in Group V | 540 |
| **Total financial services institutions** | **1,214** |

The final categories of institutions are payment institutions pursuant to section 1 (1) no. 5 of the Payment Services Supervision Act and e-money institutions pursuant to section 1a (1) no. 5 which are supervised under the Payment Services Supervision Act (see Table 9).

**Table 9** Overview of the payment institutions and e-money institutions supervised by BaFin

| | |
|---|---|
| Payment institutions | 32 |
| E-money institutions | 6 |

75 The term "CRR credit institution" is defined in section 1 (3d) of the Banking Act. This is named after the Capital Requirements Regulation (CRR) and replaces the term "deposit-taking credit institution".

### 3.1.1 Credit institutions

At the end of 2015, BaFin's Banking Supervision Directorate was responsible for 1,740 domestic institutions. They included 1,722 credit institutions[76] and 16 financial services institutions as well as two dependent *Bausparkassen*.[77] The institutions are divided into four groups for supervisory purposes: commercial banks, institutions belonging to the savings bank sector, institutions belonging to the cooperative sector and other institutions (see Table10). The criteria for allocating an institution to one of the groups are its business model and/or membership of a particular association.

Commercial banks include in particular the major banks, private commercial banks and subsidiaries of foreign banks. The savings bank sector comprises public-sector and independent savings banks together with the *Landesbanks*. In addition to the cooperative banks which have the legal form of cooperatives (primary cooperative institutions), the cooperative sector also includes DZ Bank and WGZ Bank and three further institutions due to their financial ties. The group of other institutions – these do not correspond exactly to the "other credit institutions" under point 3.1 – comprises *Bausparkassen*, securities trading banks and development banks operated by the federal government and the federal states, among others.

#### Number of savings banks falls

The number of savings banks in Germany once again recorded a slight decline in 2015 (see Figure 4, page 131). Three savings banks were absorbed into larger entities as a result of mergers during the past year. Over the last ten years, the number of savings banks declined by 50 overall, or more than 10%.

#### Decline in number of primary cooperative institutions

The number of primary cooperative institutions also fell slightly, by 26 institutions or 2.6% (see Figure 5 "Number of primary cooperative institutions", page 131). In total, there remained 1,022 institutions at the end of 2015. The mergers of various institutions were also responsible for this decline.

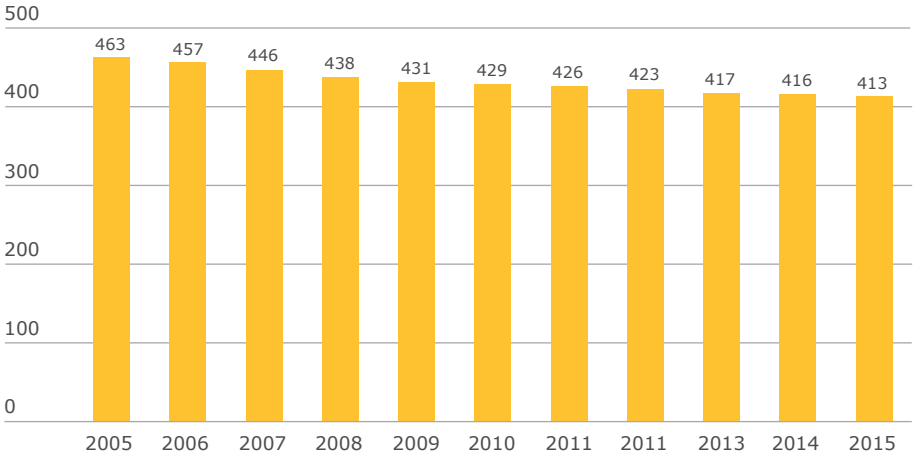
**Table 10** Number of banks by group of institutions

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Commercial banks | 179 | 182 | 184 |
| (of which SIs) | 36 | | |
| Institutions belonging to the savings bank sector | 422 | 425 | 426 |
| (of which SIs) | 11 | | |
| Institutions belonging to the cooperative sector | 1,027 | 1,052 | 1,083 |
| (of which SIs) | 4 | | |
| Other institutions | 112 | 121 | 127 |
| (of which SIs) | 16 | | |
| **Total** | **1,740** | **1,780** | **1,820** |

76 The difference from the number in Table 7 on page 129 results from the deduction of two credit institutions that provide financial market infrastructures and are therefore supervised by BaFin's Securities Supervision Directorate.

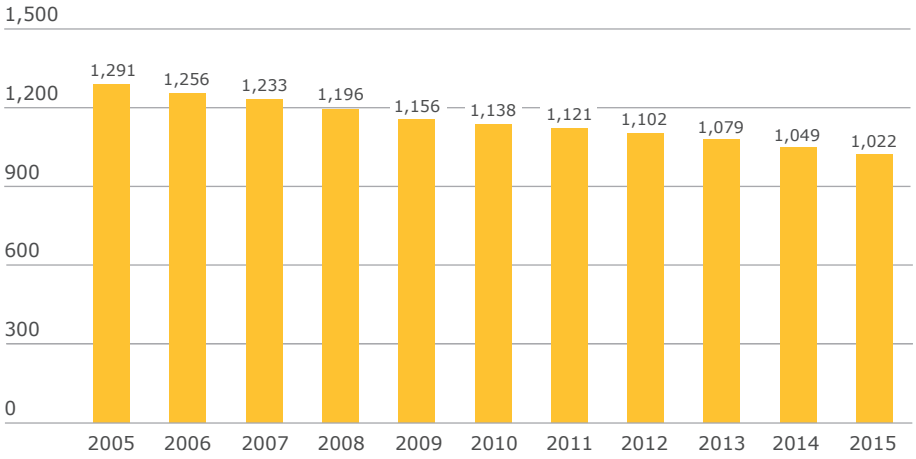
77 These *Bausparkassen* are not legally independent undertakings, but operate as departments of another bank. However, they are treated as separate entities for the purposes of banking supervision.

**Figure 4** Number of savings banks*




* This statistic does not include eight Landesbanks and Deka Bank.

**Figure 5** Number of primary cooperative institutions




### No change in number of *Pfandbrief* banks

The number of credit institutions authorised to issue *Pfandbriefe* amounted to 80 at the end of 2015, as in the previous year. Two institutions lost their authorisations as a result of changes involving legal reorganisations (mergers or spin-offs of the *Pfandbrief* business). However, the total number of *Pfandbrief* banks remained unchanged, since the absorbing institution obtained authorisation in the course of the merger for the issue of mortgage *Pfandbriefe* and a further institution was granted authorisation for the issue of mortgage *Pfandbriefe* and public-sector *Pfandbriefe*. Several authorisation procedures are pending or in preparation. The main area of interest for applicants is the issue of mortgage *Pfandbriefe*.

### Number of *Bausparkassen* unchanged

The number of *Bausparkassen* subject to supervision in 2015 was 21, the same as in the previous year. They comprise nine public-sector and twelve private *Bausparkassen*.

## 3.1.2 Financial services institutions[78]

At the end of 2015, a total of 674 financial services institutions (previous year: 676) were under supervision by BaFin, as were 86 German branches of foreign undertakings (previous year: 80).

78 For details of the other financial services institutions, see 3.1.3.

25 undertakings applied for authorisation to provide financial services in 2015 (previous year: 32). 13 financial services institutions applied to BaFin to extend their existing authorisation to allow them to provide additional financial services (previous year: 10).

The number of tied agents at the end of 2015 was around 38,500 (previous year: around 36,000).

### 3.1.3 Finance leasing and factoring institutions

In 2015, the following institutions were authorised by BaFin and subject to its ongoing supervision: 352 pure finance leasing institutions (65%, previous year: 362) and 163 pure factoring institutions (30%, previous year: 170). There were an additional 25 institutions engaged in both finance leasing and factoring (5%, previous year: 27). Overall, a slight decline in these financial services providers, the "Group V institutions", was recorded.

During the year under review, BaFin approved 13 new applications for authorisation pursuant to section 32 of the Banking Act. In total, 32 authorisations ended in 2015, in 26 of those cases as the result of waivers. In three further cases, a merger with another institution resulted in the termination of the authorisation. Furthermore, two authorisations expired as a result of formal rescission and one more due to a reorganisation of legal form.

### 3.1.4 Payment institutions and e-money institutions

32 payment institutions and six e-money institutions held an authorisation under the Payment Services Supervision Act at the close of 2015. Six of these institutions also held authorisations under the Banking Act for particular financial services (foreign currency business) or banking transactions. E-money institutions are entitled to provide all payment services, in addition to issuing e-money. Payment and e-money institutions are permitted to engage in factoring activities without specific authorisation under the Banking Act, since the payment services they provide are frequently linked to the purchase of the receivables on which the transactions are based.

CRR credit institutions are also classified as payment services providers. They are therefore permitted to provide payment services and issue e-money without specific authorisation.

The number of institutions from other countries within the European Economic Area with operations in Germany using the EU passporting procedure has risen to more than 500. BaFin has little information on the business and transactions actually processed in Germany for domestic customers, since the notifications from the foreign supervisory authorities are not required to give specific information about the transactions, and there are also no ongoing reporting requirements for the institutions in question.

## 3.2 Economic environment

The continuing low interest-rate environment was once again the principal factor affecting the banking sector in 2015. The European Central Bank's key interest rate remained unchanged at its record low of 0.05% throughout the whole year. At the start of the year, the ECB further intensified its existing expansionary monetary policy by adding to and extending the securities purchase programmes already in place.[79] In addition to *Pfandbriefe* and certain asset-backed securities, it is now also able to purchase government bonds of eurozone countries until March 2017. The ECB's objective is to purchase securities with a value of €60 billion each month. In December 2015, it also lowered the rate of interest on institutions' deposits in excess of the minimum reserve requirement from -0.2% to -0.3%. The intention behind the move is to provide a further impetus to higher lending by the institutions.

79 See press statement by Mario Draghi dated 22 January 2015, https://www.ecb.europa.eu/press/pressconf/2015/html/is150122.en.html.

## Rise in bond prices

The continuation of quantitative easing had a noticeable effect on the European bond market. Higher demand from central banks contributed to higher bond prices and a further decline in yields. At the beginning of 2015, the yields on a number of European government bonds were already negative for short-term maturities. During the course of the year, yields for medium-term maturities of up to five years also entered negative territory. Only in the second quarter was there a brief but significant increase in interest rates, triggered by higher inflation figures in Europe and a lack of liquidity in the market. Expectations of a continuation of expansionary monetary policy in Europe subsequently generated another noticeable decline in yields. The banks benefited from a favourable refinancing environment in 2015. Fewer main refinancing operations were undertaken in comparison with the previous year.[80] At the same time, institutions' deposits with the central bank grew significantly, notwithstanding negative rates of interest. This development illustrates the excess liquidity in the money market.

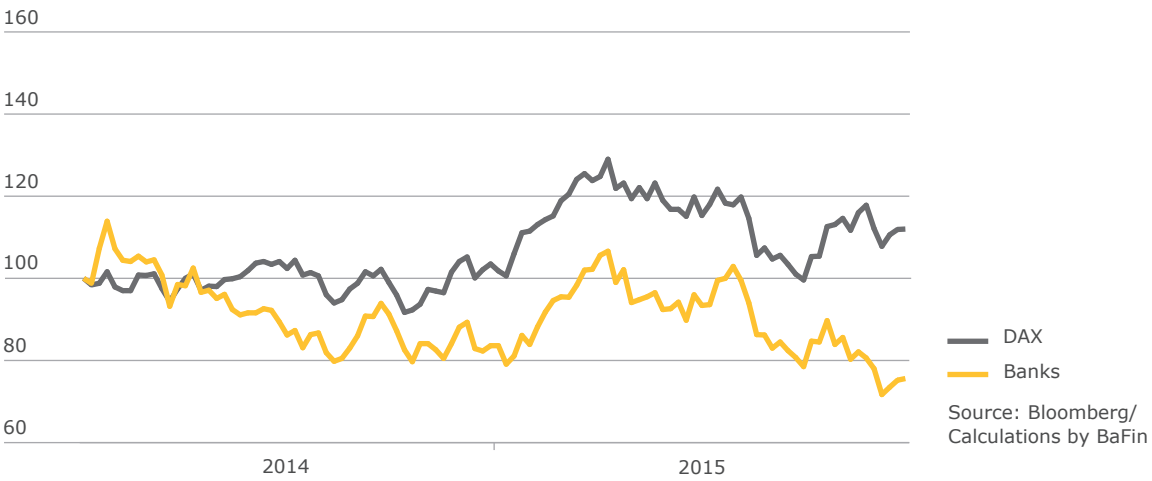
The economic environment provided a boost to the credit quality of the institutions. While the German economy had already shown itself to be in good shape over a number of years, in 2015 the economic recovery in the whole of the eurozone that had made a tentative start in 2014 was able to consolidate its position to some extent. In Germany, private consumption, together with rising numbers in employment, proved itself to be the mainstay of the growth in the economy.

The regulatory environment also gave rise to changes for the institutions. At the beginning of 2015, for example, the Recovery and Resolution Act *(Sanierungs- und Abwicklungsgesetz)* came into effect, implementing the European Bank Recovery and Resolution Directive into German law. The effect of the regulations is that in future banks will no longer be automatically able to count on government assistance in a crisis. The rating agencies responded, among other things, by changing their credit assessment methodology in the first half of the year. This resulted in the downgrading of the credit ratings of a large number of European banks – including German institutions.

The German banking shares index initially tracked the performance of the DAX index of

**Figure 6** German banking shares index

End-of-week levels, End of 2013 = 100




Source: Bloomberg/ Calculations by BaFin

80 Aggregated data for Europe: https://www.ecb.europa.eu/stats/monetary/res/html/index.en.html (Data on daily liquidity conditions).

German shares to a large extent in 2015 (see Figure 6, page 133). In the first six months of the year, the effects of quantitative easing on the equity markets were clearly identifiable. The liquidity introduced to the markets was invested in more risky types of investment – mainly in shares. This initially triggered a significant general rise in prices. Prices fell back again in the second half of the year, however. Taking the year as a whole, the DAX recorded overall growth of 9.6%. The German banking shares index, on the other hand, lost ground against the DAX, particularly in the second half of November. It recorded a significant decline over the whole year.

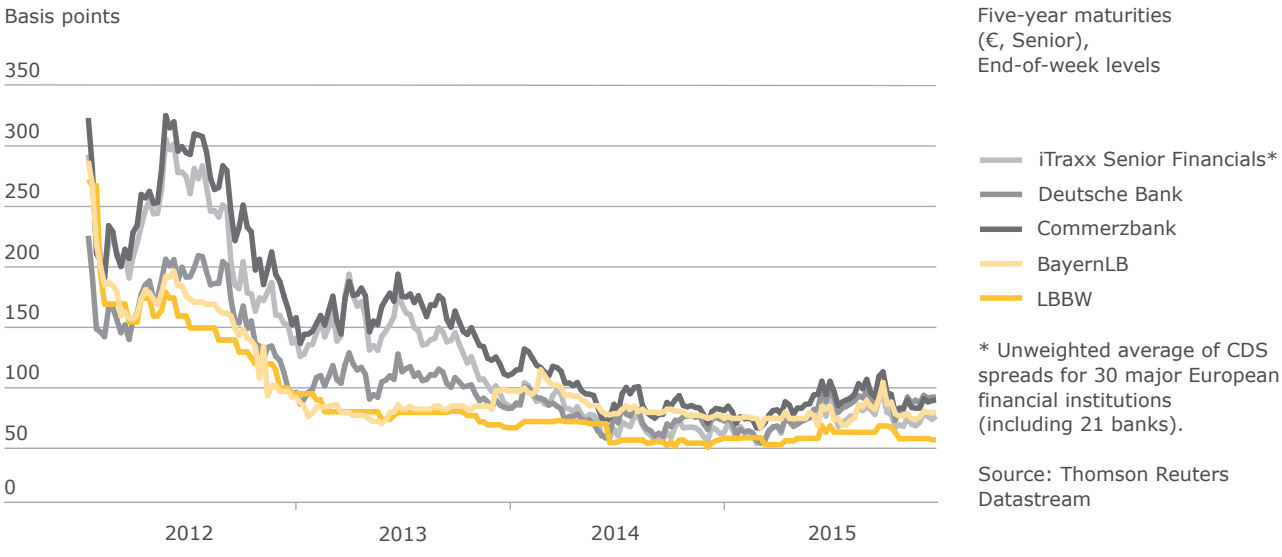
The spreads on German banks' credit default swaps (CDS) on the whole increased slightly during the course of 2015 (see Figure 7). They remained at a relatively low level overall, however. A noticeable feature is that the political unrest in Greece in the first half of the year had only a modest impact on the credit default swap spreads for major German banks. This demonstrates that market participants clearly consider the German banking sector to be more resistant to crises of this kind than a few years ago.

The quarterly Bank Lending Survey conducted by the ECB and the Deutsche Bundesbank showed that German institutions made very few changes to their lending conditions in 2015. In contrast, European institutions slightly relaxed their conditions for corporate and retail real estate loans. According to the institutions, the demand for loans has risen noticeably in Germany and in Europe in all lending categories. The first three quarters saw particularly rapid growth in demand for retail real estate and consumer loans. The increase in demand in the fourth quarter, on the other hand, related mainly to corporate lending. The institutions also reported distinctly lower margins. The narrowing of margins for corporate loans was generated principally by the high level of competition. In contrast, the main factor impacting margins for loans to private households was the development of refinancing costs. For example, some institutions with a heavy reliance on deposits for their refinancing complained that they have almost no scope for further reductions in their refinancing costs.

### Non-performing loans

There is no statutory definition of non-performing loans (NPLs) in Germany. BaFin and the Deutsche Bundesbank therefore use impaired loans reported in accordance with the German Audit Report Regulation *(Prüfungsberichtsverordnung)* as an

**Figure 7** Credit default swap spreads for major German banks



approximation for the purpose of determining the volume of NPLs for the German banking system as a whole. The two NPL indicators for Germany included in the International Monetary Fund's financial soundness indicators are also calculated with the help of this information. This method entails the possibility of retrospective revisions to the data. The results for 2013 and 2014 are therefore not comparable with the results presented in BaFin's earlier annual reports.

In 2014, the volume of NPLs in the German banking sector declined by more than 10% in comparison with the previous year to €137 billion. This represented an undiminished continuation of the downward trend seen in previous years. Measured against the total gross volume of loans to non-banks, the share of NPLs declined to 2.3% following 2.7% in 2013. After deducting risk provisions already recognised, the ratio of NPLs to reported equity fell significantly, namely from 25.0% to 20.9%. The figures for 2015 were not yet available at the time of going to press.

The renewed improvement in credit quality is likely to have been primarily due to the continuing robust growth in the German economy. Insolvencies fell once again in 2014, while the unemployment rate remained at a very low level in historical terms. At the end of 2014, the number of people in employment in Germany passed the 43 million mark for the first time. In addition, some credit institutions were once again able to reduce the volume of their NPLs by means of sales to financial investors.

## 3.3 Situation at the institutions

### 3.3.1 German institutions under direct supervision by the SSM

67 German institutions classified as significant were directly supervised by the SSM in 2015 (see Table 11, page 136).[81]

#### 3.3.1.1 Profitability and sustainability

Profitability and sustainability of business models were under examination in 2015, from two points of view. On the one hand, the review by the supervisory authorities of the sustainability of business models was a focal point of the supervision of the significant institutions in the SSM. On the other hand, the continuing low interest-rate environment again presented a challenge for the institutions' profitability.[82] Admittedly, the low level of interest rates boosted lending in the area of residential building – and the real estate market as a whole. But at the same time, the solvency of the banks becomes more susceptible to future increases in key interest rates because of the long periods for which interest is traditionally fixed for real estate loans. While in 2015 the major banks were largely successful in actively managing interest on deposits to make up for the adverse effects of the low interest-rate environment to a great extent, there is likely to be only limited scope for utilising this instrument in future. In the final analysis, it was and will remain a challenge for the major German and European banks, above all in the face of the continuing low level of interest rates, to generate sustainable income from the traditional banking business – partly as a result of the favourable lending conditions for consumers, but also because refinancing costs are likely to rise in the event of an increase in key interest rates.

#### 3.3.1.2 Old and new challenges

2015 presented further challenges to the major German and other banks in the eurozone, which included changes in the market environment due to the global slowdown in economic growth, which resulted in lower profits. The regulation of the financial markets and the new European banking supervisory regime also represented new challenges. The Swiss franc shock, unstable and volatile equity markets, the crisis in Greece and the slower rate of growth in China preoccupied the banks, as did lower commodity

81 See 1.1. The 67 institutions belong to 22 groups. The up-to-date list of all significant institutions supervised directly by the SSM can be found under the following link: https://www.bankingsupervision.europa.eu.

82 For details of the supervision of significant institutions, see also the ECB Annual Report on Supervisory Activities 2015.

## Table 11 German institutions directly supervised by the SSM

As at 31 December 2015

| |
|---|
| Deutsche Genossenschafts-Hypothekenbank Aktiengesellschaft |
| Norddeutsche Landesbank – Girozentrale – |
| ING-DiBa AG |
| DekaBank Deutsche Girozentrale |
| Westdeutsche ImmobilienBank AG |
| Dexia Kommunalbank Deutschland AG |
| Volkswagen Bank Gesellschaft mit beschränkter Haftung |
| Sal. Oppenheim jr. & Cie. AG & Co. Kommanditgesellschaft auf Aktien |
| Frankfurter Bankgesellschaft (Deutschland) AG |
| WL BANK AG Westfälische Landschaft Bodenkreditbank |
| Landeskreditbank Baden-Württemberg – Förderbank – |
| DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main |
| Deutsche Kreditbank Aktiengesellschaft |
| DEUTSCHE BANK AKTIENGESELLSCHAFT |
| Berlin Hyp AG |
| Aareal Bank AG |
| European Bank for Financial Services GmbH (ebase) |
| UniCredit Bank AG |
| State Street Bank GmbH |
| TeamBank AG Nuremberg |
| Bankhaus Neelmeyer Aktiengesellschaft |
| WGZ BANK AG Westdeutsche Genossenschaftsbank |
| VR DISKONTBANK GmbH |
| Landesbank Baden-Württemberg |
| Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale – |
| Münchener Hypothekenbank eG |
| Landwirtschaftliche Rentenbank |
| DVB Bank SE |
| netbank Aktiengesellschaft |
| Santander Consumer Bank Aktiengesellschaft |
| MKB Mittelrheinische Bank Gesellschaft mit beschränkter Haftung |
| DEUTSCHE APOTHEKER- UND ÄRZTEBANK EG |
| Deutsche Postbank AG |
| Sparkasse Mittelholstein Aktiengesellschaft |
| Deutsche Bank Privat- und Geschäftskunden Aktiengesellschaft |
| NRW.BANK |
| Deutsche Pfandbriefbank AG |
| Hamburger Sparkasse AG |
| HSH Nordbank AG |
| BHW Bausparkasse Aktiengesellschaft |
| Frankfurter Sparkasse |
| Landesbank Hessen-Thüringen – Girozentrale – |
| Landesbank Berlin AG |
| Bayerische Landesbank |
| comdirect bank Aktiengesellschaft |
| norisbank GmbH |
| SEB AG |
| COMMERZBANK Aktiengesellschaft |
| DB Investment Services GmbH |
| Deutsche Bank Bauspar-Aktiengesellschaft |
| Bausparkasse Schwäbisch Hall Aktiengesellschaft, Bausparkasse der Volksbanken und Raiffeisenbanken |
| Deutsche Hypothekenbank (Actien-Gesellschaft) |
| Hypothekenbank Frankfurt AG |
| NATIXIS Pfandbriefbank AG |
| Deutsche Bank Europe GmbH |
| PSA Lion Deutschland GmbH |
| Bethmann Bank AG, Frankfurt (Main) |
| CACEIS Bank Deutschland GmbH, Munich |
| Commerz Finanz GmbH, Munich |
| CreditPlus Bank AG, Stuttgart |
| GEFA Gesellschaft für Absatzfinanzierung mbH, Wuppertal |
| Hanseatic Bank GmbH & Co. KG, Hamburg |
| Merck, Finck & Co. oHG, Munich |
| OnVista Bank GmbH, Frankfurt (Main) |
| TARGOBANK AG & Co. KGaA, Düsseldorf |
| VON ESSEN GmbH & Co. KG Bankges., Essen |
| VTB Bank (Deutschland) AG, Frankfurt (Main) |

prices, high litigation costs and new regulatory requirements due to the SSM. The latter included, for example, the additional capital requirements based on the Supervisory Review and Evaluation Process (SREP) for banks[83], preparations by the banks for compliance with the leverage ratio and the implementation of the LCR[84] since October 2015. The major European banks had to address these and other issues in 2015, and some of them will be on the agenda in 2016 as well.

For the major German and European banks, therefore, the environment remains challenging. The situation in the eurozone, which still remains fragile, demands particular attentiveness from the SSM with respect to macroeconomic developments and their consequences for the major banks as well as the stability of the European financial market. For example, the prospects of a global economic recovery remain poor – in the light of the flagging Chinese economy, low commodity prices and the potential second-round effects the increase in the US key rate at the end of 2015 may have on the situation in emerging economies. While the economic situation in the USA in 2015 remain broadly stable, the upward trend was not sustained at the same level throughout the whole year. Despite the fact that participants in the financial markets had anticipated the Fed's increases in the key interest rate, the future effects on profitability and risk remain central issues for major European banks, not least due to the difficulty of estimating the global second-round and consequential effects.

Operational risks continue to be a concern for major German and European banks, who need to update their IT systems and further develop their security mechanisms in some cases, including their vulnerability to cyber attacks, for example. The increasing level of competition in the financial markets also plays a major role in this context, whether the competition is from the fintech industry or from US institutions who were able in 2015 to further expand their market shares in global investment banking, especially in the area of leveraged finance, at the expense of their European competitors.

The major European banks must brace themselves for further macroeconomic threats. The performance of the equity markets, for example, is weaker than expected and the fair values of financial assets in the trading book are falling as the economic situation in Europe deteriorates. This could potentially be exacerbated by the effects of a yield curve which continues to flatten out. Structural issues will be on the agenda again in 2016. The institutions will be preoccupied with their costs, with the digitalisation of their retail business and with the question of how they can retain customers and optimise their branch networks. All of these will be primary factors affecting the positioning of major European banks against their international competitors in 2016 as well.

Regulation within the SSM and in an international context will also continue to play an important part in the major banks' planning processes. The key concepts in this connection will include, for example, TLAC and MREL[85], but also SREP.[86] The challenges will also include preparations for the maximum leverage ratio and long-term compliance with the common equity Tier 1 (CET1) capital ratio required by the supervisory authorities. From the point of view of the major banks, however, the main consideration affecting the CET1 capital ratio is not so much the internal generation of capital as the anticipated "RWA inflation", i.e. the stricter regulatory provisions on the risk weighting of bank assets (risk-weighted assets – RWA).

International regulation will be a success factor not just for the major banks but also for the SSM itself. In addition to the implementation of appropriate internal structures and the creation of a Single Rulebook in the eurozone, international exchanges with other supervisory

83 See 1.1.2.

84 Liquidity Coverage Ratio – LCR.

85 For details of TLAC and MREL, see 1.3.5, for instance.

86 For details of SREP, see 1.1.2, for instance.

**Table 12** Overview of selected significant results of the transparency exercise

As at 30 June 2015

| | EU | DE | FR | IT | UK | ES |
|---|---|---|---|---|---|---|
| Degree of coverage* | 67% | 55% | 93% | 88% | 51% | 90% |
| CET1 ratio | 12.8% | 14.3% | 12.5% | 11.5% | 11.8% | 12.2% |
| Forbearance ratio** | 3.6% | 2.9% | 1.3% | 4.8% | 2.4% | 8.9% |
| Non-performing exposures ratio | 5.6% | 3.4% | 4.3% | 16.7% | 2.9% | 7.1% |
| Coverage ratio for non-performing exposures | 43.3% | 34.8% | 51.4% | 45.4% | 34.1% | 46.0% |
| Leverage ratio | 4.9% | 4.7% | 4.6% | 5.6% | 4.7% | 5.7% |
| Proportion of sovereign exposures | 9.7% | 12.3% | 6.7% | 15.6% | 9.5% | 11.8% |

* Total assets of the participating banks/total assets of the relevant national banking market.
** Proportion of portfolio subject to agreed forbearance measures.

authorities will need to remain at the centre of the SSM's endeavours to create an even more secure foundation for the stability of the financial markets in Europe.

#### 3.3.1.3 EBA transparency exercise 2015

For the first time since 2013, the European Banking Authority (EBA) once again conducted a transparency exercise in 2015. The purpose of this exercise, among other things, was to improve the transparency within the European banking industry of information on the credit institutions' capital resources, risk-weighted assets, credit and market risks, sovereign exposures and leverage ratios. The EBA also published indicators relating to credit quality, non-performing risk exposures and forbearance measures for the first time. For the nine banks – of which six were German[87] – that do not prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) and are therefore not required to report FINREP data[88], only the COREP data[89] were published.

105 banking groups from 20 EU countries and from Norway participated in the transparency exercise. They also included the 20 German institutions supervised directly by the SSM. The participants have combined assets amounting to around €30 trillion and therefore represent around 67% of the total European banking market. The EBA acted as the lead coordinator for the exercise, while the national supervisory authorities and the ECB shared responsibility for the quality of the data and for communication between the banks and the supervisory authority.

For the first time, the exercise was largely based on existing supervisory reporting requirements, namely COREP and FINREP, and recorded the data as at the 31 December 2014 and 30 June 2015 reporting dates. The supervisory authority relied on submissions by the institutions only for information relating to sovereign exposures and the leverage ratio. This approach significantly reduced the expenditure of time and resources for the banks, on the one hand, and also ensured that the figures were comparable, on the other hand.

Methodologically, the transparency exercise differed from the EBA stress tests in that only historical data were published for the purposes of the exercise, and also in that the data were not influenced by any predefined scenarios (see Table 12 "Overview of selected significant results of the transparency exercise"). The

87 Deutsche Apotheker-und Ärztebank eG, HASPA Finanzholding, Erwerbsgesellschaft derS-Finanzgruppe mbH & Co. KG, Landeskreditbank Baden-Württemberg – Förderbank, Münchener Hypothekenbank, NRW.Bank.

88 Financial Reporting, see 1.1.4.

89 Common Reporting, see 1.1.4.

exercise therefore does not enable any forecasts to be made regarding the potential future performance of the banks on the basis of scenarios.

At the aggregated level, the results for German institutions presented above seem fairly unremarkable overall in comparison with the EU as a whole and the other countries. The degree of coverage achieved by the 2015 transparency exercise shows that a good two-thirds of the assets of European banks were included in the exercise at EU level. The figure of 55% achieved for Germany indicates that the German banking market is generally less concentrated in comparison with other countries such as France (93%), Spain (90%) or Italy (88%).

The aggregated German CET1 ratio of 14.3%[90] was higher than the EU average and the ratios for France, Italy, the UK and Spain. A positive point worth emphasising is the currently low proportion of non-performing exposures in Germany (3.4%). Other countries such as Italy (16.7%) and Spain (7.1%) are reporting significantly higher levels for this indicator.

90 The German ratio is based on a relatively heterogeneous sample, which might distort the aggregated German ratio.

### 3.3.2 Institutions subject to German supervision

## 3.3.2.1 Opinion

### Raimund Röseler on the situation for small and medium-sized German institutions in the historically low interest rate environment

Despite the historically low interest rates, the majority of small and medium-sized German institutions still have relatively good capital adequacy. Nevertheless, the earnings outlook in the persistently low interest rate environment is exceedingly critical. BaFin will carefully examine the ways in which the institutions counter this, and will intervene if necessary.

**Raimund Röseler**

is BaFin Chief Executive Director of Banking Supervision.

The current low interest rate environment poses a particular challenge to German institutions, since, for the majority, net interest income remains their most important source of income, making up some two-thirds of their operating income. Interest margins[91] have been in decline since the 1980s, which has long had an impact on the earnings power of German institutions. That said, the duration and scale of the current low interest rate environment is exceptional and necessitates specific measures not just from the institutions affected, but also from the supervisors.

#### Comprehensive survey

BaFin and the Deutsche Bundesbank have reacted to this situation. In 2015, they carried out a survey on the earnings situation and resilience of less significant institutions (LSIs)[92] in Germany – i.e. those that remain directly subject to German supervision – in the low

91 Net interest income relative to average total assets.

92 Specialist banks were not included in the survey.

interest rate environment. One aim was to collect forecast earnings data to facilitate a better assessment of medium-term earnings outlooks from a supervisory viewpoint. In addition, BaFin also intends to gain a better understanding of the adjustment strategies that the institutions are planning or have already implemented to face the challenges presented by the low interest rate environment.

The survey on the impact of low interest rates was one of the largest ever carried out in Germany. Roughly 1,500 institutions took part, including some 1,000 cooperative banks, approximately 400 public-sector credit institutions and around 100 private commercial banks. BaFin and the Bundesbank worked closely with experts from various banking associations to design and carry out the survey. It was thus possible to collect data in a targeted manner which did not require a disproportionate effort by the institutions. The insights derived from the survey confirmed the approach taken by the supervisors.

### Five interest rate scenarios and stress tests

The core elements of the survey were five interest rate scenarios covering the period between 2015 and 2019. The survey was supplemented by a market and credit risk stress test, which was used as the basis for analysing the resilience of German institutions to exogenous shocks.[93] The results of the interest rate scenarios were clear:

- Unsurprisingly, the majority of the German institutions examined recorded declines in earnings before taxes (EBT) in all scenarios.
- Despite the current favourable economic trend, the German institutions expect a significant worsening as against the survey on the impact of low interest rates conducted in 2013.
- A persistently low interest rate environment would have considerable adverse effects on the institutions' earnings power.

In some instances, the earnings declines in the individual scenarios were very mixed. Based on their own planning, the institutions themselves assume an aggregate drop in EBT of 50% in the period up to 2019.

Although a sudden positive interest rate shock of +200 basis points would initially have a considerably greater impact on average EBT, this would only result in a relatively moderate drop in earnings in the long term (down 10% in the period up to 2019). A further decrease in interest rates would have a far more negative impact than a sudden increase. On average, the survey on the impact of low interest rates shows that a further decrease of -100 basis points would negatively impact earnings by up to 75% in the next four years. The fact that this decline in interest rates has partly materialised since the survey was conducted shows that this is not merely a hypothetical scenario. The drop in earnings is primarily attributable to the erosion of margins in the interest rate business. On the assets side of the balance sheet, the institutions must successively replace maturing business – some of which is still high-interest – with new lower-interest business. On the liabilities side, however, they are only to a limited extent passing the decline in deposit interest on to their customers. This places significant constraints on interest margins, and thus ultimately on the earnings power of the institutions.

The findings of the survey show that institutions are seeking to offset this imbalance through cost savings. However, the majority of German institutions do not manage to fully offset the losses in the exercise, since the interest rate business accounts for a very large proportion of their overall business. That said, the surplus capital and hidden reserves, which can be used to compensate for losses caused by the low interest rate environment in the period up to 2019, are currently having a positive effect.

### Results of the stress test scenarios

The market and credit risk stress tests have a relatively moderate impact on the institutions' current earnings and capital situations. In the

93 For the details of the survey, see www.bafin.de/dok/6780456.

market risk stress test, an impairment in debtor credit standing would cause the Common Equity Tier 1 capital ratio to decline by an average of 0.5 percentage points. Ultimately, the market risk to which the institutions are exposed seems manageable, despite the observable increase in risk-taking in the proprietary business compared to 2011. In the credit risk stress test, the decline would amount to 0.9 percentage points in scenario 1, and 2.1 percentage points in scenario 2. In both stress tests, the effects can primarily be offset using hidden reserves.

### Despite resilience, the situation is serious

In general, the survey findings show that less significant institutions in Germany are currently able to withstand the low interest rate environment thanks to their surplus capital and hidden reserves. However, they also show how serious the situation is. At the moment, the institutions are continuing to benefit from the generally positive macroeconomic conditions. The institutions will not be able to avoid further negative consequences if the situation worsens.

More than half of the surveyed institutions indicated that they had already increased their commission for individual banking services due to the current low interest rate environment, and that they are planning further increases. It remains to be seen whether this planned increase in commission income will in fact materialise. The planning is likely to include a certain degree of optimism.

### Too much optimism?

The moderate increase in costs – for instance the expected increase in pay rates and pension provisions – also seems very optimistic. The institutions expect that their administrative expenses will increase by an average of less than 5% in the next five years. These assumptions will be challenged by BaFin where it seems necessary. This is of course especially true for the roughly 200 institutions that BaFin has identified as "giving rise to concerns" based on various indicators (primarily equity-related). BaFin will be particularly thorough in its supervision of these institutions.

BaFin has drawn up an individual action plan for all institutions where concerns have become evident; in particular, this provides for a review of planned countermeasures. Some institutions have already implemented measures, for example expanding their commission-based business, optimising processes and reducing costs.

Ultimately, however, it is not BaFin that is required here. First and foremost, it is the institutions that must act. Each bank must scrutinise the viability of its business model. The same applies to pricing policy. It is vital to secure prices for banking services that are appropriate to the costs and risks. If this is not possible, there must be a critical examination of whether the services should continue to be offered.

### Further use of the findings

The findings of the survey on the impact of low interest rates also make an important contribution to the supervisory review and evaluation process (SREP)[94], which is scheduled for 2016 and forms part of Pillar II of the regulatory framework. In line with the European Banking Authority (EBA) guidelines, BaFin is planning to begin introducing SREPs for all credit institutions in 2016. The objective is for the banks to also have adequate capital available with regard to the risks that are not covered by Pillar I. Particularly in times of crisis, the availability of a sufficient equity base is crucial to the credit institution's ability to survive. Specifically, this means that BaFin will take into consideration interest rate risk and the outcome of its market and credit risk stress tests when determining the overall capital requirements for individual institutions as part of the SREP.

### Outlook

The findings presented above and their consequences show that the institutions need to address fundamental considerations. The low interest rate environment is exposing credit institutions to challenges that require the systematic implementation of countermeasures.

94 See 1.1.2.

Some institutions will have to downsize to reduce their costs. Some will have to be merged or even withdraw from the market.

Most notably, however, all banks will have to thoroughly scrutinise their business models and, as a result, their pricing and product policies.

#### 3.3.2.2 Private commercial, regional and specialist banks

This group of institutions includes a few institutions that do not fall within the narrower definition of a credit institution under EU law (Article 4(1) No 1 of the Capital Requirements Regulation (CRR)), because they are not engaged in deposit business. However, in accordance with section 1a (1) of the German Banking Act *(Kreditwesengesetz)*, these institutions, which refinance their lending business solely from their own funds or funds from shareholders, are subject to the requirements of the CRR and the provisions of the Banking Act referring to the CRR *mutatis mutandis*.

The continuing low interest-rate environment and changes in the regulatory requirements were also the major factors affecting the business environment of the private commercial, regional and specialist institutions. Nevertheless, these factors had differing effects in practice owing to the wide variety of business models. As in the past, the implementation of the regulatory requirements represented a particular challenge for smaller and medium-sized institutions.

More or less all of the institutions in this group found themselves facing persistent pressure to consolidate on the cost side – depending on their business model. The institutions adapted their business models in a variety of ways or redesigned them in order to improve their earnings situation.

Even smaller institutions placed greater emphasis on financial technologies, fintech for short, in the search for profitable areas of business – whether by developing technologies of that nature themselves and bringing them to the market, or by entering into cooperation with fintech companies.[95] The financial services are marketed in some cases under the company's own name, but in some cases also as white label services under a third-party name. The objective of the technologies is to reduce costs by utilising IT processes.

In individual cases, smaller institutions – such as a consumer credit institution specialising in sales financing – were leaving the market. However, BaFin also received applications for new authorisations. Current developments in the financial markets are of course also reflected in the types of new businesses for which applications are being made. For example, business models in line with the trend towards fintech are being proposed: Some are based on mobile banking transactions managed using a smartphone, others are aimed at project financing for renewable energy.

#### 3.3.2.3 Savings banks

German savings banks concluded the 2015 financial year with satisfactory overall results.[96] Even if net interest income recorded a decline, this contrasted with rising demand for loans in the retail and corporate businesses. The institutions belonging to the savings banks associations succeeded in consolidating their market leadership in residential building loans and the demand from *Mittelstand* companies for loans for investment purposes rose once again. According to the German Savings Banks

95 For information on fintech companies, see chapter II 4.1.

96 With the exception of Hamburger Sparkasse AG, all savings banks in Germany continue to be supervised directly by BaFin, since they are classified as less significant institutions (LSIs) within the SSM.

Association, the Savings Banks Finance Group increased its market share of residential building loans to 37.1% in the past financial year. Its share of corporate lending amounted to 42.5%, as in the previous year. The volume of new loans granted by the savings banks rose sharply in 2015. The level of risk provisions required in the lending and securities business was relatively low so that it was once again possible to add significantly to the contingency reserves. The overall result, therefore, was that the savings banks recorded a net profit for the year at the same level as in previous years.

The low level of interest rates and the continuing digitalisation of the banking business, however, increasingly represent challenges for the savings banks. Moderate rates of growth in commission-based business, for example, are not sufficient to make up for the decline in net interest income. However, the public-sector savings banks – in contrast to the private banks – are subject to statutory restrictions when it comes to developing new sources of income and adjusting their business models. For example, the savings banks legislation in force in the individual federal states provides that in principle the institutions should restrict their activities to the business territory of the respective local authority responsible for them (regional principle). In keeping with their public responsibility to provide banking services to all sections of the population, the savings banks will continue to maintain an extensive branch presence, even if customers visit the branches less and less frequently and the dense branch network generates a high level of costs. The changes in the regulatory environment and the need for investments in information technology represent additional burdens for the institutions. Simultaneously, fintech companies offering innovative services are intensifying the level of competition.

Increasing pressure on costs and changing patterns of customer behaviour have prompted the savings banks to place their branch concept under examination and at same time to consider reducing the size of the branch network. On the other hand, the remaining branches would be upgraded and expanded into larger service and advice centres. In addition, more mergers of savings banks are planned in order to lower costs and benefit from synergies. In order to ensure that close contact with the customer is maintained even in the digital world, the savings banks are planning to improve the integration of the branch operations and the online activities in future. They are taking another step in the direction of digitalisation with their involvement in the new "Paydirekt" online payment system – a collective project of the German banking industry.

#### 3.3.2.4 Securities trading banks

The business environment remained difficult for securities trading banks and exchange brokers last year. The process of consolidation for the mainly small, owner-operated institutions therefore continued in 2015 as well. Exchange trading volumes in the past year rose only modestly, since retail investors continued to be hesitant despite the positive developments in the DAX and the extremely low level of interest rates. In addition, the bond market also fell sharply following the increased level of purchases by the European Central Bank. A large number of new issuances of *Mittelstand* bonds also failed to achieve the success hoped for.

As a result, there continues to be a very high level of competitive pressure on securities trading banks and exchange brokers. A further factor is that stock exchange participants are fearful of a dramatic collapse in turnover on the trading floor if a financial transaction tax is introduced. Against this background and as a result of ongoing new developments in stock exchange trading and the increased market presence of high-frequency traders, also known as algo traders, but also due to the development of alternative trading platforms and changes in statutory requirements, the institutions are continuing to look for new areas of business and sources of income. Even though the environment for corporate finance improved slightly, particularly for small and medium-sized enterprises, not all institutions were able to benefit from this.

The turnover of the traders in energy derivatives authorised by BaFin once again failed to meet their expectations in 2015. This was due to the continuing extremely low levels of energy prices. In contrast, the European Energy Exchange (EEX) and the related clearing house European Commodity Clearing (ECC) succeeded in expanding and consolidating their role in the European competition.

High-frequency exchange trading takes place in Germany only on the European Exchange (Eurex) Deutschland and on the Frankfurt Stock Exchange. The number of high-frequency traders is therefore still manageable. Moreover, in 2015 no undertaking took advantage of the option of applying for authorisation to engage in high-frequency trading within the meaning of section 1 (1a) sentence 2 no. 4d of the Banking Act. Traders operating in Germany were either already authorised by BaFin to engage in proprietary trading or able to engage in cross-border trading anyway because they held corresponding authorisation from a European member state.

For some institutions, the implementation of supervisory regulations that have recently come into force presented a challenge, not least in view of their size and limited business model. As in previous years, BaFin therefore once again found it necessary, for these and other reasons, to remind a number of institutions of particular measures required. Institutions were expected, for example, to remedy weaknesses in their organisation, above all in risk management and control, in their risk-bearing capacity concepts and in the documentation of transactions.

#### 3.3.2.5 *Bausparkassen*

The effects of the current low interest-rate environment currently present a central challenge to the particular business model of the *Bausparkassen*. This is because *Bausparkassen* are responsible for a significant overall proportion of the financing of private residential construction. In the past year, the *Bausparkassen* increased their lending to private individuals for the purpose of residential construction.[97] Savings targets also recorded growth throughout the entire sector.

Nevertheless, the persisting low interest-rate environment continues to have a noticeable effect on the *Bausparkassen*. Despite their homogeneous business model, the group of 21 *Bausparkassen* should be regarded as heterogeneous, since they differ significantly from each other both in size and also in balance sheet structure and market share. The impact of the low interest-rate environment is therefore not felt by all *Bausparkassen* to the same extent.

In 2015 – as in previous years – the proportion of total assets of the various *Bausparkassen* represented by *Bauspar* loans continued to decline.[98] This trend contrasts with the level of *Bauspar* deposits which has been growing for years. This has a material adverse effect on the net interest income of *Bausparkassen*. Older contracts, which pay a high rate of interest in comparison with the current market level of interest rates, are primarily responsible for this problem. *Bausparkassen* customers continue to pay savings into these contracts in view of the attractive return, but without taking out the *Bauspar* loans.

In 2015, the *Bausparkassen* once again increased their lending for the purposes of interim or bridge financing in particular, to enable them to make up for the decline in income from *Bauspar* loans. Alongside income earned from investments in securities, income from such lending now accounts for a significant proportion of the interest income of *Bausparkassen*. The *Bausparkassen* once again launched new *Bauspar* plans at historically low rates of interest in 2015. However, it will only become apparent in a few years' time what effects these new plans will ultimately have on the level of *Bauspar* loans. In addition, *Bausparkassen* have repeatedly terminated

97 Deutsche Bundesbank, Banking statistics, November 2015, page 102.

98 Deutsche Bundesbank, Banking statistics, November 2015, page 102.

old contracts paying high rates of interest. The media reported in particular that the institutions were terminating *Bauspar* contracts that had been eligible for allocation for at least ten years without the savers having taken out the *Bauspar* loan. A judicial decision of the highest instance on the ability to terminate such contracts, which must be decided under civil law, is still awaited.

### 3.3.2.6 Cooperative banks

The pace of mergers in the cooperative sector remains at a low level. At the end of 2015, BaFin had a total of 1,022 primary cooperative institutions under its supervision. The number of institutions declined by 27 or 2.6% compared with the previous year. Increasingly, the reason for the mergers – in addition to a lack of income as a result of the low level of interest rates – is pressure on costs, triggered by stricter regulatory requirements and investments in information technology. If these trends continue, an increase in mergers is likely in the years to come. This was also clear from supervisory discussions with the management boards of primary institutions: They reported that, in addition to branch closures and other outsourcing measures, they were increasingly also considering mergers.

Despite regulatory changes and the persisting low interest-rate environment, 2015 proved to be a satisfactory financial year overall. The primary institutions were therefore once again able to make adequate provision for future risks by adding to reserves. The success of the cooperative institutions is also recognised by the rating agencies: The cooperative sector has a long-term rating of "AA-".

Nevertheless, the results of operations of banks organised as cooperatives fell slightly in 2015 in comparison with 2014. It was not quite possible to match the extremely good level of the six preceding years from 2009 to 2014. Income from commission-based business was not enough to make up for the decline in net interest income. The principal cause of this development was the low interest-rate environment. There was no longer scope to compensate fully for the reduction in interest income, even though it was anticipated, since interest expenses also fell over the same period. Net interest income in 2015 nevertheless remained at a comfortable level.

In view of the excess supply of liquidity at low rates of interest, banks must assume that they will continue to generate lower levels of income for the foreseeable future. The cooperative sector is endeavouring to take countermeasures by achieving further reductions in costs. The cooperative banks have now been demonstrating notable success in managing costs for ten years. Their efforts have resulted in a significant reduction of costs as a proportion of total assets.

Consolidation in the cooperative sector made further progress in 2015. At the start of the year, the two data centre operators Fiducia and GAD merged to create Fiducia & GAD IT AG, a collective IT services provider. After a number of initial attempts, the merger of DZ Bank and WGZ Bank also now looks likely to take place in 2016. This would complete the consolidation of the top level of the cooperative sector.

#### Regulatory challenges for the cooperative banks

The upcoming regulations relating to financial reporting entail not only financial challenges for the institutions, but legal and technical challenges as well. An example of this is the ECB reporting regulation.[99] The reporting format used by the ECB for these "FINREP" reports is based on the International Financial Reporting Standard (IFRS) on Financial Instruments. Primary institutions generally prepare their financial statements according to different accounting standards, however, namely those required by the German Commercial Code *(Handelsgesetzbuch)*. BaFin organised a working group on the subject at an early stage including banks, industry associations and auditors and was in a position to discuss criticisms with the ECB in good time. Nevertheless, the reporting format will cause significant organisational and technical

99 ECB/2015/13. For details on reporting, see 1.1.4.

problems for the institutions and therefore inevitably involve additional related costs as well.

#### 3.3.2.7 Foreign banks

As before, foreign banks are a significant factor in the German banking industry. Their business activities are concentrated primarily on the lending business, private banking and custodian bank operations. Trade finance and payments also play a significant role in the business activities of these institutions.

In 2015, deposits with foreign banks remained disproportionately high. This is because many of these institutions are endeavouring to attract deposits from German customers. Given their major significance to the German financial market or their infrastructural relevance, BaFin has classified various foreign banks as systemically important or as posing a potential systemic risk.

The establishment of the Single Supervisory Mechanism (SSM) also affects foreign banks with operations in Germany. As a result of BaFin's collaboration in 14 Joint Supervisory Teams, group supervision is becoming increasingly important. The joint programme of work has intensified significantly by means of regular meetings and telephone conferences and the ongoing exchange of information using the ECB's IT platform.

The majority of the foreign bank entities operating in Germany are classified as less significant institutions within the SSM. Recently, however, a number of foreign banks that were classified in principle as less significant have been taken out of this category in the light of their systemic importance. These banks are now referred to as high-priority less significant institutions. This means that these institutions are now subject to even closer supervision.

Since the ECB does not have supervisory powers over third-country branches, BaFin remains solely responsible for monitoring this group of institutions. In Germany, branches from third countries are deemed to be credit institutions pursuant to section 53 of the KWG. Accordingly, these institutions are largely subject to the same regulatory standards applicable to legally independent credit institutions. The supervision of branches from third countries has not been harmonised across Europe. The result of this is that there continue to be differences in the regulatory framework at national level.

A trend which is noticeable at the present time is that non-European foreign banks in particular are increasingly centralising their European activities. This typically involves the establishment of a European headquarters which covers the other markets using legally dependent EU branches with the aid of the EU passporting scheme.

In March 2015, BaFin for the first time authorised a credit institution whose business model is based on the religious-ethical principles of Islam, KT Bank AG. The principal distinguishing feature of a bank conforming to Islam and a conventional bank is the general prohibition on interest (riba). Accordingly, this type of bank may not pay interest to its customers on their deposits nor charge interest on financing transactions. In Islamic finance banks, an ethical council monitors compliance with the principles of Islamic banking. The function of the ethical council is solely advisory, however. It is not able to limit the scope of the statutory responsibility of an institution's management. In contrast to other countries, Germany does not have any special regulations for Islamic finance banks. They are therefore subject to the same regulatory standards as conventional banks.

A major topic for 2016 will be the further development of the sanctions against Iran. There are currently four Iranian credit institutions located in Germany whose business activities are significantly restricted by these sanctions. By a decision of 16 January 2016 and the corresponding implementing regulation of 22 January 2016 of the Council of the European Union, the measures against three of the four

Iranian institutions in Germany restricting their business activities were lifted. The three institutions are therefore now permitted to resume their banking activities, provided that a proper business organisation is in place. Appropriate preparations are currently being made for this purpose, including investments in personnel as well as technical and organisational resources.

#### 3.3.2.8 Finance leasing and factoring institutions

In 2015, the finance leasing and factoring sector once again benefited from the increasing willingness of German companies to invest. According to a forecast by the *ifo Institut*, investments in the German economy as a whole were expected to increase by around 3% to €341.8 billion in 2015 overall. This figure had already risen by 4.4% in the previous year. The leasing and factoring institutions, which are classified as "Group V institutions" for supervisory purposes, enjoyed a disproportionate share of this increase, as in the previous year. According to calculations by the Federal Association of German Leasing Companies *(Bundesverband deutscher Leasing-unternehmen)*, new leasing business grew by 3% to an estimated €52.2 billion, no more than in line with overall investments in the economy. In contrast, however, the volume of lease-purchase contracts which are also sold by the leasing institutions rose sharply by 16% to €6.7 billion. The factoring sector also recorded significant growth: According to a survey by the German Factoring Association, factoring revenues in the first half of 2015 increased by around 12% compared with the prior-year period to €100.5 billion. As a comparison: In the whole of 2009, the factoring revenues of the undertakings belonging to the German Factoring Association amounted to only €96.2 billion. If the trend for the first half of the year continues, factoring revenues can be expected to double within six years. In summary, the Group V institutions were once again able to increase their share of corporate financing in comparison with other forms of finance.

#### 3.3.2.9 Payment and e-money institutions

In 2015, there were only minor changes in the distribution of the payment and e-money institutions between the various different areas of business. One payment institution ceased its remittance business activities. A provider of online payment services received the appropriate licence. The adoption of the EU regulation on interchange fees[100] did not involve the differences in timing for the implementation of cross-border and domestic transactions that domestic acquirers had initially feared on the basis of the original draft. These differences could ultimately have resulted in an exodus of customers. The obligations under the regulation are applicable from 9 December 2015 or 9 June 2016, as appropriate.

### 3.3.3 Development of the *Pfandbrief* business

For the German *Pfandbrief* banks[101] – which include both SIs and LSIs – the performance of the *Pfandbrief* business in 2015 was satisfactory overall. The performance of the *Pfandbrief* market was sound with a healthy level of new issuances, despite the continuing low interest-rate environment accompanied by debate about the future monetary policy of central banks in Europe and the USA, the persistence of the problems in Greece and uncertainty about the future development of the Chinese economy. In addition to the still favourable environment for real estate financing and the associated need for refinancing, in particular the ECB's Third Covered Bond Purchase Programme (CBPP3), which has been running since the late autumn of 2014, continued to have a positive effect on the *Pfandbrief* market. At the start of 2016, the volume of purchases amounted to €143.3 billion. For the ECB, the whole covered bond segment represents an especially important market, which contributes to the refinancing of the banks and converts illiquid assets into liquid products.

100 Regulation (EU) 2015/751, OJ EU L 123/1. See 1.7.

101 *Pfandbrief* banks are credit institutions whose business activities comprise the *Pfandbrief* business (section 1 (1) sentence 1 of the *Pfandbrief* Act *(Pfandbriefgesetz)*.

German *Pfandbriefe* have consistently maintained their position in an international comparison with competing foreign covered bonds. German *Pfandbrief* banks led the field in benchmark issuances with a gross issuance volume of around €26 billion (previous year: around €20 billion), ahead of Spain and France with around €20 billion each. Fourth place was once again occupied by Canada with an issuance volume of €14.3 billion. These four countries therefore accounted for over 50% of the total benchmark volume in 2015. A review of the various cover assets shows that covered bonds backed by mortgages account for the clear majority (92.6%), ahead of those backed by public-sector securities (7.1%) and other types of coverage (ship and aircraft financing: 0.3%). The constant further development of the *Pfandbrief* Act in response to investors' needs is one of the great strengths of the German *Pfandbrief*. As before, it continues to meet the highest standard of quality in accordance with international covered bond legislation. Another important topic for the *Pfandbrief* banks is the open issue of the harmonisation of European covered bond regulations.[102]

With respect to the international covered bond market, the entry of issuers from new markets – such as Turkey, Singapore and South Korea – is expected to help ensure that new issuance activity in 2016 matches that of 2015. But from the point of view of the German *Pfandbrief* banks, 2016 is likely to be an equally satisfactory year. Many of the circumstances prevailing in 2015 are expected to continue to apply in 2016. For example, the *Pfandbrief* will continue to face the challenge of finding sufficient interested investors in the persisting low interest-rate environment. Today, there are hardly any buyers to be found among traditional real money investors – such as insurance companies, *Pensionskassen* and occupational pension institutions; the *Pfandbriefe* are being bought up by banks and central banks. The proportion of investors in the covered bond market represented by central banks and other public institutions rose significantly in comparison with the previous year from an average of 17.5% to 31.1%. The lack of demand from traditional investors is worrying for the institutions from a long-term point of view, especially if the ECB were to reverse its purchases in the future. If interest rates were to fall further, there could even be a threat of negative interest on new issuances.

### *Pfandbrief* sales rising again for the first time

In 2015, sales of *Pfandbriefe* rose again for the first time since the start of the financial crisis in 2008. *Pfandbriefe* with a total volume of €58.1 billion were sold. In 2014 and 2013, new issuances amounted to €45.9 billion and €49.5 billion, respectively; the last time that new issuances were significantly in excess of €100 billion was 2009 (see Table 13 "Gross *Pfandbrief* sales", page 149). Overall, therefore, the beginnings of a positive trend for the *Pfandbrief* market have recently become apparent. Mortgage *Pfandbriefe* amounting to €42.6 billion (previous year: €30.6 billion) were sold in 2015 (including in each case ship and aircraft *Pfandbriefe*, although the amounts are insignificant), well over twice as many as public-sector *Pfandbriefe*, measured by issuance volume. Issuances of the latter in 2015 amounted to €15.5 billion (previous year: €15.3 billion). The continuing high level of real estate financing is creating the potential for growth in mortgage cover assets and this has been reflected in a further increase in the proportion of mortgage *Pfandbriefe* issued for refinancing purposes. The positive performance of the real estate market is expected to continue in the immediate future. This forecast is backed up by the continuing low interest-rate environment, a lack of supply in urban areas with a strong local economy and a development programme for more residential construction worth many billions of euros planned by the federal government. An additional factor is that, in the absence of alternative investments with attractive yields, German residential and commercial property continues to be seen as highly desirable by German and foreign institutional investors. The property market boom also creates problems for the *Pfandbrief*

102 For details of regulation, see 1.9. On the number of *Pfandbrief* banks, see 3.1.1.

banks, however, since more and more banks are crowding into real estate financing and margins are declining. Concluding profitable new business is becoming a challenge.

### Decline in sales of public-sector *Pfandbriefe*

While new issuances of public-sector *Pfandbriefe* were broadly unchanged in comparison with 2014, they remained a long way below the level of earlier years (in 2007, the issuance volume of public-sector *Pfandbriefe* still amounted to €108 billion). New issuances of public-sector *Pfandbriefe* are usually only tailored towards and launched for insurance undertakings and fund investors. As a consequence of the financial crisis, many institutions whose core business consisted of government financing have cut back their activities or ceased them altogether, despite a backlog of infrastructure investment projects. A further factor here is that the transitional period for the understanding[103] on the continuation of the government guarantee for claims against *Landesbanks* and savings banks created after 18 July 2001 expired as at 31 December 2015, since that guarantee was at the same time the basis for the eligibility of those claims as cover assets for public-sector *Pfandbriefe*.

### Continued decrease in outstanding *Pfandbriefe*

The continued decline in the volume of outstanding *Pfandbriefe* (see Table 14, page 150) was due to a high level of maturities and relatively lower new issuance activity. In addition, in 2015 there were once again sufficient alternative refinancing options open to the institutions, for example in the uncovered segment of the market. The volume of public-sector *Pfandbriefe* outstanding at the end of 2015 recorded another above-average decline to €180.5 billion (previous year: €206.5 billion). In comparison, the volume of mortgage *Pfandbriefe* outstanding at the close of 2015 (including ship and aircraft *Pfandbriefe*) rose again for the first time to €203.9 billion (previous year: €195.8 billion), with the result that the total amount of *Pfandbriefe* outstanding was €384.41 billion (previous year: €402.3 billion). The share of the total amount of *Pfandbriefe* outstanding accounted for by mortgage *Pfandbriefe* therefore exceeded 50% for the first time in 2015.

**Table 13** Gross *Pfandbrief* sales

| Year | Mortgage *Pfandbriefe* (€ billion) | Public-sector *Pfandbriefe* (€ billion) | Total sales (€ billion) |
|---|---|---|---|
| 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 | 71.7 |
| 2012 | 42.2 | 14.3 | 56.6 |
| 2013 | 33.9 | 15.6 | 49.5 |
| 2014 | 30.6 | 15.3 | 45.9 |
| 2015 | 42.6 | 15.5 | 58.1 |

103 In 2001, Germany agreed to abolish *Anstaltslast* (government obligation to maintain an institution) and *Gewährträgerhaftung* (government guarantee of an institution's liabilities) for savings banks and *Landesbanks* in discussions with the EU Commission on *Anstaltslast* and *Gewährträgerhaftung* for German public-sector banks. See European Commission, "General provisions for all public credit institutions benefiting from *Anstaltslast* and/or *Gewährträgerhaftung* and/or refinancing guarantees".

**Table 14** Volumes of outstanding *Pfandbriefe*

| Year | Mortgage Pfandbriefe (€ billion) | Public-sector Pfandbriefe (€ billion) | Total outstanding (€ billion) |
|---|---|---|---|
| 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 |
| 2014 | 195.8 | 206.5 | 402.3 |
| 2015 | 203.9 | 180.5 | 384.4 |

The changes in volumes of outstanding *Pfandbriefe* in recent years and the increasing relative importance of mortgage *Pfandbriefe* are reflected in the following table. The forecast for the next few years is that the decline in the volume of *Pfandbriefe* outstanding will continue to slow down. At the same time the proportion of mortgage *Pfandbriefe* will increase further. The volume of outstanding *Pfandbriefe* is likely to stabilise in coming years and rise again in the medium term.

## 3.4 Supervisory activities

### 3.4.1 Credit institutions

#### Institutions under direct supervision by the SSM

In 2015, the ECB ordered around 50 special audits of significant institutions (SIs) located in Germany.[104] This means that almost every significant institution has been audited at least once. However, the ECB has ordered several special audits for the majority of the SIs, depending on the complexity and scope of the relevant business activities.

A priority area for the supervisory audits was the banks' lending business. The principal focus was on the appraisal of IRBA models.[105] A considerable number of ECB models for the quantification of market risk were also reviewed. In addition, the examiners paid particularly close attention to the institutions' IT systems, especially with respect to protecting them against cyber crime. Finally, the ECB assessed the adequacy of the institutions' implementation of the statutory requirements for supervisory reporting systems and the banks' internal models.

#### Institutions under German supervision

In the past year, BaFin carried out 176 special audits of less significant institutions (LSIs) pursuant to section 44 (1) sentence 2 of the Banking Act *(Kreditwesengesetz)* (see Table 15 "Breakdown of special audits of LSIs by areas of emphasis"). As audits of banking businesses,

**Table 15** Breakdown of special audits of LSIs by areas of emphasis

As at 31 December 2015

| | 2015 |
|---|---|
| Impairment-related special audits | 33 |
| Section 25a (1) of the KWG (MaRisk) | 123 |
| Cover | 13 |
| Market risk models | 1 |
| IRBA (credit risk measurement) | 6 |
| AMA (operational risk measurement) | 0 |
| Liquidity risk measurement | 0 |
| **Total** | **176** |

104 See ECB Annual Report on supervisory activities 2015.

105 Rating systems and approaches to equity risk used as part of the internal ratings-based approach.

the majority of the special audits of this nature were carried out by the Deutsche Bundesbank on behalf of BaFin. They encompass various areas of the institution under examination. In this context, BaFin distinguishes between special audits initiated by the supervisory authority and those resulting from a request by the institution.

Special audits are initiated by the supervisory authority itself on the basis of findings from the report on the audit of the annual financial statements, or other information available to it. These audits are ordered from a risk-oriented perspective if they are required as a result of existing knowledge available about the organisation or business activities of the relevant credit institution. In addition, BaFin sometimes initiates special audits without a specific reason, for example if the most recent audit was some time ago.

The priority areas for these special audits include in particular impairment testing. BaFin generally relies on the expertise of external auditors for this purpose. The principal objective is to ascertain whether the risk provisioning for individual credit exposures is adequate. This can be determined during the audit process on the basis of the bank's internal documentation on borrowers' financial circumstances and the valuation of collateral. The review of the individual exposure will generally also establish whether the institution's organisation and internal monitoring system are ensuring that all the relevant requirements are being satisfied fully and in the proper manner.

Audits aimed at providing BaFin with evidence of whether the institution's business organisation is appropriate within the meaning of section 25a of the Banking Act form another focus area for special audits initiated by the supervisory authority. In these cases, the principal concern is whether the institution is complying with the Minimum Requirements for Risk Management (MaRisk).[106] BaFin's evaluation takes into account the nature, scope, complexity and risk content of the respective institution's business activities. For example, the MaRisk include requirements relating to the institutions' internal control systems, the organisational and operational structure of different areas of the business as well as the processes for risk management and controlling.[107]

In addition, BaFin also carries out scheduled audits. These include cover audits which are generally required every two years under the *Pfandbrief* Act for banks with *Pfandbrief* activities. Of the total of 176 special audits ordered in 2015, a total of 156 audits were initiated by BaFin itself; in 13 cases, they were statutory cover audits.

Special audits initiated by the institutions themselves are requested if, for example, the institution is seeking authorisation for the use of models for supervisory purposes. These comprise audits of the internal procedures for measuring liquidity risk, of the advanced measurement approach (AMA) for operational risk, of market risk models and of procedures based on the internal ratings-based approach (IRBA) to measuring credit risk.. BaFin ordered seven special audits at the request of institutions in 2015.

In addition to the special audits described above, BaFin also made use of the option pursuant to section 30 of the Banking Act of ordering additional audit work in the context of the audit of the annual financial statements.

In total, BaFin carried out special audits for around 10% of the less significant credit institutions. A comparison of the number of audits by groups of institutions (see Table 16 "Breakdown of special audits of LSIs in 2015 by groups of institutions", page 152) with the absolute number of institutions in the various groups (see Table 10, "Number of banks by group of institutions", page 130), however, shows that there is an even distribution of

106 Circular 10/2012 (BA) Minimum Requirements for Risk Management (MaRisk).

107 See 1.4.

## Table 16 Breakdown of special audits of LSIs in 2015 by groups of institutions

As at 31 December 2015

| | Commercial banks | Savings bank sector | Cooperative sector | Other institutions |
|---|---|---|---|---|
| Impairment-related special audits | 0 | 9 | 24 | 0 |
| Section 25a (1) of the KWG (MaRisk) | 8 | 31 | 78 | 6 |
| Cover | 1 | 9 | 0 | 3 |
| Market risk models | 1 | 0 | 0 | 0 |
| IRBA (credit risk measurement) | 3 | 1 | 0 | 2 |
| AMA (operational risk measurement) | 0 | 0 | 0 | 0 |
| Liquidity risk measurement | 0 | 0 | 0 | 0 |
| **Total** | **13** | **50** | **102** | **11** |
| **Audit ratio in %*** | **8.3** | **12.2** | **10.0** | **11.2** |

* Number of audits as a proportion of the number of institutions in each group of institutions.

the audits between the groups of institutions. Accordingly, in the individual groups the supervisory authority audited between 8.3% and 12.2% of the less significant institutions within the respective category.

### Risk matrix as an element of risk-based supervision

In Table 17, the special audits initiated by the supervisory authority are analysed according to the risk matrix. The requested special audits by definition bear no relation to the risk classification of the less significant institutions under supervision.

In 2015, BaFin initiated a special audit of 18.5% in total of the institutions classified in the D quality category. Institutions in the A, B or C categories, on the other hand, were audited significantly less frequently in relation to the total number of institutions in the respective category. For example, the audit ratio of the institutions classified by the supervisory authority in the A quality category amounted to 8.9%. The more critical BaFin's rating of an institution's quality, the more closely it is supervised. Overall, BaFin initiated audits of 9.7% of the less significant institutions in 2015.

## Table 17 Breakdown of special audits of LSIs initiated by BaFin in 2015 by risk class

As at 31 December 2015

| Special audits initiated by BaFin | | Quality of the institution | | | | Total | Institutions in %* |
|---|---|---|---|---|---|---|---|
| | | A | B | C | D | | |
| Systemic importance | High | 0 | 0 | 0 | 0 | 0 | 0.0 |
| | Medium | 5 | 11 | 6 | 0 | 22 | 11.9 |
| | Low | 48 | 64 | 17 | 5 | 134 | 9.6 |
| | **Total** | **53** | **75** | **23** | **5** | **156** | **9.8** |
| | **Institutions in %*** | **9.2** | **9.5** | **12.0** | **18.5** | **9.8** | |

* Percentage of the total number of institutions in the respective quality/importance category accounted for by the audits.

### Supervisory law objections and sanctions in 2015

In the past year, BaFin imposed sanctions in a total of 82 cases across all groups of institutions (see Table 18 "Supervisory law objections and sanctions in 2015"). The majority of the sanctions related to institutions in the cooperative sector, by far the largest group of institutions by number. The deficiencies were almost always sufficiently serious that they merited a "substantial objection" from BaFin or a letter from the supervisory authority to the institutions in question. This illustrates BaFin's approach of making contact with the institutions at an early stage if weaknesses and deficiencies are detected, so that these irregularities can be corrected before it is obliged as the supervisory authority to initiate formal sanctions against the parties affected.

### IRB approaches

As at the 31 December 2015 reporting date, a total of 13 less significant institutions and groups of institutions were using internal ratings-based approaches for the purpose of calculating their capital requirements for credit risk. These institutions and groups of institutions were not applying the internal assessment approach (IAA) – for securitisation positions, on the other hand.

The IRB approach makes a distinction between whether, in accordance with its IRBA authorisation for risk exposures to central governments and central banks, institutions and undertakings, an institution is only permitted to estimate the probability of default itself (application of the basic IRB approach) or also the loss on default and the conversion factor (application of the advanced IRB approach). A total of four of the 13 less significant institutions were using the advanced IRB approach on a group or individual basis.

### Operational risk approaches

The more than 1,700 institutions or groups of institutions in Germany employ all four available approaches to calculate their capital requirements for operational risk. The basic indicator approach (BIA) and the standardised

**Table 18** Supervisory law objections and sanctions in 2015*

As at 31 December 2015

| Type of institutions | | Group of institutions | | | | |
|---|---|---|---|---|---|---|
| | | Commercial banks | Savings bank sector | Cooperative sector | Other institutions | Total |
| Substantial objections/letters | | 5 | 10 | 54 | 1 | 70 |
| Sanctions against managers | Dismissal requests*** | 0 | 0 | 0 | 0 | 0 |
| | Cautions | 0 | 0 | 1 | 0 | 1 |
| Sanctions against members of supervisory/ administrative boards | Dismissal requests*** | 0 | 0 | 0 | 0 | 0 |
| | Cautions | 0 | 0 | 0 | 0 | 0 |
| Sanctions related to own funds/liquidity, exceeding the large exposure limit (sections 10, 13 and 45 of the KWG) | | 2 | 3 | 3 | 0 | 8 |
| Sanctions in accordance with section 25a of the KWG | | 0 | 0 | 0 | 0 | 0 |
| Sanctions in accordance with sections 45, 45b and 46 of the KWG** | | 3 | 0 | 0 | 0 | 3 |
| **Total** | | **10** | **13** | **58** | **1** | **82** |

* These figures relate to LSIs.
** 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).
*** Comprises formal and informal sanctions and dismissal requests from third parties.

approach (STA) are determined using the specified indicator, which is based on the income statement figures. At the 2015 year-end, more than 1,660 institutions and groups of institutions – almost exclusively less significant institutions – were using the basic indicator approach. Another 54 institutions or groups of institutions, of which 26 are supervised by the ECB and 28 by BaFin, were applying the standardised approach. Two institutions or groups of institutions were working with the alternative standardised approach (ASA), which uses a standardised earnings indicator instead of the specified indicator. They were subject to supervision by BaFin.

Instead of indicators, the advanced measurement approach (AMA) makes use of the actual loss experience, external data, scenarios and business environment and internal control factors of the institution itself. The capital requirements for the operational risk of an institution or group of institutions are calculated on the basis of this information with the help of a complex model. At the end of 2015, a total of 14 institutions and groups of institutions, of which three were less significant institutions, were applying an advanced measurement approach. The 14 institutions and groups of institutions that are permitted to use the AMA are mainly commercial banks; two belong to the group of savings banks, one institution was a cooperative bank and one was in the group of "Other institutions".

During the course of 2015, BaFin carried out a number of follow-up audits and also participated in an implementation audit of a foreign parent company relating to the roll-out of its advanced measurement approach to its subsidiary. The procedures for measuring and managing legal risks were the focal point of the various stages of this audit, namely follow-up and implementation. Where necessary, BaFin placed particular emphasis on the legal risks. In addition, there is an increasing awareness of IT risks on the part of the institutions and of the supervisory authority, with the result that BaFin is devoting an ever larger share of its supervisory attention to this area.

## Maple Bank closed

On 6 February 2016, BaFin issued a ban on disposals and payments for Maple Bank GmbH. In addition, BaFin ordered that the bank be closed for business with customers and prohibited the institution from receiving payments not intended for the repayment of debts owed to it ("moratorium"). BaFin ordered the moratorium in order to secure the assets in an orderly process. Following a provision for taxes that the institution was required to recognise, it was facing balance-sheet overindebtedness.

Maple Bank GmbH was not systemically important and its difficulties therefore posed no threat to financial stability. As at 4 February 2016, the total assets of Maple Bank GmbH, which is domiciled in Frankfurt am Main, amounted to around €5.0 billion. At the same reporting date, the institution had liabilities to predominantly institutional customers amounting to around €2.6 billion. On 11 February 2016, BaFin determined that compensation was payable, since the institution was no longer in a position to repay all of its customers' deposits. BaFin had already made an application to the Local Court *(Amtsgericht)* in Frankfurt am Main for the initiation of insolvency proceedings for the bank on 10 February 2016. Thereupon, the Local Court opened insolvency proceedings on 11 February 2016 and appointed an insolvency administrator.

The deposits of customers of Maple Bank GmbH are protected under the German Deposit Guarantee Act *(Einlagensicherungsgesetz)*. The institution belongs to the Compensation Scheme of German Banks *(Entschädigungseinrichtung deutscher Banken GmbH)*. The determination by BaFin that compensation is payable fulfils the precondition for the compensation scheme to assess depositors' claims and satisfy them up to an amount of € 100,000, or in exceptional cases up to an amount of €500,000. The EdB has made contact with the institution's creditors on its own authority. Maple Bank GmbH is also a member of the Deposit Protection Fund of the Association of German Banks *(Einlagen-sicherungsfonds des Bundesverbands Deutscher*

*Banken e.V.)*. In accordance with its statute, this fund assumes responsibility for the portion of the deposits exceeding the statutory limit – up to the respective protection limit.

Maple Bank GmbH described itself as a niche provider in the investment banking sector, focusing on single strategies. It carried out its activities on the securities and derivatives markets in Western and Northern Europe as well as in North America. The bank's sole shareholder was Maple Financial Europe SE, domiciled in Frankfurt am Main. Maple Financial Europe SE, in turn, is a wholly-owned subsidiary of the group parent company Maple Financial Group Inc., which is domiciled in Toronto, Canada.

### 3.4.2 Financial services institutions

In the course of 2015 BaFin participated in 41 audits at financial services institutions (previous year: 59) and conducted 109 supervisory interviews with institutions (previous year: 135). A total of 30 authorisations held by financial services institutions ended during the past year (previous year: 28), in most cases because they were returned.

BaFin carried out a special audit jointly with the Dutch supervisory authority AMF (Autoriteit Financiële Markten) relating to a financial services institution engaged in cross-border operations in the Netherlands. The special audit took place at three locations simultaneously, of which two were in the Netherlands. The central focus of this audit was the institution's compliance with the prohibition on cold calling as well as the investigation of suspicions that it may also have been involved in churning. "Cold calling" means making unsolicited telephone contact with customers with whom there is no existing business relationship. "Churning" refers to financial services institutions carrying out unnecessary and frequent transactions in order to increase their commission income. The proceedings have not yet concluded.

BaFin carried out a special audit jointly with the Maltese supervisory authority MFSA (Malta Financial Services Authority) relating to the branch of a Maltese institution. In addition to monitoring compliance with the rules of conduct, the audit also concentrated on whether the institution was keeping within the scope of its authorisation. The MFSA is assessing the findings of the special audit and will initiate the measures required. The branch ceased its operations in Germany in October 2015.

In 2015, BaFin was obliged to caution the managing director of a financial services institution. The institution's management board had consisted of two members in the preceding years but a dispute arose between them in 2014. Their differences of opinion included both the strategic direction of the institution and the distribution of its profits. These differences resulted in permanent changes in the company's governing bodies. The remaining member of the management board was cautioned in mid-2015, not least in view of the collective responsibility of the members of the management board for each other resulting from the institution's group arrangements for tax purposes. BaFin's reasons for the caution were the lack of a proper system of governance, numerous deficiencies in the notification and reporting systems, in particular in the organisation of the complaints procedure, and serious breaches of the rules of conduct.

As a result of accompanying an audit pursuant to section 36 (1) of the Securities Trading Act *(Wertpapierhandelsgesetz)* in the 2014 financial year, serious deficiencies were identified at an institution, relating in particular to compliance with the rules of conduct – including the obligations to obtain proper information about customers and assess the suitability of investments, among others. The institution claimed that it only made sustainable investments. But the institution had also not established a procedure for establishing which investments were considered to be "sustainable". Since, in addition to these serious findings, deficiencies relating to the notification and reporting systems as well as to the institution's organisation were also established, BaFin issued a caution to the managing director pursuant to section 36 (2) of the Banking Act at the start of 2015.

The report of the auditor on the audit pursuant to section 36 (1) of the Securities Trading Act, however, had not adequately covered all of the deficiencies detected while accompanying the audit, and moreover there seemed to be no guarantee of a rapid correction of the irregularities and improvement of the organisation. BaFin therefore ordered a special audit in accordance with section 44 of the Banking Act and section 35 of the Securities Trading Act. The special auditors also discovered serious shortcomings affecting the organisational requirements and rules of conduct which related, among other areas, to the obligations to prepare minutes of investment advice, obtain proper information from customers and assess the suitability of investments, as well as to internal audit, compliance and risk management. The institution was required to remedy all of these deficiencies promptly and to provide ongoing reports on the progress made. Otherwise the institution could expect further measures to be taken by the supervisory authority, including the possible withdrawal of its authorisation.

Another institution received a caution from BaFin for having less than the minimum initial capital of €50,000. In the course of monitoring its key indicators, it was noticed that the institution had not complied with the required ratio of capital to costs. Under Article 97 of the CRR, institutions must hold eligible capital of at least one quarter of the fixed overheads of the preceding year. Initially, BaFin warned the institution to increase its capital accordingly. Since its capital base continued to deteriorate, however, and in addition the required level of €50,000 of minimum initial capital was not met, BaFin finally cautioned the institution. As a result, it improved its capital base.

### 3.4.3 Finance leasing and factoring institutions

#### Holder controls and appointments of senior executives and supervisory board members

BaFin initiated a total of 104 holder control procedures in accordance with section 2c of the KWG in conjunction with the Holder Control Regulation *(Inhaberkontrollverordnung)* in 2015. In these proceedings, which have to be completed by a certain deadline, BaFin is required, among other things, to build up a comprehensive picture of the integrity and aims of the potential purchaser of a qualifying holding. It must also verify the existence and origin of the funds used to make the purchase.

BaFin once again received numerous notifications of changes in personnel at Group V institutions. The supervisory authority received notifications of the intention to appoint 150 new members of management or commercial attorneys-in-fact; it also received notification that the appointments of 32 members of supervisory or advisory boards had been completed. BaFin's role is to review the suitability and reliability of these persons. In seven cases, it expressed its disapproval of managers of Group V institutions in writing.

#### New developments in supervisory law for leasing and factoring institutions

In 2015, the Audit Report Regulation *(Prüfungsberichtsverordnung)* was revised in order to improve the meaningfulness of reports on the audit of annual financial statements. The regulation governs the scope and intensity of the audit of institutions' annual financial statements. Although the Audit Report Regulation is aimed directly at the auditors of annual financial statements, the expansion of the scope of the audit also reflects BaFin's requirements for the institution at the same time. The most significant changes for leasing institutions include the obligation on the auditor to report in future on the calculation of the institution's intrinsic value – especially in cases where leasing institutions are required to include the latter in their calculations of risk-bearing capacity. The calculation of intrinsic value is a material factor in the credit assessment of leasing institutions and their ability to raise debt capital in the market on appropriate terms and conditions.

### Collaboration with the European Central Bank

The national supervision of finance leasing and factoring institutions comes into contact with the supervisory activities of the ECB at various points. This is especially the case for leasing and factoring institutions forming part of a group where the group of institutions includes a credit institution under direct supervision by the ECB, in addition to the finance leasing or factoring institution. Close consultation with the ECB is indispensable, in particular, for holder control procedures running in parallel in relation to institutions supervised nationally and by the ECB.

The national supervisory authorities also participate regularly in meetings of supervisory colleges within the group-wide supervision carried out by the ECB. In addition to enabling the mutual exchange of information to ensure that all participants have the fullest possible view of the risk position of the respective group of institutions, this also allows national supervisors who are not represented in the Joint Supervisory Teams to be integrated into the supervisory planning process. This coordination helps to avoid placing an excessive burden on the groups of institutions.

### Supervisory priority area: Suitability of senior managers

BaFin paid particular attention in 2015 to monitoring the suitability of senior managers. In a number of cases, there were specific reasons for a particularly close examination of the reliability of an institution's senior management in accordance with commercial law. This was followed by various supervisory sanctions up to and including the withdrawal of the institution's authorisation. BaFin uses this option as a last resort if other measures no longer appear likely to be successful.

As in the past, the detection of business models with doubtful business practices remains one of the focal points of the ongoing supervision of finance leasing and factoring institutions. BaFin cooperates closely with the criminal prosecution authorities in this area. The "Forum on White-Collar Crime", which BaFin hosted for what is now the twelfth time in 2015, provides a particular platform for an exchange of views on these topics.[108] The forum also included presentations and discussions on matters with criminal implications arising from the ongoing supervision of leasing and factoring institutions. The improvement in the integrity of the markets which BaFin has pushed for benefits two sides at the same time: Customers are protected against financial loss, while the institutions benefit over the medium and long term from increased confidence in the industry.

### Market survey on factoring

In a decision dated 21 October 2014, the Federal Court of Justice ruled that the assignment of a receivable to a factoring company was invalid since the case had involved a breach of the provisions of the Legal Services Act *(Rechtsdienstleistungsgesetz)*. In the light of this judgment, in 2015 BaFin organised a market survey of factoring institutions potentially affected by the ruling. Its objective was to find out whether factoring institutions supervised under the Banking Act required a registration under the Legal Services Act for collection services and whether they had one. BaFin also asked the institutions how they assessed the operational risk that an assignment of a receivable in their favour could be declared invalid if they do not have the – technically necessary – registration.

The initiative received a large response: Around 95% of the institutions contacted participated voluntarily in the survey. Almost two-thirds of the institutions demonstrated clearly that their business operations did not fall within the scope of the authorisation requirement of the Legal Services Act for collection services. The remaining third indicated either that they already had the registration required under section 10 of the Legal Services Act, that they would shortly be applying for registration or had already applied, or on the other hand that, as professional associations in accordance with section 7 of the Legal Services Act, they were not required to register. The findings of the survey therefore gave BaFin no immediate cause to take further action.

108 See chapter VI 4.2.

### 3.4.4 Payment service providers and e-money institutions

As in the past, authorisation procedures represent another area of focus for BaFin's activities. At the end of 2015, nine authorisation procedures pursuant to the Payment Services Supervision Act *(Zahlungsdiensteaufsichtsgesetz)* were outstanding. Eight undertakings withdrew their applications during the course of the year following the hearing on the refusal of authorisation. There were no cases in which BaFin had to issue a formal notice of refusal following the hearing. It is clear that many applicants are not able to make an accurate estimate of the cost and effort required to implement the authorisation requirements in practice. The business plans in particular are often inadequately documented, lacking in explanatory notes, completely unrealistic or not provided at all. Some applicants were also unable to comply with the capital requirements.

In a number of cases, the applicants attached astonishingly little importance to organising the institution's financial relationships in a transparent manner in accordance with the Payment Services Supervision Act, so that the necessary insight was lacking. Applicants should be aware that the amendments to the Payment Services Directive provide for stricter requirements and a more rigorous demonstration of the measures planned to comply with them. The requirements relating to the protection of client funds are also proving to be problematic for applicants, as before, and to a great extent for ongoing supervision as well. In one case, BaFin had to issue an institution with a formal notice imposing conditions on the procedures to be adopted for protecting clients' money. However, the supervisory authority is usually successful in persuading the institution to remedy the deficiencies simply on the basis of an informal request.

### 3.4.5 Account information access procedures in accordance with section 24c of the Banking Act

Section 24c (1) of the Banking Act *(Kreditwesengesetz)* places an obligation on credit institutions, German asset management companies and payment institutions to record certain account master data for all customers in a file. The data include, for example, the account number, the name and date of birth of the account holders and authorised users as well as the date of opening and closure. BaFin may access individual items of data from this file in the context of its supervisory activities. Upon request, BaFin also provides information from the account information access file to the authorities listed in section 24c (3) of the Banking Act, such as tax authorities and public prosecutors. The statistical data on the number

**Table 19** Account information access procedures in accordance with section 24c of the Banking Act

| Account information recipients | 2015* | | 2014** | |
|---|---|---|---|---|
| | Absolute | in % | Absolute | in % |
| BaFin | 1,183 | 0.9 | 370 | 0.3 |
| Tax authorities | 13,003 | 9.7 | 14,020 | 10.2 |
| Police authorities | 86,702 | 64.7 | 89,542 | 65.0 |
| Public prosecutors | 25,851 | 19.3 | 26,495 | 19.2 |
| Customs authorities | 6,915 | 5.2 | 7,052 | 5.1 |
| Others | 301 | 0.2 | 300 | 0.2 |
| **Total** | **133,955** | **100** | **137,779** | **100** |

* As at 31 December 2015.
** As at 31 December 2014.

and distribution of such requests are presented in Table 19 "Account information access procedures in accordance with section 24c of the Banking Act" on page 158.

# 4 Market supervision

## 4.1 Employee and Complaints Register

Using the database pursuant to section 34d of the Securities Trading Act *(Wertpapierhandelsgesetz)*, known as the Employee and Complaints Register (see info box), BaFin is able to check directly and at short notice whether investment services enterprises are complying with their conduct of business obligations when providing investment advice to retail customers.[109] For BaFin, complaints in the Register are an indication of possible violations of consumer protection law. The Register therefore serves the purpose of collective consumer protection.

In 2015, BaFin once again discovered violations on the basis of repeated complaints. For example, BaFin became aware of two investment advisers and their breaches of conduct of business obligations thanks to customer complaints notified in the Register. Although one of the employees is now working for another institution, BaFin was able to use the Register to track the change of employer. In both cases, BaFin launched proceedings to formally caution the employees.

Where BaFin has doubts about the expertise or reliability of employees, it initiates inquiries and confronts both the undertaking and the employee with the allegation. In such cases, the investment services enterprise in question usually takes appropriate measures immediately on its own initiative, and provides additional training for the employee or transfers the employee to activities not subject to the notification requirement. Otherwise the undertaking runs the risk that BaFin may prohibit the use of the employee. BaFin carried out 24 procedures for the review of employees' reliability in 2015. At the year-end, 17 procedures were still in progress. BaFin initiated these procedures, for example, because it had become aware of criminal investigations. Other cases related to insider trading and market manipulation.

In a few individual cases, BaFin was obliged to take formal measures. In 2015, BaFin penalised 111 breaches of notification requirements by two investment services enterprises with the imposition of two administrative fines. In three further procedures, BaFin's Administrative Fines Division investigated a total of 138 infringements. Repeated complaints in the Employee and Complaints Register sometimes indicate possible further violations by the undertaking, such as a faulty investment advice minutes, unsuitable investment recommendations, incomplete customer information or deficient product information sheets. In such cases, BaFin makes an on-site visit to investigate the matter and, if

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**Employee and Complaints Register**

Undertakings which provide investment services are required under section 34d of the Securities Trading Act to enter their investment advisers and their sales officers, as well as their compliance officers, into the Employee and Complaints Register maintained by BaFin. What is noteworthy for investment advisers is that BaFin also receives reports whenever retail clients complain about investment advice they have received. BaFin regularly evaluates the complaints entered into the Register.

109 On this subject, see also 2014 Annual Report, page 131 ff.

### Table 20 Number of complaints*

| Complaints | 2014 | 2015 |
|---|---|---|
| Private and foreign banks | 2,382 | 1,569 |
| Savings banks/*Landesbanks* | 2,003 | 1,691 |
| Cooperative banks | 1,528 | 1,299 |
| Financial services institutions | 137 | 69 |
| **Total** | **6,050** | **4,628** |

* The respective total number of complaints was adjusted to reflect corrections. The table does not include complaints relating to investment services enterprises which were no longer subject to supervision pursuant to Part 6 of the Securities Trading Act at the time the database was queried. The figures presented here may therefore differ from data published previously or elsewhere. On the 2012 and 2013 figures, see 2014 Annual Report, page 133.

appropriate, imposes an administrative fine on the investment services enterprise.

The number of entries into the Employee and Complaints Register has changed since 2014 as shown in Table 20 ("Number of complaints"). The number of employees reported has changed since 2014 as presented in Table 21.

## 4.2 Focal points of supervision

### Evaluation of information sheets

In the first half of 2015, BaFin completed its evaluation of product information sheets pursuant to section 31 (3a) of the Securities Trading Act which it had begun in the previous year. BaFin had asked 33 investment services

### Table 21 Number of employees*

**Total number of employees**

| as at | 31 December 2014 | 31 December 2015 |
|---|---|---|
| Private and foreign banks | 48,900 | 45,764 |
| Savings banks/ *Landesbanks* | 64,427 | 61,832 |
| Cooperative banks | 45,090 | 43,378 |
| Financial services institutions | 5,438 | 5,552 |
| **Total** | **163,855** | **156,526** |

**Investment advisers**

| as at | 31 December 2014 | 31 December 2015 |
|---|---|---|
| Private and foreign banks | 48,125 | 44,789 |
| Savings banks/ *Landesbanks* | 61,481 | 58,854 |
| Cooperative banks | 41,980 | 40,361 |
| Financial services institutions | 4,864 | 5,036 |
| **Total** | **156,450** | **149,040** |

**Sales officers**

| as at | 31 December 2014 | 31 December 2015 |
|---|---|---|
| Private and foreign banks | 8,555 | 8,122 |
| Savings banks/ *Landesbanks* | 9,875 | 9,820 |
| Cooperative banks | 7,301 | 7,116 |
| Financial services institutions | 450 | 378 |
| **Total** | **26,181** | **25,436** |

**Compliance officers**

| as at | 31 December 2014 | 31 December 2015 |
|---|---|---|
| Private and foreign banks | 118 | 110 |
| Savings banks/ *Landesbanks* | 423 | 413 |
| Cooperative banks | 1,014 | 978 |
| Financial services institutions | 754 | 696 |
| **Total** | **2,309** | **2,197** |

* The table does not include employees of investment services enterprises which were no longer subject to supervision pursuant to Part 6 of the Securities Trading Act at the time the database was queried. The figures presented here may therefore differ from previously published data. Employees may exercise several activities (investment adviser, sales officer and compliance officer). With the exception of the total number of employees, the figures presented are not counted by individual person, but rather by activities exercised, so the total of the different activities may be greater than the number of persons. This data is subject to constant change in line with the ongoing change and correction reports submitted by the investment services enterprises. This, too, may result in the figures presented here differing from previously published data. On the 2012 and 2013 figures, see 2014 Annual Report, page 134.

enterprises, selected from risk-oriented points of view, to submit their information sheets pursuant to section 31 (3a) of the Securities Trading Act. 26 information sheets on equities, 34 information sheets on bonds, 29 information sheets on certificates with a broad-based market index as the underlying and 25 information sheets on reverse convertibles were then received. The divergences from the figure of 33 are due to the fact that not all the investment services enterprises provided investment advice on all classes of financial instruments. On the other hand, some investment services enterprises submitted several product information sheets on one class of financial instruments.

The evaluation of the product information sheets showed that their quality was significantly better than that of the information sheets analysed by BaFin three years earlier. Nevertheless different levels of transparency and clarity were apparent, depending both on the financial instrument and on the producer of the information sheet.

### Safe custody business

In 2014 and 2015, BaFin turned its attention to the question of whether investment services enterprises in the safe custody business were complying with the relevant conduct of business obligations and organisational requirements.[110] The background was that inadequate processes, procedures, criteria and/or insufficient monitoring of such can result in considerable adverse consequences for the financial markets and shake the confidence of market participants in the provision of securities custody and management services.

In order to review the relevant processes and the quality of such processes – including outsourced areas – BaFin ordered special audits of 16 investment services enterprises in the 2014 audit season. The evaluation of the findings of the audits was completed in 2015. BaFin established that all of the investment services enterprises covered by the special audits were not complying with the conduct of business obligations and organisational requirements in the provision of safe custody services. The deficiencies related mainly to the institutions' processes, but also to the management of IT authorisations. All of the institutions revised their processes. With respect to the management of IT authorisations, the authorisations were updated and the processes for managing them were also modified. BaFin did not identify any indications that the inadequate processes had caused losses for individual clients.

### Meeting with representatives of CFD providers

The decision of the Swiss National Bank to abandon the minimum exchange rate for the euro in January 2015 caused major disturbances in the foreign exchange market. Increasing numbers of customers subsequently complained to BaFin about providers of contracts for difference (CFDs). As a result of the fall in the exchange rate, a large number of retail clients were faced with very high margin calls.

In parallel to processing complaints, BaFin invited representatives of CFD undertakings with operations in Germany and representatives of the German CFD industry association *(CFD-Verband Deutschland e. V.)* to take part in discussions. BaFin indicated to the CFD industry representatives that the marketing of the purported advantages of CFDs must also draw attention to the risks associated with CFDs, including the risk that the customer may incur additional losses going beyond the capital invested for speculative purposes. The providers must also take seriously the requirements issued by the ESMA with respect to clients' knowledge and experience that are necessary to understand the risks of trading in CFDs or FX products.[111] Equally, they must comply with the requirements of sections 31a and 33a of the Securities Trading Act on best execution and handling of client orders.

110 See 2014 Annual Report, page 136.

111 ESMA warning dated 28 February 2013.

## 4.3 Rules of conduct for financial instruments analyses

### Credit and financial services institutions

Financial analyses must be prepared with the requisite expertise, care and diligence. At the end of 2015, BaFin supervised a total of 383 credit and financial services institutions that either produced their own research or acquired third-party research for their clients or for public dissemination (previous year: 346).

In the case of institutions or groups of institutions with Europe-wide activities, it was observed that, as far as possible, financial research was produced only at one location in Europe. Institutions that had previously produced financial analyses were therefore now only passing on research produced elsewhere. In the case of cooperative banks and savings banks in Germany, in particular, there has been a growing tendency to pass on financial research prepared by the top institutions and not to produce any in-house analyses. No matters of particular importance were identified relating to the implementation of and compliance with the statutory provisions for the preparation and distribution of financial research in 2015.

### Independent analysts

198 independent natural or legal persons who had notified BaFin of their activities as analysts in accordance with section 34c of the Securities Trading Act were subject to supervision by BaFin in 2015 (previous year: 192). A one-page form, which is easy to fill out, is provided on BaFin's website for the purpose of notifying activities in accordance with section 34c of the Securities Trading Act. Investment services enterprises, German asset management companies, investment stock corporations and analysts employed by them are not required to submit notifications pursuant to section 34c of the Securities Trading Act. The same applies to journalists, if they are subject to comparable self-regulation.

## 4.4 Administrative fine proceedings

In 2015, BaFin initiated 29 new administrative fine proceedings (previous year: 27) because investment services enterprises had breached the rules of conduct, organisational obligations and transparency requirements under section 31 ff. of the Securities Trading Act *(Wertpapierhandelsgesetz)*. BaFin concluded 18 proceedings with the imposition of an administrative fine (previous year: 2), of which four related to breaches of obligations in connection with investment advice minutes. The highest individual fine amounted to €10,000, imposed in proceedings relating to the negligent failure to give notification at the proper time of an auditor. 23 proceedings were discontinued, 18 of them for discretionary reasons.

### Proceedings due to breaches in connection with investment advice minutes

For the first time, the Local Court *(Amtsgericht)* in Frankfurt am Main dealt with negligent breaches of supervisory obligations in connection with the investment advice documentation requirements set out in section 34 (2a) of the Securities Trading Act, and imposed a fine of €5,000. The management board of the bank had failed to take appropriate supervisory measures to prevent contraventions of the obligation to provide the minutes without delay. In total, four investment advice minutes were provided late, since – in breach of the clearly formulated regulation – they were sent by post only after the conclusion of a transaction. It was only after BaFin drew attention to the matter in 2010 and made a further request in February 2011 that the management board of the bank reacted in March 2011 and revised the defective organisational guidelines. The court supported BaFin's assessment that the bank's experienced investment adviser had breached his or her obligations in a negligent manner, and stressed that the fourth infringement, at least, could have been avoided if the deficiencies in the organisational guidelines had been rectified straightaway at BaFin's first request.

### Proceedings due to breaches of the notification obligations under section 34d of the Securities Trading Act

In 2015, BaFin imposed an administrative fine of €9,000 on a major credit institution for a negligent breach of supervisory requirements relating to the notification obligations under section 34d of the Securities Trading Act. The undertaking had failed to take adequate organisational and supervisory measures for the notification of newly appointed investment advisers and sales partners to BaFin at the proper time prior to the start of their activities. The notifications were not received by BaFin until one to 230 days after the investment advisers and sales partners had commenced their activities. The infringements were attributable to organisational deficiencies with respect to data processing systems, insufficient monitoring of the outsourced recording of data and inadequate control over the implementation of corresponding work instructions.


# IV Supervision of insurance undertakings and *Pensionsfonds*

## 1 Bases of supervision

### 1.1 New developments in the global framework

#### 1.1.1 Focus

Global capital standards

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Some time ago, the International Association of Insurance Supervisors (IAIS, see info box on page 165) set itself the task to develop the first ever global capital standard for insurance undertakings. As a first step, the body adopted Basic Capital Requirements (BCR)[1] at the end of 2014. In a second step, it is planning to develop a risk-sensitive Insurance Capital Standard (ICS).

What are these two standards, and how will Europe – and therefore also BaFin – deal with the challenge of reconciling the global requirements of the IAIS with the European Solvency II framework, which was implemented on 1 January 2016? This article seeks to give some answers.

1 The abbreviation BCR is used as a singular.

##### ICS and BCR – different addressees

BCR and ICS are aimed at different groups of addressees: the IAIS is currently developing the Insurance Capital Standard (ICS) for all large internationally active insurance groups (IAIGs). The Basic Capital Requirement (BCR), by contrast, is intended for a smaller group of

**IAIS**

Established in 1994, the International Association of Insurance Supervisors (IAIS) specifies the global standards for insurance supervision. In addition, it promotes cooperation among the supervisory authorities and provides training for their employees. Its members are national insurance supervisors such as BaFin. Principles and standards developed by the IAIS are of considerable importance for national supervisory practices. Organisations such as the International Monetary fund use them as audit benchmarks to assess the stability of national and international financial markets.

**Global systemically important insurers**

An insurance undertaking is deemed to be a global systemically important insurer (G SII), if its disorderly failure would cause significant disruption to the wider financial system and economic activity. The Financial Stability Board (FSB) has to date designated nine primary insurers worldwide as global systemically important. The FSB reviews this list once a year.[3]

undertakings: global systemically important insurers (G-SIIs, see info box).

The BCR is an initial, relatively simple factor-based approach, which, by definition, only has limited risk sensitivity. The undertakings have disclosed this figure to their group supervisor and the IAIS since 2015. The BCR has not been designed as a stand-alone standard, but as a basis for calculating the higher loss absorbency (HLA) of G-SIIs. The HLA requirement is intended to cover the systemic risk, but only the combined BCR and HLA requirement will provide the actual capital requirements for systemically important insurers.

### Design of HLA requirement similar to BCR

The HLA requirement, which is part of a larger package of measures for G-SIIs, was adopted in its current form at the end of 2015. It also takes non-traditional non-insurance activities and products (NTNIs) into account, which is vital for determining the systemic importance of insurance undertakings.[2] In terms of design, it is very similar to the BCR in that it derives a factor-based capital requirement for selected elements. The IAIS used field testing results to determine the factors and achieved an appropriate balance that takes account of the traditional insurance business and NTNI activities of the G-SIIs. The undertakings will report the HLA requirement as well as the BCR to their group supervisor and the IAIS by 2018. The current version of the HLA requirement should be seen as a compromise and an initial attempt. It would be conceivable – and desirable – to shift the focus towards systemically important components, as hinted at by the IAIS in earlier publications. The HLA requirement is to be implemented as a binding capital requirement for G-SIIs only in 2019.

### Why a two-tier capital standard?

The reason for the two-tier approach – BCR plus HLA requirement – is that to date there has been no global approach to determining capital requirements or own funds for insurance supervision. The BCR is intended to close this gap temporarily, until the IAIS has completed its work on the ICS for IAIGs. The ICS will then also replace the BCR as the basis for calculating the HLA of global systemically important insurers.

### Risk-sensitive ICS

Unlike the factor-based BCR, the ICS for IAIGs is aimed at assessing the insurance business with significantly greater risk sensitivity. In 2015, the IAIS tested an initial version of the framework in a field test with the voluntary participation of 34 insurance undertakings from

2 See 1.1.2.

3 See 1.1.2.

### ComFrame

The Common Framework, or ComFrame for short, is one of the core components of the common supervisory framework for large internationally active insurance groups (IAIGs). The IAIS (see info box on page 165) is developing this framework together with its members, including BaFin.

ComFrame consists of three modules. Module 1 establishes the criteria for identifying IAIGs and the identification process. The module also deals with the scope of supervision and the identification of the group supervisor.

Module 2 comprises the supervisory requirements for the IAIGs. It deals with legal structures, group governance and risk management, as well as requirements for the risk management strategy that IAIGs are expected to develop and implement. Module 2 also currently includes a placeholder for the global Insurance Capital Standard (ICS).

Module 3 is concerned with the requirements for the supervisors of IAIGs and describes, among other things, the group-wide supervisory process and requirements for the supervisory colleges. The third module also addresses the resolution of IAIGs.

all over the world – including Europe, North America and Asia.

The aim is to enhance the ICS continuously until the end of 2019 and to subject it to new field tests every year as part of this process. An initial version of the ICS, ICS 1.0, is to be launched in the course of 2017. Subsequent versions will be based on this and ultimately be integrated into the Common Framework (ComFrame) for IAIGs, into which the ICS will be embedded (see info box on "ComFrame").

#### ICS 2.0

At the end of 2019, a second version of the ICS (ICS 2.0) is expected to be completed, with implementation planned for 2020. In BaFin's view, it should then also be possible to use internal models in addition to a standard method. The ICS will still continue to be fine-tuned and adjusted, even after 2019 and 2020. In 2015, the IAIS agreed on an ultimate goal for the enhancement of the ICS[4], which involves various characteristics that the ICS should have, but does not give a specific deadline. A key objective is that a consistent method is to be used worldwide so that, in substance, the results of the ICS would be the same anywhere in the world. This will affect above all the underlying valuation approach, the capital requirement and own funds.

The ICS firstly covers all risks that could become relevant for a globally active insurance undertaking. These include not only the underwriting risk from the life and non-life business, but also any market or operational risks.

The ICS consists of a mix of factor-based and stress-based approaches, which are specifically tailored to the respective risk category. Secondly, the ICS comprises requirements for available eligible own funds.

#### ICS as prescribed capital requirement

The ICS should be seen as a prescribed capital requirement (PCR), which makes it conceptually similar to the solvency capital requirement (SCR) under Solvency II, which has applied in the EU since January 2016 (see info box on page 167).

#### Interplay of IAIS capital requirements and Solvency II

Any assessment of the interplay between the IAIS capital requirements and Solvency II has to keep sight of the distinction made earlier: is it an additional capital requirement for G-SIIs, intended to strengthen their loss absorbency?

4 Can be found at http://iaisweb.org.

**Solvency capital requirement under Solvency II**

The solvency capital requirement (SCR) is a capital target for insurers. It is calculated in accordance with Solvency II using either a specified standard formula or an internal model. The undertakings can ask for models to be approved that are tailored to their individual situation. Otherwise, they have to use the standard formula, which takes account of both the different risks specific to each type of insurance and the market and operational risks.

Or is it a global capital standard for all large internationally active groups?

### HLA feasible complement to the European SCR

The HLA requirement covers systemic risks and should therefore be regarded as independent of Solvency II, which does not specifically refer to these risks. The HLA could in future therefore be considered a kind of add-on to Solvency II, although it has to be remembered that the IAIS is a standard-setter and consequently only formulates soft laws. De facto implementation of the HLA requirement in the EU would therefore only be possible if European legislators adopted the requisite provisions.

### ICS as a prescribed requirement

As described above, the risk-sensitive ICS has been designed as a prescribed capital requirement – a regulatory variable that, as from January 2016, is uniformly covered in the EU by the SCR under Solvency II. From a European – and explicitly also a German – perspective, the aim should therefore be to avoid another regulatory layer. This could be achieved if the Solvency II SCR is in future understood as a – stricter – implementation of the ICS that fully meets all the minimum requirements of the ICS. However, it seems very unlikely that all Solvency II requirements will be copied into the ICS, and such an approach would not be desirable either. This is because, despite their conceptual similarity, the two standards, ICS and SCR, do not pursue the same aim nor do they target the same group of addressees: Solvency II serves to ensure maximum harmonisation and is intended for the majority of insurance undertakings in Europe (see info box "Supervision under Solvency I or II?" on page 188).[5] Aimed at large internationally active groups, the ICS is intended as a minimum standard to ensure greater global convergence in terms of capital requirements and own funds. BaFin will continue to work in the IAIS towards reaching the objective of global convergence, while ensuring that the ICS is compatible with the existing European regulations as far as possible.

5 See 1.3.1 for more information on the exceptions.

## 1.1.2 Identification of G-SIIs

Each year since July 2013, the Financial Stability Board (FSB) has determined which insurance undertakings are classified as global systemically important insurers (G-SIIs), based on the proposal of the International Association of Insurance Supervisors (IAIS) and in collaboration with the national competent authorities (NCAs). Since 2014, the timing of this classification process has been coordinated with the determination of global systemically important banks (G-SIBs); it takes place in November each year. On each occasion, the IAIS analyses a sample of around 50 insurance groups which must respond each year to an extensive data questionnaire and provide supplementary qualitative information. The IAIS then prepares a ranking of the participating

insurance groups in accordance with the methodology[6] published in 2013. The ranking is based on 19 indicators in five categories, with NTNI[7] business receiving a 45% weighting and interconnectedness with the financial system a 40% weighting. The methodology also takes into account the categories of size, global activity and substitutability.

The methodology can be applied both to primary insurers and to reinsurance undertakings; however, the FSB has only identified primary insurance undertakings to date.[8] The IAIS indicated at the start of the process in 2013 that it would regularly revise the methodology, partly to reflect developments in the market and also to apply lessons learned from the experience built up. In November 2014, the IAIS and the FSB decided, in addition to this routine review, to reassess the reinsurance element within the methodology, with the result that from 2016 the IAIS methodology takes appropriate account of all types of insurance undertakings and activities.

Since December 2014, the IAIS has devoted extensive efforts to the assessment of the methodology. It established its own task force, the G-SII Methodology Task Force (G-MTF), with responsibility for developing specific proposals. In close cooperation with the FSB, the G-MTF had produced a revised version of the methodology by November 2015. This was available for public consultation between the end of November and the end of January.[9] The IAIS also began a consultation exercise on NTNI business in parallel.

The continuing development of the methodology will incorporate a number of lessons learned from the data analyses carried out since 2013, as well as the solution of the reinsurance question requested by the FSB. It is not intended to change the fundamental concept of a relative ranking. Nevertheless, the IAIS decided to add absolute reference values for three indicators. These introduce an absolute element into the hitherto purely relative analysis, resulting in an improved presentation of developments in the market affecting all areas and their systemic importance. At the same time, the IAIS decided to remove two indicators from the quantitative analysis and use them as auxiliary indicators.

### G-SIIs for two years

In the course of this work, the IAIS established that there are advantages to allowing the list of G-SIIs to stand for a while and refraining from making frequent changes. The revised methodology therefore provides that once an insurance undertaking has been identified as a G-SII, it will keep that status in principle for two years.

In addition, the IAIS reorganised the general structure as well as individual elements of the process, improving its overall transparency. In future it will consist of five phases, which will ultimately be incorporated into a recommendation to the FSB supported by a broad majority of the IAIS. A particularly noteworthy feature, in addition to the data collation and data validation stages including the production of an initial ranking, is that the process will now establish for the first time an explicit quantitative distinction between potential G-SIIs and non-G-SIIs, based on a variety of statistical and heuristic methods.

### Discovery phase

The wide-ranging discovery phase, going beyond the quantitative analysis already carried out, is also new. This phase introduces into the process additional auxiliary indicators and significant qualitative information, which could affect the assessment of an insurance undertaking's systemic importance. The new approach therefore explores these aspects to a somewhat greater extent than the current practice. A material element of this phase is the

6 http://iaisweb.org/page/supervisory-material/financial-stability-and-macroprudential-policy-and-surveillance/file/34257/final-initial-assessment-methodology-18-july-2013.

7 The abbreviation NTNI stands for non-traditional non-insurance.

8 On this subject, see *inter alia* the press statements by the FSB dated 18 July 2013, 6 November 2014 and 3 November 2015, www.financialstabilityboard.org.

9 http://iaisweb.org.

supplemental reinsurance assessment, which is primarily concerned with collecting quantitative data from insurers with significant reinsurance activities. The purpose of this information is to help the IAIS improve its understanding and assessment of the undertakings' reinsurance activities. The IAIS's objective is to derive extenuating or aggravating circumstances for the insurers under consideration on the basis of the findings of the discovery phase.

As the fourth phase, the IAIS is introducing the possibility of entering into dialogue with the insurance undertakings that may be classified as G-SIIs. This is intended to give the insurers the ability to react to a pending designation and at the same time to ensure that their view of their own systemic importance is firmly anchored in the process. This phase goes beyond the scope of the existing supervisory judgement and validation process. Following the discussions with the insurance undertakings, the IAIS will make a final decision on its recommendation to the FSB.

The members of the IAIS have made good use of the time since November 2014 and improved the methodology for identifying G-SIIs. It is to be hoped that the revised methodology will put the IAIS in a position to fulfil the FSB's mandate for the insurance sector in all respects. It will be necessary to hold intensive discussions on the feedback to the consultation exercise in the time remaining until the next designation, in order to finally establish a consistent approach for G-SIIs, from the designation through to all of the policy measures.

## 1.2 Opinion

### Dr Frank Grund on changing perspectives: from the insurance industry to insurance supervision

**Dr Frank Grund**

has been Chief Executive Director of Insurance and Pension Funds Supervision at BaFin since October 2015.

After spending about 30 years working in the insurance industry, switching to top-level insurance supervision is a major step. Yet heading up a company is not entirely dissimilar to heading up an authority: to begin with, each requires management and leadership when it comes to defining the substantive, strategic orientation of the area of responsibility. The remaining differences are not as great as one might think. Winning over employees and executives to master the task at hand is a significant challenge when embarking on any new venture. And the industry and its supervision are – by their very nature – similar in substance.

However, a supervisor sees things from a different perspective. The needs of the policyholder take precedence over the needs of the insurer. For the insurers, in most cases customers constitute one of several groups of stakeholders – in addition to shareholders, member representatives, analysts and sales staff. By contrast, BaFin's primary objective is to protect policyholders and beneficiaries. It is vital that this objective be met. This work is primarily focused in three areas: the actual work of supervision; participation in regulatory efforts in Germany, Europe and in the global context; and collective consumer protection.

## Focal points of supervision in 2016

At the beginning of 2016, the European Solvency II regime ushered in a new era of insurance supervision. It is only logical that both supervisors and insurers are putting their focus on ensuring the seamless implementation of this modern risk-based supervisory system. In practice, it remains to be seen especially in 2016 how well prepared both sides are. The outlook is optimistic. Both BaFin and the undertakings needed the rather long preparatory and introductory phase – and have made good use of it. In the meantime, the first months have passed and the initial results of the new regime are emerging: day-one reporting will provide BaFin with the first real picture of how German insurance undertakings are faring in this new regulatory environment. When it evaluates these initial reports, BaFin will also see whether its new evaluation tools are practical and complete and in which areas it may have to make improvements.

BaFin is primarily interested in how the new quantitative solvency requirements dovetail with the insurers' risk management systems. As a consequence of this new principles-based supervisory regime, insurers are required now more than ever to take responsibility for evaluating and steering their own risks. Dialogue with the insurers in this regard now constitutes a core element of BaFin's supervisory activities. Communication with market participants thus remains a key factor in effective supervision.

## Promoting a shared understanding

Beyond this, BaFin seeks to further promote a shared understanding of the new principles-based supervisory regime throughout the German insurance industry; to that end, it will issue interpretative decisions, circulars and further pronouncements regarding Solvency II also in 2016. It is also keen to ensure that insurers throughout Europe are supervised in accordance with uniform and consistent standards. BaFin does so by participating in a wide variety of working groups and committees, as well as in the Board of Supervisors and the Management Board of EIOPA, the European Insurance and Occupational Pensions Authority.

## General economic situation

Of course, this does not all happen in a purely formal context, but rather in a highly challenging overall economic situation. The persistent low interest rate phase is leaving its mark on the business policies of all insurers. Declining returns on investment are negatively affecting property and health insurance providers. However, the biggest impact is on life insurers. Insurance supervisors will take a particularly close look at the insurers' strategies to manage the resulting risks. Several insurers are foregoing new business in the area of conventional guarantees while new guarantees are hitting the market and some insurers are looking into the possibility of transferring long-term commitments entered into in earlier times to run-off platforms.

BaFin must examine particularly carefully whether and how the policyholder interests are accounted for, particularly as run-offs are potentially developing into a business model of their own. In such an examination, a case-by-case comparison of the policyholders' situation prior to and following the transfer represents the critical measuring stick – which includes a forecast covering several decades. In order to be able to make such a forecast, BaFin must comprehensively assess the transferring and receiving undertakings in terms of process security of workflows, economic performance and – if applicable – their integration within a group of companies. In the interest of ensuring reliable supervision, BaFin is working to develop a dependable assessment framework for future cases.

## Internal models

The introduction of Solvency II means an additional important field of responsibility for BaFin: the initial authorisation and ongoing monitoring of internal models and the approval of model changes.[10] At the beginning of the year, BaFin approved seven initial applications and

10 For details on internal models, see also 1.3.6 and chapter II 9.2.

must now review its first applications for changes and expansions. The long-term acceptance of internal models by the insurance industry depends largely on how consistent the insurers use them to steer their business. This means that the industry itself can influence whether internal models in all of their forms will be able to have the desired significance. However, merely optimising regulatory capital requirements cannot be the sole motivating factor behind the use of such models. Particular attention will have to be paid to this in ongoing supervision.

### Digitalisation

The new technical possibilities offered by tablets, smartphones and apps are motivating many insurance undertakings to realign their business processes. New sales forms are being developed, communication is to become more and more paperless and the insurance industry overall is expected to become more agile. New market participants are attempting to enter the market as InsuranceTechs[11], although at present no trend towards new digital business models is emerging in the insurance sector. Most of the activities observed so far appear to be upstream insurance activities relating to sales. If this results in a change in business models, supervision may be required. BaFin will prepare for these developments and, if possible, support them while keeping a critical eye on them – as per our mandate to protect policyholders. Insurers are also leveraging the new possibilities offered by digitalisation in order to optimise their internal processes. For BaFin, it is important that new, digitalised workflows of the insurers are secure, transparent and well documented.

### Further regulatory developments

Recent years have been strongly marked by the development of the Solvency II supervisory regime. The task at hand now is to gather experience with the new framework through operational supervision. Consequently, there are no major regulatory projects at the European level as far as the supervisory system is concerned, while work continues on the global framework. However, questions concerning sales and product design are coming to the fore in Europe. BaFin will advocate for a balance between good consumer information and appropriate differentiation between the various product types. Pension products are subject to different criteria than those which apply to savings plans.

### Consumer protection

It is a well-known fact that the issue of consumer protection is nothing new in the field of insurance supervision: it has always been a core element. Ensuring that the needs of the policyholders and beneficiaries are sustainably met has been and remains the pivotal point of supervision. The legislator has further bolstered the supervisors' role with the Retail Investor Protection Act *(Kleinanlegerschutzgesetz)*.[12] In response to this, BaFin has created a new department for consumer protection within the Securities Supervision directorate. Under the guiding principle of "One for all", this department deals with issues of relevance to consumer protection which arise directly from the relationship between insurance undertakings and consumers. BaFin is at the beginning of a new collaboration between all directorates to benefit consumers, under which the Insurance Supervision directorate will contribute its expertise.

### Outlook

Where does BaFin stand? Where must it turn its focus? Where must its requirements be stepped up or relaxed? Reviewing the day-to-day business, identifying weaknesses and developing new strategies are among the core elements of any leadership role, including as head of insurance supervision. Someone coming from the outside might ask different questions than someone who can look back on many years of experience as a supervisor. A change in perspective can be very helpful. However, continuity is of great importance. It has always been vital that the relationship between the

11 For information on fintech companies, see chapter II 4.1.2.

12 For details on consumer protection, see also chapters II 5.1. and 5.2.

industry and BaFin be reliable and dependable. BaFin must always – and particularly now – maintain this reliability and dependability since the insurance industry is undergoing a major process of change as Solvency II comes into force. Aside from reliability and dependability, supervisory discretion and patience is also required, particularly as insurers are facing economically challenging times. Dialogue between BaFin and the industry remains indispensable – with a clear division of roles. BaFin will continue to keep an eye on the interests of policyholders and, where necessary, will be resolute in safeguarding them.

## 1.3 Solvency II

### 1.3.1 Focus

#### Solvency II transposed into German law

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The German Act to Modernise Financial Supervision of Insurance Undertakings *(Gesetz zur Modernisierung der Finanzaufsicht über Versicherungen)* was promulgated in the Federal Law Gazette on 10 April 2015 and fully entered into force on 1 January 2016.[13] It reforms the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) and transposes, among other things, the European Solvency II Directive into German law.[14] This article presents the key amendments to the VAG.

##### Holistic risk assessment

Solvency II introduces more risk-sensitive solvency requirements for insurance undertakings based on a holistic assessment of the risk situation. In addition, the Directive contains new valuation requirements for assets and liabilities, which will have to be recognised at their market values in future. The intention is to reduce the risk of insolvency for insurance undertakings in this way. At the same time, the Directive aims to harmonise supervisory law in the European internal market. Qualitative and quantitative disclosure requirements have also been added to ensure greater transparency.

Insurers and reinsurers within the scope of Solvency II are in principle subject to the same regulations of the VAG in accordance with the provisions of the Directive, unless the wording of a particular provision determines otherwise.

One new provision[15] contains an alphabetic list of legal definitions of key terms used in the VAG. Moreover, the principle of proportionality – a core element of the Solvency II Directive – has been anchored in the VAG. According to

13 Federal Law Gazette I 2015, page 434.

14 Directive 2009/138/EC, OJ EC L 335/1.

15 Section 7 of the VAG.

this principle, BaFin has to apply the provisions of the VAG in a way that takes adequate account of the nature, extent and complexity of the risks associated with the undertaking's activities. The principle of proportionality always focuses on how – rather than whether – the legal provisions have to be met.

### Solvency

Solvency II changes both the supervisory solvency requirements and the rules on own funds that have to be available to cover them. For solvency purposes, there are now specific supervisory rules for calculating technical provisions, in addition to the commercial law regulations, which will still have to be observed. All assets and liabilities are valued at market values.

The supervisory capital requirements distinguish between the solvency capital requirement (SCR) and the minimum capital requirement (MCR, see info box on "SCR and MCR").

### Tiers

Own funds are divided into three tiers, which are subject to different eligibility limits. At least half of the SCR must be covered with own funds of the highest quality (Tier 1). A distinction is made between basic own funds and ancillary own funds. Ancillary own funds comprise capital that has not been paid in, but which can be called up by the undertaking at any time. The MCR can only be covered with Tier 1 and Tier 2 own funds, i.e. funds already held by the undertaking. Tier 1 own funds must account for at least 80% of the total.

### Technical provisions

In addition to the SCR and the MCR, the insurance undertakings must have adequate technical provisions. They correspond to the amount another undertaking would require in order to take over the insurance obligations. A best estimate is determined for the provisions, which corresponds to the probability-weighted average of future cash-flows, taking account of the time value of money (expected present value of future cash-flows). This present value (after discounting) must be determined using the relevant risk-free interest rate term structure[16] specified by the European Insurance and Occupational Pensions Authority (EIOPA). A risk margin is added to the best estimate to ensure that the amount of technical provisions recognised corresponds to the transfer value. The risk margin is calculated using a cost-of-capital rate; it is equivalent to the expected cost of capital an undertaking would be expected to require in order to take over the underwriting commitments.

### Focus on business organisation

The rules on business organisation, which were previously contained in section 64a of the old version of the VAG, can now be found, in greater detail, spread over several sections.[17] The provisions of the old version have been refined and additions have been made in accordance with the Solvency II Directive. A new term, "key task" *(Schlüsselaufgabe)*, has been introduced into the Act. As part of the business organisation, it covers, among other

**SCR and MCR**

The solvency capital requirement (SCR) determines how much capital must be held by undertakings in order to be in a position, with a probability of at least 99.5% over the course of one year, to offset unexpected losses they may incur within the next year and to ensure their technical provisions are covered during this period. The SCR can be calculated using a standard formula or on the basis of a (partial) internal model, which requires prior approval from BaFin.

The minimum capital requirement (MCR) describes the level of capital that insurers have to set aside to protect policyholders and beneficiaries.

16 Commission Implementing Regulation (EU) 2016/165, OJ EU L 32/31.

17 Part 2 chapter 1 segment 3: sections 23 to 32 of the VAG.

things, the four key functions prescribed by the Directive: the independent risk management function, the internal audit function, the compliance function and the actuarial function, which is completely new in this form. Another key requirement is the own risk and solvency assessment (ORSA)[18], which is intended to provide important information to the insurance undertakings and BaFin.

### Mandatory reporting requirements

From 2017 onwards, insurance undertakings and groups will have to publish an annual solvency and financial condition report (SFCR).[19] The report contains information provided in prescribed form on the business and performance of the undertaking, its governance system, risk profile, valuations for solvency purposes and capital management.

Under Solvency II, insurance undertakings and groups have to meet extensive harmonised reporting requirements vis-à-vis the supervisory authority. In addition to the mostly descriptive parts of the report, a comprehensive set of figures has to be submitted quarterly and annually. Most of the reporting requirements are not set out in the Directive itself, but only in the Delegated Regulation[20] on the Solvency II Directive as well as in implementing technical standards. For this reason, they are not mentioned in the VAG. Most of the existing reporting requirements on the basis of accounting data, which are again not governed directly by the VAG, have been retained, unless they have become obsolete as a result of Solvency II reporting requirements or regulations.

Solvency II also sets out additional notification requirements for undertakings. For example, they have to notify the supervisory authority immediately if they fail to comply with the SCR or MCR requirement, or if there is a risk that this will occur within the following three months. Notification is also required if an undertaking intends to outsource important functions or insurance activities. The undertakings also have to inform the supervisory authority about the qualifications of certain persons at the time of appointment; these include management board members, supervisory board members or persons responsible for one of the key functions.

### New rules for group-wide supervision

The requirements for insurance undertakings within a group have also been comprehensively revised and expanded in accordance with the Solvency II Directive. In some instances, reference is made to the requirements for individual undertakings, which in these cases have to be applied at group level accordingly. In order to reduce the burden on the companies of a group, group-wide supervision generally focuses on the highest level within the European Economic Area (EEA). The VAG sets out the cooperation and consultation among the supervisory authorities involved. A new aspect is comprehensive supervisory regulation of the supervisory colleges, which have been given an important consultation and coordination function. Risk concentrations and intra-group transactions are monitored at group level. The VAG makes use of the option set out in Solvency II to allow the supervisory authority to order sub-group supervision at the national level for groups with cross-border activities.

### Small insurance undertakings

Some insurance undertakings are not subject to Solvency II for reasons of size, for example.[21] In order to allow a corresponding distinction to be made for primary insurers, the VAG introduces the term of "small insurance undertaking" *(kleines Versicherungsunternehmen)*.[22] The definition implements the Solvency II provisions relating to the conditions for not applying the Solvency II provisions to primary insurance

18 Section 27 of the VAG; for information on ORSA see 1.3.4.

19 See 1.3.5.

20 Commission Delegated Regulation (EU) 2015/35 supplementing Directive 2009/138/EC, OJ EU L 12/1.

21 See info box on "Supervision under Solvency I or II?" on page 188.

22 Section 211 (1) of the VAG.

undertakings.[23] Key criteria include certain thresholds and the type of business conducted. Reinsurers always fall under the scope of the Solvency II Directive and can therefore not be considered small insurance undertakings.

Since the amended VAG fully entered into force on 1 January 2016, BaFin has been required to inform small insurance undertakings if they do not fall under the scope of the new regime. These undertakings are in part subject to other provisions, which are mostly based on the previous Solvency I provisions. In particular, this means that the Solvency II provisions on capital adequacy requirements do not apply and the undertakings continue to be subject to specific rule-based capital investment requirements. Small insurance undertakings may, however, apply to be supervised in accordance with the provisions of Solvency II.

There are also supervised undertakings that are generally excluded from the scope of Solvency II, such as institutions for occupational retirement provision and death benefit funds. They are mostly subject to the provisions applicable to small insurance undertakings.

### Repeal and readoption of statutory orders

Since the previous version of the VAG was repealed as at 31 December 2015, all statutory orders based on this version had to be repealed as well. This was done by means of a repealing regulation[24], which bundled the statutory orders to be repealed and determined the effective date of the repeal. The Federal Ministry of Finance *(Bundesministerium der Finanzen)* will pass new statutory orders on the basis of the new VAG.

23 Article 4 of the Solvency II Directive.

24 Federal Law Gazette I 2015, page 2345.

## 1.3.2 Implementing technical standards and guidelines

Following the conclusion of the legal provisions on the new European supervisory regime Solvency II at Level I (Solvency II Directive[25]) and Level II (Delegated Act[26]) in 2014, the other legal levels were also developed further.[27]

### Implementing technical standards

In 2015, the European Commission adopted a wide-ranging package of implementing technical standards (ITS) relating to Solvency II (see info box "Technical standards", page 176). The standards had been drawn up previously by the European Insurance and Occupational Pensions Authority (EIOPA). They are intended to assist the practical implementation of the provisions of the Solvency II Directive and the delegated act. Their application is legally binding for supervisory authorities and undertakings. The standards deal with, among other aspects, the approval processes for various application processes under Solvency II, the calculation of the solvency capital requirement (SCR) using a standard formula, the process for setting capital add-ons and the formats for submitting reports to the supervisory authority.

### Guidelines

EIOPA published its guidelines (see info box "Guidelines", page 176) on Solvency II in all of the official languages of the EU member states in stages in February and September 2015. The guidelines supplement the implementing technical standards and define the regulations relating to all three pillars of the new supervisory regime in greater detail. EIOPA did not translate the explanatory texts

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

26 Commission Delegated Regulation (EU) 2015/35, OJ EU L 12/1.

27 For information on Level I to III of the EU legislative procedure, see also Figure 2 in chapter II, page 67.

### Technical standards

Technical standards relate purely to technical matters. They may therefore not contain strategic or political decisions. Furthermore, the standards call for specialist supervisory knowledge. The EU Commission adopts the standards on the basis of drafts prepared by EIOPA. It must then make a decision on these drafts within three months.

The technical standards are divided into regulatory technical standards (RTS) and implementing technical standards (ITS). Regulatory technical standards are adopted by the Commission as delegated acts while implementing technical standards are approved as implementing acts. Regulatory standards may not supplement or amend essential aspects of the other provisions, while implementing standards may only define provisions in greater detail.

### Guidelines

Pursuant to Article 16 of the EIOPA Regulation[30], EIOPA may issue guidelines in order to generate consistent, efficient and effective supervisory practices within the European financial supervisory system, and to ensure the uniform interpretation and application of EU law. These guidelines are intended for the national competent supervisory authorities. The latter must state in the comply-or-explain process whether they intend to apply the guidelines in their supervisory practice or not. If a supervisory authority decides not to implement the guidelines, it must give reasons for its decision, which will then be published by EIOPA.

accompanying the guidelines. BaFin arranged for a translation into German in order to assist the undertakings in the process of implementation.[28]

The publication of the guidelines by EIOPA was followed by the beginning of the comply-or-explain phase for the national supervisory authorities, which lasted two months. BaFin has stated on its website that in principle it will comply with and apply all of the EIOPA guidelines on Solvency II published to date.[29] It therefore expects the undertakings to meet the statutory requirements on Solvency II in a way which is consistent with the interpretation of those requirements by the guidelines.

BaFin is unable to apply a small number of the EIOPA guidelines in full, even though it considers their contents to be acceptable: Either it has identified legal impediments or it fears that the guidelines may prevent the consistent application of the principle of proportionality. It has informed EIOPA of these matters. BaFin has published further information on the guidelines, which it will apply only in part or not at all, on its website.[31]

As a supplement to the European provisions on Solvency II on the various legal levels, the German supervisory authority, with the entry into force of the new supervisory system, has incorporated pronouncements from the preparatory phase relating to the qualitative requirements (Pillar II) of Solvency II into interpretative decisions. Furthermore, BaFin has published a series of interpretative decisions relating to the application of the quantitative requirements (Pillar I) under Solvency II on its website. In May 2014, BaFin had issued corresponding explanatory notes on the particular features of the German market, such as the special system for discretionary bonuses. BaFin has now integrated these explanatory notes into interpretative decisions and published them for application of the Solvency II requirements.[32] In doing so, BaFin's objective is to ensure that insurers apply the Pillar I requirements consistently with respect to the special features of the German market.

28 www.bafin.de/dok/6744732.

29 www.bafin.de/dok/6744732.

30 Regulation (EU) 1094/2010, OJ EU L 331/48.

31 www.bafin.de/dok/6744732.

32 www.bafin.de/dok/6744732.

### 1.3.3 Infrastructure investments

Even before Solvency II came into force at the beginning of 2016, the EU Commission had submitted draft amendments to the previously published delegated act to the EU Parliament.[33] The draft provides, among other things, for a reduction in the capital requirements calculated in accordance with the standard formula for specific investments in infrastructure project financings. However, the revised capital requirements only apply to investments that comply with a number of quality requirements.

Prior to the amendments, the regulations on the capital charge under the standard formula contained no specific provisions for investments in infrastructure. The sector of the economy in which an insurer had made the respective investment was therefore not a deciding factor for the level of the capital requirements. The credit rating and duration were the primary criteria for bonds and loans, while for equity investments the criterion was whether or not the relevant investment is admitted to trading on a stock exchange in the countries belonging to the Organisation for Economic Co-operation and Development (OECD).

#### Reduced requirements

The new capital requirements for investments in infrastructure projects are up to one-third lower than under the general provisions that would otherwise apply. In the case of debt investments, the capital requirements are determined as before on the basis of the credit rating and the duration of the investment. The level of the revised capital requirements is based on an analysis by EIOPA. The EU Commission issued a call for advice to EIOPA in February 2015, requesting it to carry out a review of the level of capital requirements for infrastructure investments at short notice and present its findings to the Commission in the summer.

#### Simplifications for less risky investments

For the purposes of the analysis, EIOPA took the idea of selecting less risky investments using appropriate criteria and reducing the level of own funds required to back them and applied it to investments for the purpose of financing infrastructure projects. In order to specify the quality criteria necessary to make this selection, EIOPA took advantage of the fact that the Basel II framework applying to credit institutions already contains criteria for determining the credit risk of project financings. However, for a number of reasons, EIOPA did not consider it appropriate to adopt the system used by banking regulations without making changes. In the first place, those criteria are used only as the basis for a model for determining the credit risk which has to be approved by the supervisory authority. Without additional requirements, therefore, they do not produce a clear result. Moreover, the classification of credit risk is more differentiated and therefore more complex than is necessary for the standard formula under the insurance regulations, which simply allows "qualifying" or "non-qualifying" as results to be used. Finally, the financing of infrastructure projects represents only one aspect of project financing, which was why the criteria needed to be tailored to this particular case. In addition, EIOPA adopted the requirement applying to securitisations that, if the investment has a rating, it must be an investment grade rating.

The provisions on the capital charge for investments in accordance with the standard formula are the subject of ongoing development. Only a few weeks after the EU Commission had received EIOPA's response to the call for advice, it issued a further call for advice to EIOPA – this time asking whether the procedure for determining less risky investments used for project financing could also be transferred to the financing of corporates.[34] EIOPA is currently working on its advice.

The ultimate impact of the resolved amendments to the standard formula on the

33 http://ec.europa.eu/finance/insurance.

34 http://ec.europa.eu/finance/insurance.

actual capital requirements of German insurers will depend on the extent to which the latter invest in the relevant investments.

### 1.3.4 BaFin publications on Solvency II

#### ORSA

The Own Risk and Solvency Assessment (ORSA) links risk management with the management of capital and therefore forms a material component of the governance systems of insurance undertakings. The integration of the ORSA into the strategic planning process ensures that an undertaking does not make strategic decisions without first having run through and factored in the potential implications for its future capital requirements.

In the past, undertakings had to submit their internal risk reports to BaFin. This obligation applied for the last time for 2015; from 2016, insurers must submit their ORSA reports. Undertakings and groups are required to report to BaFin on each ORSA they have conducted. They have to carry out an ORSA process at least annually and when there is any material change in their risk profiles. Undertakings and groups were already required in the past to assess their own risk-bearing capacity as part of their risk management systems, including consideration of their capital requirements and the financial resources available to them. The regulations relating to the ORSA, which came into effect on 1 January 2016, expand the existing requirements for capital management and the forecasting of capital requirements.

During the whole preparatory phase for Solvency II over the past two years, BaFin has therefore constantly been urging insurance undertakings and groups to take into account the requirements within the ORSA for the assessment of their overall solvency needs when evaluating their risk-bearing capacity. Undertakings and groups were also requested to assess during the preparatory phase whether they would be able, currently and over the medium term, to meet the supervisory capital requirements applicable from 1 January 2016. They were expected to include the results of these assessments in their risk reporting to BaFin.

The ORSA reporting is an important prospective instrument for BaFin, enabling it to identify emerging problems and tackle them at an early stage. The ORSA report is required to provide BaFin with comprehensive information on the risks an undertaking is or could be exposed to. It must also provide details of the consequences those risks could have for the solvency of the undertaking. BaFin will therefore make sure that undertakings and groups establish high-quality ORSA reporting procedures.

#### BaFin publications on the ORSA

After having published information on the first two parts of the ORSA in 2014, BaFin published the third and final part in February 2015. It is concerned with evaluating whether an undertaking's risk profile is significantly different from the assumptions on which the calculation of the Solvency II solvency capital requirement (SCR)[35] is based. This evaluation must be carried out at least once each year, irrespective of whether an undertaking uses the standard formula or an internal model for the purposes of the SCR calculation.

The risk profile may be different if the SCR calculation does not take into account quantifiable material risks to which an undertaking is exposed, or does so inadequately. Where an undertaking determines a significant difference, it must also quantify it. BaFin is informed of these results by the ORSA reporting process and follows them up. If an undertaking's SCR fails to a material extent to take into account the risks to which the undertaking is exposed, or does so inaccurately, BaFin may intervene directly. If the relevant statutory preconditions are met, it may, for example, require the insurer to apply undertaking-specific parameters or to develop and then use a (partial) internal model to calculate the SCR. If these measures prove

35 On the SCR, see info box "Solvency capital requirement under Solvency II", page 167.

to be insufficient, BaFin may stipulate a capital add-on to the SCR, i.e. prescribe higher capital requirements.

On 1 January 2016, BaFin combined its three publications on the ORSA in a single interpretative decision.[36]

### Risk management

In February 2015, BaFin issued another publication on the preparations for Solvency II, dealing with risk management. The publication was mainly concerned with providing further details on the provisions of EIOPA preparatory guidelines 15 to 24 on the system of governance.[37]

Under Solvency II, the risk management system covers all risks to which the undertakings are actually or could potentially be exposed. The risk management system must ensure that the risks are adequately identified, assessed, monitored, managed and reported to the supervisory authority. The undertakings are required to establish suitable strategies, processes and internal reporting procedures for this purpose.

BaFin's publication looked particularly closely at EIOPA preparatory guidelines 15 and 17 on the roles and responsibilities of the undertaking's administrative, management or supervisory body and of the independent risk control function. At the same time, it provided further details relating to the requirements of EIOPA preparatory guideline 16 on the written risk management policy. Furthermore, BaFin provided explanatory notes on selected aspects of risk management, for example in relation to operational risk, investment risk and liquidity risk as well as active/passive management.

The undertakings had already implemented many of the provisions on the risk management system under Solvency II at an early stage. In particular section 64a of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG), old version, and its requirements described in detail in the Minimum Requirements for Risk Management in Insurance Undertakings (*Aufsichtsrechtliche Mindestanforderungen an das Risikomanagement* – MaRisk VA)[38] and the "Guidance on investing restricted assets held by insurance undertakings"[39] established a firm foundation for the undertakings' preparations. Nevertheless, in some cases the requirements for the risk management system also represented new territory for the undertakings, for example the new concept of materiality for risks.

### Actuarial function

In April 2015, BaFin published the guidance document "Preparation for Solvency II: Actuarial function".[40]

For undertakings falling within the scope of Solvency II, the actuarial function is one of two new key functions, together with the compliance function, that they were required to set up at the latest by 1 January 2016. The BaFin publication was intended to assist undertakings in making efficient preparations for the supervisory requirements relating to the two new key functions. It is based on EIOPA guidelines 38 to 43 on the governance system. In those guidelines, EIOPA described in detail the supervisory requirements found in particular in section 31 of the Insurance Supervision Act and in Article 272 of the Solvency II Delegated Regulation.[41]

In addition to many other topics, BaFin goes into greater detail in its publication on the tasks of the actuarial function. For example, the actuarial function is required, among other things, to coordinate the calculation of the technical provisions, express an opinion on the general underwriting policy and contribute to the effective implementation of the risk management system.

36 www.bafin.de/dok/7499552.

37 www.bafin.de/dok/4589744.

38 Circular 3/2009; www.bafin.de/dok/2677166.

39 Circular 4/2011; www.bafin.de/dok/2675992.

40 www.bafin.de/dok/6112644.

41 Commission Delegated Regulation (EU) 2015/35 supplementing Directive 2009/138/EC, OJ EU L 12/1.

BaFin also makes it clear that the Responsible Actuary will remain in place alongside the actuarial function. In the past, the Responsible Actuary performed an important protective function for customers in life and health insurance, accident insurance with premium refund and for third-party liability and accident benefits. In certain circumstances, the undertakings may transfer the tasks of the Responsible Actuary to the actuarial function. In such cases, there is a requirement to ensure that the actuarial function can carry out its own tasks and those of the Responsible Actuary in full and independently. The undertakings can achieve this, for example, by integrating the actuarial function properly into their organisational and operational structures.

#### Outsourcing

An especially important consideration for insurance undertakings is the ability to outsource functions or insurance activities. BaFin therefore dedicated a publication to these issues in the context of the preparatory phase for Solvency II, namely "Preparation for Solvency II: Outsourcing" dated 28 April 2015.[42]

A particular point to note here first of all is that, even where activities are outsourced, insurance undertakings continue to be responsible for complying with all supervisory regulations. The publication therefore focuses, among other things, on the rules relating to the outsourcing officer. In accordance with EIOPA preparatory guideline 14 on the governance system, as soon as key functions are outsourced, the undertaking must designate an outsourcing officer with overall responsibility for the oversight of those functions. In this case, the notification requirement to BaFin pursuant to section 47 no. 1 of the Insurance Supervision Act relates to the outsourcing officer as the responsible person.

An outsourcing officer has a monitoring function, not an operating one. Subject to certain preconditions, this function can also be transferred to a person employed by another undertaking within the same group. BaFin does not consider it permissible, however, for the outsourcing officer to be employed at the group undertaking to which the key function has been outsourced. In this event, namely, the outsourcing officer would be answerable from a disciplinary point of view to the management of the undertaking whose services he is responsible for monitoring.

Managers may only act as outsourcing officers for a key function if they have the professional qualifications required to monitor that function. It is also necessary to ensure that the make-up of their portfolio of responsibilities, including their function as outsourcing officer, complies with the rules on the segregation of duties in a proportional manner. It is a precondition that outsourcing officers have sufficient time at their disposal to be able to fulfil all their responsibilities in the proper manner. Solvency II does provide for a governance structure in which the key functions form a level below the management board so that the latter can concentrate on its management responsibilities. But with respect to the outsourcing officer, it seems justifiable on the whole – provided that all the conditions mentioned are satisfied – to permit exceptions from the separation in principle between management and key functions without applying the principle of proportionality.

BaFin incorporated its publication "Preparation for Solvency II: Outsourcing" into its "Interpretative decision on outsourcing at insurance undertakings"[43] on 1 January 2016.

## 1.3.5 Reporting

### 1.3.5.1 Technical aspects

#### Guidance Notice on reporting

In October 2015, BaFin published a Guidance Notice on reporting for primary insurers and reinsurers, insurance groups and *Pensionfonds* (only available in German).[44] It contains information for the undertakings and groups

42 www.bafin.de/dok/6151648.

43 www.bafin.de/dok/7496172.

44 www.bafin.de/dok/6917248.

under supervision at the start of the new Solvency II supervisory regime on 1 January 2016 on the extensive changes it entails for reporting to BaFin (see also info box "BaFin Solvency II conference", page 184). This affects not just undertakings and groups that fall within the scope of the Solvency II Directive, but to a lesser extent the other undertakings as well. The Guidance Notice with its detailed information on the various technical aspects, is therefore important for all the undertakings and groups under supervision.

The section "Guidance on previous reporting" deals with previous reporting obligations that have been revised or that no longer apply. These details are important for all undertakings and groups supervised by BaFin. The following section explains future reporting under Solvency II and therefore only affects undertakings and groups subject to the regulations of the new regime. A general introduction to the topic is followed by sections on the components of future reporting, the deadlines for submission, the transitional provisions on obligations to provide information (Day 1 reporting), quantitative reporting to BaFin and narrative reporting to BaFin and the general public. This is followed by particular issues relating to quantitative reporting on the solvency capital requirement for users of internal models. Finally, there are details on reporting for the purposes of financial stability.

### Voluntary test run

In the preparatory phase, German primary insurers and reinsurers submitted information on reporting in accordance with Solvency II requirements for the first time. The submissions included both quantitative information (reporting templates) in the form of

- the annual report based on the information as at the 31 December 2014 reporting date and
- the report for the 3rd quarter as at the 30 September 2015 reporting date

and qualitative information in the form of a narrative report to the national supervisory authorities based on the information as at the 31 December 2014 reporting date. Both the quantitative and the narrative information submitted in the preparatory phase represent only a limited portion of the information required for future reporting under Solvency II.

The widespread willingness of German insurers to participate was particularly welcome: The majority of the industry submitted the annual report (312) and the report for the 3rd quarter (307). German Insurance groups under Solvency II submitted 50 valid reports for the annual report.[45] A large proportion of these insurance groups therefore also submitted the quantitative annual report.

BaFin used the data submitted to engage in a constructive dialogue with the undertakings. It investigated the solvency situation and the effect of the preferred transitional measures or the LTG measures specifically for the life insurers. The evaluation showed that the transitional measures are fulfilling their purpose and will enable German life insurers to make a smooth transition to the new supervisory regime.

### Proportionality – exemption of smaller insurers from particular reporting requirements

Under section 45 of the Insurance Supervision Act, BaFin may exempt primary insurers and reinsurers from elements of the quantitative reporting process subject to certain preconditions. This applies to a number of forms and templates in the quarterly reporting and the reporting on individual items. Insurance undertakings may only be exempted, however, if their total business volume in accordance with section 45 (3) of the Insurance Supervision Act does not exceed a market share of 20% of the life or non-life insurance market, respectively. For the life insurance market, market share is determined on the basis of the total technical provisions, and in the non-life market on

45 The quantitative group report for the 3rd quarter was not submitted until January 2016 as a result of the six-week extension of the submission deadline for groups.

the basis of the gross premiums written.[46] Smaller insurance undertakings with lower market shares are preferred for exemption. The undertakings must not only demonstrate an appropriate market share, but also satisfy a range of additional risk-oriented criteria in accordance with section 45 (5) of the Insurance Supervision Act. Undertakings forming part of an insurance group are a special case: they may only be exempted if they can also demonstrate pursuant to section 45 (1) and/or (2) of the Insurance Supervision Act that regular interim reporting is disproportionate to the nature, scope and complexity of the risks associated with the group's business. Furthermore, as the group supervisory authority pursuant to section 282 of the Insurance Supervision Act, BaFin may also exempt German insurance groups under Solvency II from elements of the quantitative group reporting. The precondition for this is that all members of the group have previously been exempted at the level of the individual undertakings. In the case of an international insurance group, possible exemption at group level can only occur after such a step has been agreed with the other relevant national supervisory authorities. The evaluation of whether an undertaking or insurance group can be exempted must be reassessed annually.

BaFin already implemented the procedure for exempting undertakings from elements of the quantitative reporting process at the beginning of 2015. It informed the undertakings and insurance groups in question at an early stage that they were exempted for financial year 2016. On the first occasion, therefore, the procedure was necessarily based on the figures for financial year 2013 in accordance with commercial law, since at the date in question no data in accordance with Solvency II were available. In addition, BaFin established a uniform basis for the extent of the exemption for all insurance undertakings and insurance groups. It made the greatest possible use of its ability to grant exemptions while observing the general legal framework.

From financial year 2017 onward, partial exemption on the basis of Solvency II data will be possible for the first time. BaFin will continue to inform the relevant undertakings and insurance groups in good time. BaFin will also stipulate the frequency for the submission of the regular supervisory report (RSR) in the future. This will involve deciding for the undertakings on a case-by-case basis whether they must submit the RSR in a cycle ranging between one and three years, which may result in further simplified requirements. However, BaFin will require all undertakings subject to reporting obligations to submit the RSR for the first time in 2017.

### 1.3.5.2 Formal and technical aspects

#### Insurance Reporting Regulation

The formal and technical requirements of the new reporting obligations under Solvency II will be governed in future by a separate regulation, the Insurance Reporting Regulation (Versicherungs-Meldeverordnung). This is intended to ensure that the data required to be submitted electronically in accordance with European requirements are of adequate quality and that BaFin can accept and process them and forward them to EIOPA. The regulation therefore specifies the manner in which the data are submitted, the file formats which must be observed and the quality of data to be delivered. It is not possible to stipulate the necessary requirements in parallel at European level, not least because there is no legal basis for doing so.

The regulation also covers the statistical reporting obligations for the ESCB[47] insurance statistics[48], which insurance undertakings and groups within the scope of the Solvency II Directive have an obligation to the European Central Bank (ECB) to comply with. The

46 More specific information on the determination of the relevant market share can be found in the EIOPA guidelines on reporting methods.

47 European System of Central Banks.

48 www.bundesbank.de/Navigation/DE/Statistiken/Banken_und_andere_finanzielle_Institute/Versicherungen_und_Pensionseinrichtungen/versicherungen_und_pensionseinrichtungen.html.

undertakings and groups are required to submit expanded Solvency II reporting templates for this purpose. These "unofficial reporting templates including ECB add-ons" consist of Solvency II reporting templates, to which the ECB has added additional requirements, and new forms for purely statistical purposes.

These reports are submitted using BaFin's reporting platform. BaFin forwards the data to the Deutsche Bundesbank, which then validates them and submits them to the ECB.

### New reporting platform

At the beginning of February 2015, BaFin launched the new "Insurance supervision – Solvency II" specialised procedure on its reporting and publishing platform, the MVP portal. The specialised procedure consists of the

- "Quantitative Solvency II Report (XBRL)" and
- "Narrative Solvency II Report (PDF)" submissions.

The "Quantitative Solvency II Report (XBRL)" submission enables insurance undertakings to upload their Solvency II report to BaFin in the XBRL file format. Once received, the files are automatically checked for correctness, for example with respect to the format used and the construction of the filename. In addition, the taxonomy of the files is subjected to a validation process. This means that the data record description used for the Solvency II files, the Solvency II taxonomy, contains plausibility checks that are carried out automatically. When they have been successfully checked, the files are accepted; if errors are detected, the report is deemed not to have been submitted. In both cases, the reporting entity is informed of the outcome.

In addition, the "Narrative Solvency II Report (PDF)" submission enables insurance undertakings to upload the ORSA, RSR, Day 1 and SFCR reports in the PDF file format.

### LEI code

For the purposes of electronically reporting quantitative information to BaFin, clear identification is necessary for every legal person falling within the scope of section 1 of the Insurance Reporting Regulation as an entity. The Legal Entity Identifier (LEI) code has been designed for this purpose. The LEI code is a 20-character alphanumeric entity identifier being introduced as the international standard for entities in the financial markets. Each LEI code is only issued once and can therefore be allocated to an entity on a worldwide basis.

Entities whose investment activities include derivatives have already been using an LEI code for reporting their derivatives transactions since 2012.

## 1.3.6 Internal models

Since 1 April 2015, undertakings have been able to make a formal application to BaFin for the authorisation of their internal models.[49] If BaFin has authorised such an internal model, insurance undertakings have been permitted since 1 January 2016 to use it to calculate their own funds requirements (see also info box "BaFin Solvency II conference", page 184).

The documentation alone required for the application is considerable – in two respects: firstly, an application may comprise up to 100,000 pages, whose completeness and contents must be checked by BaFin. Secondly, the supervisory authority must forward the documentation without undue delay to any foreign supervisory authorities involved.

The undertaking receives confirmation as soon as the application has been received. The completeness of the application is then checked within 30 days or, in the case of applications for group internal models under Article 231 of the Solvency II Directive, within 45 days. If the application is complete, this marks the start of a six-month period from its receipt. BaFin must

49 For details on internal models, see also chapter II 9.2.

make a full decision on the application within that period.

BaFin expects the EIOPA Common Application Package for Internal Models to be used for the purpose of the formal application. In order to avoid differences in the interpretation of the requirements and in the application of group internal models, BaFin also takes into account an additional statement of opinion from EIOPA on how applications for the authorisation of internal models should be handled.

### BaFin Solvency II conference

On 4 November 2015, BaFin hosted its fifth Solvency II conference in Bonn. This time, the conference was dominated by the imminent start of the new supervisory regime on 1 January 2016. Around 280 participants exchanged ideas in two panel discussions and a series of lectures on the application processes for internal models, key functions and the reporting system. In addition to BaFin and the insurance industry, representatives of EIOPA, the Deutsche Bundesbank and academia were also present. The President of BaFin, Felix Hufeld, spoke in his welcome speech about "the most comprehensive reform of insurance supervisory law to date". To ensure that Solvency II was implemented consistently in practice, it was important for the discussion to continue even after 1 January 2016, he said.

The Chief Executive Director of Insurance Supervision, Dr Frank Grund, indicated that the intensive dialogue between BaFin and insurers was being developed further. Only contact with the undertakings could enable BaFin to determine what was good and what was not; it was now a matter of combining theory and practice, he said. Both BaFin and the insurance undertakings had made great efforts to implement the requirements imposed by the new regulatory framework from 1 January 2016.

It proved to be highly beneficial to the application process that, since the beginning of October 2014, BaFin had allowed insurers wishing to calculate their solvency capital requirements using an internal model to make a test application. BaFin checked that the test applications were complete and sufficiently detailed and that they had adequately documented the tests and standards required. This provided the insurers with valuable guidance on the actual application process and enabled them to amend their documentation in good time, where necessary. BaFin also benefited from this test run. It was able to gain an initial overview of the expected quantity and quality of the applications and of the method of processing them. In addition, applications from groups created an opportunity to consult with supervisors from other member states of the EU or the European Economic Area in the supervisory colleges, which was helpful in view of the ambitious time limit of six months for processing the applications. In 2015, BaFin granted approval to six insurance groups for the use of their own internal models.

## 1.4 Occupational retirement provision

### 1.4.1 State of progress on the revision of the IORP Directive

On 27 March 2014, the European Commission published a proposed amendment to the Directive on the activities and supervision of institutions for occupational retirement provision (IORP II Directive). On 10 December 2014, the member states then approved a general approach to the IORP II Directive, which the European Council will take into the trilogue negotiations. The EU Parliament's relevant Committee on Economic and Monetary Affairs decided on a position on an IORP II Directive on 25 January 2016.

The objective of the EU institutions' proposals is to remove the remaining supervisory obstacles to institutions for occupational retirement provision (IORPs) with cross-border activities. They are also intended to ensure

that the institutions have a proper system of governance and appropriate risk management systems, prepare understandable and relevant information for the beneficiaries and provide the supervisory authorities with the instruments necessary to monitor the IORPs effectively. At the same time, none of the proposals alters the quantitative requirements of the current directive (IORP I).[50]

In contrast to the EU Commission's proposal, the proposals of the Council and of the EU Parliament do not envisage any delegated acts for remuneration policy, risk evaluation for pensions and the pension benefit statement. Another significant difference is that the EU Commission's proposal contains very detailed requirements on information for beneficiaries, while the proposals of the Council and the EU Parliament aim to allow the member states more leeway in this respect. The trilogue negotiations began in February 2016 and the hope is that they will be concluded in the first half of 2016, if possible.

### 1.4.2 Quantitative assessment

The European Insurance and Occupational Pensions Authority (EIOPA) conducted a quantitative assessment (QA) for institutions for occupational retirement provision (IORPs) from 11 May to 10 August 2015.[51] In Germany, the latter include *Pensionskassen* and *Pensionfonds* within the meaning of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG).

The quantitative assessment ran in parallel to the EIOPA stress test for IORPs (see info box); participation was voluntary for the national supervisory authorities and the IORPs.

BaFin participated in the QA to enable EIOPA to include data for German IORPs in its subsequent work. The proportion of the total number of *Pensionskassen* and *Pensionfonds* which participated in the QA was encouragingly high, especially in view of the expenditure of time and resources involved. The QA required participants to produce data for six possible examples of a future supervisory system. EIOPA had already presented the six examples

**EIOPA stress test 2015**

In 2015, EIOPA arranged the first Europe-wide stress test for IORPs. The aim was to test the resilience of the European IORP sector against potential adverse capital market scenarios and the rising life expectancy of benefit recipients.

As it was a macro stress test, only aggregated results were analysed and published. The EIOPA did not publish individual results.

The stress test covered both defined benefit and defined contribution plans. However, pure defined contribution plans are not relevant for institutions for occupational retirement provision in Germany, since they are not permitted under the Occupational Pensions Act *(Betriebsrentengesetz)*.

The stress test for defined benefit plans comprised two parts. The first part was based on the respective national accounting and solvency standards. The second part used the holistic balance sheet, which had also formed the basis for the quantitative assessment of the IORPs' solvency in 2015. The holistic balance sheet was used in the stress test as a uniform European standard, enabling the results of different member states to be compared with each other.

The results of the EIOPA stress test confirmed that a persistent phase of low interest rates is likely to remain a major challenge for the German IORP sector.

50 Directive 2003/41/EC, OJ EU L 235/10.

51 https://eiopa.europa.eu/Pages/News/EIOPA-launches-pensions-stress-test-and-quantitative-assessment-on-solvency-for-occupational-pension-funds.aspx.

in an earlier consultation paper.[52] They are all based on the holistic balance sheet[53], but each example excludes particular components or assesses them differently. Five of the six examples envisage using the holistic balance sheet to determine the solvency capital requirements in accordance with Solvency II, while one uses it as a risk management tool and for transparency.

EIOPA's intention is to incorporate the results of the quantitative assessment into a statement of opinion addressed to the European institutions, in which it suggests how the holistic balance sheet could be used in future. EIOPA will also publish the results of the QA alongside its statement of opinion.

## 1.5 Insurance intermediaries

### 1.5.1 Insurance Distribution Directive (IDD)

The Insurance Distribution Directive (IDD) was published in the Official Journal of the EU on 2 February 2016 and came into effect on 22 February 2016. The implementation period for the IDD is two years, so that it will be applicable from 23 February 2018.

The IDD replaces the Insurance Mediation Directive (IMD) of 2002. It covers the entire distribution chain and imposes requirements on all distributors of insurance policies, i.e. including direct sales by the insurers themselves in addition to brokers and (tied) intermediaries. It does not apply to persons practising insurance distribution as an ancillary activity, if it is a complementary service for the delivery of goods or relating to risks in connection with the booking of a journey, provided that the premiums do not exceed specified amounts.

#### Standards

The IDD contains a number of authorisations for the issue of regulatory technical standards. On 24 February 2016, the EU Commission issued a call for advice to EIOPA in this connection, asking for a response by 1 February 2017.[54]

The following articles of the IDD are affected:

- Article 25(2) – product oversight and governance requirements (POG),
- Article 27 and Article 28(4) – prevention of conflicts of interest,
- Article 29(2) – inducements and
- Article 30(5) – suitability and appropriateness of advice and information for the customer.

The EU Commission has already made clear that convergence with the anticipated implementing regulations is expected, to the extent that the Markets in Financial Instruments Directive II (MiFID II) and the IDD are based on the same depth of regulation and comparable subject matter. However, convergence is limited insofar as the IDD, in contrast to MiFID II, conforms to the principle of minimum harmonisation and in particular contains no ban on commissions. The planned regulatory technical standards may therefore also not result in a ban on commissions in practice.

In addition, Article 20(4) of the IDD contains the authorisation for the issue of an implementing standard for a European product information document (PID) for non-life insurers.

EIOPA is intending to commission a consumer survey for this product information document. This is to ensure that the implementing standard also meets the objective of providing consumers with understandable and comprehensive information.

The content of the work will also be able to benefit from the preparatory work carried out

52 https://eiopa.europa.eu/Pages/Consultations/Consultation-Paper-on-Further-Work-on-Solvency-of-IORPs-(CP-14040).aspx.

53 See BaFin's 2013 Annual Report, info box page 122.

54 https://eiopa.europa.eu/Publications/Requests%20for%20advice/I-EIOPA-2016-073%20COM%20Letter%20IDD%20%28GBE%29.pdf.

by EIOPA internally on a standardised product information document for motor vehicle liability insurance.

The Insurance Distribution Directive also contains provisions relating to cross-selling. These differ from the corresponding provisions in MiFID II in that they also cover the combination of an insurance contract with the sale of goods or services – such as linking the sale of spectacles with spectacles insurance or of a mobile phone or mobile phone contract with mobile phone insurance.

BaFin is collaborating on the drafting of the standards and guidelines.

### 1.5.2 Collective decree on irregularities in insurers' administrative and sales operations

BaFin has revised the collective decree "Order on the reporting of irregularities in insurers' administrative and sales operations" of 23 November 2007, including the accompanying forms, and replaced it with the collective decree of the same name dated 10 December 2015 (only available in German).[55]

The revision is primarily a consequence of the new Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) which came into effect on 1 January 2016. The revised version also reflects BaFin's experience gained since the 2007 collective decree was issued. In addition, the revision has enabled BaFin to bring the collective decree into line with the circular "Cooperation with insurance intermediaries, risk management in distribution"[56] of 23 December 2014.

The new collective decree applies to all insurance undertakings subject to supervision by BaFin. The only exceptions are reinsurers and insurers domiciled in another EU member state or EEA signatory state.

Forms A, B/1 to B/4 and C in the new collective decree are designed in a more user-friendly way than in the old version. For the B forms, BaFin has provided separate forms for tied agents and product-accessory intermediaries, for insurance brokers and multi-firm agents, for employed sales staff and for administrative staff.

## 1.6 BaFin circulars

### 1.6.1 Trustee to monitor the guarantee assets *(Sicherungsvermögen)*

BaFin is planning to revise its circular on trustees[57] to reflect the amendment of the Insurance Supervision Act *(Versicherungsaufsichtsgesetz)* in 2015 (see info box "Responsibilities of the trustee"). The draft was the subject of public consultation in November 2015. The finalised circular will be published in the second quarter of 2016 (see also info box "Information event for trustees", page 188).

**Responsibilities of the trustee**

The trustee reviews the undertakings' guarantee assets. He makes sure that the undertakings comply with the supervisory requirements for the investment, securing and monitoring of the guarantee assets.

The revised version provides that in future Solvency I and Solvency II trustees (see info box "Supervision under Solvency I or II?", page 188) should use their own discretion to decide the extent to which they review a particular investment. The intensity of the analysis should be based on the risk of the individual investment.

In addition, from 1 January 2016, the trustee of a Solvency II undertaking should review whether an undertaking's investments are appropriate for the guarantee assets,

55 www.bafin.de/dok/7489688.

56 Circular 10/2014 (VA), www.bafin.de/dok/5800616.

57 Circular 4/2014 (VA), www.bafin.de/dok/5247724.

### Supervision under Solvency I or II?

The following undertakings do not fall within the scope of the new Solvency II regulations:

- small insurance undertakings pursuant to section 211 of the new Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG as amended),
- funeral expenses funds pursuant to section 218 of the VAG as amended,
- institutions for occupational retirement provision (*Pensionskassen* pursuant to section 232 of the VAG as amended and *Pensionfonds* pursuant to section 236 of the VAG as amended),
- guarantee funds in accordance with section 223 of the VAG as amended,
- public-law insures of the public service or of the churches, engaged solely in provision of retirement, invalidity or surviving dependants' benefits (section 2 of the VAG as amended),
- agricultural liability insurance in accordance with section 140 (1) of the Seventh Book of the Social Security Code *(Sozialgesetzbuch)*.

using the internal schedule of investments the undertaking is required to maintain in accordance with EIOPA guideline 25.

Under Solvency II, the trustee is also under an obligation to investigate whether unit-linked life insurance funds are qualitatively suitable as guarantee assets, since they are also subject to the prudent person principle.

The revised trustees circular now also draws attention to the obligation from 1 January 2016 to appoint a trustee for accident insurance with premium refund. In addition, there is a specific requirement that the trustee must have adequate time to fulfil his responsibilities in a proper manner. Furthermore, the inflexible time limits for information on values to be submitted by *Pensionfonds* with investments in pension liability insurance were deleted. At the same time, the circular provides more detailed information on the date of securing the assets and the role of the trustee in coinsurance activities.

### 1.6.2 Guarantee assets *(Sicherungsvermögen)*

In its circular on guarantee assets (only available in German)[58], BaFin provides the undertakings with guidance on the maintenance of the guarantee assets register which they are required to submit to BaFin annually. Given that since 1 January 2016 Solvency I and Solvency II undertakings have had to invest their guarantee assets in accordance with fundamentally differing requirements, BaFin has decided to produce two separate circulars on this subject.

The draft of the guarantee assets circular for Solvency I undertakings (see also info box "Information event for trustees") is based on the structure of the old circular. It provides for only insignificant substantive changes. In order to allow the addressees of the circular sufficient time to adapt their computer systems to the new forms for the guarantee assets register, the revised circular will not come into effect

### Information event for trustees

The drafts of the revised trustees circular and the new guarantee assets circular for Solvency I undertakings formed the central focus of the second information event for trustees, organised by BaFin on 11 November 2015 in Bonn. The insurance supervisors explained the contents of the drafts, which were available for public consultation until 8 December, to an audience of some 240 trustees and representatives of undertakings and industry associations. The original reason for the revision of the circular was the implementation of Solvency II by the amended version of the Insurance Supervision Act dated 1 April 2015.

58 Circular 12/2005 (VA), www.bafin.de/dok/2677562.

until 1 January 2017. Until then, the existing circular continues to apply for Solvency I undertakings.

The draft of a guarantee assets circular for Solvency II undertakings is still being worked on. It is intended to be put out for consultation in 2016 and is also expected to come into effect at the beginning of 2017. Until then, Solvency II insurers can use the forms in the old circular for their guarantee assets registers.

# 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* and funeral expenses funds, and *Pensionsfonds* 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.

In order to comply with EIOPA guideline 15 on the Supervisory Review Process[59], BaFin modified the risk classification procedure in 2015 to include four levels of market relevance. Market relevance is now measured on a four-tier scale of "very high", "high", "medium" and "low". The quality of the insurers continues to be based on an assessment of the following factors: net assets, financial position and results of operations; growth; and quality of management.

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

The following table shows the assessment based on the data as at 31 December 2015:

**Table 22** Risk classification results for 2015

| Undertakings in % | | Quality of the undertaking | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Market relevance | Very high | 0.2 | 1.2 | 0.9 | 0.0 | 2.3 |
| | High | 1.4 | 6.0 | 2.8 | 0.0 | 10.2 |
| | Medium | 0.9 | 14.3 | 7.1 | 0.0 | 22.3 |
| | Low | 8.3 | 35.9 | 19.6 | 1.4 | 65.2 |
| | **Total** | **10.8** | **57.4** | **30.4** | **1.4** | **100.0** |

59 https://eiopa.europa.eu/publications/eiopa-guidelines/guidelines-on-supervisory-review-process.

### Small decline in number of good-quality insurers

In the course of the risk classification, BaFin rated 68.2% of the insurers as "A" or "B". Compared with the previous year, there was a decline in the proportion of undertakings in the upper quality range as well as in those rated as "D". The number of undertakings rated "C" rose slightly, on the other hand. 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

The proportion of health insurers with an "A" rating increased fractionally. There were no health insurance undertakings assessed with a "D" rating in the year under review, as in the previous year. Health insurance undertakings rated as "B" once again represented the majority of the segment with a proportion of more than 60%.

In the life insurance and funeral expenses funds segment, most undertakings again received ratings in the middle quality categories.

The proportion of property/casualty insurers with an "A" and "B" rating also increased moderately. As in previous years, the overall proportion of property/casualty insurers rated "A" or "B" was in excess of 80%.

A shift in quality rating from "B" to "C" was observed for *Pensionsfonds* and *Pensionskassen*.

There were no significant movements between quality categories for reinsurers. The proportion in the upper range was again more than 75%, as in the previous years.

### Number of insurers continues to decline

As in previous years, the number of undertakings classified during the year under review declined further. This represented a continuation of the downward trend in the number of insurers recorded in previous years.

### 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 2015. In contrast to a 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 and loss 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

**Table 23** Breakdown of on-site inspections by risk class in 2015

| On-site inspections | | Quality of the undertaking | | | | Total | Under-takings in % |
|---|---|---|---|---|---|---|---|
| | | A | B | C | D | | |
| Market relevance | Very high | 0 | 0 | 0 | 0 | 0 | 0.0 |
| | High | 0 | 12 | 4 | 0 | 16 | 23.2 |
| | Medium | 0 | 10 | 4 | 0 | 14 | 20.3 |
| | Low | 6 | 24 | 9 | 0 | 39 | 56.5 |
| | **Total*** | 6 | 46 | 17 | 0 | 69 | **100.0** |
| | **Undertakings in %** | **8.7** | **66.7** | **24.6** | **0.0** | **100.0** | |

* Three on-site inspections were also conducted at unclassified undertakings, bringing the total to 72 inspections.

of the risk classification, one of the factors that BaFin takes into account is whether an insurer or *Pensionsfonds* 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 72 on-site inspections. The overall decline in the number of on-site inspections compared with the prior year reflected the lower number of internal model reviews due to the expiry of the pre-application phase, although the number of regular inspections increased.

The risk matrix in table 23 (page 190) shows the breakdown of the inspections by risk class.

## 2.3 Areas of emphasis of inspections

In order to carry out its supervisory function in an effective and efficient manner based on the principle of risk-orientation, BaFin decided on areas of emphasis. During the year under review, it carried out more intensive inspections of those insurance undertakings for which an on-site inspection had not been possible for a lengthy period of time as a consequence of the implementation of Solvency II.

The areas of emphasis for BaFin's inspections in 2016, in addition to the insurers' financial position, will be the general and specific requirements for their governance and for persons with key functions pursuant to sections 23 ff. of the Insurance Supervision Act *(Versicherungsaufsichtsgesetz)*. BaFin will also pay particularly close attention to the monitoring of the system of governance in accordance with sections 275 ff. of the Insurance Supervision Act. In addition, it is intended to assess the implementation of the reporting requirements under Solvency II as well as the use of internal models.

## 2.4 Collective consumer protection

### 2.4.1 Group insurance contracts

In the interests of collective consumer protection[60], BaFin has been examining insurers' industry-wide treatment of group insurance contracts since mid-2015. For this purpose, BaFin carried out a comprehensive survey of 29 insurance undertakings from all industry segments to obtain further information on the nature and structure of the group insurance contracts used. Group insurance contracts play a major role in practice.

They are widely used in occupational retirement provision. In addition, they are used in particular when insurance protection is linked to the sale of goods and services. A typical example of this is the combination of a credit card with an insurance service. Equally, payment protection insurance is frequently taken out in connection with a loan agreement or, for example, travel cancellation insurance at the same time as a journey is booked.

Despite the importance of group insurance contracts in practice, however, the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG) only contains selective rules relating to this type of contract, for example in sections 43 ff. of the Act relating to insurance for the account of third parties.

According to the general understanding, a group insurance contract represents a standardised contract in which there is only one policyholder but a large number of insured persons. The head of the group, for example an association or company, becomes the policyholder. The members of the association or the employees or customers of the company can then be insured under the group insurance contract as members of the group. The implication of this is that, in such a contract, the insured group members therefore only have the legal status of an insured person.

60 For details on collective consumer protection, see also chapters II 5.1. and 5.2.

### Advantages and disadvantages

In return, the group members generally benefit from a significantly more favourable premium than for a corresponding individual insurance policy, since the insurer's administrative and commission expenses are obviously lower. However, there are also significant disadvantages associated with the legal status of an insured person.

For example, under section 6 of the Insurance Contract Act the insurer only has a duty to provide appropriate advice to the policyholder, both before the contract is entered into and when required during the term of the contract. In the general opinion, therefore, in the case of a group insurance contract this duty is owed only to the head of the group as the policyholder, and not (also) to the group members as insured persons.

The same applies to the insurer's obligations to provide information both prior to and during the contract in accordance with section 7 of the Insurance Contract Act. In a group insurance contract, these obligations also apply solely to the head of the group as the policyholder. The only exception to this is based on section 144 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) and relates to occupational retirement provision. This stipulates a direct duty of the insurer to provide information to the beneficiaries and pensioners, who are not at the same time policyholders.

### Head of the group controls the contract

In the prevailing opinion, the head of the group as the policyholder is also in control of the contract, and has the right to determine the nature of a group insurance contract, including amending it on the basis of a bilateral agreement with the insurer. Such amendments, for example, could involve changing the insurer or modifying the terms and conditions of the policy. According to court rulings, amendments of this nature could even be to the disadvantage of the insured persons in particular circumstances.[61]

61 See BGH VersR 2013, 853.

The Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen* – BAV), one of BaFin's predecessors, therefore published a number of circulars in the 1990s with the aim of ensuring appropriate consumer protection. They address the supervisory requirements for the treatment of group insurance contracts. Particularly noteworthy is the circular on the principles for combining transactions for goods and services with insurance protection (only available in German).[62] It sets out detailed requirements for the contents of group insurance contracts in the specific case that transactions for goods and services are combined with insurance protection. In addition, the circulars providing guidance on special payments and preferential contracts for both the life insurance[63] and health insurance[64] segments (both only available in German) imposed further supervisory requirements relating to the treatment of group insurance contracts.

On the basis of the survey, BaFin is now in a position to consider whether the existing supervisory requirements for group insurance contracts are adequate or need to be revised. Given that the survey was very wide-ranging, the results are only expected to become available during the course of 2016.

## 2.4.2 Request for information on acquisition costs and commission agreements

In the fourth quarter of 2015, BaFin submitted a request for information to 24 life insurance undertakings. The aim is to investigate whether and how the amendments to the Premium Reserve Regulation *(Deckungsrückstellungsverordnung)* as at 1 January 2015 have affected acquisition costs and therefore also commission agreements with insurance intermediaries in the life insurance segment. The life insurance undertakings selected represented a market coverage of around 80%, measured by gross premiums earned in 2013.

62 Circular 3/90, www.bafin.de/dok/2677640.

63 Circular 3/94, www.bafin.de/dok/2677650.

64 Circular 2/97, www.bafin.de/dok/2677638.

The background to the request: The Life Insurance Reform Act *(Lebensversicherungs-reformgesetz)* of 1 August 2014 had amended a number of statutory provisions in order to guarantee the financial capability of life insurers in Germany and to improve the protection of consumers. One of the amendments related to section 4 (1) of the Premium Reserve Regulation. Simply put, this provision stipulates, among other things, the maximum level (Zillmer rate) – in relation to the insurance premium – of one-off acquisition costs factored into the premium that may be included in the calculation of the premium reserve.

The corresponding amendment to the Premium Reserve Regulation came into effect on 1 January 2015. As a result of the reduction in the maximum Zillmer rate from the existing 40 per mille to 25, acquisition costs may now only be recognised up to 25 per mille of the total premium.

There are as yet no dependable data on the effects of the amendment to section 4 of the Premium Reserve Regulation in practice. The request for information is intended to contribute to enabling authoritative statements to be made on this subject and to create objectivity in the discussion of acquisition costs in the life insurance industry. In view of the quantity of documentation submitted by the insurance undertakings, it will only be possible to make reliable statements on the results of the request for information during the course of 2016. However, is already clear that there has been a positive effect on the surrender values of endowment insurance policies, which is important above all from a customer point of view.

### 2.4.3 Request for information on the liability period for cancellations

At the same time as the request for information on the effects of the Life Insurance Reform Act, BaFin directed another request for information to a selection of life and health insurers, which also accounted for a market coverage of around 80%. BaFin's purpose is to determine how the insurers are handling the liability period for cancellations pursuant to section 80 (5) of the Insurance Supervision Act in practice. This provision has existed since 1 April 2012.

The background to the request was as follows: Section 80 (5) of the Insurance Supervision Act stipulates the extent to which, in life and health insurance, an insurance intermediary must repay its commission to the insurer if an insurance policy it has mediated is terminated within five years.

#### No further requirements under supervisory law

There are currently no further requirements under supervisory law relating to the application of this provision in practice. In the past, for example, BaFin has repeatedly discussed compliance with this requirement in the context of on-site inspections at insurance undertakings and monitored the topic on the basis of related complaints. In doing so, it was unable to discover any indications of serious infringements. However, information from the processing of complaints and the on-site inspections may provide only limited insight.

Since section 80 (5) of the Insurance Supervision Act is a provision aimed largely at protecting consumers, the survey is intended to establish the extent to which industry-wide implementation of the legislative requirement has actually occurred.

BaFin will only be able to make definitive statements about the outcome of the request for information during the course of 2016. However, it is apparent from the insurers' answers relating to the implementation of the regulation on the liability periods for cancellations that the statutory provision is enabling the legislators' requirements to be implemented effectively in practice.

## 2.5 Money laundering prevention

The department for the prevention of money laundering also carried out on-site inspections at insurance undertakings in 2015, in order to monitor whether they are complying with

the requirements on the prevention of money laundering and the financing of terrorism. Banking-related transactions represented one of the priority areas for the inspections. These include in particular mortgage loans and transactions with customers similar to overnight deposits. Given their irregular payment flows in comparison with traditional life insurance, it is more likely that deposit accounts will be used for money laundering.

### Inadequate integration into money laundering prevention

The inspections demonstrated that in many cases these products were not adequately integrated into the insurance undertakings' procedures for the prevention of money laundering. As a result of these findings, among other things, the inspections therefore turned their attention to monetary transactions flowing from and to the insurance undertakings. This revealed occasional discrepancies between the registered and actual account holders. In order to prevent possible front-man transactions, BaFin advised the undertakings to review their payment flows on a regular basis for indications of divergences from the registered account holders.

In 2015, BaFin continued its close discussions with the German Insurance Association (*Gesamtverband der Deutschen Versicherungswirtschaft e. V.* – GDV) on questions relating to money laundering prevention. The knowledge accumulated in this process and in the course of supervisory practice will also be reflected in the implementation of the Fourth Anti-Money Laundering Directive.[65] Conversely, this knowledge will be incorporated in the revision of the GDV's interpretation and application guidance notes agreed in consultation with BaFin.

# 3 Supervision of undertakings

## 3.1 Authorised insurance undertakings and *Pensionsfonds*

The number of insurance undertakings supervised by BaFin declined slightly in 2015. At the end of the year under review, BaFin supervised a total of 567 insurance undertakings (previous year: 573) and 31 *Pensionsfonds*. Out of the total number of insurance undertakings, 539 were engaged in business activities and 28 were not. In order to give as full a picture as possible of the insurance market in Germany, all of the information in the rest of this chapter also includes eleven public-law insurance undertakings supervised by the federal states – ten conducting business activities and one without business activities. The breakdown by segments is shown in table 24 (page 195).

### Life insurers

Four German life insurers supervised by BaFin ceased operating in 2015. One Liechtenstein life insurer established a branch office in Germany.

One branch of an undertaking from Ireland ceased operating. Nine insurers from the European Economic Area (EEA) registered for the cross-border provision of services in Germany (see Table 25 "Registrations by EEA life insurers in 2015", page 195).

### Health insurers

The number of German health insurers supervised by BaFin in 2015 remained unchanged at 47 undertakings.

### Property and casualty insurers

Two property/casualty insurance undertakings terminated their activities. Two undertakings

65 Directive (EU) 2015/849, OJ EU L 141/73.

**Table 24** Number of supervised insurance undertakings and *Pensionsfonds**

As at 31 December 2015

| | Insurers with business activities | | | Insurers without business activities | | |
|---|---|---|---|---|---|---|
| | BaFin supervision | Federal states supervision | Total | BaFin supervision | Federal states supervision | Total |
| Life insurers | 84 | 3 | 87 | 9 | 0 | 9 |
| *Pensionskassen* | 140 | 0 | 140 | 4 | 0 | 4 |
| Funeral expenses funds | 35 | 0 | 35 | 2 | 0 | 2 |
| Health insurers | 47 | 0 | 47 | 0 | 0 | 0 |
| Property/casualty insurers** | 205 | 7 | 212 | 8 | 1 | 9 |
| Reinsurers | 28 | 0 | 28 | 5 | 0 | 5 |
| **Total** | **539** | **10** | **549** | **28** | **1** | **29** |
| *Pensionsfonds* | 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 federal states (BaFin 2014 statistics – Primary insurers and *Pensionsfonds*, page 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 projection for health insurers in chapter IV 3.3.3.2.

received new authorisations. Four property/casualty insurance undertakings established a branch office in Germany. One branch of an undertaking from the United Kingdom and one from Romania ceased operating. 51 insurers from the EEA registered for the cross-border provision of services in Germany. Other insurers that had already registered for the cross-border provision of services in Germany reported an expansion in their business activity.

**Table 25** Registrations by EEA life insurers in 2015

As at 31 December 2015

| Country | CBS* | BO** |
|---|---|---|
| Croatia | 1 | |
| France | 1 | |
| Ireland | 1 | |
| Liechtenstein | | 1 |
| Luxembourg | 1 | |
| Malta | 1 | |
| Netherlands | 1 | |
| Sweden | 1 | |
| United Kingdom | 2 | |

* CBS = Cross-border provision of services within the meaning of section 61 (3) of the VAG.
** BO = Branch office business within the meaning of section 61 (2) of the VAG.

### Reinsurers

The number of active reinsurers decreased to 28 in the year under review. 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*, *Pensionsfonds* and funeral expenses funds

Three *Pensionskassen* ceased operating and one was established. One funeral expenses fund ceased taking on new business,

## 3.2 Economic environment

The main characteristics of the economic environment in Germany in 2015 were stable growth and low unemployment. Employees' wages and salaries increased noticeably. German insurers' premium income rose slightly by 0.5% to €193.6 billion, according to the GDV's preliminary figures.

**Table 26** Registrations by EEA property and casualty insurers in 2015

As at 31 December 2015

| Country | CBS* | BO** |
|---|---|---|
| Belgium | 1 | |
| Croatia | 2 | |
| Czech Republic | 1 | |
| Denmark | 1 | |
| France | 3 | |
| Ireland | 3 | |
| Italy | 1 | |
| Liechtenstein | | 1 |
| Malta | 1 | |
| Netherlands | 28 | |
| Norway | 1 | |
| Poland | 1 | |
| Slovakia | 1 | |
| Slovenia | 1 | |
| Czech | 1 | |
| United Kingdom | 6 | 3 |
| of which Gibraltar | 1 | |

* CBS = Cross-border provision of services within the meaning of section 61 (3) of the VAG.
** BO = Branch office business within the meaning of section 61 (2) of the VAG.

The principal risk for insurance undertakings, as before, is the low interest-rate environment. During the course of the year, the yield on ten-year German government bonds rose slightly for the first time for many years; however, the yield then fell sharply in response to the European Central Bank's expansionary monetary policy and, according to Thomson Reuters, declined to a new low of less than 0.08% in April.

The insurers were affected as before by the financial and sovereign debt crisis. It was apparent that insurance securities are sensitive to changes in the political environment. This was reflected both in the share prices of the insurers and in their CDS spreads (see Figure 8 "Sector index for German insurance shares" and Figure 9 "CDS spreads for selected insurers", page 197).

### Insurance shares higher

The insurance index moved in line with the German DAX equity index in the first half of 2015. The basic mood of confidence initially benefited the shares of the insurers and the market as a whole. But the turbulence surrounding Greece then had a lasting negative effect on the stock exchanges. The economic slowdown in the People's Republic of China on the whole affected the insurers less than other DAX stocks. The insurance index and the DAX drifted apart in the autumn. In the

**Figure 8** Sector index for German insurance shares

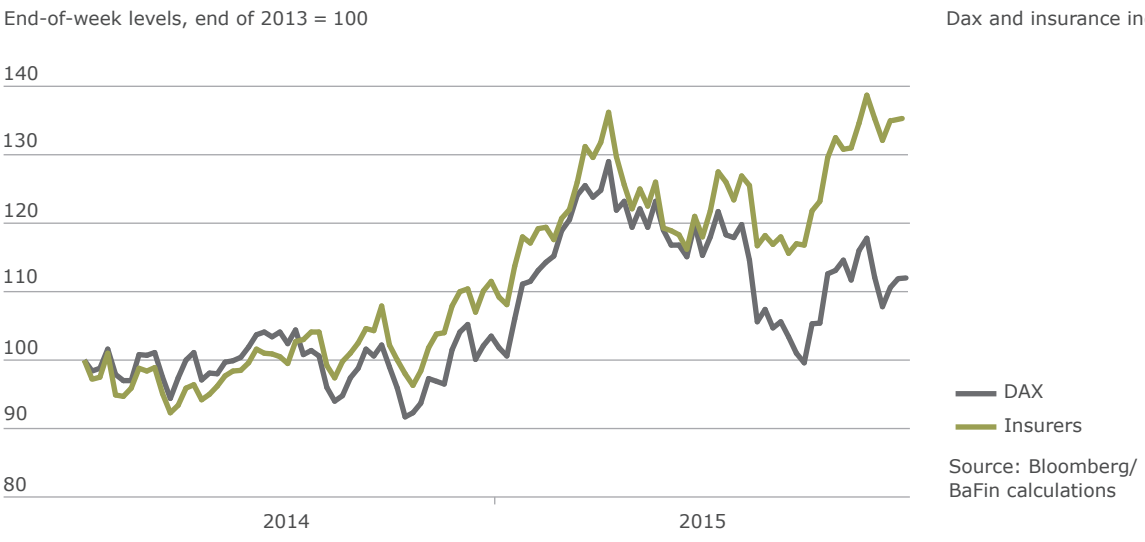
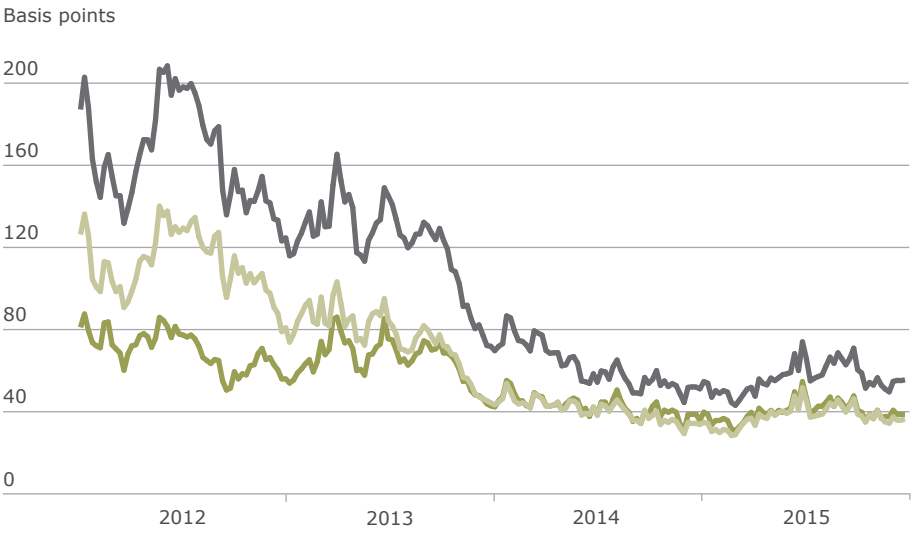


**Figure 9** CDS spreads for selected insurers




final analysis, insurance share prices recorded significantly more growth over the course of 2015 than the DAX, which increased by 9.6%.

### CDS spreads slightly higher

The CDS spreads of European insurers rose slightly in 2015, with the spreads for the German insurers Allianz and Munich Re constantly around 20 basis points below the European average. In the interim, the tough negotiations with Greece on a further aid programme pushed CDS spreads upwards to a small extent, despite the fact that the insurers held very few remaining Greek investments. On the whole, however, spreads remained significantly below the figures for the crisis years from 2011 to 2013.

The rating agencies assessed the outlook for life insurers in 2015 as stable to negative.[66] This was mainly due to the continuing low interest-rate scenario and changes in the regulatory environment, especially as a result of Solvency II. The future requirement for higher capital backing will apply particularly to products with long-term guarantees, which are typical for the German market. The wide-ranging product portfolio and the healthy profitability of less interest rate-sensitive products counted as plus points for the rating assessment.

The outlook for non-life insurers, in contrast, was assessed as positive. The absence of major loss events was reflected in a renewed improvement in the combined ratio in 2015. For 2016, the rating agencies are expecting growth in premiums, as in the previous year. They do not anticipate any negative effects from Solvency II.

### Moderate loss levels

Global losses from natural disasters once again remained below the long-term average in 2015. Loss levels amounted to US$90 billion while insured losses were US$27 billion. The loss levels were 18% lower than in the previous year and 50% below the ten-year average. Insured losses amounted to US$27 billion, 13% lower than in the previous year.

Windstorm events were responsible for the largest insured losses. A winter storm in the USA at the end of February was responsible for overall losses of US$2.8 billion, while the insured loss amounted to US$2.1 billion. The largest loss event in Europe was Storm Niklas which caused total losses of US$1.4 billion, with an insured loss of US$1 billion.

The largest humanitarian catastrophes were the earthquake in Nepal with 9,000 deaths and the heatwave in Pakistan with 3,670 deaths.[67]

66 Sources: Thomson Reuters, Bloomberg, Fitch, Moodys.

67 Source: Munich Re NatCatSERVICE, 2016.

## 3.3 State of the insurance sector

### 3.3.1 Investments by insurers overview[68]

As at 31 December 2015, the carrying amount of the aggregate investments by German insurers supervised by BaFin amounted to €1,659.0 billion (previous year: €1,591.2 billion), see Table 27, page 199. Broken down by insurance classes, health insurers (+5.9%) and *Pensionskassen* (+6.3%) recorded the largest percentage increases. Aggregate investments by all primary insurers supervised by BaFin increased by 4.2% in 2015 to €1,408.8 billion (+€56.4 billion). Aggregate investments by reinsurers increased by 4.8% in 2015 to €250.2 billion (+€11.4 billion).

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 12.0% to €275.4 billion in the year under review, while the share of investments at credit institutions again declined year on year, not least due to the persisting very low interest rate environment. Indirect investments held by insurance undertakings via investment funds recorded above-average growth in 2015, rising by +10.2%, and – as in the previous year – now account for over a quarter of all investments or €492.2 billion. The assets acquired via investment funds relate predominantly to listed securities.

Aggregate direct investments in property rose by 3.2% year on year to €35.8 billion.

### 3.3.2 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 28 (page 200) 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 totalled €1,361.9 billion as at 31 December 2015 (previous year: €1,308.7 billion).

In accordance with section 3 (3) sentence 1 of the German Investment Regulation (*Anlageverordnung* – AnlV), insurance undertakings can invest up to 35% of their restricted assets in investments associated with a higher level of risk. Specifically, these risk investments include directly or indirectly held investments in equities, profit participation rights and subordinated debt assets, as well as hedge funds and investments linked to commodity risks. In addition to high-yield bonds and investments in default status, the risk asset ratio also includes certain units in funds that are risky or cannot be clearly assigned to other investment types.

The risk asset ratio for primary insurers at the end of 2015 was 13.1% of their restricted assets, slightly higher in comparison with the previous year (11.8%). 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 10.7% for health insurers to 17.0% for property/casualty insurers.

The largest individual item within risk assets was investments in equities (mostly listed) held through funds, which accounted for 4.7% of restricted assets (previous year: 3.9%). The trend seen in previous years of primarily acquiring shares via funds continued.

There were minor changes in alternative investments (see Table 29 "Share of total investments attributable to selected asset classes", page 201) compared with the figures for the previous year: directly and indirectly held asset-backed securities and credit-linked notes as well as investments in hedge funds and commodities rose slightly.

68 See chapter IV 3.3.3 for details on investments by individual insurance classes and *Pensionsfonds*.

## Table 27 Investments by insurance undertakings

| Investments by insurance undertakings | Portfolio as at 31 December 2015 | | Portfolio as at 31 December 2014 | | Change in 2015 | |
|---|---|---|---|---|---|---|
| | in € million | in % | in € million | in % | in € million | in % |
| Land, land rights and shares in real estate companies, REITs and closed-end real estate funds | 35,781 | 2.2 | 34,659 | 2.2 | 1,122 | 3.2 |
| Fund units, shares in investment stock corporations and investment companies | 492,217 | 29.7 | 446,857 | 28.1 | 45,360 | 10.2 |
| Loans secured by mortgages and other land charges and shareholder loans to real estate companies | 57,143 | 3.4 | 55,513 | 3.5 | 1,630 | 2.9 |
| Securities loans and loans secured by debt securities | 668 | 0.0 | 519 | 0.0 | 149 | 28.7 |
| Loans to EEA/OECD states, their regional governments and local authorities and international organisations | 128,925 | 7.8 | 127,251 | 8.0 | 1,674 | 1.3 |
| Corporate loans | 17,379 | 1.0 | 16,391 | 1.0 | 988 | 6.0 |
| ABSs/CLNs | 8,213 | 0.5 | 7,610 | 0.5 | 603 | 7.9 |
| Policy loans | 3,350 | 0.2 | 3,794 | 0.2 | -444 | -11.7 |
| *Pfandbriefe*, municipal bonds and other debt instruments issued by credit institutions | 224,572 | 13.5 | 236,930 | 14.9 | -12,358 | -5.2 |
| Listed debt instruments | 275,358 | 16.6 | 245,867 | 15.5 | 29,491 | 12.0 |
| Other debt instruments | 25,490 | 1.5 | 23,449 | 1.5 | 2,041 | 8.7 |
| Subordinated debt assets/profit participation rights | 31,454 | 1.9 | 29,697 | 1.9 | 1,757 | 5.9 |
| Book-entry securities and open market instruments | 626 | 0.0 | 627 | 0.0 | -1 | -0.2 |
| Listed equities | 6,557 | 0.4 | 6,778 | 0.4 | -221 | -3.3 |
| Unlisted equities and interests in companies, excluding private equity holdings | 134,821 | 8.1 | 129,941 | 8.2 | 4,880 | 3.8 |
| Private equity holdings | 14,851 | 0.9 | 12,902 | 0.8 | 1,949 | 15.1 |
| Investments at credit institutions | 167,034 | 10.1 | 180,647 | 11.4 | -13,613 | -7.5 |
| Investments covered by the enabling clause | 21,272 | 1.3 | 19,072 | 1.2 | 2,200 | 11.5 |
| Other investments | 13,249 | 0.8 | 12,708 | 0.8 | 541 | 4.3 |
| **Total investments** | **1,658,961** | **100.0** | **1,591,215** | **100.0** | **67,746** | **4.3** |
| Life insurers | 851,494 | 51.3 | 822,743 | 51.7 | 28,751 | 3.5 |
| *Pensionskassen* | 147,694 | 8.9 | 138,994 | 8.7 | 8,701 | 6.3 |
| Funeral expenses funds | 2,076 | 0.1 | 2,050 | 0.1 | 26 | 1.3 |
| Health insurers | 246,939 | 14.9 | 233,181 | 14.7 | 13,759 | 5.9 |
| Property/casualty insurers | 160,599 | 9.7 | 155,439 | 9.8 | 5,160 | 3.3 |
| Reinsurers | 250,158 | 15.1 | 238,808 | 15.0 | 11,350 | 4.8 |
| **All insurers** | **1,658,961** | **100.0** | **1,591,215** | **100.0** | **67,746** | **4.3** |
| Primary insurers | 1,408,803 | 84.9 | 1,352,407 | 85.0 | 56,396 | 4.2 |

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

## Table 28 Composition of the risk asset ratio

As at 31 December 2015

| 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 % | Absolute in € m | Share in % |
| Total investments* | 829,329 | 100.0 | 243,921 | 100.0 | 142,222 | 100.0 | 146,455 | 100.0 | 1,361,927 | 100.0 |
| of which attributable to: | | | | | | | | | | |
| Securities loans (no. 2), where equities (no. 12) are the subject of the loan | 108 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 108 | 0.0 |
| Subordinated debt assets and profit participation rights (no. 9) | 14,684 | 1.8 | 3,633 | 1.5 | 2,044 | 1.4 | 2,382 | 1.6 | 22,743 | 1.7 |
| Listed equities (no. 12) | 825 | 0.1 | 140 | 0.1 | 157 | 0.1 | 35 | 0.0 | 1,157 | 0.1 |
| Unlisted equities and interests in companies (no. 13) | 16,737 | 2.0 | 4,870 | 2.0 | 4,667 | 3.3 | 1,449 | 1.0 | 27,723 | 2.0 |
| Fund units (nos. 15-17, incl. hedge funds) that | | | | | | | | | | |
| – include equities, profit participation rights, etc. | 35,090 | 4.2 | 8,293 | 3.4 | 11,053 | 7.8 | 9,544 | 6.5 | 63,980 | 4.7 |
| – cannot be clearly assigned to other investment types; fund residual value and non-transparent funds | 16,412 | 2.0 | 3,590 | 1.5 | 2,672 | 1.9 | 2,497 | 1.7 | 25,171 | 1.8 |
| High-yield bonds and investments in default status | 13,510 | 1.6 | 5,007 | 2.1 | 2,814 | 2.0 | 3,824 | 2.6 | 25,155 | 1.8 |
| Increased fund market risk potential** | 10,675 | 1.3 | 566 | 0.2 | 670 | 0.5 | 377 | 0.3 | 12,288 | 0.9 |
| Investments linked to hedge funds (partly already contained in other nos. of the AnlV) | 224 | 0.0 | 47 | 0.0 | 61 | 0.0 | -4 | 0.0 | 328 | 0.0 |
| Investments linked to commodities 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** | **108,265** | **13.1** | **26,146** | **10.7** | **24,138** | **17.0** | **20,104** | **13.7** | **178,653** | **13.1** |

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.
** 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 2015 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 29** Share of total investments attributable to selected asset classes

As at 31 December 2015

| Investment type | Total 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 % | Absolute in € m | Share in % |
| Total investments* | 851,494 | 100.0 | 246,939 | 100.0 | 160,599 | 100.0 | 147,694 | 100.0 | 1,406,726 | 100.0 |
| of which attributable to: | | | | | | | | | | |
| Investments in private equity holdings | 8,567 | 1.0 | 1,484 | 0.6 | 2,728 | 1.7 | 1,004 | 0.7 | 13,783 | 1.0 |
| Directly held asset-backed securities and credit-linked notes | 2,632 | 0.3 | 938 | 0.4 | 915 | 0.6 | 1,167 | 0.8 | 5,652 | 0.4 |
| Asset-backed securities and credit-linked notes held via funds | 4,409 | 0.5 | 992 | 0.4 | 1,173 | 0.7 | 724 | 0.5 | 7,298 | 0.5 |
| Investments in hedge funds and investments linked to hedge funds (held directly and via funds) | 1,420 | 0.2 | 942 | 0.4 | 435 | 0.3 | 312 | 0.2 | 3,109 | 0.2 |
| Investments with commodity risks (held directly and via funds) | 1,078 | 0.1 | 864 | 0.3 | 360 | 0.2 | 48 | 0.0 | 2,350 | 0.2 |

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

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

Source: Sector totals as at 31 December 2015 for life, health and property/casualty insurers, as well as *Pensionskassen*, from financial statement forms 670 and 673, collective decree dated 21 June 2011.

### 3.3.3 Results in the individual insurance classes

The following figures for 2015 are only preliminary. They are based on the interim reporting as at 31 December 2015.

#### 3.3.3.1 Life insurers

##### Business trends

New direct life insurance business fell by 7.7% year on year, from 5.4 million to approximately 5.0 million new policies in 2015. The total value of new policies underwritten nevertheless rose by 0.7% to €252.2 billion compared with €250.6 billion in the previous year.

The share of the total number of new policies accounted for by term insurance policies increased by 0.5 percentage points year on year to 33.1%. The share accounted for by endowment insurance policies declined by 0.7 percentage points in the same period, to 10.1%. This represents a decline from 585,384 new endowment life insurance policies in 2014 to 508,528 in 2015. While the share attributable to pension and other insurance contracts recorded a slight increase, rising by 0.1 percentage points to 56.7%, in absolute terms this represented a decrease from 3,074,497 policies in the previous year to 2,841,740.

Early terminations of life insurance policies (surrender, conversion to paid-up policies and other forms of early termination) declined by 9.5% from 2.6 million contracts in 2014 to just under 2.4 million contracts in the year under review. The total sum insured of policies terminated early fell accordingly to €99.0 billion compared with €104.2 billion in the previous year. The proportion of early terminations of endowment policies declined from 24.7% in the previous year to 22.3%, and the proportion of

the total sum insured decreased from 15.1% to 12.5%.

There were a total of approximately 85.9 million direct insurance contracts in 2015, representing a 2.2% decrease compared with the previous year. By contrast, the sum insured increased by 2.0% to €2,928 billion. Term insurance policies recorded a decrease in the number of contracts – from 14.1 million to 13.4 million – although the sum insured rose from €714.0 billion to €739.3 billion. Pension and other insurance policies continued their positive trend, with the number of contracts growing from 49.1% to 50.9%. The share of the total sum insured rose from 52.2% to 53.5%.

Gross premiums written in the direct insurance business of the German life insurers amounted to €86.9 billion in the year under review (previous year: €88.6 billion). This represented a 1.9% decline.

### Investments

Aggregate investments increased from €819.3 billion to €844.1 billion (+3.0%). Since interest rates on the capital market increased slightly, net hidden reserves at the end of the year decreased to €132.1 billion (previous year: €163.8 billion). This corresponds to 15.5% of the aggregate investments, following 19.9% in the previous year.

Preliminary figures put the average net investment return at 4.50% in 2015, and thus down slightly as compared to the prior-year figure of 4.6%. The reason for the high net return is that the insurers have again liquidated valuation reserves in order to fund the high cost of establishing *Zinszusatzreserven* (additional provisions to the premium reserve introduced in response to the lower interest rate environment).

### Projections

BaFin prepared two projections for life insurers in 2015: the first as at 30 June and the second as at 30 September 2015. BaFin uses projections to analyse how four different capital market scenarios stipulated by it affect the insurers' performance for the current financial year.

For the projection as at 30 June, the insurers had to simulate how a 200 basis point rise in interest rates and cancellation of 40% of the insurance portfolio would affect their current profit for the year with regard to the premium reserve. A combined scenario involving an increase in interest rates and in cancellations also enables BaFin to estimate how a significant short-term increase in interest rates and a change in consumer behaviour would affect 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.

For the projection as at 30 September, the insurers had to simulate the impact of a 22% drop in equity prices and a 50 basis point rise in interest rates on their current profit for the year. In addition, the insurers were also required to make projections for the next four financial years.

The analysis of the projections confirmed BaFin's assessment that the life insurers would be able to satisfy their contractual obligations in the short term. However, should interest rates remain low, it is to be expected that the economic position of the undertakings will deteriorate further. BaFin will therefore continue to monitor the insurers closely to ensure that they analyse their future financial development at an early stage and in a forward-looking and critical manner in a continued low interest rate phase. It is essential that the life insurers introduce appropriate measures in time and make the relevant preparations.

### Solvency

According to the projection as at 31 December 2015, all life insurers meet the solvency requirements set out in Solvency I. However, the downward trend of recent years continues: while the solvency margin ratio was still 162%

in the previous year, it declined slightly in 2015 to a projected figure of 159%.

### Results of the second comprehensive life insurance survey *("Vollerhebung Leben")*

Due to the significant decrease in interest rates, BaFin carried out a second comprehensive life insurance survey in 2015 on the own funds situation of all German life insurers within the scope of Solvency II. The survey was conducted as at 31 December 2014.

Virtually all life insurers were able to demonstrate that as at 31 December 2014 they had sufficient own funds. The number of insurers which did not have sufficient own funds did not increase as compared to the first comprehensive survey. Insurers facing potential difficulties at the start of Solvency II are monitored closely by BaFin in order to ensure a sufficient level of own funds.

The second comprehensive survey again confirmed that the transitional measures and the volatility adjustment provided under Solvency II had had the desired effect. Nevertheless, life insurers will have to make considerable efforts to strengthen their capital base during the 16-year transitional period if the low interest rate phase persists. They will have to raise additional own funds amounting to a cumulative €12 billion during this period.

The Solvency II coverage ratios were very sensitive to changes in spreads and interest rates. The life insurance undertakings will therefore have to brace themselves for the possibility that their own funds situation could change sharply within a short period of time.

### Life insurers reduce discretionary bonuses

Because interest rates for new investments are still very low, many life insurers have further reduced their discretionary bonuses for 2016. The current total return, i.e. 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 2.79% for the sector. This figure was 3.06% in 2015 and 3.31% in 2014.

### Development of the *Zinszusatzreserve* (ZZR)

Since 2011, life insurers have been required to establish an additional buffer, the *Zinszusatzreserve*, to provide on the one hand for the lower investment income in the future and the guarantee obligations on the other, which remain high. They spent a good €10.7 billion on this in 2015. The cumulative ZZR therefore stood at an absolute amount of €32.0 billion at the end of 2015. The reference interest rate used to calculate the ZZR was 2.88% at the end of 2015.

### Review of the ZZR

It can be expected in the years to come that a considerable effort will continue to be necessary to build up the ZZR. Although in general it remains the right tool for securing policyholders' guarantees for the long term in low interest rate periods, BaFin will keep a close eye on how things develop throughout the industry and at individual insurers. If the need arises, it will examine whether the ZZR has been adequately calibrated.

## 3.3.3.2 Private health insurers

### Business trends

The 47 private health insurers supervised by BaFin generated premium income totalling around €36.7 billion in 2015. This represents an increase of approximately 1.1% as compared to 2014. The growth in premiums was slightly higher than in the previous year. One particular reason for the continued low rate of premium growth is that comprehensive health insurance has been experiencing a slight gradual decline due to the fact that new business remains weak.

Nevertheless, comprehensive health insurance, with around 8.8 million persons insured and premium income of €26 billion and thus 71% of the total premium income, continued to be the most important business line by far for the private health insurers in 2015. Together with the other types of insurance, such as compulsory long-term care insurance, daily benefits insurance and the other partial health insurance types, the private health insurance undertakings insure approximately 40 million people.

### Investments

The health insurers increased their investment portfolio by 6.3% to approximately €247 billion in the year under review. Investments remain focused on fixed-income securities. *Pfandbriefe*, municipal bonds and other debt instruments accounted for approximately 18% of all investments. These were also the largest single item in the portfolio of direct investments. Listed debt instruments accounted for a further 16%, while promissory note loans and registered bonds issued by credit institutions accounted for 17%. The health insurers invested around 26% of their portfolio in investment funds. BaFin did not identify any significant shifts between the asset classes.

The main macroeconomic factor affecting private health insurers is currently the low interest rate environment, reflecting measures taken by the ECB. During the year under review, interest rates remained roughly at the same extremely low level as in the previous year. The health insurers' reserve situation therefore remains comfortable, especially in light of high valuation reserves in fixed-income securities. At 31 December 2015, net hidden reserves in investments amounted to just under €39 billion, or roughly 16% of investments (previous year: 20%).

Preliminary figures put the average net investment return at around 3.5% in the year under review, and therefore below the previous year's level (3.9%).

### Projections

The health insurers also prepared projections in 2015 that were submitted to BaFin. The objective of the exercise was to simulate the effects of unfavourable developments on the capital market on their performance and financial stability.

The projection as at the 30 September 2015 reference date focussed on examining the medium-term impact of the low interest rates on the health insurers. For this purpose, BaFin collected data on the developments forecast for the 2015 financial year and the following four years in different adverse capital market scenarios. In one scenario, it assumed that new investments and reinvestments were made exclusively in ten-year *Pfandbriefe* with an interest rate of 1.08%. In a second scenario, the health insurers could simulate new investments and reinvestments according to their individual corporate planning.

Forty insurers participated in the projection as at 30 September 2015. BaFin exempted just eight insurers that offer Non-SLT health insurance from participating. The undertakings involved do not have to establish a provision for increasing age and do not have to generate a specific technical interest rate.

The overall conclusion is that a continuation of the low interest rate environment would be tolerable for the health insurers from an economic perspective. As expected, the data presented demonstrate that a low interest rate scenario results in a (further) materialisation of new investment and reinvestment risk and therefore in a reduction in the returns from investments. This conclusion implies the need to lower the technical interest rate in stages when adjusting premiums. The premium adjustment mechanism will have a significant beneficial effect for the health insurers even if the current low interest rate environment persists.

### Solvency

All health insurers comply with the solvency requirements according to the projection as at 31 December 2015. The target solvency margin ratio for this sector is expected to be around 280% and therefore higher than the approximately 260% reported in the previous year. The sector thus continues to have a good level of own funds.

### Problems with the actuarial corporate interest rate

All but two insurers which offer SLT health insurance contracts were no longer able to demonstrate that they would continue to be able to generate with the required high degree of certainty the maximum technical interest rate of 3.5% in the future, as set out in the

### Actuarial corporate interest rate

The business model of SLT health insurance (operated Similar to Life techniques) is based on premium rates which must be reviewed annually in accordance with the relevant statutory requirements to ascertain whether they are appropriate or whether they require adjustment. All assumptions underlying the calculation of premiums are subject to review – particularly those pertaining to the development of net returns on investments. Insurers estimate this development and the safety margin which must additionally be factored into these assumptions on the basis of the actuarial corporate interest rate (ACIR) developed by the German Actuaries Association (*Deutsche Aktuarvereinigung* – DAV). Insurers must report their ACIR to BaFin each year. This determines whether they are also required to lower the technical interest rate for existing tariffs if they are required to adjust their premiums.

Health Insurance Supervision Regulation (*Krankenversicherungsaufsichtsverordnung* – KVAV; formerly the Calculation Regulation (*Kalkulationsverordnung* – KalV). This was the finding of the 2015 Actuarial Corporate Interest Rate Process (ACIRP), i.e., the forecasts of the actuarial corporate interest rate (ACIR) prepared by the insurers for the 2016 financial year (see "Actuarial Corporate Interest Rate" info box). In light of the persistent low interest rate phase, which is having an ever-increasing impact on the return on investments, many health insurers are reporting ACIR figures which are in some cases significantly lower than in previous years. This will also have an impact on the upcoming premium adjustments.

In addition, section 11 (2) of the Health Insurance Supervision Calculation – which refers to the calculation of premiums upon premium adjustment – now permits insurers to spread over several years the effects of premium adjustments on their economic performance resulting from the required adjustment of the technical interest rate. This is designed in the interest of the policyholder so that premiums develop more steadily overall and unreasonable premium hikes are avoided. The number of levels is limited in the interest of a stable calculation. The ability to use further means to limit premium adjustments remains explicitly unaffected.

## Stability of premiums in old age

Stable premiums for members of private health insurance undertakings constitute a significant topic, particularly for older policyholders. The current low interest rate environment and the adjustments to the technical interest rate that have become ever more common since this environment arose, have led to a direct increase in the premiums of older insureds. In 2015, in keeping with its mandate to ensure collective consumer protection, BaFin surveyed the health insurers. This survey was conducted to ascertain the scope of the task that lies before it. Also under examination were the effectiveness of existing tools, the options for further refining them and the appropriateness of measures which have already been discussed or which may need to be implemented in the future.

The survey found that given the present legal framework, a relative stabilisation of private health insurance premiums for older policyholders can be expected in general across the industry over the medium term. Longer-term projections reveal, however, that if the general economic conditions remain unchanged, there could be developments which at least in individual cases would require countermeasures. For this reason, the insights gained should be updated at regular intervals.

## Health apps

The collection of health-related data by insurers is a topic which has been the subject of much public debate. Technical gadgets such as smartphone and tablet apps are often mentioned in this context, as are wearables which are designed to measure the wearers' movement, pulse, calorie consumption and other sensitive data. Those who agree to the

collection and processing of such data receive bonuses in return, such as discounts, gifts and gift certificates.

Aside from the question as to whether the relevant data protection requirements are being complied with, many other factors determine whether possible products in the area of private health insurance are compliant with the law. At any rate, the rights of insured persons to switch tariffs must be guaranteed. One consequence of this is that private health insurers may factor in deteriorating health after an insurance contract is entered into, even if there has been a switch in tariffs, only if this relates to any additional benefits under the desired target tariff.

Any special withdrawals from the provisions for bonuses in connection with such products must be made in a manner which ensures that the usual principles, particularly the principle of equal treatment, will be observed. However, the extent to which the use of wearables can in fact lead to potential savings which would justify such withdrawals or price discounts remains questionable in light of current knowledge. In BaFin's view, this must be clarified on a case-by-case basis.

In addition, the applicable legislation strictly limits private health insurers' ability to restrict eligibility for coverage under individual health insurance tariffs.

### Insurance terms and conditions

In accordance with section 158 (1) no. 1 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) (prior to 31 December 2015: in accordance with section 13d no. 7 of the VAG) private health insurers must notify BaFin if they intend to apply new or modified general terms and conditions of insurance for comprehensive health insurance tariffs. The conditions under which changes to general terms and conditions may be implemented with effect on existing contracts is a topic which is frequently debated in this connection.

In BaFin's view, any unilateral amendment to terms and conditions by the insurer that affects existing contracts must be measured against section 203 (3) of the Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG). Given the significance of the modification of the current policy, the requirements of the provision must be interpreted narrowly. Although no expected effect on equivalence between coverage and consideration can be made mandatory based on the wording, the modification of the policy must be material. This should be assumed if it is expected that equivalence will be affected. The terms and conditions may be amended to include or exclude individual benefits if the conditions set out in section 203 (3) of the Insurance Contract Act have been met.

A limitation to this is where the nature of the original tariff is completely changed due to the change in benefits and coverage. Changes in legislation can also give rise to the right to amend terms and conditions. If the legislation changes, the terms and conditions may generally not be amended. The exception to this is where a ruling of the highest court is changed; however, a change in the interpretation of general terms and conditions and terms and conditions of tariffs is not sufficient. Other amendments may be made in individual cases in accordance with the principle of transparency in the event of formal and editorial amendments or clarifications. Such amendments must appear necessary in order to sufficiently safeguard the interests of insured persons. This means that without such amendments, insured persons would have to be likely to suffer a detrimental impact to their interests. The interests of the policyholders as a whole are relevant in this context. An improvement for the policyholders as a group may also give rise to a detrimental effect for individual policyholders or with respect to individual benefits. The interests of the policyholders as a group are primarily to ensure that the insurers are always able to fulfil their obligations under the insurance contracts and that the primary benefits of the insurance contract remain intact. The appropriateness assessment can also factor in the cost implications at the expense of the policyholders.

When reviewing the general insurance policy conditions in 2015, BaFin found that not every insurer examined their conditions to a sufficient extent to determine whether the strict requirements of the provision were complied with. BaFin expects the private health insurers to take due account of this.

### 3.3.3.3 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 2015 to €69.2 billion (previous year: €66.1 billion).

Gross expenditures for claims relating to the year under review increased by 9.7% to €23.6 billion (previous year: €21.5 billion). Gross expenditures for claims relating to prior years fell by 3.5% to €16.8 billion. Provisions recognised for individual claims relating to the year under review amounted to €18.4 billion, compared with €17.9 billion in the previous year; provisions recognised for individual claims relating to prior years amounted in total to €56.3 billion, compared with €55.7 billion in the previous year.

With gross premiums written amounting to €24.7 billion, motor vehicle insurance was by far the largest insurance class. This represented growth of 4.7% over the previous year. As in the previous years, the increase is attributable both to a rise in the number of policies and to higher average premiums. Gross expenditures for claims relating to the year under review increased by 5.8% year on year, while gross expenditures for claims relating to previous years were down 5.8%. Overall, gross provisions recognised for individual claims relating to the year under review declined by 1.6% year on year, while they increased by 1.7% for outstanding claims relating to 2014.

Property and casualty insurers collected premiums of €9.2 billion (+4.6%) for general liability insurance. At €1.0 billion, claims relating to the year under review rose by 1.9% year-on-year. Property and casualty insurers paid out €2.9 billion for claims relating to previous years. Gross provisions for individual claims, which are particularly important in this insurance class, rose by 3.6% to €2.9 billion for outstanding claims relating to the year under review. Gross provisions for outstanding individual claims relating to the previous year rose relatively significantly by 10.4% to €18.0 billion.

Insurers recorded gross fire insurance premiums written of €2.1 billion (+10.5%). Gross expenditures for claims relating to the year under review rose significantly by 36.4% to €667.7 million.

Insurers collected premiums for comprehensive residential buildings insurance and comprehensive contents insurance contracts of €9.0 billion (+5.9%). Expenditures for claims relating to the year under review increased by 12.9% year on year. By contrast, provisions for individual claims fell by 10%. Expenditures for claims relating to prior years were 18.1% lower. Provisions for claims relating to previous years also recorded a substantial decrease of 25.5%.

Premium income for general accident insurance contracts remained virtually unchanged compared with the prior year at €6.4 billion. Gross expenditures for claims relating to the year under review amounted to €392.8 million. €2.3 billion was reserved for outstanding claims relating to the year under review (+4.6%).

#### Solvency

At 319%, the solvency margin ratio for property and casualty insurers at the end of 2014[69] was slightly higher than the previous year's figure of 311%. This increase is attributable to two offsetting trends: on the one hand, the insurers' premium income was higher. This resulted in a significantly higher premium index. At the same time, the lower claims expenditures resulted in the claims index falling. On the other hand, the insurers recorded growth in their own funds due to capital contributions by shareholders and profits retained. This increase was slightly

69 This disclosure related to the year 2014 since there are no projections for property/casualty insurance.

higher than that of the solvency margin required to be established, causing the solvency margin ratio to rise slightly overall.

Overall, two property and casualty insurers did not comply with the solvency requirements as at 31 December 2014. BaFin immediately took appropriate steps to restore the solvency margin coverage. However, the sector's own funds are still at a very high level and significantly higher than the minimum capital requirements.

### 3.3.3.4 Reinsurers

#### Business trends

Reinsurers again experienced a relatively low level of claims in 2015. This year's figures were even lower than the prior-year's low figures. Natural disasters caused total economic losses amounting to US$90 billion worldwide. This amount was thus not only lower than the prior-year figure of US$110 billion but also significantly below the 10-year average of US$180 billion.[70] Of that amount, US$27 billion was insured. This figure was also below the prior-year figure of US$31 billion and below the 10-year average of US$56 billion. This development was due in particular to the fact that the hurricane season was comparatively mild. For ten years now, the US continent has not been affected by very strong hurricanes.

The most significant individual event for the insurance industry in 2015 was a series of severe winter storms in the United States and Canada in February. These storms caused damage totalling US$2.1 billion. In Boston, nearly three metres of snow fell throughout the winter, an absolute record. In Germany, winter storm Niklas, which saw top wind speeds of approximately 200 kilometres per hour and affected broad swathes of central Europe in March, was the most expensive natural disaster. The total economic damage caused by Niklas amounted to approximately US$1.4 billion. Of that amount, US$1 billion was insured.

The reinsurance market continued to battle against excess capacity. The below-average claims expenditures around the world in 2015 intensified the soft market, i.e., a market situation characterised by relatively low reinsurance prices. This applied in particular to the coverage of natural disaster risks, which was reflected in a further fall in prices. However, the premium erosion appears to be slowing overall. Nevertheless, a broad stabilisation of prices is not evident. Another major factor putting pressure on reinsurance premiums, in addition to the lack of claims affecting the market, was the continuing inflow of alternative capital.

Hedge funds and *Pensionsfonds* are increasingly investing in catastrophe bonds and collateralised reinsurance. The market for catastrophe bonds (insurance-linked securities – ILS) remained at a high level in 2015 with an issue volume of over US$7.9 billion. The total amount of catastrophe bonds in circulation even reached a record high of more than US$26 billion.[71] The relatively handsome returns in the ILS market are increasingly attracting investors whose search for yield – intensified by the continuing low interest rate environment – does not stop at new and unfamiliar market segments. The next rise in interest rates and future natural disasters causing heavy losses will show whether these investors are committed for the long term.

Overall, competitive pressure in the reinsurance market continued to increase. The combination of persistent capital inflows into the reinsurance market, below-average claims expenditures and declining investment income due to the persistent low-interest rate phase increased the pressure on profitability in the reinsurance business. The challenge for reinsurers during the forthcoming renewals is to maintain prices at a level that is adequate to cover the risks insured and to resist downward pressure on prices at the expense of returns.

70 Swiss Re: Press release dated 18 December 2015.

71 ARTEMIS: Artemis website: Accessed on 23 December 2015.

### Solvency

At the end of 2014, the supervised reinsurers in Germany had own funds amounting to €72.9 billion (previous year: €73.3 billion). As at the same date, the solvency margin was €8.4 billion (previous year: €7.7 billion). As a result, the solvency margin ratio fell to 865.9% (previous year: 954.3%).

As before, the reason for the high level of own funds was a feature specific to the sector: reinsurers also frequently assume the function of holding 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 247.0% in 2014 for reinsurers supervised in Germany (previous year: 259.6%). The lower average solvency ratio was attributable to disproportionately increased solvency margins.

## 3.3.3.5 *Pensionskassen*

### Business trends

According to the projection as at the 2015 reporting date, the amount of premium income for all *Pensionskassen* in 2015 fell year on year. Premium income amounted in total to approximately €6.1 billion in the year under review, a year-on-year decrease of around 7.4%. In 2014, it had increased by 2.4%.

Premium income for the stock corporations newly formed since 2002, which offer their benefits to all employers, increased slightly to approximately €2.8 billion.

In the case of mutual associations *(Vereine auf Gegenseitigkeit)* funded largely by employers, premium income trends depend on the headcount at the sponsoring company. The premium income of these *Pensionskassen* fell year on year. It amounted to around €3.3 billion, as compared with €3.9 billion in the previous year.

### Investments

The aggregate investment portfolio of the *Pensionskassen* supervised by BaFin increased by around 6.5% in 2015 to approximately €148.2 billion (previous year: €139.1 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.

Given that in 2015, interest rates, which have been low for years, continued to remain at a very low level, the valuation reserves in the industry changed only slightly year on year. Based on preliminary figures, the *Pensionskassen* reported hidden reserves across all investments of approximately €21.6 billion at the end of the year (previous year: €25.3 billion). This corresponds to roughly 14.6% of the aggregate investments (previous year: 18.1%). The hidden liabilities were negligible at 0.6% overall.

### Projections

BaFin prepared a projection for the *Pensionskassen* as at 30 September 2015. Undertakings were asked to estimate their results for the financial year under four equity and interest rate scenarios. As in the previous year, the projections also encompassed the four following financial years in view of the continuing low level of interest rates.

The *Pensionskassen* are not subject to the new Solvency II regime. The projections revealed that the solvency margin ratio was lower than the prior-year level. As a general rule, the undertakings meet the solvency requirements; the sector's short-term risk-bearing capacity therefore seems to be assured as before. Based on the projections, the net return on investment for all *Pensionskassen* was approximately 3.9% in 2015, lower than the figure for the previous year (4.2%). The persistently low interest rates are also posing particular challenges for the *Pensionskassen* (see info box on page 210). The projections reveal clearly that the gap 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 will become increasingly difficult for these *Pensionskassen* to finance increases in reserves that then prove to be necessary.

### Solvency

The solvency margin ratio for the *Pensionskassen* was an average of 132% as at the 2015 reporting date, lower than the figure for the previous year (136%). According to the estimates, one *Pensionskasse* was unable to meet the solvency margin ratio in full as at 31 December 2015. This *Pensionskasse* has already contacted BaFin in order to develop measures aimed at improving its risk-bearing capacity.

**Impact of the low interest rate environment**

The low interest rate environment represents a considerable burden on the *Pensionskassen* as well. BaFin therefore continues to monitor and assist the *Pensionskassen* intensively so that they can maintain and further strengthen their risk-bearing capacity as best as possible even in a long-term low interest rate environment.

The *Pensionskassen* have taken measures to maintain their risk-bearing capacity early on; this is also underlined by the results of the projection mentioned above. Almost every *Pensionskasse* has recognised additional provisions. However, it appears that if the low interest rate environment persists, certain *Pensionskassen* will require additional funds.

As a rule, *Pensionskassen* with the legal form of stock corporations belong to guarantee schemes in accordance with section 223 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG). If an employer appoints a *Pensionskasse* to be responsible for occupational retirement provision for its employees, the employer is obliged to pay the benefits to the employees itself if necessary, in accordance with its subsidiary liability under the Occupational Pensions Act *(Betriebsrentengesetz)*. This gives the beneficiaries and pensioners additional security.

## 3.3.3.6 *Pensionsfonds*

### Business trends

*Pensionsfonds* recorded gross premium income of €2,170 million in 2015. This represents a substantial increase over the prior year (€1,648 million). The fluctuations in premium income are attributable in particular to the fact that, in the case of *Pensionsfonds*, the premiums are often paid as a single premium, depending on the type of commitment agreed.

The total number of beneficiaries fell in the year under review to 889,247 persons compared with 949,038 persons in the prior year. Of those, 560,666 were vested employees who were members of defined contribution pension plans while 39,261 vested employees were members of defined benefit plans. The majority of *Pensionsfonds* authorised in previous years were pension plans with non-insurance-based benefit commitments in accordance with section 236 (2) of the Insurance Supervision Act. With this form of benefit commitment, the employer is obliged to pay premiums also in the payout phase. Benefit payouts decreased from €1,900 million to €1,643 million in the year under review. The payouts were made to 286,493 persons who drew benefits.

### Investments

Investments for the account and at the risk of *Pensionsfonds* grew from €1,780 million to €2,190 million in the year under review. This corresponds to an increase of 23% in investments (previous year: +11.1%). *Pensionsfonds* portfolios were dominated by contracts with life insurers, bearer bonds, other fixed-income securities and investment units. As at 31 December 2015, net hidden reserves in the investments made by *Pensionsfonds* amounted in total to approximately €127.5 million. Assets administered for the account and at the risk of

employees and employers fell only slightly in 2015, from approximately €29.5 billion in the previous year to €29.4 billion. Roughly 93% 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). All 31 *Pensionsfonds* supervised by BaFin at the end of the 2015 reporting year were able to cover their technical provisions in full. 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 2015, BaFin asked all 31 *Pensionsfonds* to submit a projection as at 30 September. 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 22% drop in prices. In addition, it required scenarios to be calculated that combined each of the two above-mentioned scenarios with a 50 basis point increase in the yield curve. The assessment of the projections indicated that the 31 *Pensionsfonds* included are able to withstand the defined scenarios financially.

*Pensionsfonds* generally do not offer guarantees for the obligations assumed. The few guaranteed obligations assumed are, moreover, in part covered by congruent reinsurance. However, BaFin considers it necessary for the *Pensionsfonds* to also examine the potential medium- and long-term ramifications of a low interest rate phase that persists over the long term. Therefore, the *Pensionsfonds* also were required to estimate, together with the projection, their expenses for the *Zinszusatz-reserve* for the four financial years following the current financial year and to state whether they expect that the expense can be covered by corresponding income and whether they expect that the solvency requirements will continue to be met in the future. Of 21 *Pensionsfonds* which operate insurance-based business, only nine were required thus far to establish a *Zinszusatz-reserve*. These nine *Pensionsfonds* are currently financed through congruent reinsurance cover or through current income.

### Solvency

According to the 2015 projection, all *Pensionsfonds* supervised had sufficient free uncommitted own funds. They therefore complied with BaFin's solvency requirements. At most of the *Pensionsfonds*, the level of own funds required by supervisory law equalled the minimum guarantee funds of €3 million for stock corporations or €2.25 million for mutual *Pensionsfonds*. The individual solvency margin for these *Pensionsfonds* is below the minimum guarantee funds. This is due either to the relatively low volume of business engaged in or the type of business concerned. The solvency margin of the other *Pensionsfonds* – based on the volume of business – exceeded the minimum guarantee funds and was therefore the amount applicable to the minimum own funds available.

## 3.4 Supervision of cross-border insurance groups

Supervisory colleges represent a significant component of group-wide supervision. They are important in particular to the supervision of multinational insurance groups in order to identify strategic or unfavourable economic developments in other parts of the group and to be able to initiate countermeasures early on. At the end of 2015, BaFin was involved in supervising a total of 33 insurance groups that have cross-border business activities via subsidiaries. For 20 (previous year: 17) of the 33 (previous year: 31) groups, BaFin was the group supervisor. This meant that it had the lead role in exercising group supervision. It also had to ensure that the supervisors involved worked together effectively and efficiently.

### Arrangements for supervisory colleges

Supervisory colleges have existed for 16 years already. The Solvency II and Omnibus II Directives provide a new statutory framework for supervisory colleges, which has been in effect in Germany since 1 April 2015. Collaboration amongst the colleges has gained a new level of quality as a result. The group supervisor, i.e. the coordinator who is responsible for group-wide supervision, takes on a key function while the other supervisory authorities collaborate and are expected to work hand-in-hand with the group supervisor. This cooperation also includes information exchange between the members in certain areas and joint decisions.

The Delegated Act which has been in force since 18 January 2015 includes among other things clarifying provisions for the coordination agreements, on the approval of group-specific parameters and on the information to be systematically exchanged. The most comprehensive rules by far governing the colleges' working practices are set out by the EIOPA[72], which plays a key role with respect to the rules and work of the colleges of supervisors.

The 26 EIOPA guidelines[73] governing the operational functioning of colleges are of particular significance. These guidelines are addressed to the group supervisors as well as to the college members and participants. For instance, there are guidelines governing the establishment of the colleges, on the responsibilities of participants, the conduct of meetings – which must be held at least once annually – on the exchange of information, working plan, joint on-site inspections and the manner in which responsibilities are shared or delegated. In addition, the appendices to the guidelines include a comprehensive template for a coordination agreement, which can be tailored to suit the needs of the individual colleges.

The obligation to enter into such a coordination agreement is set out in the Solvency II Directive.

BaFin completed this work in 2015 for all supervisory colleges in which it is the group supervisor. The coordination agreements were adapted to suit the relevant insurance groups and coordinated within the college. All participating supervisory authorities have signed the coordination agreements.

### Duties of colleges under Solvency II

The public often characterises a supervisory college as a body which takes decisions. However, this is only the case for the approval of internal models and a centralised risk management system.

Only one authority is responsible in each case for group-wide supervision. In general, the group supervisor is the supervisor of the ultimate parent undertaking. It occupies a strong position: in addition to coordinating responsibilities, it chairs the supervisory college, has lead responsibility in approvals processes and is the final deciding instance for an internal model. The task of the college is to assist it in group-wide supervision. The supervisors of the solo entities are required to work closely together in supervising the insurance group.

Since the authorities, which are responsible for supervising the solo entities, are provided comprehensive information through the exchange of information in the colleges, colleges not only help to improve group-wide supervision but also enhance supervision of the solo entities. However, it should be noted that the more subsidiaries are active in various countries, the more interfaces there will be between the responsible supervisory authorities. Certain supervisory processes which had previously been developed largely at the national level must now also be structured, planned and executed at a cross-border level. However, given the great degree of complexity of Solvency II, the requirements at the European level have yet to be defined,

72 https://eiopa.europa.eu/regulation-supervision/insurance/colleges-of-supervisors.

73 https://eiopa.europa.eu/Pages/Guidelines/Guidelines-on-operational-functioning-of-colleges.aspx.

particularly with respect to technical issues. It is for that reason that there currently exist stand-alone solutions in some countries, such as with respect to the "secure supervisory data cloud", i.e., encryption standards for electronic communication via e-mail and in the use of shared electronic file repositories on secure servers. In 2015, BaFin set up such a cloud solution for colleges supervising large international groups, thus simplifying the secure exchange of data significantly.

# V Supervision of securities trading and the investment business

## 1 Bases of supervision

### 1.1 First Financial Markets Amendment Act

On 6 January 2016, the Federal Cabinet adopted the government draft of a First Financial Markets Amendment Act. Similar to many other national provisions applicable to the financial markets, this act will also serve to adapt the legal framework to new European requirements: the Market Abuse Directive (MAD)[1], the Market Abuse Regulation (MAR)[2], the Central Securities Depositories Regulation (CSDR)[3] and the PRIIPs Regulation[4], which are aimed at improving capital market integrity and transparency as well as investor protection in the EU. The Act is expected to be adopted in the first half of 2016. Its provisions will then enter into force in stages (see info box "MiFID II delayed").

**MiFID II delayed**

Originally, the intention was to implement the revised Markets in Financial Instruments Directive (MiFID II) also through the First Financial Markets Amendment Act. But in November 2015, the European Commission and the European Parliament began to signal that the application of MiFID II could possibly be delayed by one year to January 2018. On 10 February 2016, the European Commission presented a proposal for an Amending Directive and an Amending Regulation providing for application of MiFID II and the Markets in Financial Instruments Regulation (MiFIR) to be delayed by one year to 3 January 2018. The federal government is planning to submit a draft Second Financial Markets Amendment Act in the course of 2016 to transpose the provisions of MiFID II into German law.

1 Directive 2014/57/EU, OJ EU L 173/179.

2 Regulation (EU) No 596/2014, OJ EU L 173/1.

3 Regulation (EU) No 909/2014, OJ EU L 257/1.

4 Regulation (EU) No 1286/2014, OJ EU L 352/1.

### 1.1.1 Market Abuse Directive and Regulation

The provisions of the Market Abuse Directive and the Market Abuse Regulation entered into force on 2 July 2014, replacing the old Market Abuse Directive. Most of the provisions of the Regulation will apply directly as from 3 July 2016. Its provisions relating to BaFin's supervisory and sanctioning powers and all the provisions of the Directive will still have to be transposed into national law.

The new European regulation against market abuse adapts the existing provisions to the technical changes in the area of market infrastructures. The regulations intended to prevent market abuse will in future therefore also apply to financial instruments traded on multilateral trading facilities (MTFs) and organised trading facilities (OTFs). Reporting and submission requirements, for example for inside information and lists of insiders, will in future also apply to issuers whose financial instruments are offered on an MTF or OTF. The prerequisite is that the issuers have received authorisation to trade their financial instruments on an MTF or OTF or have applied for their financial instruments to be admitted to trading on an MTF. In addition, the new provisions expand the ban on market manipulation to include benchmark manipulation.

The competent supervisory authorities will also be given additional powers in order to monitor market activity and intervene if necessary. Moreover, the new provisions standardise and tighten the sanctions available for insider trading and market manipulation. In future, all EU member states will be obliged to impose criminal sanctions, at least for infringements with intent and serious infringements of the ban on insider trading and market manipulation.

#### Provisions for criminal and administrative fines

Because of the new regulations against market abuse, legislators in Germany will in particular have to amend the provisions for criminal and administrative fines. Since the new Regulation applies directly, the administrative fine provisions will no longer refer to the corresponding prohibitions and requirements of the German Securities Trading Act *(Wertpapierhandelsgesetz)*, but directly to the European Regulation.

Moreover, the administrative fines under the Securities Trading Act *(Wertpapierhandelsgesetz)* can be considerably higher: BaFin will in future be able to impose fines of up to €5 million on natural persons who infringe the ban on market manipulation and thus commit an administrative offence; the previous maximum fine was €1 million. In addition, the Securities Trading Act will in future specify in concrete terms which fines apply to legal persons. In the case of infringements, BaFin will then also be able to impose revenue-based fines, which may amount to up to 15% of total annual revenue, for example, if there have been infringements of the ban on insider trading or market manipulation.

Similarly, the criminal provisions of the Securities Trading Act will also have to be amended, because in accordance with the provisions of the Market Abuse Directive, all forms of insider trading will in future no longer be punishable only for primary insiders, but equally also for secondary insiders, i.e. persons who, unlike management board or supervisory board members, have no special connection with the company concerned, but have nevertheless obtained inside information. Similar to attempted insider trading, attempted market manipulation will in future also be a criminal offence.

#### Implementing arrangements

However, in addition to transposing the provisions of the Market Abuse Regulation and of the Market Abuse Directive into national law, the Market Abuse Regulation also requires further clarification. This is usually done through Commission delegated acts or technical standards, which are drafted by the European Securities and Markets Authority (ESMA) and subsequently adopted by the European Commission.[5]

5 See Figure 2 "EU legislative process and ESAs" on page 67.

The Commission had asked ESMA for technical comments on the delegated acts (call for advice), which ESMA presented in February 2015. Among other things, the comments deal with specifying the indicators of market manipulation and defining the minimum thresholds relevant for the publication requirements of participants in the market for emission allowances. In addition, ESMA will determine the authority responsible for notifications of delays in the immediate publication of inside information, specify which managers' transactions will have to be published and will ultimately establish procedures for reporting actual or potential infringements of the Market Abuse Regulation to the competent authorities.

On 28 September 2015, ESMA also submitted proposals to the European Commission containing details of regulatory and implementing technical standards. These standards are intended to clarify the provisions of the Market Abuse Regulation and ensure that their application is harmonised in the individual member states.

The standards describe, among other things, what requirements should be imposed on conducting share buy-backs and stabilisation measures as well as market soundings. They also regulate the ways in which market practices are recognised. They also set out the arrangements, systems and procedures that market operators, all investment services enterprises operating a trading venue or persons brokering or executing transactions on a commercial basis have to establish or maintain in order to prevent or detect market abuse. The standards also set out the obligations to publish inside information and managers' transactions and to keep lists of insiders. Finally, they specify how to deal with persons who circulate investment recommendations and with statistics and forecasts distributed by public sector entities.

The European Commission adopted the standards on 9 March 2016. The Council of the European Union and the European Parliament may file objections within a review period of up to six months. If they do not, the standards will be published in the Official Journal of the European Union and can enter into force.

### 1.1.2 PRIIPs Regulation

Pursuant to the PRIIPs Regulation, manufacturers of packaged retail and insurance-based investment products will have to publish key information documents as from 31 December 2016. Anyone who sells, or gives advice on, such products will have to provide retail investors with these information documents before they sign a binding contract or offer. The Regulation specifies the form and content of the key information documents.

The provisions of the PRIIPs Regulation will now have to be transposed into German law. To this end, the draft First Financial Markets Amendment Act intends to expand BaFin's powers laid down in the Securities Trading Act *(Wertpapierhandelsgesetz)*, the Banking Act *(Kreditwesengesetz)*, the Investment Code *(Kapitalanlagegesetzbuch)* and the Insurance Supervision Act *(Versicherungsaufsichtsgesetz)*. In addition, it extends the lists of sanctions in the respective supervisory laws: they will in future define administrative fine criteria for infringements of the requirements of the Regulation. The corresponding implementing rules for distribution, including by insurance and financial intermediaries, are additionally planned in the Industrial Code *(Gewerbeordnung)* and other implementing regulations.

Products covered by the PRIIPs Regulation are not also subject to national requirements to prepare information sheets. The draft Act makes it clear that from 31 December 2016 onwards providers of packaged retail investment products will no longer have to create product information sheets in accordance with the Securities Trading Act or capital investments information sheets in accordance with the German Capital Investment Act *(Vermögensanlagengesetz)*. For special AIFs[6], providers are obliged to provide

6 AIF stands for "alternative investment fund". AIFs are all investment funds other than UCITS (section 1 (3) of the Investment Code). On UCITS, see footnote 27 on page 224.

semi-professional investors with either the key investor information in accordance with the Investment Code or key information documents in accordance with the PRIIPs Regulation. For products that do not fall under its scope, the PRIIPs Regulation continues to leave scope for national regulations on the preparation and distribution of information sheets.

### 1.1.3 Central securities depositories

Another aim of the First Financial Markets Amendment Act is to adapt the Banking Act to the provisions of the European Central Securities Depositories Regulation[7], which harmonises the key provisions applicable to the authorisation and ongoing supervision of central securities depositories.

BaFin will be responsible for the new authorisation procedure specified by the Regulation from the date on which the corresponding regulatory technical standards enter into force on the basis of the Act Implementing the Transparency Directive Amending Directive *(Gesetz zur Umsetzung der Transparenzrichtlinie-Änderungsrichtlinie)*, which will amend the Banking Act accordingly. For providers intending to provide banking services in combination with their activities as central securities depositories, the Regulation specifies a separate authorisation procedure. Future responsibility for this procedure has also been assigned to BaFin. The existing German central securities depository, Clearstream Banking AG, will continue to be subject to national law until a final decision has been made on authorisation and approval applications under the European Central Securities Depositories Regulation.

Under the current draft, BaFin will remain responsible under the European Regulation for ongoing supervision of central securities depositories, which has to date been based on the Banking Act. BaFin's supervisory powers will remain in force and will merely be adapted to the new European requirements. Moreover, the draft makes it clear that new authorisations under the Regulation will replace approval under the Banking Act. Central securities depositories have required this approval in the past to be able to carry on their activities.

Finally, the draft standardises a comprehensive catalogue of administrative offences in accordance with the provisions of the Regulation. Central securities depositories infringing the new European requirements will in future have to expect fines of up to €20 million, or alternatively up to 10% of the total revenue they generated in the financial year before the supervisory authority's decision, if the revenue-based amount is higher.

## 1.2 Transparency Directive

The Act Implementing the Transparency Directive Amending Directive[8] entered into force on 26 November 2015. It brought about extensive changes to the voting rights notification system, such as

- the new composition of the three notification criteria[9],
- the introduction of a compulsory notification form,
- the capture of all three notification criteria on a single notification form
- and the introduction of group notifications.

All four amendments are aimed at improving the transparency of voting rights notifications while at the same time reducing the number of notifications. The new composition of the notification criteria and the introduction of a compulsory notification form are above all aimed at making voting rights notifications easier to understand – firstly because the notification criteria will in future be distinguished more clearly: for voting rights under section 21 of the Securities Trading Act, for financial instruments under section 25 of the Securities Trading Act and for aggregated portfolios under section 25a of the Securities Trading Act. Secondly, the new notification form standardises the submission

7 See also 1.4.

8 Directive 2013/50/EU, OJ EU L 294/13.

9 Sections 21, 25 and 25a of the Securities Trading Act.

of voting rights notifications that issuers will in future also have to take into account when publishing the notification.

In addition, the introduction of a compulsory notification form brings together the holdings of voting rights, financial instruments and aggregated portfolios of a party subject to the notification requirement on a single notification form. Previously, each of the three notification criteria had its own notification form.

The introduction of group notifications is likewise aimed at reducing the number of notifications: if one or more group companies reach or cross a reporting threshold, only the ultimate group parent has to submit a notification. In its notification, it has to disclose certain information on its subsidiaries on the compulsory notification form, thus making notifications by the subsidiaries superfluous.

The compulsory notification form is largely based on a template developed by ESMA in 2015. ESMA recommends its use by the EU member states. It thus already reflects the European harmonisation trends even before the EU has introduced a compulsory European notification form.

Commission Delegated Regulation (EU) 2015/761[10] entered into force at the same time as the Implementing Act. It contains further regulations on the voting rights notification system and applies directly alongside the national provisions. Among other things, the Regulation governs how the thresholds for trading book and market making exemptions are calculated. In addition, it sets out details that parties subject to the notification requirement have to take into account when they calculate their percentage of voting rights they hold through cash-settled financial instruments on a delta-adjusted basis.

In addition to implementing the Transparency Directive Amending Directive, legislators have incorporated new requirements in the Implementing Act that provide for delisting, i.e. removing a company from the stock exchange. As from 26 November 2015, section 39 of the German Stock Exchange Act *(Börsengesetz)*, as amended, requires issuers seeking to withdraw the admission of their shares to trading on a regulated market in all cases to submit to the shareholders a compensation offer in accordance with the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz* – WpÜG). The compensation offer must be denominated in euros and comply with the minimum pricing rules of the Securities Acquisition and Takeover Act and the WpÜG Offer Regulation *(WpÜG-Angebotsverordnung)*. BaFin's responsibility is to monitor such compensation offers.

## 1.3 Prospectus Directive

On 30 November 2015, the European Commission published its proposal for the revision of the Prospectus Directive. This Directive will in future be replaced by a directly applicable regulation. At the time of going to press, the ordinary legislative procedure had not yet been completed at the European level. The revision of the Prospectus Directive is a component of the planned Capital Markets Union.[11]

According to the Commission's proposal, the new rules are aimed in particular at making the summaries of securities prospectuses more succinct and thus easier to understand for retail investors. The intention is that issuers that have already had their securities admitted to trading on the regulated market and are therefore subject to subsequent transparency requirements can make better use of the information published already for the purposes of preparing a prospectus. For frequent issuers, the amended regulations provide for an accelerated prospectus examination process. Ultimately, small and medium-sized enterprises (SMEs) will get further simplifications for the

10 Commission Delegated Regulation (EU) 2015/761, OJ EU L 120/2.

11 On Capital Markets Union, see chapter II 3.2.

preparation of prospectuses without adversely impacting on investor protection.

The existing exemptions from the obligation to publish a prospectus for securities with a minimum denomination of €100,000 are to be removed according to the Commission proposal. This is to ensure that prospectus law no longer provides any incentive to issue high denominations, because these types of securities are often inaccessible for retail investors. They are also blamed for illiquid markets.

According to the Commission's proposals, the prospectus summary should not exceed six A4 pages in length. Although the document has to follow a set outline structure, no particular order has been specified for the different information components within the individual sections. The aim is to make the summaries more informative in this way.

According to the Commission, issuers that have listed securities on a regulated market or an MTF will in future be able to choose whether they want to create a "universal registration document", which will be used both for publishing the annual financial report in accordance with the Transparency Directive and as a registration document that is compliant with prospectus law, i.e. as part of the section of the prospectus that provides information about the issuer. If there are subsequent securities issues, the only documents required will be the description of the securities and the summary. According to the proposal, the competent supervisory authorities should review the documents within five working days in this case, rather than the ten working days that applied previously.

In addition, the Commission proposes to relax the prospectus requirements for secondary issues by issuers that have already had securities listed on a regulated market or an SME growth market, unless these offerings are in any case exempt from the obligation to publish a prospectus. The reason is that, because of the existing listing and the associated subsequent transparency requirements, the market participants already have information about such issuers.

At the same time, the list of documents that can be included in the prospectus by way of reference has been extended. To qualify, they must have been published previously and meet the language requirements that apply to the prospectus.

Finally, the Commission proposes a special prospectus regime for SMEs. In addition to simplifying the content requirements for the prospectus, enterprises planning to issue equities or simple debt securities are to get the option of choosing a special form of presentation for the prospectus: they will be able to write a standardised text in question and answer format, which they can adapt freely to the needs of each issuer. In this way, the Commission wants to make it easier for SMEs to prepare prospectuses and enable them to save costs.

# 1.4 Focus

## Central securities depositories

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The settlement of securities transactions in Europe is one of the last areas in the securities business that are mostly still organised and regulated on a national level. Two developments in particular are expected to shape the business of central securities depositories in the coming years: in terms of regulation, the implementation of the new European Central Securities Depositories Regulation (CSDR, see info box on page 221)[12] is imminent. In terms of organisation, the Eurosystem's[13] "Target 2 Securities" (T2S) project is expected to change the landscape.

### Responsibilities of a central securities depository

According to the European Central Securities Depositories Regulation (see info box on page 221), a central securities depository (CSD) is a legal person that operates a securities settlement system and provides another "core service". This core service may involve the initial recording of newly issued securities in a book-entry system (central depository) or the provision and maintenance of securities accounts at the top tier level, i.e. for the CSD's participants.

Where securities are issued, they are (electronically) recorded in a book-entry system by a CSD; this is referred to as "notary service". The "settlement service" comprises above all the transfer of securities from one account to another. The critical factor here is that the seller of securities receives payment and the buyer receives the securities, normally according to the delivery-versus-payment principle. To this end, central securities depositories often maintain securities accounts for their participants; this represents the third core service, the "central maintenance service".

In addition, other services play an increasingly significant role, such as securities account management during corporate actions and distributions, securities lending and collateral management. Collateral management in particular is becoming more and more important in an environment where collateral is demanded with increasing frequency. Not least, CSDs may under certain conditions also provide banking-type ancillary services (see info box on page 221).

### Uncertainty about the number of CSDs

It is unclear how may central securities depositories there are in the European Union (EU) at present. For example, as at 1 March 2016, the European Central Securities Depositories Association (ECSDA) had exactly 41 European members, 31 of them domiciled in the EU.[14] In contrast, the list of "designated securities settlement systems", which is maintained by ESMA, showed just under 40 CSDs domiciled in the European Union as at March 2016.[15] The difference is due to CSDs operated by government bodies or central banks, which are not members of the ECSDA.

The number of CSDs is therefore somewhere between the number of central counterparties authorised under European law (16) and the number of trading venues (253).[16] The current

12 On this subject, see also 1.1.3.

13 The Eurosystem comprises the European Central Bank and the national central banks of all EU member states, irrespective of whether they have adopted the euro as their currency.

14 The list can be accessed at http://ecsda.eu.

15 The list can be accessed at https://www.esma.europa.eu.

16 Both figures as at 16 March 2016. Source: https://www.esma.europa.eu/databases-library/registers-and-data.

## Central Securities Depositories Regulation

The Central Securities Depositories Regulation (CSDR)[17] of 23 July 2014 puts the regulation of central securities depositories (CSDs) on a new platform. It is based on the standards for financial market infrastructures adopted by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO).[18] In particular, the CSDR provides for a European-based authorisation and supervision procedure. There will be a number of regulatory standards and delegated acts to expand on the CSDR.

The 76 Articles of the CSDR are organised into six Titles. Title I contains, among other things, the definition of a CSD: CSDs are legal persons that, firstly, operate a "securities settlement system" and additionally provide either certain notary services or provide and maintain securities accounts at the top tier level, i.e. for their participants. Title II mainly contains rules and measures on settlement discipline, relating especially to buy-in and penalty processes in cases where settlement fails.

Title III is expected to have the most significant consequences. It deals primarily with the authorisation and ongoing supervision of CSDs. In addition, it contains organisational and supervisory requirements, conduct of business rules and rules on links between CSDs. The "competent authority" in the CSD's respective home member state has to involve other European authorities, including certain central banks, in the authorisation and ongoing supervision process. These authorities are required to cooperate closely.

Title IV also focuses on authorisation and supervision. It relates to, among other things, "banking-type ancillary services" provided by a CSD for its participants. They include, for example, the provision of cash accounts for participants, the acceptance of deposits and lending services; the Annex to the CSDR contains a non-exhaustive list. CSDs have to meet a number of conditions in order to be authorised to provide such services. For example, they have to be authorised as CRR credit institutions.[19]

The approval procedure for "banking-type ancillary services" is more complex than the authorisation procedure for a CSD. Not only does it require more authorities to be involved, including the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA), these authorities have also been given extended rights of involvement. This makes the procedure similar to the authorisation procedure for a central counterparty (CCP), although ultimate decision making remains with the national "competent authority".

In addition, the CSDR contains provisions on penalties as well as a number of amendments to existing regulatory frameworks. The CSDR entered into force on 17 September 2014. It is not known at this stage when the delegated acts and technical standards that still require adoption will enter into force.

structure of the CSD landscape has primarily been shaped by the fact that most CSDs have arisen as a result of their association with the national stock exchanges, but without undergoing the same diversification and fragmentation in trading.

### Heterogeneous CSD landscape

The ECSDA's numbers show how fragmented and heterogeneous the European Union's

17 Regulation (EU) No 909/2014, OJ EU L 257/1.

18 CPSS-IOSCO: Principles for Financial Market Infrastructures, 16 April 2012.

19 See Article 8 of the Capital Requirements Directive IV (CRD IV, Directive 2013/36/EU, OJ EU L 176/338) and the Capital Requirements Regulation (CRR, Regulation (EU) 575/2013, OJ EU 176/1). Credit institutions that fall under the narrow definition of credit institution in accordance with Article 4(1)(1) of the CRR are referred to as CRR credit institutions.

CSD landscape is.[20] While for the two ICSDs (international CSDs), Clearstream Banking S.A. (CBL), Luxembourg, and Euroclear Bank S.A., Belgium, participants domiciled abroad account for over 90%, the average for the other CSDs is only 18%.

The distribution is similar for the number of participants: the two ICSDs have over 1,300 participants each, the other CSDs average around 110. The range extends from a maximum of 20 participants (at 11 CSDs) to just under 300, while the number of CSD employees ranges from three to over 2,800. There are also huge differences in the value of securities held in CSD accounts (€47.2 trillion for all CSDs) and the number and value of settled transactions (471 million transactions and €1,160 trillion for all CSDs).

These very heterogeneous structures may be due to the fact that regulation has to date largely been nationally based. But a second factor is likely to be that CSDs, similar to other financial market infrastructures, tend to form natural monopolies. Natural monopolies occur predominantly in capital-intensive industries with high fixed costs. Examples of natural monopolies are infrastructure providers such as power utilities or rail network operators. The result of natural monopolies is that the provider with the lowest average costs can attract an ever greater market share and the barriers to entry by new competitors are high.

### Consolidation possible

It would therefore not be surprising if the application of the Central Securities Depositories Regulation (see info box on page 221) were to lead to a consolidation process, which should initially be preceded by fierce competition among the larger CSDs. In addition or as an alternative to consolidation, CSDs could increasingly specialise in certain markets and services. There will probably still be CSDs that occupy (national) niches that are less financially attractive to others.

The German central securities depository is Clearstream Banking AG (CBF), Eschborn. Like CBL, which is domiciled in Luxembourg, it is part of Deutsche Börse Group. While CBF primarily performs settlement services for German securities trading, CBL focuses on cross-border settlement. A third CSD within Deutsche Börse Group is LuxCSD S.A., a joint venture of Clearstream International S.A. and Banque centrale du Luxembourg, which covers the market in Luxembourg.

Both CBF and CBL are licensed to conduct banking business, so both of them are subject to direct supervision by BaFin and indirect supervision by the Single Supervisory Mechanism (SSM) under the auspices of the European Central Bank.

CBF, CBL (through CBF) and LuxCSD S.A. participate in the "Target 2 Securities" project, which was launched on 22 June 2015. T2S provides cross-border securities settlement in central bank money; securities depository and related services will remain the responsibility of the CSDs. Settlement in highly liquid, secure central bank money, in combination with real-time settlement and shorter settlement chains, is intended to reduce settlement risk.

20 See the ECSDA's CSD Factbook 2014, page 12 f. The figures below have been taken from the Factbook.

## 1.5 Benchmarks Regulation

In December 2015, the European Parliament and the European Council agreed on new rules for determining financial benchmarks. In September 2013, the European Commission had already presented an initial proposal for a Benchmarks Regulation. The Regulation is aimed at ensuring that financial benchmarks are representative and have integrity. A number of cases in recent years had shown that benchmarks such as the LIBOR and Euribor may be susceptible to manipulation.

The scope of the Benchmarks Regulation is broad. First, it defines as an index any measure that is regularly calculated and published or made available to the public. An index becomes a benchmark whenever it is used as a reference price for payments or a financial instrument or financial contract or to measure the performance of an investment fund.

For benchmark administrators, the Regulation provides that they will have to be authorised and supervised by the national competent authority. At the same time, various organisation and control obligations will be imposed on benchmark administrators in order to prevent conflicts of interest. In addition, administrators will have to meet specific requirements when calculating benchmarks: only transaction data must be used as input for determining a benchmark. The Regulation also contains rules on how a code of conduct should be produced for the contributors of the input data.

In terms of the requirements, the Regulation distinguishes between benchmarks of different categories on the basis of type and size, for example. There are benchmarks that are produced on the basis of regulated data, commodity benchmarks, interest-rate benchmarks, significant and non-significant benchmarks as well as critical benchmarks. Of special significance are critical benchmarks that are not based on regulated data and are used as a reference in particular for financial instruments or contracts and investment funds with a total value of at least €500 billion. They are subject to the strictest requirements of the Benchmarks Regulation. Commodity benchmarks are also subject to special arrangements. In contrast, benchmarks based on regulated data, such as data provided by trading venues, are exempt from certain requirements, for example. The same applies to significant benchmarks (especially those with an aggregate average of the underlying financial instruments, contracts and investment funds of at least €50 billion) and non-significant benchmarks (overall aggregate average of less than €50 billion) because of their significantly lower values and lesser significance.

The Benchmarks Regulation is to be applied 18 months after it enters into force. In the meantime, ESMA has been given 12 months to develop a number of Level 2 rules and present them in the form of regulatory technical standards and proposals for delegated acts. On 15 February 2016, ESMA published a discussion paper in this regard.[21]

## 1.6 Loan-originating funds

In May 2015, BaFin responded to the legal situation in Europe and the current debate at ESMA by amending its administrative practice for originating and restructuring loans for the account of the investment fund.[22] They must now be treated as part of collective investment management and are thus permissible, if this is in line with the product regulations of the Investment Code *(Kapitalanlagegesetzbuch)*.

Under the previous administrative practice, it was not permissible at all to originate loans for the account of the investment fund. The European Alternative Investment Fund Managers (AIFM) Directive[23], however, hardly contains any product regulations and no regulations on lending by AIFs, for example. This means that the Directive does not rule out the permissibility of lending for the account of AIFs. Moreover, in accordance with the

21 https://www.esma.europa.eu.

22 www.bafin.de/dok/6190494.

23 Directive 2011/61/EU, OJ EU L 174/1.

provisions of the Regulations on European venture capital funds[24], on European social entrepreneurship funds[25] and on European long-term investment funds[26], loans granted by such funds to a qualified portfolio company are included in the permissible assets in which such funds can invest.

Given the current legal situation in Europe, ESMA believes at present that loan-originating AIFs are permissible. Some other EU member states also allow AIFs to originate loans, based on either their respective administrative practice or on explicit national regulations. In accordance with the AIFM Directive, loan-originating AIFs may also be marketed to professional investors across borders under the EU passport system. However, the legal situation in the EU member states is not yet consistent. ESMA is currently working on a discussion paper to formulate minimum requirements for these loan-originating AIFs. The issue of loan origination is also one of the focal points of the catalogue of measures for creating a Capital Markets Union, which the European Commission presented on 30 September 2015.

Based on the current state of opinion, German legislators added supplementary rules of the Investment Code to the draft Act Implementing the UCITS[27] V Directive *(OGAW-V-Umsetzungsgesetz)*, which entered into force in March 2016. These rules relate to the origination and restructuring of loans by AIFs. Against this backdrop – as well as to ensure investor protection and in response to the shadow banking problem – BaFin formulated what are now legal provisions as recommendations in its letter of 12 May 2015, which German AIF management companies *(AIF-Kapitalverwaltungsgesellschaften)* were expected to comply with from that date already. For example, BaFin had recommended that loans should only be granted for the account of closed-ended special AIFs and that no loans should be issued to consumers, that a critical approach should be taken to leverage and that AIF management companies should observe special risk management requirements.

# 2 Monitoring of market transparency and integrity

## 2.1 Market analysis

In order to uncover and prevent market manipulation and insider trading, BaFin routinely analyses trading activities. If the analyses reveal any indications, it launches formal investigations.

In 2015, BaFin analysed a total of 570 cases (previous year: 721, see Figure 10 on page 225).

The unusually high number of analyses in the previous year and the decline in 2015 to an otherwise continuously rising level is primarily due to the review of BaFin's internal market surveillance system and the associated adjustments to the parameters for identifying suspicious transactions. In addition, BaFin concentrated to a greater extent on warning consumers of market abuse. It issued consumer notifications on eleven occasions, and thus more frequently than in the previous year (eight). BaFin always publishes consumer warnings on its website as soon as it observes manipulation attempts – for example in the form of calls or spam e-mails. At the same time, it informs the affected banks and trading venues on which the financial instruments concerned are traded.

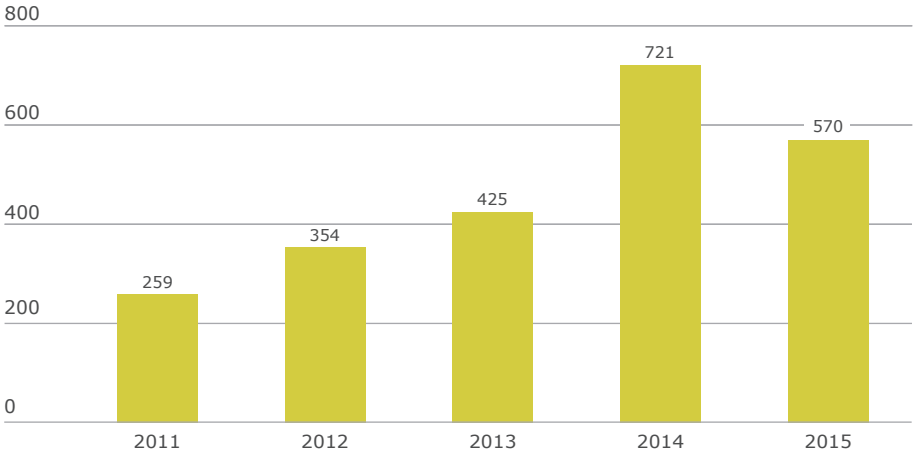
24 Regulation (EU) No 345/2013, OJ EU L 115/1.

25 Regulation (EU) No 346/2013, OJ EU L 115/18.

26 Regulation (EU) No 760/2015, OJ EU L 123/98.

27 UCITS are undertakings for collective investment in transferable securities. UCITS funds are funds complying with the requirements of Directive 2009/65/EC.

**Figure 10** Market analyses




There were initial indications of market abuse in 125 cases (previous year: 162). Market manipulation was identified in 79 cases (previous year: 105) and 46 cases (previous year: 57) related to insider trading.[28]

Around half of the analyses launched in 2015 were triggered by suspicious transaction reports pursuant to section 10 of the Securities Trading Act *(Wertpapierhandelsgesetz)*. Their number rose significantly, to 547, compared with the previous year's 435 suspicious transaction reports. The reports in 2015 related to a total of 331 financial instruments (previous year: 323). From July 2016, new rules will apply to identifying and reporting suspicious transactions. Market participants will then be obliged to actively screen trading activities for abnormalities suggesting market abuse offences. BaFin is currently creating the technical conditions to allow the future reports to be uploaded electronically.

In 2015, BaFin drew up six expert reports for public prosecutors' offices and courts in market abuse proceedings. In cases of market manipulation, BaFin was asked repeatedly to comment on whether this manipulation had influenced the quoted or market price, because until now this has been the decisive criterion for determining whether certain conduct can be pursued as a criminal offence. If the manipulation has not influenced the price, BaFin pursues the matter further as an administrative offence. The expert reports in connection with the ban on insider trading related primarily to calculating the special advantage that insiders were able to generate through their actions.

### Market manipulation analyses

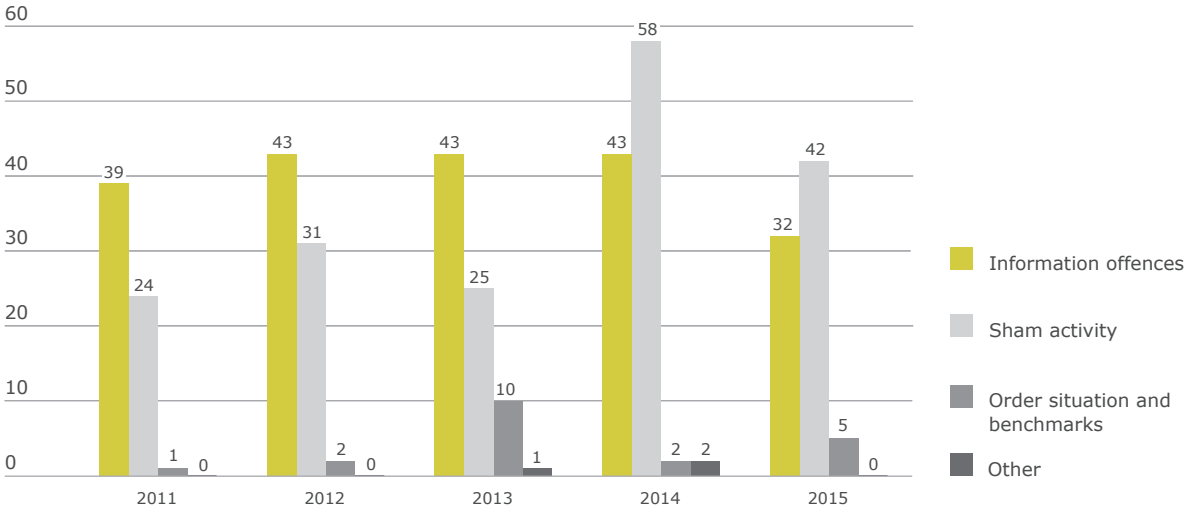
As described above, BaFin identified cases of alleged market manipulation in a total of 79 analyses (previous year: 105). Broken down by the underlying subject matter, the majority of cases (42; previous year: 58) related to manipulation through sham activities such as wash sales and pre-arranged trades (see Figure 11 "Subject matter of positive market manipulation analyses" on page 226).

In 32 cases (previous year: 43), BaFin found indications of information-based manipulation, i.e. incorrect, misleading, or deliberately withheld information as well as manipulation in the form of scalping (information offences), where manipulators recommend a stock for purchase – providing incorrect or misleading information – without disclosing that they themselves own a considerable amount of this stock. The remaining five cases (previous year: two) were based on manipulation of order situations or benchmarks.

In terms of the different market segments, the analyses of market manipulation focused on the

28 For information on further investigations, see 2.2. and 2.3.

**Figure 11** Subject matter of positive market manipulation analyses




regulated unofficial market, which accounted for 59%, although its share of positive market manipulation analyses declined compared with the previous year (70%). At the same time, the proportion of market manipulation analyses on the regulated market increased to 41% (previous year: 30%).

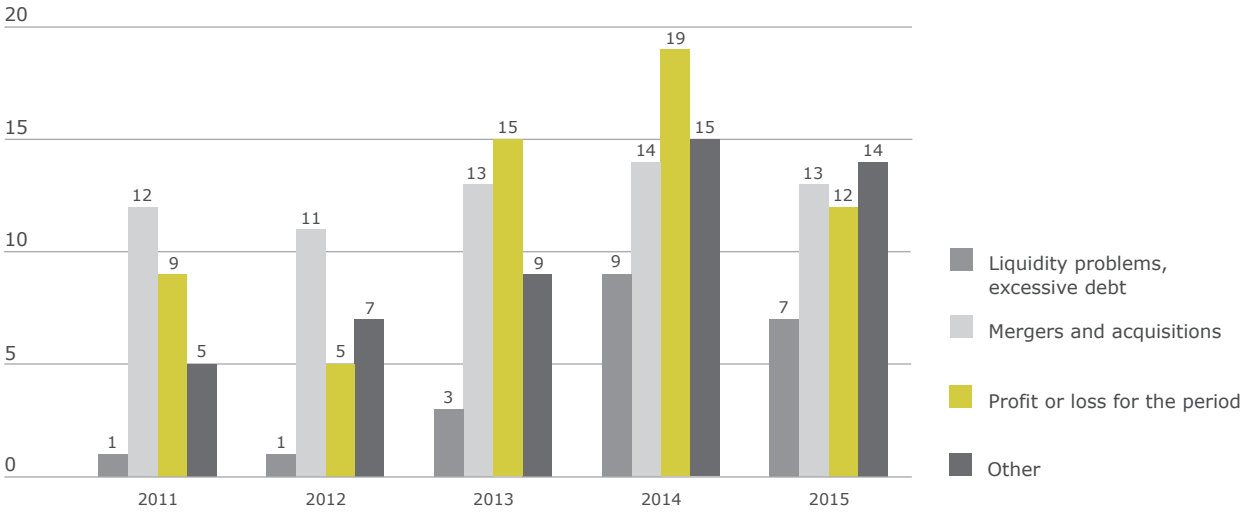
### Insider trading analyses

The number of positive insider trading analyses decreased to 46. This compares with 57 cases where BaFin had found initial indications of insider trading in 2014.

The main focus, accounting for 13 cases (previous year: 14), was on issues relating to mergers and acquisitions (see Figure 12 "Subject matter of positive insider analyses"). This was closely followed by cases involving companies' earnings figures, of which 12 were recorded (previous year: 19). Another category, in which seven cases (previous year: nine) were recorded, relates to liquidity problems, excessive debt levels and similar issues.

Following a decline in 2014, it was above all the regulated market that was affected by insider trading in 2015. There was another significant increase in this category: 78% of all positive

**Figure 12** Subject matter of positive insider trading analyses



analyses (previous year: 61%) related to financial instruments admitted to trading on the regulated market. 22% of all the cases (previous year: 37%) involved financial instruments traded on the regulated unofficial market.

## 2.2 Market manipulation

### 2.2.1 Investigations

In 2015, BaFin investigated a total of 256 cases of suspected market manipulation (see Table 30 "Market manipulation investigations"). This is a sign that the trend of increasing numbers of investigations not only continues, but has accelerated.

More than half of the formal investigations launched – 135 analyses in total – were based on referrals by the trading surveillance units at the German exchanges (previous year: 130). Most of the investigations related to trade-based manipulation activities, such as manipulation of reference markets, wash sales and pre-arranged trades.

Another priority area of BaFin's day-to-day activities related to investigations initiated by public prosecutors' offices or police authorities: a total of 17 cases were attributable to such requests (previous year: 14). In most of these cases, complaints were filed with the prosecuting authorities by investors who had followed manipulative recommendations and invested in shares.

In 2015, BaFin continued its close cooperation with foreign supervisory authorities. BaFin requested administrative assistance in 107 cases (previous year: 169), contacting the supervisory authorities of a total of 24 different countries (previous year: 36). Most of the requests for assistance related to customers who had engaged in unusual trading activities on a German exchange via a foreign institution. Foreign authorities from 17 countries (previous year: 16) requested assistance from BaFin in 55 cases (previous year: 45).

BaFin found evidence of market manipulation in 160 cases completed in 2015 (previous year: 156 cases, see Table 30). It filed complaints against 290 suspects with the relevant public prosecutor's office (previous year: 311). In ten other cases (previous year: six) involving a total of 14 persons (previous year: nine), there was evidence that an administrative offence had been committed. In 44 cases, the investigation did not find any evidence of violations (previous year: 33). The number of investigations still pending at the end of 2015 was 279 (previous year: 237).

### 2.2.2 Sanctions

In 2015, judgements were handed down to a total of seven people following a full public trial, compared with four in the previous year. Six of them were sentenced, one person was acquitted (see Table 31 "Completed market manipulation proceedings" on page 228). The judges passed

**Table 30** Market manipulation investigations

| Period | New investigations | Results | | | | | | Pending |
|---|---|---|---|---|---|---|---|---|
| | | Discontinued | Referred to public prosecutors or BaFin's Administrative Fines Division | | | | | |
| | | | Public prosecutors | | Administrative Fines Division | | Total (cases) | Total |
| | | | Cases | Individuals | Cases | Individuals | | |
| 2013 | 218 | 66 | 142 | 281 | 10 | 18 | 152 | 208 |
| 2014 | 224 | 33 | 156 | 311 | 6 | 9 | 162 | 237 |
| **2015** | **256** | **44** | **160** | **290** | **10** | **14** | **170** | **279** |

**Table 31** Completed market manipulation proceedings

| Period | Decisions made by public prosecutors' offices* | | | | |
|---|---|---|---|---|---|
| | Discontinued | | | | Discontinued in accordance with section 153a of the StPO |
| | 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 | 56 | 27 | 12 | 5 | 21 |
| 2014 | 77 | 29 | 14 | 22 | 52 |
| **2015** | **97** | **29** | **16** | **37** | **49** |

| Period | 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 |
| 2013 | 1 | 4 | 4 | 0 | 2 | 3 |
| 2014 | 2 | 3 | 3 | 1 | 0 | 7 |
| **2015** | **1** | **10** | **6** | **1** | **4** | **6** |

* All figures also include investigations completed in previous years, but of which BaFin only became aware in 2015.

sentences against ten other people (previous year: three).

The public prosecutors' offices discontinued a total of 228 investigations (previous year: 194). In 97 of these cases, a conviction was not sufficiently probable to bring a charge (previous year: 77). The public prosecutors' offices discontinued these proceedings pursuant to section 170 (2) of the Code of Criminal Procedure (*Strafprozessordnung* – StPO). This shows that it is sometimes very difficult to provide evidence that the offence of market manipulation has been committed.

Another 37 investigations (previous year: 22) were provisionally discontinued in accordance with section 154f of the Code of Criminal Procedure because the defendant's place of abode was unknown. In addition, the public prosecutors' offices discontinued 29 cases, the same number as in the previous year, in accordance with section 153 of the Code of Criminal Procedure, because they considered the perpetrator's degree of fault minor and there was no public interest in criminal prosecution. In another 49 cases (previous year: 52), the investigations launched were discontinued in accordance with section 153a of the Code of Criminal Procedure, after the defendants had made a payment as part of out-of-court settlements.

Moreover, proceedings were discontinued in 16 cases in accordance with section 154 or 154a of the Code of Criminal Procedure (previous year: 14). 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 contributing to accelerating the proceedings. Proceedings can be discontinued, for example, if the importance of the expected punishment for the offence concerned is not substantial compared to the legal consequences of another punishable offence. The fact that a number of investigations were again discontinued in 2015 on the basis of these provisions documents clearly that many violations of the ban on market manipulation continue to also involve other serious criminal offences.

### 2.2.3 Selected cases

#### Asset manager

On 5 November 2015, the Local Court *(Amtsgericht)* in Munich handed down sentences to two managing directors of an asset management company. One had to pay 90 daily units of €250 each, the other 50 daily units of €180 each. The Munich I public prosecutor's office discontinued the proceedings against two other employees of this company in return for a payment of €6,000 each as part of an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure. The accused accepted the sentences in both cases and also met the conditions of discontinuation in accordance with section 153a of the Code of Criminal Procedure. The proceedings were thus finally concluded.

The asset management company concerned had executed pre-arranged trades and wash sales in various bonds and warrants for its customers. The unusual transactions had been motivated by tax reasons: their only purpose was to reduce the tax burden of the customers artificially by charging accrued interest at a supposedly favourable rate. In the period from June to September 2013, the four accused traded five financial instruments in the questionable transactions for more than €23 million for various customer securities accounts.

BaFin reported the case, which comprised a total of 38 such transactions, to the Munich I public prosecutor's office in February 2015. In the interest of prevention, BaFin published important information on these types of contraventions in the April 2015 issue[29] of BaFinJournal.

#### Tria IT Solutions AG

The Local Court *(Amtsgericht)* in Munich sentenced the former sole member of the managing board of Tria IT Solutions AG to a total prison term of two years for information-based market manipulation with intent, among other reasons. The sentence was suspended. In the period from mid-December 2009 to mid-March 2010, the managing board member had unduly failed to publish information on the insolvency of the company, which is listed on the regulated market, by way of an ad-hoc disclosure pursuant to section 15 of the Securities Trading Act. In this way, he managed to hold the market price of the company's shares artificially at the existing level and prevent a decline in the share price. When the disclosure was subsequently published on 16 March 2010, the share price decreased significantly.

The judges imposed the punishment not only for proven market manipulation, but also for deliberately delaying insolvency proceedings in five cases, withholding and embezzling wages and salaries, deliberate bankruptcy and violating the obligation to keep accounting records. The judgement is not yet final as to the legal consequences.

#### Clean Enviro Tech Corp.

On 24 June 2015, the Regional Court *(Landgericht)* in Stuttgart sentenced an Australian national resident in Switzerland and a German national to a suspended prison term of one year and nine months each. The Australian had already been remanded in custody for more than a year, and the German for more than three months. They had jointly violated the ban on market manipulation by providing incorrect information and using scalping when they recommended shares in the US-based company Clean Enviro Tech Corp. in May and June 2003.

This is the first ruling by a court that relates not only to recommending shares through e-mailed market letters and websites, but also through smartphone applications. A large number of witnesses, including BaFin employees, were questioned in court proceedings lasting 17 days. The Local Court in Stuttgart had previously handed down suspended prison sentences of one year each to two Canadian exchange traders. They had spent more than five and two months in custody respectively.

29 www.bafin.de/dok/6116768.

BaFin had triggered the investigations by the public prosecutor's office in Stuttgart and the Baden-Württemberg Criminal Police Office *(Landeskriminalamt)* by filing a complaint in October 2013 and then provided ongoing support during their investigations. BaFin in turn received administrative assistance for its investigations from numerous foreign supervisory authorities. The judgement and sentences are final.

### eSky Exchange Corp. etc.

On 2 April 2015, the Regional Court in Stuttgart sentenced a qualified banker to a total prison term of six years. He was guilty of multiple fraud in coincidence with information-based and trading-based market manipulation. Two other accused persons were given suspended prison sentences of one and two years respectively for aiding and abetting fraud in coincidence with market manipulation. The judgement is final.

Previously, in 2009 and 2010, the Regional Court in Düsseldorf had convicted seven individuals from this group of offenders by a final judgement for a particularly serious case of fraud and sentenced them to prison terms of between 21 months and six years. With regard to market manipulation committed in coincidence with the other offence, criminal prosecution at the time had been limited to the criminal offence of fraud pursuant to section 154b of the Code of Criminal Procedure. The public prosecutors' office can invoke these provisions, if the expected punishment for individual component parts of an offence or for several infringements of the law committed as a result of a single offence are not material.

The perpetrators sentenced by the courts had got together in order to market shares of several companies without operating activities – known as shell companies – to retail investors all over Germany through call centre telemarketing. To this end, they used shares in some cases that came from shell companies established abroad and were or had been listed on a number of trading venues in Germany. They then proceeded to market the shell companies, giving incorrect or misleading information about the companies and their actual business. They deceived investors in order to encourage them to buy the shares. In addition, before and during the marketing of the shares, the perpetrators generated prices quoted on the basis of turnover at the respective stock exchanges in order to create a supposedly attractive share price performance for potential investors. By doing so, the fraudsters succeeded in selling the basically worthless shares to a large number of investors.

The proceedings were triggered by complaints filed by BaFin in 2008, 2009 and 2010 as well as suspicious transaction reports of suspected money laundering filed by several banks.

### 3D Capital AG

On 26 June 2015, the Regional Court in Lübeck sentenced a German business consultant to a jail term of three years for market manipulation as well as fraud and attempted fraud. In addition, the judges declared an amount of approximately €440,000 forfeited. The forfeiture measure ensures that assets the perpetrators have obtained through a criminal offence or administrative offence are confiscated. Another amount of €1,250,000 was seized so it could be used to settle compensation claims of investors who had suffered losses.

The court found that the convicted individual had shares in 3D Capital AG. 3D Capital AG provided a special service to companies, enabling them to get listed on a stock exchange even though they could not afford the costs associated with an initial public offering. They did this by advancing all the costs of the IPO, including for the preparation of the prospectus and the application process. The remuneration of 3D Capital AG was paid in shares of the company planning the IPO. By subsequently selling off these shares, the convicted individual wanted not only to settle the expenses of 3D Capital AG incurred previously, but also make as much profit as possible.

To achieve that, he and other involved parties organised massive marketing campaigns for the shares. In order to fake trading volumes and drive up the share price, the perpetrators

had agreed in advance to trade the securities concerned between them repeatedly. However, the marketing material did not point out existing conflicts of interest. People reading the glossy brochures therefore did not find out that the convicted individual who had initiated the campaign and the other people behind the buy recommendations had a financial interest of their own in the performance of the shares. This is because, at the time of the marketing campaign, they or companies under their control held shares of the companies featured in the marketing material for the sole purpose of selling them subsequently.

The proceedings had been prompted by a complaint filed by BaFin in 2008. The subsequent investigations by the public prosecutors' office involved BaFin as well as the Federal Criminal Police Office *(Bundeskriminalamt)* and the trading surveillance unit of the Frankfurt Stock Exchange, among others. The investigations were very extensive and long-winded, especially as they necessitated requests for administrative and legal assistance to foreign bodies. As a result, the public prosecutor's office in Lübeck was ultimately only able to bring charges in March 2014.

The investigations against four other accused individuals were discontinued in return for payments of €230,000, €210,000, €100,000 and €50,000 as part of an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure. The judgement is final.

## 2.3 Insider trading

### 2.3.1 Investigations

Due to suspected insider trading, BaFin initiated a total of 43 new investigations in 2015 (see Table 32 "Insider trading investigations"). It contacted foreign supervisory authorities in 32 cases (previous year: 27) and processed 19 enquiries from supervisory authorities abroad (previous year: 36).

BaFin filed complaints with the relevant public prosecutors' offices in 26 cases (previous year: 22) involving a total of 87 individuals (previous year: 45). In 19 cases it investigated it did not find any indications of insider trading. 41 investigations, some of which had been initiated in prior years, had not been completed by the end of 2015 (previous year: 43).

**Table 32** Insider trading investigations

| Period | New investigations | Results | | | Pending |
|---|---|---|---|---|---|
| | | Discontinued | Referred to public prosecutors | | |
| | Insiders | Insiders | Cases | Individuals | Total |
| 2013 | 42 | 13 | 35 | 99 | 26 |
| 2014 | 50 | 11 | 22 | 45 | 43 |
| **2015** | **43** | **19** | **26** | **87** | **41** |

**Table 33** 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 |
| 2013 | 27 | 12 | 5 | 0 | 8 | 0 | 2 |
| 2014 | 46 | 39 | 5 | 1 | 1 | 0 | 0 |
| **2015** | **41** | **31** | **8** | **1** | **1** | **0** | **0** |

One accused individual was convicted of insider trading in 2015 (see Table 33 "Completed insider trading proceedings" on page 231). A total of 39 cases were discontinued by the public prosecutors' offices, eight of them as part of out-of-court settlements.

### 2.3.2 Selected cases

#### International Rectifier Corporation

On 1 December 2015, following a complaint filed by BaFin, the Munich I public prosecutor's office handed down a sentence to the spouse of a primary insider of Infineon Technologies AG for insider trading and imposed a fine of 50 daily units of €125 each. In addition, it ordered that €28,657.45 be forfeited as compensation. The decisions are final.

On 20 August 2014, Infineon Technologies AG published an ad-hoc disclosure, announcing its intention to acquire International Rectifier Corporation for US$40 (€30.17) per share in cash. Only one day before this disclosure, the primary insider's spouse had bought a total of 4,000 shares of International Rectifier Corporation with a volume of €82,800. He subsequently resold the shares in two tranches, generating net proceeds, i.e. gross profit less capital yields tax and solidarity surcharge, of €28,657.45.

#### Dürr AG

On 31 March 2015, the Local Court in Stuttgart discontinued proceedings against a management employee at Dürr AG in return for a payment of €30,000 as part of an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure (*Strafprozessordnung* – StPO). The proceedings against a senior manager of the company were also discontinued after he had paid €9,000 as part of an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure. The decisions are final. Both proceedings were prompted by complaints filed by BaFin.

Dürr AG announced in an ad-hoc disclosure on 4 August 2010 that it was planning a bond issue for autumn 2010 and intended to buy back the previous bond at a bond quote of 100% of par. Before the disclosure, the old bond was trading significantly above 100%.

On 1 August 2010, the management employee, who worked in Corporate Communications & Investor Relations, sold the Dürr bonds in his mother's securities account at a quoted price of approximately €28,000. On 4 August 2010, the senior manager of the same corporate department unlawfully informed the customer adviser of a bank before the ad-hoc disclosure was published that the bond buy-back was imminent.

#### Bilfinger SE

On 11 December 2015, following a complaint filed by BaFin, the public prosecutor's office in Mannheim discontinued the proceedings against a board member of Bilfinger SE in return for a payment of €1,500 in an out-of-court settlement in accordance with section 153a of the Code of Criminal Procedure. The discontinuation is final.

Bilfinger SE had announced in an ad-hoc disclosure on 3 September 2014 that it would have to further reduce its forecast for financial year 2014. One day before the disclosure, the board member of the company sold all his 200 shares of Bilfinger SE, thus avoiding a loss of €1,109.60.

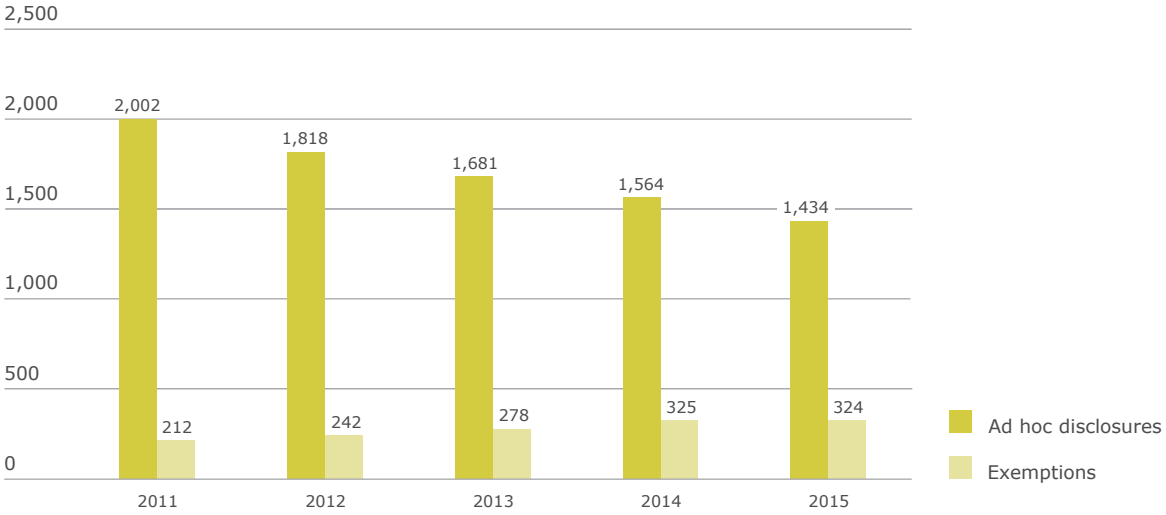
## 2.4 Ad hoc disclosures and managers' transactions

### 2.4.1 Ad hoc disclosures

In 2015, issuers published a total of 1,434 ad hoc disclosures (previous year: 1,564, see Figure 13 on page 233). Although the number of ad hoc disclosures declined again, the trend towards a higher proportion of exemptions continues.

BaFin expects the number of ad hoc disclosures to increase significantly in 2016. The reason is that, from 3 July 2016, Article 17 of the Market Abuse Regulation (MAR) will also require issuers on multilateral trading facilities (MTFs) to

**Figure 13** Ad hoc disclosures and exemptions




publish inside information in the form of ad hoc disclosures.

The prerequisite is that they have applied for or received authorisation to trade their financial instruments. In Germany, all regulated unofficial markets are MTFs. The obligation to publish ad hoc disclosures is already triggered by the application for listing. Likewise, participants in the market for emission allowances will in future be subject to not only the publication requirements under REMIT[30], but also the publication obligation under Article 2 of the MAR.

In 2015, a special focus area of BaFin's supervisory activities was the publication practice of companies in relation to corporate actions. Companies often announce corporate actions at short notice, followed immediately, in some cases only a few hours later, by a report that they have been implemented. BaFin found that the issuers often justified the delayed disclosure of the planned corporate action by invoking section 15 (3) of the Securities Trading Act *(Wertpapierhandelsgesetz)* in conjunction with section 6 no. 2 of the Securities Trading Reporting and Insider List Regulation *(Wertpapierhandelsanzeige- und Insiderverzeichnisverordnung)*. According to

30 Regulation (EU) No 1227/2011, OJ EU L 326/1.

§

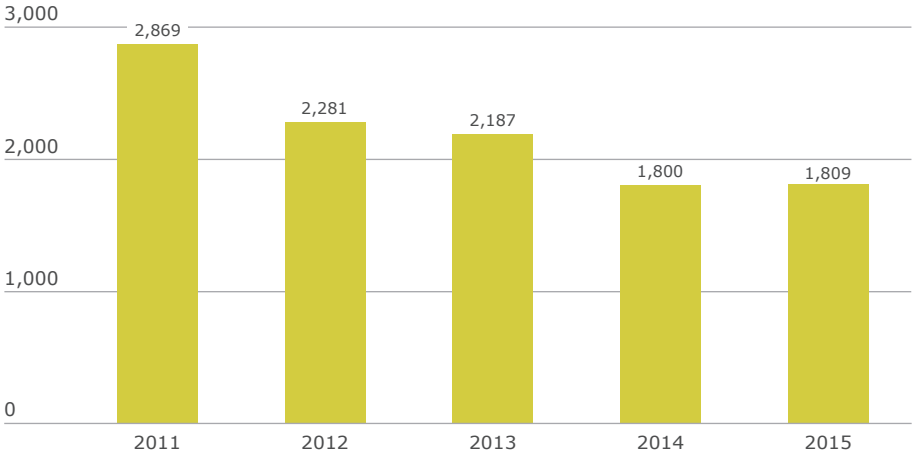
### Lafonta judgement

The so-called Lafonta judgement[31] of the Court of Justice of the European Union (CJEU) caused a stir in 2015. In this judgement, the CJEU commented on, among other things, the ability to influence significantly the prices of the financial instruments concerned as a criterion for assessing whether a crime has been committed. In order to determine the ability to influence the prices to a significant extent, it was ruled that it was not relevant whether the information would lead to a clear positive or negative effect on prices. Rather, it was sufficient that a significant effect on prices could be expected, irrespective of the direction.

BaFin adapted its administrative practice to the judgement of the CJEU. Even if, from an ex ante perspective, it was not possible to forecast a clear positive or negative effect on prices, for example because negative and positive effects cancelled each other out, BaFin will confirm the existence of inside information in cases where at least significant price movement was to be expected.

31 Judgement of the Court of Justice of the European Union dated 11 March 2015 (case ref. C-628/13).

**Figure 14** Managers' transactions




this reason for exemption, decisions of the board of management may only be delayed until the supervisory board has made its decision, if the approval required for the action to take effect is still pending. However, this approval requirement is only legitimate in a very small number of cases. BaFin therefore draws particular attention to the fact that the scope for applying this exemption is very narrow. In 2015, BaFin found objective evidence of violations of the obligation to publish immediately, because issuers had incorrectly assumed that the legitimate interest referred to in section 15 (3) of the Securities Trading Act in conjunction with section 6 no. 2 of the Securities Trading Reporting and Insider List Regulation applied to any decision of the board of management for which supervisory board approval is sought. BaFin notified the issuers of these violations and pursued some cases further in administrative fine proceedings.

### 2.4.2 Managers' transactions

Members of boards of management and supervisory boards as well as persons closely associated with them reported a total of 1,809 transactions for their own account in 2015 (previous year: 1,800; see Figure 14 "Managers' transactions").

## 2.5 Monitoring of short selling

### Prohibitions

The EU Short Selling Regulation[32] prohibits uncovered short sales in shares and certain types of sovereign debt. The same applies to taking positions in or entering into sovereign credit default swaps (CDSs) other than for hedging purposes. BaFin investigated 185 cases in relation to this in 2015, prompted by suspicious transaction reports and on the basis of its own evidence. Suspicious transaction reports related to sales by both companies and private individuals; BaFin also received voluntary self-reports.

BaFin discontinued 148 investigations (previous year: 17). Most of the discontinued investigations related to voluntary self-reports due to minor infringements, caused by human error, for example a misunderstanding when the customer placed an order. As at 31 December 2015, the investigation of 17 cases had not yet been completed (previous year: 60); of this total, two date from 2013, six from 2014 and nine from 2015. BaFin referred another 17 cases to other EU authorities for reasons of competence (previous year: 44). Four cases were pursued further in administrative fine proceedings (previous year: nine).

32 Regulation (EU) No 236/2012, OJ EU L 86/1.

### Transparency requirements

In 2015, BaFin again investigated 58 violations of the transparency requirements for net short positions (previous year: 61). It discontinued a total of 29 investigations (previous year: 31). As at 31 December 2015, the investigation of 28 cases had not yet been completed (previous year: 30); of this total, two date from 2012, six from 2014 and 21 from 2015. One case was referred to the Administrative Fines Division.

Net short positions are notified using BaFin's reporting and publishing platform. By the end of 2015, 998 companies and 17 private individuals had used this facility to submit a total of 1,977 applications for authorisation to BaFin. As in previous years, most parties subject to the notification requirement came from the United Kingdom and the USA. For shares admitted to trading on a regulated market or multilateral trading facility, 289 parties subject to the notification requirement notified BaFin in 2015 of 13,525 net short positions (previous year: 8,568; see Figure 15 "Notifications broken down by index") in 234 different shares (previous year: 199). This corresponds to an average of 54 notifications per trading day. A total of 4,074 notifications (previous year: 1,507) had to be published in the Federal Gazette in 2015, because the threshold of 0.5% of the share capital in issue had been crossed or reached. In addition, BaFin received 67 notifications for federal government debt securities (initial threshold: 0.5%), slightly fewer than in the previous year (86 notification). As in the previous year, there were no notifications for debt securities of the federal states (initial threshold: 0.1%). Most net short positions were built in shares of issuers on the regulated market.

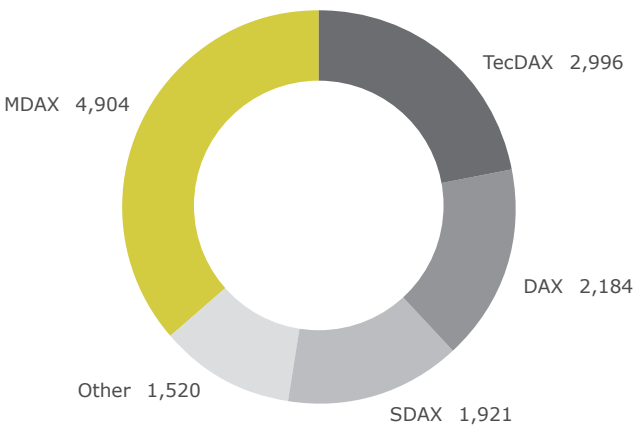
### Restrictions on short selling in exceptional circumstances

On 29 June 2015, the Greek supervisory authority, the Hellenic Capital Market Commission (HCMC), adopted a prohibition on short selling for Greek shares as an emergency measure. Emergency measures such as this one adopted in accordance with Article 20 of the EU Short Selling Regulation apply worldwide and can be ordered for a period of up to three months, with an option to extend.

The Greek measure comprised a prohibition on creating or enlarging net short positions in Greek shares. Among other things, this step was aimed at stabilising Greece's own financial market. In addition, stock exchange trading was suspended and credit institutions were closed. The prohibition on short selling was to have been in force until the end of 6 July 2015, but it was extended several times until the end of 31 August 2015.

From 1 to 30 September 2015, the HCMC then prohibited covered short sales of Greek shares. This measure was subsequently modified and from 1 October 2015 up to and including

**Figure 15** Notifications broken down by index



9 November 2015 only applied to shares of the five banks in the FTSE/Athex Banking Index.[33] This measure was extended several times until 21 December 2015.

On 21 December 2015, the HCMC prohibited covered short selling only for shares of Attica Bank S.A. This institution-specific prohibition initially applied until 11 January 2016, but was ultimately extended to 25 January 2016.

ESMA issued opinions on all these measures and extensions. In these opinions, ESMA comments on whether it believes supervisory steps are necessary and appropriate. Opinions can support or oppose the adoption of a measure, but the measure can be adopted even if ESMA is opposed to it. With the exception of the last extension, ESMA concurred with all the measures adopted.

Both the Portuguese supervisory authority, Comissão do Mercado de Valores Mobiliários (CMVM), and the Italian supervisory authority, Commissione Nazionale per le Società e la Borsa (CONSOB), prohibited short selling in 2015 because of significant price falls of a financial instrument at a trading venue. Such a prohibition only applies at the national trading venues for which it has been adopted, and can be ordered for a maximum duration of two trading days, with an option to extend. The competent authorities of other member states can then decide whether to replicate this step at their own trading venues. ESMA does not issue any opinions on these types of measures, which are based on Article 23 of the EU Short Selling Regulation. The Portuguese prohibition was in force on 8 January 2015 for the shares of Portugal Telecom, SGPS S.A.; the Italian prohibitions were in force on 13 January 2015 and 5 June 2015 for shares of Saipem S.p.A.

### Notifications by market makers

In 2015, 50 market makers (previous year: 49) and 33 primary dealers (previous year: 33) notified BaFin of their activity and made use of the exemptions from the ban on short selling and transparency requirements (see Table 34). Two of the 50 market makers notified BaFin that they had ended their activities in 2015; one new market maker was added. One of the 33 primary dealers issued notification of the end of its activities in the course of the year. A total of 43 of the 50 market makers submitted further notifications of intent, which are required if market makers extend their activities to include a new instrument or if primary dealers extend their activities to include public-sector debt securities from another issuer. In 2015, BaFin received a total of 1,221 notifications of intent from market makers (previous year: 1,160) and two notifications of intent from primary dealers (previous year: two).

**Table 34** Notifications by market makers and primary dealers

| | Market makers | Primary dealers |
|---|---|---|
| **Total number of companies** | **50** | **33** |
| of which from Germany | 46 | 9 |
| of which from abroad | 4* | 24** |
| **Total number of notifications in 2015** | **1,221** | **2** |
| **Total number of notifications since September 2012** | **3,670** | **37** |

* Non-EU third country.
** Domiciled outside Germany.

33 Alpha Bank A.E., Attica Bank S.A., National Bank of Greece S.A., Eurobank Ergasias S.A. and Piraeus Bank S.A.

## 2.6 Supervision of OTC derivative transactions

### Preparations for central clearing obligation

The European Market Infrastructure Regulation (EMIR)[34], which entered into force in 2012, sets out requirements on how the risk management of the counterparties involved must be handled for over-the counter (OTC) derivative transactions. In addition, EMIR provides the basis for requiring financial and non-financial counterparties to clear certain derivatives via a central counterparty (CCP). The first Commission Delegated Regulation that sets out the central clearing obligation for certain classes of interest rate derivatives entered into force on 21 December 2015.[35] Because of the transitional periods set out in this regulation, the clearing obligation will become effective for the first institutions in mid-2016. BaFin provided support for the companies affected during their preparations for the clearing obligation. In addition, BaFin established processes to enable companies that are in principle subject to the clearing obligation to be exempted from this obligation upon application or notification, once the risk-based factors for intra-group transactions, i.e. OTC derivative transactions within the group of consolidated companies, have been reviewed.

At the same time, the European Commission launched a consultation process on the review of EMIR in summer 2015, which gave both companies and supervisory authorities the opportunity to suggest any amendments to EMIR. The European Commission is expected to come forward with possible amendments to EMIR in the course of 2016.

No other legislative acts relating to the collateralisation of bilateral OTC derivative contracts entered into force in 2015, however. This should, in all probability, also happen in the course of 2016. From then on, financial counterparties and non-financial counterparties whose derivative position exceeds specified thresholds, will have to provide adequate recoverable collateral for derivative contracts not cleared via a central counterparty.

### Compliance with EMIR provisions

As part of its market surveillance, BaFin checked to what extent financial counterparties, such as insurers, investment services enterprises, banks and funds comply with the requirements for OTC derivative contracts. In this process, the audit reports are subjected to risk-based analysis and, if there are any queries or problems, the issue is investigated further. In two cases, effective enforcement of regulatory measures was threatened because the requisite processes had not been implemented. However, the companies subsequently changed their processes in order to be compliant with the law. Non-financial counterparties whose derivative position exceeds certain thresholds are required under section 20 of the Securities Trading Act *(Wertpapierhandelsgesetz)* to have an auditor certify that they comply with the key requirements of EMIR. If, in the auditor's opinion, there is evidence of deficiencies, the corresponding reports have to be handed to BaFin. BaFin used the reports prepared by the auditors in 22 cases as the basis for further investigations. It became apparent that the companies affected normally adjusted their processes as quickly as possible.

BaFin found that the details of reporting derivative transactions to the trade repositories are still causing difficulty. Problems frequently arise from the requirement that both parties to a derivative transaction have to report the transaction, but their reports cannot be matched because they have not agreed on a unique transaction identifier (UTI). However, to obtain data of consistent quality, it must be possible to identify matching trade repository reports. BaFin and other supervisory authorities are working at ESMA level towards improving data quality, for example by specifying a standard data format for trade repositories. The CPMI-IOSCO Working Group for the Harmonisation of Key OTC Derivatives Data Elements, in which BaFin is also involved, is

34 Regulation (EU) No 648/2012, OJ EU L 201/1.

35 Commission Delegated Regulation (EU) 2015/2205, OJ EU L 314/13.

working on guidance for, among other things, the UTI and the unique product identifier (UPI). The aim is to improve data quality further by making it easier for the parties to a derivative transaction to use compatible UTIs.

Moreover, since 2014, EMIR has required counterparties and central counterparties to report to one of the six trade repositories authorised in the EU when derivative contracts are entered into, amended, or terminated. This applies to both OTC and exchange-traded derivatives transactions. The trade repositories provide rejection lists with information on reports rejected as incorrect. These lists allow BaFin to uncover potential violations of the reporting requirement pursuant to section 18 of the Securities Trading Act in conjunction with Article 9 of EMIR.

ESMA has revised the regulatory technical standards (RTS) and implementing technical standards (ITS), which expand on the reporting requirement pursuant to Article 9 of EMIR, and submitted them to the European Commission for a decision. In addition, on 11 December 2015, ESMA published a consultation paper on the review of the technical standards on access to data in accordance with Article 81 of EMIR. Comments could be submitted until 1 February 2016. The results were still being analysed at the time of going to press.

## 2.7 Voting rights and duties to provide information to security holders

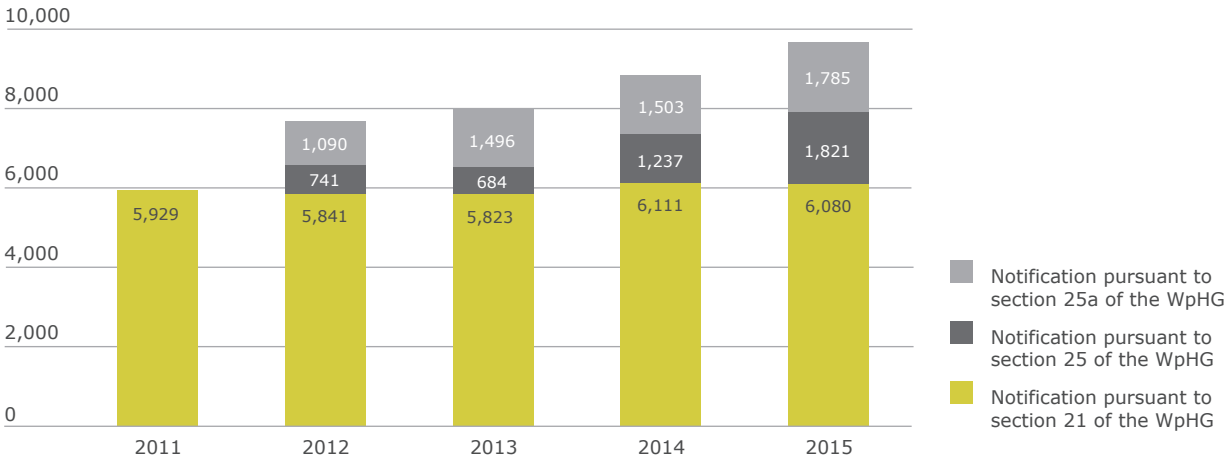
### 2.7.1 Voting rights

In 2015, a total of 6,080 voting rights notifications were issued, slightly fewer than in the previous year (previous year: 6,111, see Figure 16 "Voting rights notifications"). In the same period, the number of notifications on financial and other instruments, such as call options with physical settlement and rights of redemption under securities loans, received pursuant to section 25 of the Securities Trading Act *(Wertpapierhandelsgesetz)* again increased significantly, to 1,821 (previous year: 1,237). The number of notifications on financial and other instruments, such as call options with cash settlement and rights of first refusal, received pursuant to section 25a of the Securities Trading Act, also increased, to 1,785 (previous year: 1,503).

BaFin received a total of more than 9,500 notifications pursuant to sections 21, 25 and 25a of the Securities Trading Act and monitored their publication.

The number of companies admitted to trading on the regulated market declined further in 2015, from 716 in the previous year to 657 in 2015. The number of notifications these companies published on changes in their voting share capital also decreased to 350 (previous year: 386). At the end of 2015, three real estate

**Figure 16** Voting rights notifications



investment trusts (REITs) were still subject to the reporting requirement to BaFin.

### 2.7.2 Duties to provide information to securities holders

In 2015, issuers of listed securities reported a total of 215 planned changes in the legal basis of their activities to BaFin (previous year: 255). In addition, in 385 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: 520). Moreover, a large number of resolutions and events in connection with the annual general meeting are subject to the publication requirement. 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 3,086 cases in the year under review (previous year: 2,751).

## 3 Prospectuses

### 3.1 Securities prospectuses

The total number of prospectuses, registration documents and supplements approved in 2015 rose slightly to 1,810 (see Table 35 "Number of approvals in 2015 and 2014"). There were no cases in which BaFin declined to grant approval.

Particularly noteworthy is the fact that the number of prospectus procedures relating to shares increased significantly year-on-year: in 2015, there was a total of 86 such procedures, compared with 69 in the previous year. This is due to the increased number of IPOs and capital increases, among other factors.

Similar to the total number of documents approved, the number of securities prospectuses and supplements that BaFin notified to other national supervisory authorities under the European Passport also rose slightly, to 3,436 notifications issued (previous year: 3,281, see Table 36 "Notifications", page 240). Most of the notifications issued were again attributable to Austria and Luxembourg. 831 prospectuses – more than half of the 1,298 notifications received from other European countries – again came from Luxembourg in 2015.

The rising trend in total issue volume thus continued in 2015 (3,436,969, see Figure 17, page 240). A total of 3,436,840 final terms were submitted in the course of the year. This trend is expected to continue in 2016.

In Delegated Regulation (EU) 2016/301[36], the Commission expands on the formal requirements that apply to the prospectus approval process. The Regulation, which entered into force on 24 March 2016, also specifies how a securities prospectus has to be published and sets out rules for advertising.

For example, all draft prospectuses, including the accompanying documents, must be submitted to the competent supervisory authority electronically. At BaFin, this is done using the reporting and publishing platform

**Table 35** Number of approvals in 2015 and 2014

| Product | 2015 | 2014 |
|---|---|---|
| Shares (IPOs/capital increases) | 86 | 69 |
| Derivatives | 260 | 246 |
| Debt securities | 181 | 138 |
| Registration documents | 32 | 34 |
| Supplements | 1,251 | 1,231 |
| **Total** | **1,810** | **1,718** |

36 Commission Delegated Regulation (EU) 2016/301, OJ EU L 58/13.

**Table 36** Notifications

| Country | Notifications issued | Notifications received |
|---|---|---|
| Austria | 1,075 | 85 |
| Belgium | 82 | 8 |
| Bulgaria | 1 | 0 |
| Czech Republic | 7 | 0 |
| Denmark | 26 | 0 |
| Finland | 80 | 1 |
| France | 130 | 105 |
| Greece | 1 | 0 |
| Ireland | 69 | 113 |
| Italy | 146 | 0 |
| Liechtenstein | 174 | 13 |
| Luxembourg | 935 | 831 |
| Netherlands | 267 | 54 |
| Norway | 104 | 0 |
| Poland | 4 | 0 |
| Portugal | 34 | 0 |
| Spain | 83 | 1 |
| Sweden | 72 | 3 |
| United Kingdom | 146 | 84 |
| Others | 0 | 0 |
| **Total** | **3,436** | **1,298** |

(MVP Portal). The only additional requirement is a signed print-out of the approval version of prospectuses and supplements.

The Delegated Regulation also clarifies that access to a prospectus published electronically must not be made dependent on the payment of a fee or the investor's prior registration on the corresponding website, even if registration is free of charge.

If a significant new factor or material mistake or inaccuracy leads to a supplement being published and this renders the contents of the previously disseminated advertisement inaccurate or misleading, the issuer has to amend the advertisement. The issuer is required to specify in the new version of the advertisement the points where it is different from the previous version.

## 3.2 Non-securities investment prospectuses

At the beginning and in the middle of 2015, issuers of non-securities investment products were initially rather slow at submitting prospectuses to BaFin. This was because the German Retail Investor Protection Act *(Kleinanlegerschutzgesetz)* was about to enter into force. This Act provided for a transitional period until the end of 2015, during which

**Figure 17** Total issue volume

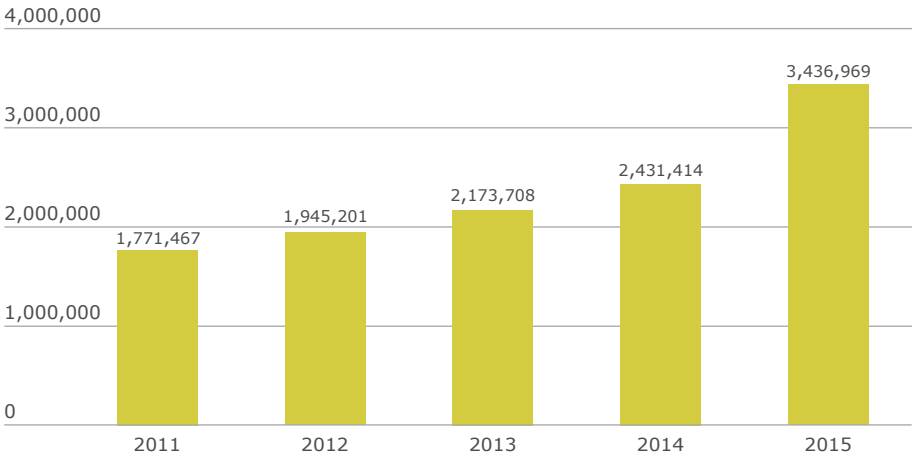
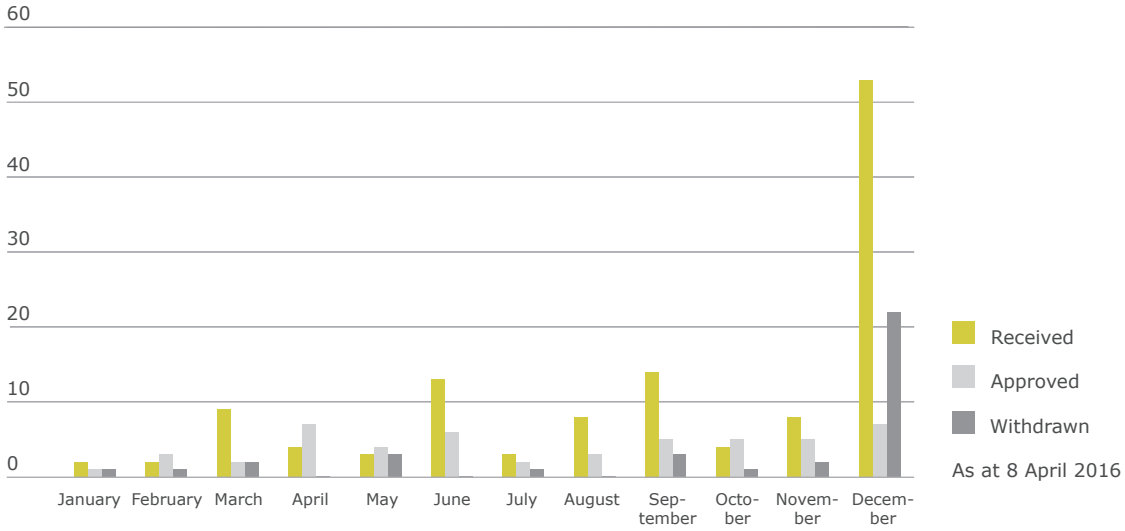


**Figure 18** Prospectuses received, approved, withdrawn and rejected




certain investment products, such as direct investments (containers, commodities etc.) did not require a prospectus. Shortly before the end of this period, in December 2015, restraint was abandoned, and a considerable number of prospectuses were submitted to BaFin. A total of 123 non-securities investment prospectuses were received for review, up from the 104 documents received in the previous year (see Figure 18). Due to the expanded prospectus requirements, the increasing submissions trend is expected to intensify further in 2016. BaFin approved 50 prospectuses (previous year: 53); no unauthorised public offers were rejected. Issuers withdrew their applications in 36 cases. The remaining processes, especially those started at the end of the transitional period, continued at the end of 2015, so that the increase in the number of approvals will only reflect in the 2016 statistics.

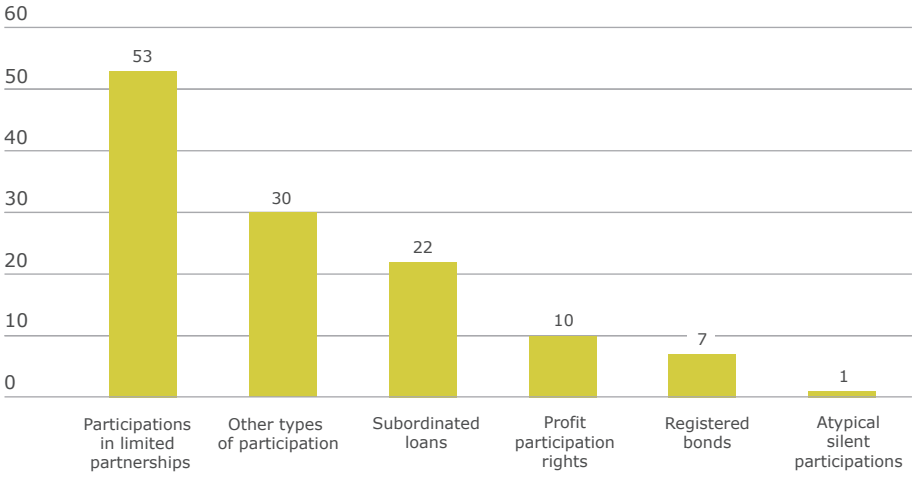
In particular the new minimum requirements for financial information led to greater review needs, which in turn translated into longer processing times. For example, under the new requirements, issuers have to demonstrate their ability to meet their obligations to investors in terms of financial position and financial performance as well as business prospects.

Broken down by type of participation, the greatest share was represented by participations in limited partnerships, accounting for 53 prospectuses submitted (around 48%, previous year: 56%). This was followed by subordinated loans, for which 22 prospectuses were submitted (around 18%); this category required a prospectus for the first time due to the Retail Investor Protection Act. Ten submissions were received for participation rights (around 8%, precious year: 13%). Registered bonds declined significantly (around 6%, previous year: 28%, see Figure 19 "Prospectuses by type of participation", page 242).

As at 10 July 2015, the Retail Investor Protection Act for the first time introduced a prospectus requirement for subordinated loans, profit participation loans and other investments that grant a right to interest and redemption or grant a right amounting to cash settlement in exchange for the temporary provision of funds. However, if the new investments were offered to the public before the Retail Investor Protection Act entered into force, the prospectus requirement only applies as from 1 January 2016.

Among the target investments offered, renewable energy again took first place, with 41 prospectuses received (around 33%, previous year: 52%, see Figure 20 "Prospectuses by target investment", page 242) – despite a falling trend. The proportion represented by wind power (37 prospectuses or 30%) was down significantly on the previous year (41%). Investments in solar power facilities declined

**Figure 19** Prospectuses by type of participation

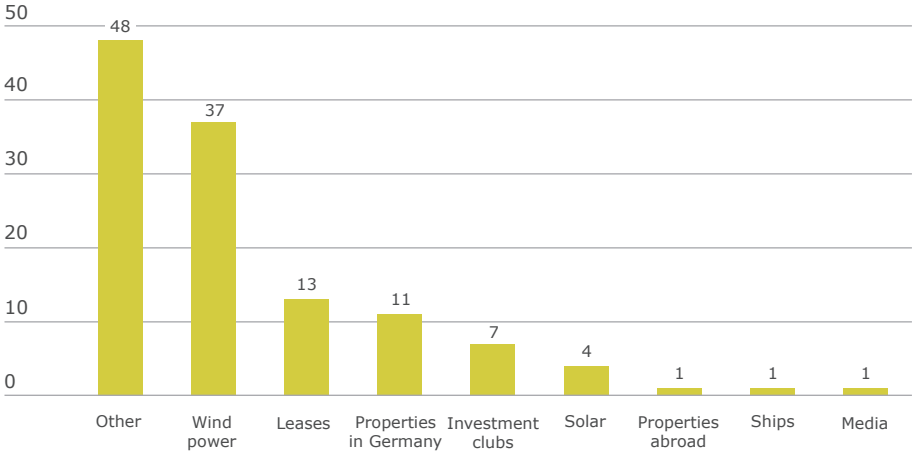



considerably to 3% (previous year: 10%), while for the first time there were no prospectuses for biogas plants (previous year: 1%). Twelve prospectuses were received for real estate as investment target (around 10%), thus remaining constant year-on-year; eleven prospectuses (around 9%, previous year: 5%) related to investments in German real estate and only 1% (previous year: 5%) to foreign real estate. Investment clubs, at 6%, and ships, at just under 1%, returned to the mix of target investments in the reporting period. Leasing accounted for around 11% with 13 prospectuses received, thus representing a notable proportion of investments.

Other target investments continued to represent a significant proportion of prospectuses received alongside the traditional target investments, accounting for 48 prospectuses received (39%, previous year: 38%). This category captured above all blind pool structures, where the target investments are not known at the time of purchase. They are only selected at a later date according to investment criteria defined in advance.

The number of supplements again fell significantly compared with the previous year: a total of 38 applications for the approval of supplements under the Capital Investment Act *(Vermögensanlagengesetz)* were submitted, compared with 70 in the previous year. 34 supplements were approved in the reporting period (previous year: 64).

**Figure 20** Prospectuses by target investment



# 4 Company takeovers

## Offer procedures

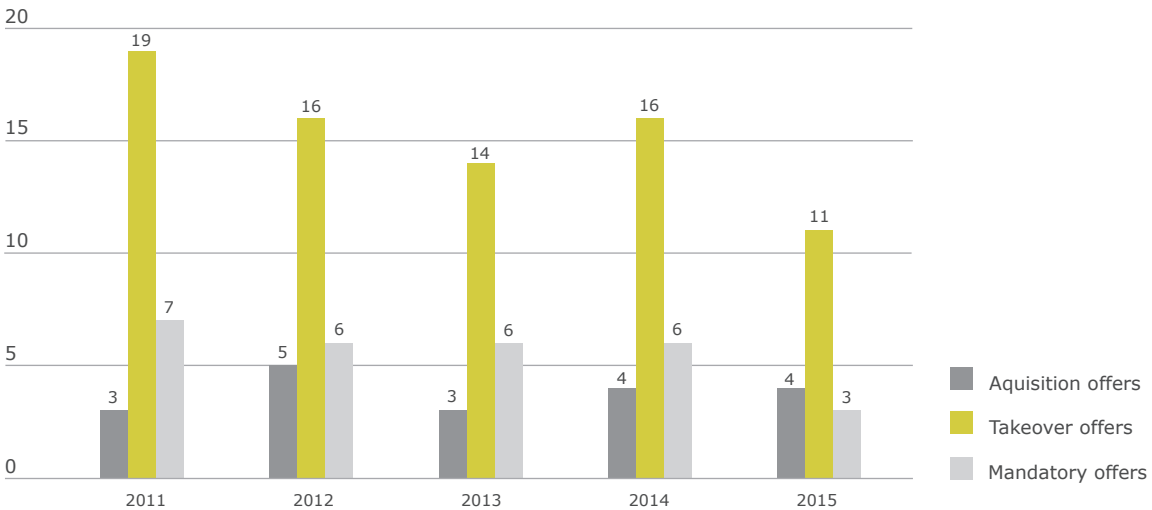
In 2015, BaFin examined a total of 19 offer documents and approved their publication in 18 cases (previous year: 26). One offer document was rejected (see Figure 21).

## Takeover battle between Vonovia SE and Deutsche Wohnen AG

The backdrop of the only takeover bid that BaFin rejected in 2015 was the (indirect) takeover battle between Vonovia SE (formerly Deutsche Annington Immobilien SE) and Deutsche Wohnen AG. The process was started by Vonovia SE, which wanted to prevent an exchange offer announced by Deutsche Wohnen AG to the shareholders of LEG Immobilien AG. It announced therefore that it intended to take over Deutsche Wohnen AG. Following this announcement, Deutsche Wohnen AG cancelled its extraordinary general meeting scheduled for 28 October 2015. In a statement published on 21 October 2015, Deutsche Wohnen AG explained that following the "hostile attempt" by Vonovia SE, influential institutional voting rights consultants had changed their recommendation. For this reason, it was no longer possible to achieve the 75% majority required for corporate actions. The scheduled general meeting was to have resolved on a capital increase against contributions in kind. Deutsche Wohnen AG had planned to use this as a way to create the shares it intended to pay as consideration to the shareholders of LEG Immobilien AG. Since Deutsche Wohnen AG had cancelled the general meeting and thus also the capital increase, BaFin could no longer assume that the financing of the exchange offer was secure (see info box on page 244). BaFin therefore had to prohibit the offer because of an apparent violation of the German Securities Acquisition and Takeover Act *(Wertpapiererwerbs- und Übernahmegesetz)*.

The fact that Deutsche Wohnen AG's exchange offer was rejected was therefore partly due to its own actions. This allowed the company to release itself from its fundamental obligation – triggered by the announcement of a takeover bid – to publish an offer document. However, this release mechanism created by the legal system by no means constitutes a legal right to cancel for the bidder or a precedent condition analogous to section 18 of the Securities Acquisition and Takeover Act. On the contrary, the prohibition of an offer triggers further legal consequences that could hurt the bidder. Eligible tools are the lockup period in accordance with section 26 of the Securities Acquisition and Takeover Act, administrative fines, if appropriate, and in extreme cases investigations into market abuse.

**Figure 21** Offer procedures



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### Securing the financing of exchange offers

Section 13 of the German Securities Acquisition and Takeover Act *(Wertpapiererwerbs- und Übernahmegesetz)* requires the bidder to take all measures necessary to ensure, before the offer document is published, that it has all the funds required to fulfil the offer in full when the claim to consideration becomes due. Unlike in the case of cash offers, the provisions for exchange offers do not specify that an investment services institution independent of the bidder has to confirm that it has in fact taken the necessary financing measures. This makes the level of protection different in such cases. BaFin has to account for this fact by expanding the scope of review for exchange offers. If bidders are planning to finance an exchange offer with a capital increase, the required resolution on the capital increase therefore has to have been adopted at the time BaFin authorises the publication of the offer document. In addition, bidders have to mitigate the risk of contesting actions and actions for annulment under stock corporation law by formulating the terms and conditions accordingly in the offer document.

Vonovia SE's subsequent cash/exchange offer for Deutsche Wohnen AG was ultimately unsuccessful, because the minimum acceptance threshold, which had been reduced to 50% plus one share, was not achieved.

## Acquisition of property companies by way of exchange offers

Even apart from the takeover battle between Vonovia SE and Deutsche Wohnen AG, BaFin observed a continuing trend of attempts to acquire property companies by way of exchange offers. Offers were made by Adler Real Estate Aktiengesellschaft to the shareholders of Westgrund AG, by alstria office REIT-AG to the shareholders of DO Deutsche Office AG, by Demire Deutsche Mittelstand Real Estate AG to the shareholders of Fair Value Reit AG and by Vonovia SE to the shareholders of Deutsche Wohnen AG so that there were a total of five bidders in 2015 that offered the shareholders of the target company own shares as consideration, at least in part.

For bidders wanting to acquire property companies by way of exchange offers, there are normally two aspects of particular relevance under takeover law. When the bidder in an exchange offer wants to implement the transaction with shares as consideration, it often has to comply with other countries' regulations on public offers of shares as a result. This can lead to conflicts for the bidders, because they may in such cases be subject to the laws of different legal systems that are not coordinated with each other. The bidders then try to avoid such conflicts of laws by asking BaFin for authorisation to exclude certain shareholders from the offer. It is, however, only possible to exclude shareholders in this way under specific, narrowly defined circumstances. For certain shareholders resident in the United States, BaFin allows bidders to use a special exchange offer procedure known as vendor placement, under which shares that would have to be granted to the shareholders concerned as consideration are sold on the stock exchange on their behalf so that the proceeds can be then be paid over to them. The key criterion is that bidders have to be able to argue credibly that, by using the vendor placement procedure, they can avoid the obligation to have their shares registered in the United States and that, based on the specific design of the vendor placement, the affected shareholders are only impacted to a minor extent. Otherwise shareholders resident in the United States would face the risk of being excluded from the offer in accordance with section 24 of the Securities Acquisition and Takeover Act.

The second aspect is that bidders in exchange offers for property companies constantly try to make sure that they acquire less than 95% of the share capital of the target company and in order to claim an exemption from real estate

transfer tax *(Grunderwerbsteuer)*. However, bidders that do not submit exchange offers in a permissible manner cannot limit their offers from the outset to acquiring less than 95% of the share capital of the target company, since this is contrary to the principle of having to make a full offer (see info box).

Bidders have used various means in the past to make sure that they acquire less than 95% of the target company without violating the full offer principle.

For example, the bidder in the exchange offer made by Vonovia SE to the shareholders of Deutsche Wohnen AG had planned to transfer a portion of the tendered shares of the target company directly – without the bidder acquiring them in the interim – to a third party (a bank) as part of processing the offer. In this way, the bidder wanted to make sure that there would be no way under the exchange offer to acquire more than 95% (rounded down to the next whole share) less 10,000 shares of the Deutsche Wohnen shares outstanding. This approach may be permissible under takeover law, as there are no provisions in the Securities Acquisition and Takeover Act that necessarily require the shares offered to the bidder under the offer to be transferred to the bidder. But the construct selected must not violate any general rules of takeover law. For example, it would not be permissible not to allow some shareholders of the target company to turn to the bidder to enforce their fulfilment claims under the offer, because the bidder has already entered into an exchange agreement with the third party. This would violate the principle of equal treatment under takeover law. What is more, bidders are not allowed to argue vis-à-vis the shareholders of the target company that the transfer, to a third party, of a portion of the shares tendered to the bidder results in certain thresholds not being reached that are relevant under takeover law. This applies in particular to the threshold of 95% of the voting rights of the target company, which triggers the right of sell-out in accordance with section 39c of the Securities Acquisition and Takeover Act.

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### Full offer principle

The full offer principle set out in section 32 of the Securities Acquisition and Takeover Act specifies that a takeover bid or mandatory offer is inadmissible, if it is aimed at only a portion of the shares of the target company. A takeover bid is defined as an offer subject to the Securities Acquisition and Takeover Act if it is aimed at gaining control over a target company. Takeover law specifies a control threshold of 30% of the voting rights. With the exception of the provisions of section 24 Securities Acquisition and Takeover Act (certain cross-border offers), bidders can only make limited partial offers, if the intention of the offer is to acquire less than 30% of the voting rights of the target company. The same applies to bidders that already hold a control-relevant interest in the target company.

In the exchange offer made by Adler Real Estate Aktiengesellschaft to the shareholders of Westgrund AG, the bidder had made arrangements with certain shareholders, according to which these shareholders would have been required to withdraw from the offer, if otherwise the bidder had had to acquire more than 95% of the shares of the target company. The exchange offer made by alstria Office REIT-AG to the shareholders of DO Deutsche Office AG contained similar arrangements: in that offer, certain shareholders had undertaken to refrain from tendering a portion representing 5.4% of the respective share capital of the target company as part of the offer. Such types of exchange offer constructs may also be permissible under takeover law. The key factor is again that no general takeover law rules are violated in the specific case. For example, it would be a violation of the principle of equal treatment in takeover law, if the bidder gave individual shareholders the option to cancel their legally effective acceptance of the offer, while all other shareholders could only cancel their acceptance declaration in cases regulated by law. The same applies to

cases where the bidder specifies in the offer document that acceptance declarations by certain shareholders only become effective under certain conditions. Moreover, under section 150 (2) of the German Civil Code *(Bürgerliches Gesetzbuch)*, conditional acceptance of the offer would de facto not be acceptance of the offer at all.

### Exemption procedures

In 2015, BaFin received 88 applications for exemption or non-consideration (previous year: 100). In 31 cases, holders of voting rights requested non-consideration of voting rights in accordance with section 36 of the Securities Acquisition and Takeover Act (previous year: 60), while 57 applications for exemption were made in accordance with section 37 of the Securities Acquisition and Takeover Act (previous year: 41). BaFin approved 34 applications. Five applications were withdrawn and 49 were still being processed at the end of 2015. In 2015, many applications for exemption from the obligation to make an offer or for non-consideration of voting rights were again submitted for reasons related to inheritance law. In many cases, holders of larger blocks of shares had opted to pass some of these shares to their heirs by way of anticipated inheritance during their lifetime. The parties concerned often consulted BaFin prior to taking this step. Unintended violations of the Securities Acquisition and Takeover Act can normally be avoided by doing so.

In some cases, however, the parties concerned do not know that even to order the execution of the will may have consequences under takeover law. Thus BaFin assumes that, in accordance with section 30 (1) sentence 1 no 6 of the Securities Acquisition and Takeover Act, executors have to have voting rights from shares belonging to a deceased estate attributed to them, if they can exercise these rights under their administrative powers. This means that obligations under takeover law may also arise for executors. Moreover, there may be cases where, as a result of their conduct, executors trigger other voting rights to be attributed to them from shares that do not belong to the deceased estate. An example is a voting agreement entered into with other shareholders that leads to this kind of attribution.

## 5 Financial reporting enforcement

### Monitoring of financial reporting

The number of companies subject to the German enforcement procedure by BaFin and the German Financial Reporting Enforcement Panel (FREP, *Deutsche Prüfstelle für Rechnungslegung*) declined significantly in 2015. As at 1 July 2015, only 686 companies from 19 countries were affected (previous year: 756 companies from 21 countries).

Following amendments to the Securities Trading Act *(Wertpapierhandelsgesetz)*, which entered into effect on 1 January 2016, companies are no longer subject to financial reporting enforcement on the basis of the admission of securities to trading on an organised market in Germany. The relevant criterion is now their home country. One of the consequences is, for example, that issuers of shares are no longer subject to financial reporting enforcement in Germany, if they have their registered office in another member state of the European Union (EU) or in another signatory to the Agreement on the European Economic Area, even though their securities are also admitted to trading on the organised market in Germany. In contrast, issuers of shares whose registered office is in Germany and whose securities are exclusively admitted to trading on an organised market in another EU member state are now monitored by the FREP. Moreover, in special constellations, issuers may also have the option to choose a home country. This may, for example, apply to issuers of shares whose registered office

is in a third country and whose securities are registered for trading on an organised market in Germany and on another organised market in the European Union or a signatory to the Agreement on the European Economic Area.

The FREP completed a total of 81 examinations in 2015 (previous year: 104), of which 71 were sampling examinations. BaFin itself performed financial reporting enforcement procedures at 15 companies (previous year: 11) and ordered the publication of errors in 11 cases. The FREP had previously identified errors in consultation with the relevant companies in eight of the 15 cases (see Table 37 "Enforcement procedures"). The remaining seven cases were based on error identification procedures performed by BaFin. In four of these cases, the companies had not accepted the FREP's findings, and in two cases the companies had refused to cooperate with the FREP. In one case, BaFin reported that it had material doubts as to the accuracy of the FREP examination findings. A total of three of the seven cases ended in error findings. For these three procedures, BaFin ordered the publication of the findings. The procedures related to various accounting issues, such as the recognition of inventories even though the corresponding goods had been delivered or the failure to recognise liabilities even though the recognition criteria were met. In the management and group management report, the findings related to, among other things, the consequences of violating clauses in a loan agreement in the presentation of the position and business performance of the company and of the assessment and explanation of risks of future development. Eight cases were still pending at BaFin at the end of 2015.

### Publication of financial reports

In 2015, BaFin examined in approximately 950 cases whether the issuers had published their online annual and half-yearly financial reports on time. 28 cases were referred to the BaFin division responsible for administrative offences due to failures to comply with obligations (previous year: 27 cases). The compliance ratio is on a level with the previous year.

BaFin launched eight administrative procedures to enforce the financial reporting requirements. A total of 23 proceedings were still pending from the previous year. BaFin closed 17 administrative proceedings.

During administrative proceedings, BaFin threatened coercive fines in 14 cases in order to enforce the publication of financial reports. BaFin imposed coercive fines of up to €165,000 in 12 cases, which were paid in five cases. Execution was levied in the remaining seven cases.

**Table 37** Enforcement procedures

| | Error findings: yes | Error findings: no | Error publication: yes | Error publication: no |
|---|---|---|---|---|
| Company accepts FREP's findings | 8 | | 8 | 0 |
| Company does not accept FREP's findings | 3 | 1 | 3 | 0 |
| Company refuses to cooperate with FREP | 0 | 2 | 0 | 0 |
| BaFin has material doubts as to the accuracy of the FREP examination findings/ procedure | 0 | 1 | 0 | 0 |
| BaFin takes over the examination (banks, insurance undertakings) | 0 | 0 | 0 | 0 |
| **Total** | **11** | **4** | **11** | **0** |

As a result of the Act Implementing the Transparency Directive Amending Directive *(Gesetz zur Umsetzung der Transparenzrichtlinie-Änderungsrichtlinie)*, which entered into force on 26 November 2015, management is no longer required to prepare or publish interim management statements. Companies in certain commodity sectors are now required to submit and publish an annual report on payments.

A simplification for issuers is that they now have up to three months from the end of the reporting period to publish half-yearly financial reports instead of the previous two months.

# 6 Supervision of the investment business

## 6.1 German asset management companies and depositaries

In 2015, BaFin authorised 26 German asset management companies *(Kapitalverwaltungsgesellschaften)* to manage investment funds in accordance with the German Investment Code *(Kapitalanlagegesetzbuch)* (previous year: 97). One management company surrendered its authorisation (previous year: three). This meant that, at the end of 2015, 138 management companies were licensed in accordance with the Investment Code (previous year: 113). In addition, 74 German management companies registered in accordance with section 44 of the Investment Code (previous year: 143), taking the total number of management companies registered as at the end of 2015 to 218 (previous year: 143). In 18 cases, management companies established a branch in another EU member state or offered cross-border services for the first time. A total of 19 companies from other EU countries notified BaFin that they had established a branch or started providing cross-border services in Germany.

BaFin allocates supervised external management companies that require authorisation to risk classes, which it uses to define how closely they are supervised. A two-dimensional matrix is used for this purpose, which considers not only the quality of the company, but also the potential market impact of any errors (see Table 38 "Risk classification of German asset management companies").

BaFin performed a total of 90 supervisory visits and annual interviews on site in 2015 (previous year: 80). In addition, it accompanied 16 audits and special audits at German asset management companies and depositaries. BaFin examined the management companies for, among other criteria, compliance with the general rules of conduct and organisation obligations. Other focus areas of BaFin were liquidity and risk management systems, and it also examined whether the companies had met their organisational obligations in relation to outsourced areas. Among other things, the special audits at depositaries were aimed at

**Table 38** Risk classification of German asset management companies

| German asset management companies | | Quality | | | | Total |
|---|---|---|---|---|---|---|
| | | A | B | C | D | |
| Impact | High | 12 | 0 | 0 | 0 | 12 |
| | Medium | 9 | 3 | 0 | 0 | 12 |
| | Low | 46 | 9 | 0 | 0 | 55 |
| | **Total** | **67** | **12** | **0** | **0** | **79** |

identifying whether adequate mechanisms and processes had been established for the control of investment limits in accordance with the provisions of the Investment Code. BaFin also examined whether the regulatory requirements were met when unit prices were determined and when unit certificates were issued and redeemed. In relation to securities lending transactions, it established whether the required collateral for securities lending had been duly provided and was available at all times.

In addition, as part of its regular trend scouting activities, BaFin analysed the information on how the German asset management companies deal with the prevailing low interest rate environment, which it had gathered from in its annual interviews between mid-2014 and the first quarter of 2015.

The German Act Implementing the UCITS V Directive *(OGAW-V-Umsetzungsgesetz)* entered into force on 18 March 2016. Firstly, the Act transposes the provisions of the UCITS V Directive and includes, for example, rules for UCITS management companies, expands on the tasks and obligations of the UCITS depositary and harmonises sanctioning powers. Secondly, it also contains regulations not specified by the UCITS V Directive, such as rules on lending by AIFs.

## 6.2 Investment funds

The German investment market continued to grow in 2015. Despite various price fluctuations, most of which affected the stock market, special and retail funds recorded cash inflows. Broken down by fund type, the fund volumes of both equities funds and mixed securities funds increased. In contrast, the fund volume of bond funds was down on the previous year.

At the end of 2015, the German asset management companies managed a total of 5,649 investment funds (previous year: 5,410) with assets amounting to €1,743 billion (previous year: €1,421 billion). Of these funds, 1,777 (previous year: 1,617) were retail funds with assets totalling €427.0 billion (previous year: €363.3 billion) and 3,872 (previous year: 3,789) were special AIFs with assets of €1,316 billion (previous year: €1,058 billion).

Aggregate (net) cash inflows into retail funds and special funds amounted to €146.1 billion (previous year: €91.3 billion). (Gross) cash inflows amounted to €367.5 billion (previous year: €283.1 billion), of which €137.3 billion were attributable to retail investment funds (previous year: €96.4 billion) and €230.2 billion to special AIFs (previous year: €186.7 billion). This was set against total cash outflows totalling €221.4 million (previous year: €191.8 million).

In 2015, BaFin approved a total of 230 new retail investment funds in accordance with the Investment Code, including 121 UCITS, 36 open-ended retail AIFs and 73 closed-ended retail AIFs.

### 6.2.1 Open-ended real estate funds and hedge funds

As at the end of 2015, BaFin supervised 45 German asset management companies *(Kapitalverwaltungsgesellschaften)* authorised to manage open-ended real estate funds (previous year: 43). Two of the companies were granted their authorisation in 2015.

While 21 German asset management companies had also launched open-ended real estate funds for retail investors (previous year: 20), the other 24 companies (previous year: 23) had thus far limited their activities to the management of open-ended real estate special funds.

One open-ended real estate fund for retail investors was issued in the course of 2015, increasing the number of these funds to 48 (previous year: 47). The fund volume of this market segment amounted to €85.2 billion as at the end of the year (previous year: €82.9 billion).

Following declines in gross cash inflows in previous years, open-ended real estate funds

for retail investors increased again in 2015, to €7.0 billion (previous year: €5.3 billion). In contrast, gross cash inflows into open-ended real estate special funds increased substantially for the fifth year in succession, to €13.0 billion (previous year: €10.2 billion). The fund assets of open-ended real estate special funds amounted to €64.5 billion at the end of the year (previous year: €54.8 billion).

19 open-ended real estate funds for retail investors were in liquidation at the end of 2015 (previous year: 18). Their fund volume amounted to €10.8 billion (previous year: €13.7 billion). The management rights for 11 of these funds have already been transferred to the depositary (previous year: eight). In the case of another real estate fund for retail investors, redemption of units is still temporarily suspended.

There were 24 hedge funds in Germany at the end of 2015, including four funds in which retail investors were still invested on the basis of transitional provisions. The total volume under management was around €2.85 billion. The number of German funds of hedge funds fell to zero.

### 6.2.2 Foreign investment funds

The number of EU UCITS authorised for marketing amounted to 10,513 in 2015 (previous year: 9,003). BaFin processed a total of 846 new notifications by companies wanting to market EU UCITS in Germany (previous year: 1,087). As in previous years, most of the notifications – 383 in total – came from Luxembourg. In addition, 178 notifications were received from Ireland, 63 from France and 39 from Austria. Marketing was discontinued for 608 EU UCITS.

In addition, 1,324 EU AIFs and 168 AIFs from third countries were authorised to conduct marketing in Germany (previous year: 609 EU AIFs und 92 AIFs from third countries). Of the total number, 675 originated in Luxembourg, 202 in the United Kingdom, 223 in Ireland, 73 in the Cayman Islands, 62 in the USA, 41 in France, five in Switzerland and 21 in the Netherlands. In 2015, marketing for 486 AIFs started in Germany, including 137 from Luxembourg, 133 from the UK, 28 from Ireland, 14 from the Cayman Islands and 47 from the USA. 68 EU AIFs and foreign AIFs ceased marketing, including 26 from Luxembourg, 16 from the UK and 15 from Ireland.

### 6.2.3 AIFMD reporting

In accordance with the Alternative Investment Fund Managers Directive (AIFMD), AIFs and German asset management companies *(Kapitalverwaltungsgesellschaften)* that manage or market AIFs in Germany have to provide BaFin with comprehensive data on the funds and their managers, including, for example, volume or risk positions. The reported data is mainly intended to allow BaFin and ESMA to detect potential systemic risk at an early stage so that countermeasures can be taken. Since the required information is very complex, the data can only be captured electronically. For this reason, BaFin has implemented a new process, which the companies can use to upload the required data in XML format via BaFin's reporting and publishing platform (MVP Portal). 343 German asset management companies participate in this reporting system, reporting data for 5,192 AIFs. In addition, BaFin expects data for 179 foreign AIFs authorised for marketing in Germany.

In preparation for the reporting system, BaFin contacted the companies concerned to make them aware of the new requirements. BaFin also published a number of helpful guides on AIFMD reporting in the course of the year, including for example a guidance notice, annotated examples of the XML reports and updates to the e-mail procedure. Furthermore, it set up a special support post box for AIFMD reporting. BaFin processed a total of 1,500 queries relating to the reporting system from industry representatives and associations in 2015.

At the beginning of February 2015, BaFin also launched a test system for AIFMD reporting, which allows companies subject to the reporting

requirement to test their own systems and their connection to the BaFin system in a secure environment before the actual reports are uploaded. The AIFMD reporting system went live on 10 August 2015. First of all, the companies uploaded the reports required retrospectively. As from this date, the data was also transferred to ESMA, as required by law. The companies, ESMA and BaFin used the subsequent months to fine-tune the systems and iron out a few difficulties that had occurred at the beginning. Most of these problems had been eliminated by the end of November 2015.

All AIFs and their managers submitted the first regular annual report as at 31 December 2015. The companies had until the end of January 2016 to transfer the data to BaFin; funds of funds had until the middle of February 2016. BaFin first checks the data for completeness before starting the actual analysis.

### 6.2.4 Trustees as depositaries for closed-ended funds

Since the German Investment Code *(Kapitalanlagegesetzbuch)* entered into force, an increasing number of AIF management companies have made use of the option to appoint trustees as depositaries for closed-ended funds. These trustees – lawyers, tax advisers, public auditors *(Wirtschaftsprüfer)* and sworn auditors *(vereidigte Buchprüfer)* – perform the functions of the depositary as part of their professional or business activities, although these activities do not have to be the main focus of their job. They act exclusively as depositaries for closed-ended AIFs invested in tangible assets in accordance with section 80 (3) of the Investment Code.

In 2015, BaFin approved the selection of such trustees as depositaries for closed-ended retail AIFs in 15 cases and examined four appointments of such trustees for special AIFs.

The trustees do not have to submit annual reports or audit reports on their depositary activities to BaFin. They are only required to notify BaFin of any changes affecting their financial and professional guarantees. BaFin has therefore decided to routinely conduct special inspections in addition to the ongoing supervision of trustees. BaFin conducted the first routine inspection with its own staff in the 4th quarter of 2015. The main focus of the inspection was to establish whether the business processes of the trustee activities were compliant and whether the financial and professional guarantees were adequate.

### 6.2.5 Circular on valuers

In July 2015, BaFin published its circular on the requirements for the appointment of external valuers for properties and property companies (*"Anforderungen bei der Bestellung externer Bewerter für Immobilien und Immoblien-Gesellschaften"*; only available in German). Before the German Investment Code *(Kapitalanlagegesetzbuch)* entered into force, these valuers were referred to as experts *(Sachverständige)* in the previous Investment Act *(Investmentgesetz)*. Until July 2015, the requirements for appointing external valuers of properties were based on a letter of the former Federal Banking Supervisory Office *(Bundesaufsichtsamt für das Kreditwesen)* dating from 1994.

BaFin had to issue the new circular, because the Investment Code lays down new rules both for the valuation process of directly or indirectly held tangible assets in investment funds and for the requirements for valuers. In addition, the valuation of closed-ended investment funds is now also regulated by law for the first time: the managers of these funds have to notify BaFin of the appointment of valuers for these funds. Since the Investment Code allows not only natural, but also legal persons as external valuers, the requirements for their appointment also had to be expanded. Other amendments relate to the conditions applicable to the appointment of valuers determining the value of investments in property companies in accordance with section 250 (1) no. 2 of the Investment Code. These valuers are auditors within the meaning of section 319 of the German Commercial Code *(Handelsgesetzbuch)*, i.e. public auditors *(Wirtschaftsprüfer)* and auditing firms.

Although the principles laid down in the circular are designed primarily for valuers of properties and property companies, they can also be applied to the appointment of external valuers for other assets.

# 7 Administrative fine proceedings

## 7.1 Administrative fines

In 2015, BaFin instituted a total of 421 new proceedings for the imposition of administrative fines relating to violations of the provisions of securities law (previous year: 514; see Table 39 "Administrative fine proceedings" on page 253). A total of 1,101 cases were still pending from previous years. BaFin concluded 180 proceedings with administrative fines (previous year: 164) totalling around €7.2 million (previous year: €3.8 million).

The prosecution ratio was approximately 37.8% in 2015 (previous year: 38.7%). BaFin discontinued 296 proceedings, 236 for discretionary reasons. 1,046 cases were still pending at the end of 2015.

## 7.2 Selected cases

### Record fine

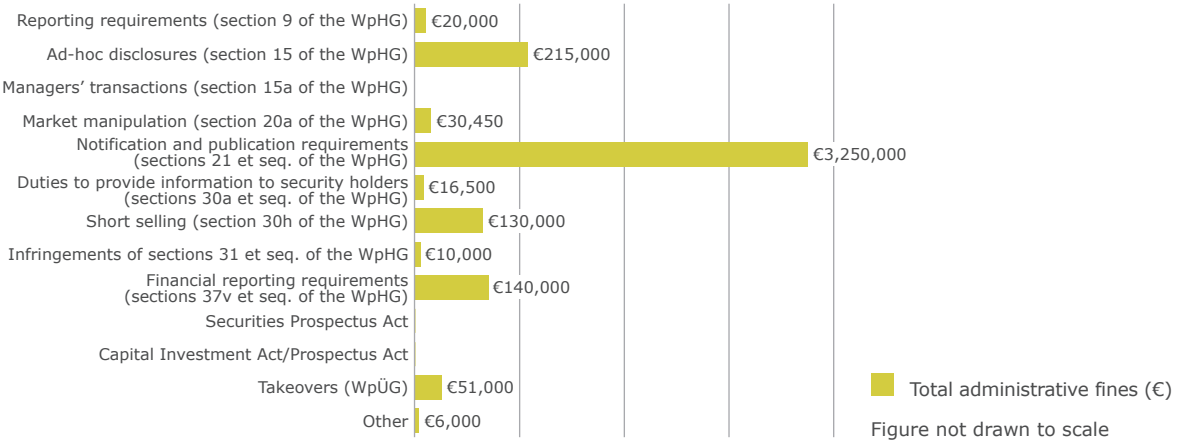
BaFin imposed a fine of €3.25 million on BlackRock Investment Management (UK) Ltd. – the highest administrative fine imposed to date (see Figure 22 "Highest total administrative fines (€)").

BlackRock group companies had issued incorrect or late notifications of voting interests and financial instruments held, thus violating the provisions (sections 21, 22, 25) of the German Securities Trading Act (*Wertpapierhandelsgesetz* – WpHG). The incorrect or late notifications, which related to a large number of German issuers of shares, were due to the fact that the group companies had implemented the German notification requirements incorrectly. In July 2014, BlackRock contacted BaFin of its own accord in relation to this matter, cooperated during the investigations and finally corrected and submitted the notifications concerned at the end of September 2014.

### Increased maximum amounts

When the EU Transparency Directive was transposed in 2015, the maximum amounts for violations of sections 21 ff. of the Securities Trading Act were increased in the Securities Trading Act. Since then, it has been possible to impose on legal persons maximum fines of

**Figure 22** Highest total administrative fines (€)



## Table 39 Administrative fine proceedings

| | Number of cases pending at the beginning of 2015 | Number of new cases in 2015 | Administrative fines* | Highest administrative fine imposed (€) | Discontinued for | | Number of cases pending at the end of 2015 |
|---|---|---|---|---|---|---|---|
| | | | | | factual or legal reasons | discretionary reasons | |
| Reporting requirements (section 9 of the WpHG) | 2 | 5 | 2 | 20,000 | 0 | 0 | 5 |
| Ad hoc disclosures (section 15 of the WpHG) | 79 | 35 | 20*** | 215,000 | 4 | 9 | 81 |
| Managers' transactions (section 15a of the WpHG) | 7 | 3 | 0 | – | 0 | 4 | 6 |
| Market manipulation (section 20a of the WpHG) | 33 | 17 | 12** | 30,000 | 7 | 4 | 27 |
| Notification and publication requirements (sections 21 ff. of the WpHG) | 686 | 302 | 121*** | 200,000 | 22 | 153 | 692 |
| Duties to provide information to security holders (sections 30a ff. of the WpHG) | 72 | 12 | 4 | 14,000 | 7 | 23 | 50 |
| Short selling (section 30h of the WpHG) | 3 | 5 | 1 | 25,000 | 0 | 1 | 6 |
| Infringements of sections 31 ff. of the WpHG | 62 | 21 | 13 | 10,000 | 1 | 15 | 54 |
| Financial reporting requirements (sections 37v ff. of the WpHG) | 137 | 29 | 16*** | 90,000 | 3 | 38 | 109 |
| Securities Prospectus Act | 10 | 3 | 0 | – | 0 | 1 | 12 |
| Capital Investment Act/Prospectus Act | 14 | 3 | 0 | – | 8 | 1 | 8 |
| Takeovers (WpÜG) | 53 | 3 | 4 | 51,000 | 8 | 2 | 42 |
| Other | 17 | 9 | 5 | 6,000 | 4 | 3 | 14 |

* Proceedings closed by imposing an administrative fine.
** The discrepancy between this Table and Table 31 ("Completed market manipulation proceedings") on page 228 is due to the fact that Table 31 shows the number of administrative fines imposed, whereas Table 39 details the number of proceedings ending in a fine. If BaFin institutes several administrative fine proceedings, e.g. against natural persons, these may, in individual cases, only result in a single fine, e.g. against the legal person.
*** Includes proceedings that ended in a sentence for the parties affected following criminal proceedings. This also captures the assessment of the real-life situation in relation to administrative fines.

up to €10 million or 5% of the previous year's total revenue. Companies that fail to observe the obligations under securities trading law will therefore face higher individual administrative fines in future.

### Violations of reporting requirements

BaFin imposed an administrative fine of €20,000 on a credit institution authorised in Germany in 2015. The institution had negligently breached its duties of supervision by violating

the reporting requirements for transactions in financial instruments in accordance with section 9 (1) of the Securities Trading Act. For an extended period, the management board had not taken adequate supervisory and organisational measures to ensure that the notification requirements in the electronic trading system were met in good time for all transactions. Numerous transactions in two financial instruments were reported with delays of up to several years, because they had been captured with incomplete entries in the data processing system. When notified by BaFin, the credit institution ensured that the transactions entered into were subsequently reported and corrected the organisational deficiencies.

### Violation of ad hoc disclosure obligations

A domestic MDAX issuer had violated section 15 (1) sentence 1 of the Securities Trading Act by failing to issue an ad hoc disclosure. BaFin responded by imposing an administrative fine of €215,000. The management board only published a press release on the positive quarterly figures, which differed significantly from market expectations in that the key earnings indicator, EBITDA (earnings before interest, taxes, depreciation and amortisation), was more than 100% above market expectations. Further evidence of this effect was that the media were positively surprised by the figures and the issuer's share price increased by more than 10%. However, the company failed to publish the information in an ad-hoc disclosure.

### Market manipulation

BaFin imposed an administrative fine of €80,000 on the sole member of the management board of a property company for, among other things, violations of the prohibition on market manipulation in accordance with section 20a of the Securities Trading Act. As a result of the financial crisis in 2008, the company was in financial difficulties that were threatening its existence. The sole member of the management board, who held indirect interests in the company through subsidiaries under his control, had failed to disclose information that had the potential to affect the domestic share price of the company. In addition, the management board had resolved no longer to meet publication, notification and disclosure requirements and to inform neither the shareholders nor the capital market about the extremely precarious financial situation. Prior to that, administrative fines totalling €268,000 had been imposed on the company, because it had also violated financial reporting requirements.

### Voting rights notifications

A cross-border financial services institution was given a total administrative fine of €1.1 million for failing to transfer voting rights notifications from the associated investment group in a timely manner. The administrative fine was made up of ten individual fines of €90,000 each for negligently failing to transfer voting rights notifications in a timely manner in ten cases and a fine of €200,000 for negligently violating its supervisory duty, because it had also failed to transfer other voting rights notifications in a timely manner. In violation of the requirements of sections 21 ff. of the Securities Trading Act, the voting rights notifications were either not received in time and only when demanded by BaFin, or they were presented in the wrong format. The institution had included financial instruments not attributable to it in the calculation, quoted incorrect share numbers, failed to disclose voting rights exceeding the threshold, or did so quoting the wrong date, or allocated the attributed voting rights incorrectly.

### Short selling

BaFin imposed a total administrative fine of €130,000 – the highest total administrative fine to date in this area – for eight negligent violations of the prohibition on naked short selling pursuant to section 30h of the Securities Trading Act, old version. The holder of a special statutory authority *(Prokurist)* and the management board of an investment company had sold debt instruments in proprietary trading without holding the securities in the company's portfolio. Moreover, they had not ensured sufficient cover for the transaction before the transactions were executed, or by the end of the trading day at the latest. The transactions had also not been objectively necessary for the company's function as market maker.


# VI About BaFin

## 1 Human resources

As at 31 December 2015, BaFin had a total of 2,577 employees (previous year: 2,535) at its offices in Bonn (1,924) and Frankfurt am Main (653). Approximately 74.2% (1,911) were civil servants *(Beamte)* and approximately 25.8% (666) were public service employees covered by collective wage agreements *(Tarifbeschäftigte)* and others not covered by collective wage agreements (see Table 40, "Personnel").

As a modern employer, BaFin attaches great importance to equality of opportunity: at the end of 2015 almost half (47.5%) of BaFin's employees were female (1,224). The total proportion of management positions held by women at the end of the year amounted to around 25.4%.

73 BaFin employees were on long-term assignment to international institutions and supervisory authorities as at 31 December

**Table 40** Personnel

As at 31 December 2015

| Career level | Employees | | | Civil servants | Public service employees |
|---|---|---|---|---|---|
| | Total | Female | Male | Total | Total |
| Higher civil service | 1,182 | 470 | 712 | 1,078 | 104* |
| Higher intermediate civil service | 812 | 367 | 445 | 667 | 145 |
| Intermediate/ basic civil service | 583 | 387 | 196 | 166 | 417 |
| **Total** | **2,577** | **1,224** | **1,353** | **1,911** | **666*** |

* Including those employees not covered by collective wage agreements.

2015. At the close of 2015, more than half that number, namely 38 employees, were delegated to the European Central Bank (ECB).

### A total of 104 new staff recruited

In response to its growing workload, BaFin recruited a total of 104 new members of staff in 2015, 59 fewer than in the previous year (see Table 41 "Recruitment in 2015").[1]

The majority of the new recruits were fully qualified lawyers and economists, as well as university of applied sciences graduates and graduates in other disciplines; however, they also included candidates for entry to the higher intermediate civil Service, vocational trainees and temporary staff.

**Table 41** Recruitment in 2015

| Career level | Total | Female | Male |
|---|---|---|---|
| **Higher civil service** | **50** | **26** | **24** |
| Qualifications: | | | |
| Fully qualified lawyers | 27 | | |
| Economists | 14 | | |
| Mathematicians/statisticians | 3 | | |
| Other | 6 | | |
| **Higher intermediate civil service** | **48** | **22** | **26** |
| Qualifications: | | | |
| Business lawyers | 8 | | |
| Economists | 30 | | |
| IT specialists | 6 | | |
| Other | 4 | | |
| **Intermediate/ basic civil service** | **6** | **3** | **3** |
| **Candidates for higher intermediate civil service/vocational trainees** | **15/9** | **4/6** | **11/3** |
| **Total** | **104*** | **51*** | **53*** |

* Excl. candidates for entry to the higher intermediate civil service/vocational trainees.

### Career entry at BaFin

Those starting their careers at BaFin may either prepare for the higher intermediate civil service or complete vocational training. 15 candidates for entry to the higher intermediate civil service began preparing for their careers in 2015; nine trainees commenced their vocational training with BaFin. The corresponding figures for 2014 were 15 candidates for entry to higher intermediate civil service and 15 vocational trainees.

By the end of the year under review, BaFin was preparing 34 candidates for entry to the higher intermediate civil service for their future responsibilities and activities in collaboration with the Deutsche Bundesbank. In addition, one candidate was completing a course in information technology for public administration at the Federal University of Applied Administrative Sciences *(Hochschule des Bundes)*.

At the end of 2015 BaFin had a total of 67 vocational trainees and candidates for entry to the higher intermediate civil service, seven more than in the previous year.[2] Vocational training is available in five different careers at the present time: office communication specialists (9 vocational trainees), administration specialists (15 vocational trainees), IT specialists for system integration (3 vocational trainees), business administration specialists for office management (4 vocational trainees) and media and information services specialists, specialising in librarianship (1 vocational trainee).

### Emphasis on continuing professional development (CPD)

BaFin attaches great importance to an extensive CPD offering for its employees. This was reflected in the fact that in 2015 BaFin employees took part in a total of 709 internal and external CPD events (previous year: 651). The total number of attendances at such events was 4,601 (previous year: 4,514). On average,

1 Differences from the figures in the 2014 Annual Report are the result of changes after the editorial deadline.

2 Differences from the figures in the 2014 Annual Report are the result of changes after the editorial deadline.

each BaFin employee attended a CPD session on 4.12 days (previous year: 3.89 days).

The events held in 2015 focused on specialist supervisory topics in particular. For example, BaFin offered CPD sessions in connection with the introduction of the Single Supervisory Mechanism for eurozone banks (SSM). These also include events arranged by BaFin on behalf of the ECB which may be attended by employees of other European supervisory authorities. In addition, BaFin arranged multipart seminars on the reform of European insurance supervision law by Solvency II.

BaFin also expanded the range of sessions designed to enhance employees' foreign language skills in 2015 by adding new specialist English courses lasting several days. In addition, as in the previous year, there were once again various courses on soft skills, with the aim of developing cooperation between employees and the ability to work in a team.

## 2 New organisational structure

BaFin has had a new organisational structure since 1 January 2016 (see Organisation chart, from page 264). It is one of the outcomes of a comprehensive organisational review in which BaFin has thoroughly examined, among other things, the allocation of its resources and the efficiency of its processes as well as its interfaces and structures.

BaFin acquired wide-ranging additional powers relating to consumer protection[3] as a result of the Retail Investor Protection Act *(Kleinanlegerschutzgesetz)*. A further factor was the very substantial growth in responsibilities and employee numbers of various organisational units over the years. Thanks to its new organisational structure and changes to how its resources are managed, BaFin is able to take on these new tasks as well as further responsibilities going forward without the need for additional staff increases.

### One for All – the OfA principle

BaFin's new organisational structure is founded on the OfA principle which has already been applied in isolated cases in the past. The abbreviation "OfA" stands for the idea of "one for all". OfA units bring together functions that are relevant across the whole of BaFin and are allocated to the respective department that is closest to their particular specialisation. In practice, however, these units are centres of expertise which they use to perform functions for BaFin as a whole.

For example, a newly-created department is now dedicated exclusively to the issue of consumer protection. This department is based in Bonn and Frankfurt am Main and conducts its activities across different locations. It is affiliated to securities supervision, but this does not in any way imply that it is concerned solely with the protection of investors. The protection of policyholders and banking customers is also a priority for the new department, which works closely together with insurance and banking supervision.

The department for the prevention of money laundering is another OfA unit. Since most – if not all – cases of suspected money-laundering involve banks, it is now affiliated to banking supervision. But by its very nature, the department for the prevention of money laundering also has a role to play across all directorates: If suspected money-laundering occurs at an insurer, for example, the department's employees will investigate this case as well.

### Europeanisation of banking supervision

BaFin has also made changes within its directorates. The main objective here was to reflect their particular responsibilities

3 See chapter II 5.1 and 5.2.

in the best possible way and to reduce the number of interfaces to a minimum. In banking supervision, this related to all of the responsibilities connected with the new Single Supervisory Mechanism (SSM) to which BaFin also belongs. In 2014, BaFin had already combined its supervisory activities for significant institutions into two sections and also established a further section which was tasked with coordinating all matters relating to the SSM within BaFin. These ad hoc measures helped to organise cooperation with the ECB as efficiently as possible. With the creation of its new organisational structure as at 1 January 2016, BaFin has brought together its supervisory activities for all significant institutions in one department, and established a new department which has responsibility for SSM supervisory standards and coordination.

### New responsibilities for securities supervision

Securities supervision is facing the challenge of implementing the requirements of an enormous number of new laws into supervisory practice. For this purpose, BaFin has focused in particular – in addition to consumer protection – on strengthening prospectus supervision; it, too, now forms a separate department. As a result, securities supervision now comprises six departments instead of four as in the past. Other new areas of responsibility, such as product and sales supervision, monitoring repo and securities transactions and new reporting requirements, have been integrated into existing departments.

### Insurance supervision and President's Directorate

BaFin had already created a new structure for its insurance supervision activities in mid-2014. These changes have proved to be effective in practice and have therefore been kept in place in most respects. The department for quantitative risk modelling, which also happens to be an OfA unit, is now located within the insurance supervision directorate in view of the similarity of their respective subject matters. The President's Directorate acquired a new organisational unit: "Strategy and Risk". The task of this unit is to take up current issues and react quickly or launch its own initiatives. The Press and Public Relations office has been converted into a group with three sections.

## 3 Budget

BaFin's Administrative Council approved a budget of €242.1 million for 2015 (previous year: €224.4 million). Personnel expenses accounted for around 69.5% of the projected expenditure (€168.3 million; previous year: €152.4 million) and non-staff costs for

**Figure 23** 2015 budget expenditure

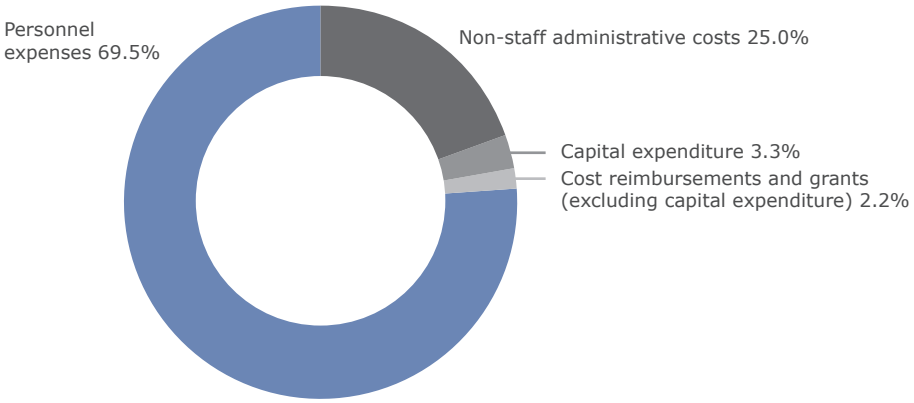
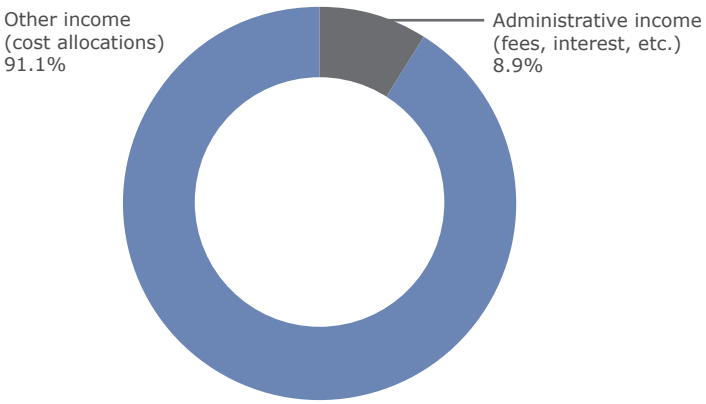


**Figure 24** 2015 budget income




around 25.0% (€60.6 million; previous year: €58.4 million). Capital expenditure represented 3.3% of the budget (previous year: 3.9%). Cost reimbursements and grants remained at the prior-year level, accounting for 2.2% of the budget (see Figure 23 "2015 budget expenditure" on page 259).

### Financing through cost allocations and fees

BaFin is independent of the federal budget as it is fully self-financed from its own income. The largest proportion of this was attributable to cost allocations levied on the supervised companies, a special levy with a financing function (projected figure for 2015: €220.6 million; previous year: €200.8 million). BaFin also generates administrative income such as fees and interest (projected figure for 2015: €21.5 million; previous year: €23.6 million, see Figure 24 "2015 budget income").

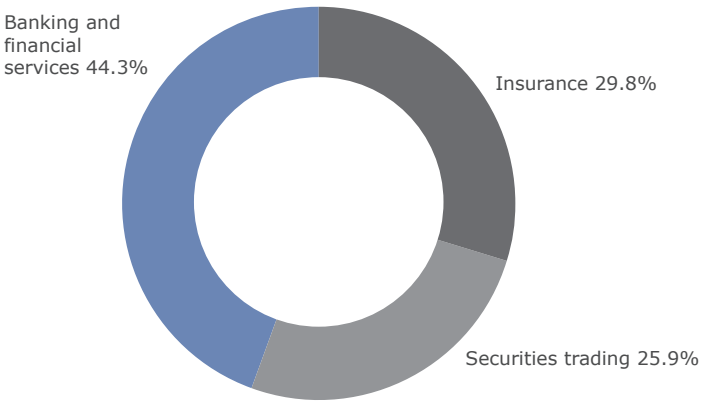
The final cost allocation for 2014 was performed in 2015. The banking industry contributed 44.3% of the total income from cost allocations. The insurance sector financed 29.8% and the securities trading sector 25.9%. The final cost allocation for 2015 will be performed during the course of 2016 (see Figure 25 "Cost allocations by supervisory area in 2014").

BaFin's actual expenditure in 2015 was approximately €237 million (previous year: €217.6 million). This was set against income of around €243.1 million (previous year: €220.7 million). The Administrative Council still has to approve the annual financial statements.

### Separate enforcement budget

BaFin drew up a separate enforcement budget of €8.2 million in 2015 (previous year: €8.2 million). This included a cost

**Figure 25** Cost allocations by supervisory area in 2014



reimbursement to the German Financial Reporting Enforcement Panel *(Deutsche Prüfstelle für Rechnungslegung)* amounting to €6 million (previous year: €6 million). Actual expenditure amounted to around €7.7 million (previous year: €7.7 million), while income – including advance cost allocation payments for 2016 – amounted in total to approximately €14.7 million (previous year: €14.9 million).

# 4 Press and Public Relations

## 4.1 Press enquiries

In 2015, BaFin again received several thousand enquiries from journalists relating to its various areas of responsibility.

### Deutsche Bank and the SSM

Enquiries relating to banking supervision were frequently concerned with BaFin's investigations into manipulated reference interest rates at Deutsche Bank. The media were particularly interested in when the investigations would end and whether any changes in personnel could be expected at the bank. A further question was whether BaFin was going to publish the report on the investigations, in a departure from its normal practice. Another question frequently raised was what options for imposing penalties were available to BaFin in comparison with supervisory authorities in other countries, for example those in the USA and England.

Many journalists sought information on how the cooperation between BaFin and the ECB had turned out in practice in the first year of the Single Supervisory Mechanism – in particular the work of the joint supervisory teams.

There was also substantial media interest in the topic of fintech companies and in particular the regulatory requirements that these companies must comply with.[4]

Numerous enquiries related to the position of the *Bausparkassen*. The issues raised included the fact that *Bausparkassen* are terminating old contracts where the conditions for granting a loan have been met for more than ten years. BaFin also received many questions relating to the economic position of the *Bausparkassen* in the low interest-rate environment and whether this would require changes to the *Bausparkassen* Act *(Bausparkassengesetz)*.[5]

### Retail investor protection and Volkswagen

The dominant topic for press enquiries relating to securities supervision was the Retail Investor Protection Act *(Kleinanlegerschutzgesetz)* which came into effect in July 2015. In particular, the additional powers granted to BaFin by the legislation led to numerous further questions: For example, BaFin is now able to restrict or even prohibit the sale of specific products and to examine the books of companies operating in the grey capital market. In addition, BaFin can publish measures taken against market participants on its website and thus warn investors about financial transactions that involve risks.

The Volkswagen (VW) scandal relating to manipulated emissions data also generated a significant response. With a view to an investigation by BaFin, the issue was repeatedly raised as to whether the company had informed the capital markets about the manipulative practices at the proper time and whether there had been any abnormal transactions in VW securities.

The media also demonstrated lively interest in the loan funds permitted since May 2015 and in the distinction between funds that are still considered to be actively managed and passive funds.

4 See chapter II 4.1.2.

5 See chapter III 1.6.

### Low interest rates and telemonitoring

As before, the low interest-rate environment and its effects on life insurers are a major topic of interest for the media too.

Journalists were also concerned with the issue of telemonitoring premium rates: These are determined when a life insurer gathers data relating to the behaviour of individual clients, such as their state of fitness, which is supplied to the undertaking by the clients themselves. Based on the information provided, the insurer then offers premium rates which reward a particular – desired – pattern of client behaviour. The media constantly cast these new types of premium rates in a critical light in view of the implications for data protection. BaFin is following current developments in this area very closely so that it can intervene in the event of any breaches of data protection rules.

### Simplified requirements for refugees

A large number of press enquiries to BaFin related to the simplified requirements for opening bank accounts allowed for refugees. In anticipation of the implementation of the European Directive on Payment Services, BaFin had drawn up transitional rules allowing refugees to open a basic payment account even if they are not able to produce documentation which satisfies the passport and identity card requirements in Germany. The media enquiries were particularly interested in how German banks would implement BaFin's guidelines in practice.

A further topic of interest for the press was a foundation that had offered investors to purchase, store and resell physical gold. In doing so, however, they had engaged in a deposit business without the necessary authorisation from BaFin.

Following the attacks in Paris in November 2015, BaFin received many enquiries asking which requirements of the Financial Action Task Force on Money Laundering (FATF) and of the German Money Laundering Act *(Geldwäschegesetz)* financial institutions must comply with in order to prevent the financing of terrorism.

## 4.2 Events and trade fairs

### Forum on "White-collar Crime and the Capital Market"

In December 2015, BaFin hosted its annual forum on "White-Collar Crime and the Capital Market" for the twelfth time. The objective of the forum is assist in combating white-collar crime even more effectively. In order to reflect the interests of the constantly growing number of participants – consisting of police officers, judges, public prosecutors as well as employees of the Deutsche Bundesbank, stock exchange supervisory authorities, trading surveillance offices of stock exchanges and international supervisory authorities – the forum also offered workshops for the first time, for example on the topics of "Price Formation on Stock Exchanges and Opportunities for Manipulation" and "Criminal Liability of Enterprises".

### Industry event on Solvency II

BaFin's industry event on Solvency II in November 2015 in Bonn enabled representatives of the supervisory authorities, the insurance sector and academia the opportunity to engage in an intensive debate on the reform project. The topics discussed included the extent to which it is important that undertakings put in place an appropriate risk management system. Small and medium-sized insurers in particular made it clear once again that they had reservations about the quantity and complexity of the disclosure and reporting requirements. BaFin's "Vollerhebung Leben II" survey in 2015 demonstrated that, overall, the industry is well positioned as far as the capital requirements of Solvency II are concerned.

### Information for investors

In April 2015, BaFin once again took part in the "Invest" trade fair in Stuttgart, providing information for investors. Talks by BaFin representatives enabled investors to familiarise themselves with the particular features of structured products, for example. BaFin also used the trade fair as an opportunity to present the updated new edition of its brochure setting out the information that customers need to know in the event of a bank or an insurer

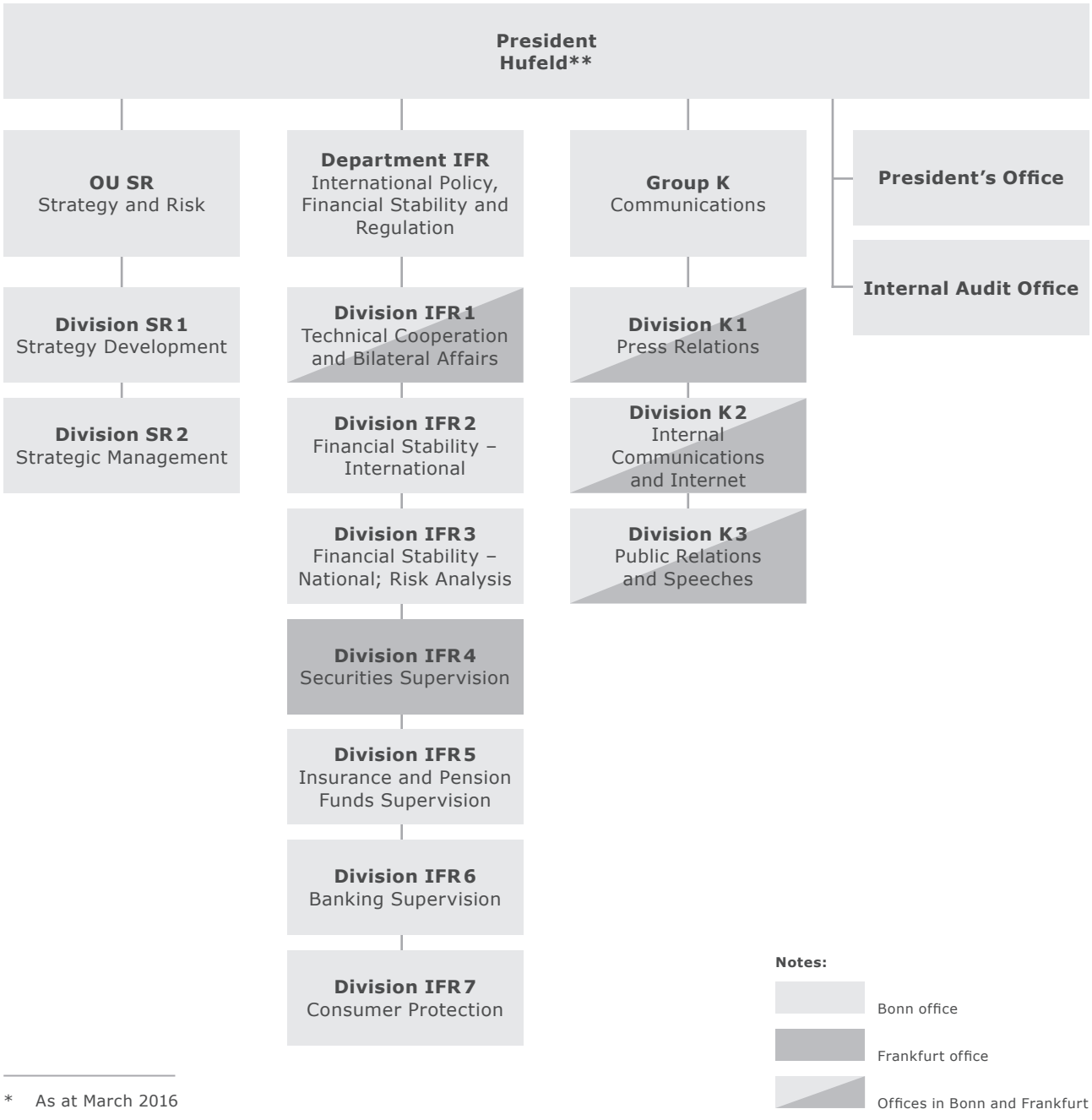
getting into financial difficulties. Among other things, this publication clarifies the way in which private deposits with German and foreign banks are guaranteed in the event of insolvency. The new edition reflects the changes for German savers and insured persons arising from the implementation of the European Directive on Deposit Guarantee Schemes in July 2015.[6]

BaFin also gave interested members of the public the opportunity to ask questions at the stock exchange days in Dresden, Munich, Frankfurt and Hamburg as well as at the Federal Ministry of Finance's open day in Berlin.

6 This brochure and other brochures on topics relating to investors and consumers are available at www.bafin.de.

# Appendix

## 1 Organisation chart*



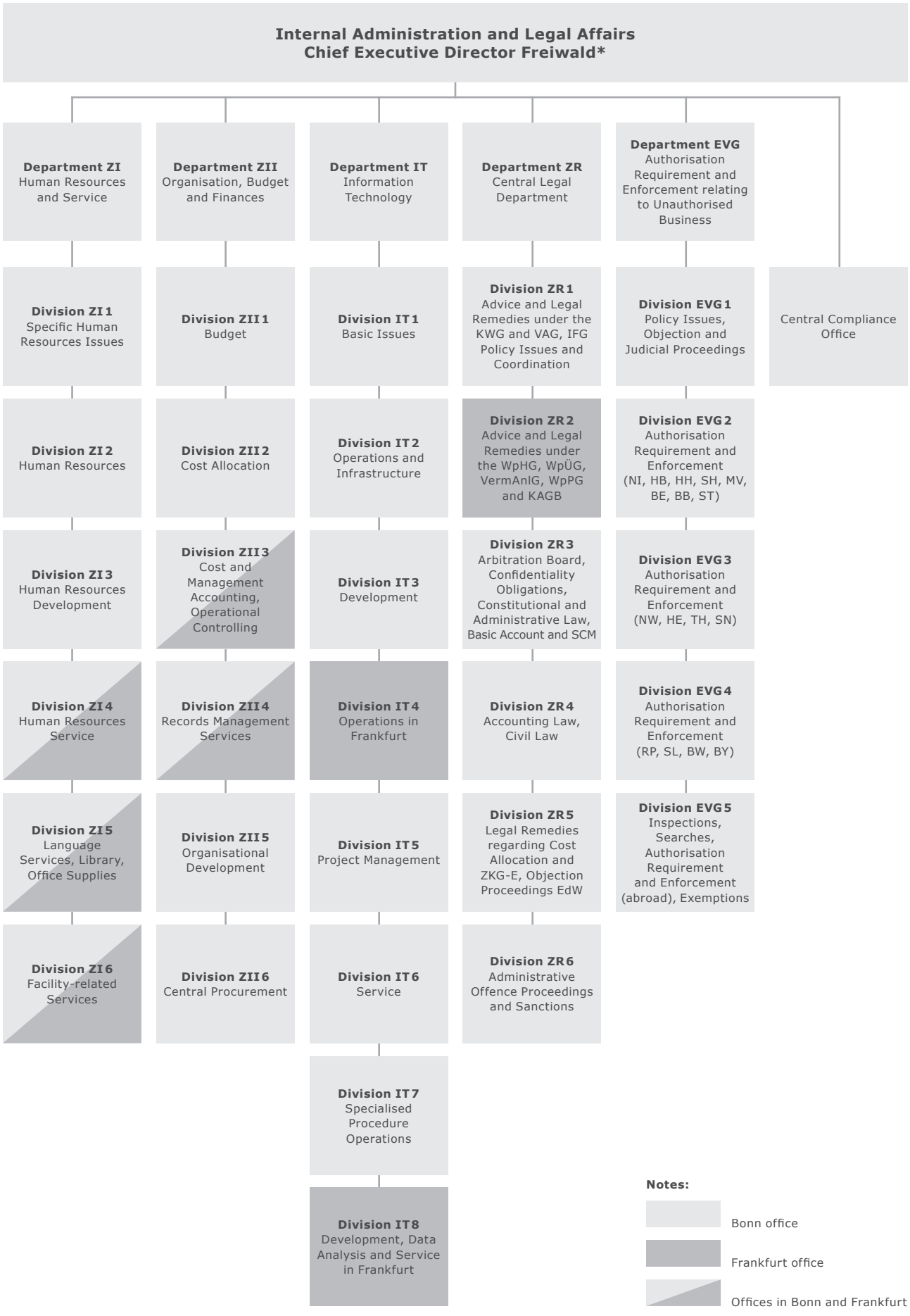

* As at March 2016

** Felix Hufeld has been President since March 2015.


Banking Supervision
Chief Executive Director Röseler
Department BA 1
SSM Supervisory Standards
Division BA 11
Organisation of Supervision
Division BA 12
SSM/SB Coordination
Division BA 13
Analyses, Stress Tests, Peer Review Analyses
Division BA 14
Development of National Law
Division BA 15
Common Procedures
Department BA 2
Supervision of Significant Institutions
Division BA 21
Landesbanks in Southern Germany
Division BA 22
Landesbanks in Northern Germany
Division BA 23
SI Commercial and Regional Banks
Division BA 24
SI Specialist Banks
Division BA 25
SI Cooperative Banks
Division BA 26
Landesbanks Central Germany and SI Savings Banks
Division BA 27
Important SI Hosts
Division BA 28
Deutsche Bank AG Group
Division BA 29
Commerzbank AG Group
Department BA 3
Supervision of Savings Banks and Private Banks
Division BA 31
Supervision of Savings Banks I
Division BA 32
Supervision of Savings Banks II
Division BA 33
Supervision of Savings Banks III
Division BA 34
Bausparkassen Competence Centre
Division BA 35
Supervision of Private Banks I
Division BA 36
Supervision of Private Banks II
Division BA 37
Supervision of Private Banks III
Department BA 4
Supervision of Cooperative and Specialist Banks
Division BA 41
Cooperative Banks I
Division BA 42
Cooperative Banks II
Division BA 43
Cooperative Banks III
Division BA 44
Cooperative Banks IV
Division BA 45
Pfandbrief Competence Centre/Examination of Cover Assets
Division BA 46
KfW Group, ProCredit, Development Banks and Guarantee Banks
Division BA 47
European Banks
Division BA 48
Non-European and Swiss Banks
Department BA 5
Banking Risks
Division BA 51
Competence Centre for IT Security
Division BA 52
Credit Risk
Division BA 53
Financial Accounting and Valuation Practices
Division BA 54
SREP, Remuneration Schemes, Operational Risk
Division BA 55
Market Risk/ Liquidity/Interest Rate Risk in the Banking Book
Division BA 56
Deposit Guarantee and Investor Compensation Schemes
Department GW
Prevention of Money Laundering
Division GW 1
Policy Issues and International Affairs relating to AML/CFT
Division GW 2
AML/CFT Supervision of Credit Institutions and Insurance Undertakings
Division GW 3
Payments Services and E-Money Institutions
Division GW 4
Bank Account Register Enquiry, Freezing of Accounts
Division GW 5
Ongoing Supervision of Leasing & Factoring Institutions and AML/CFT Supervision of Financial Services Institutions in Southern and Central Germany
Division GW 6
Ongoing Supervision of Leasing & Factoring Institutions and AML/CFT Supervision of Financial Services Institutions in Northern Germany
Group R
Recovery, Restructuring
Division R 1
Policy Issues relating to Restructuring
Division R 2
Restructuring of Private Banks and FMIs
Division R 3
Restructuring of Banks that are Members of an Institutional Protection Scheme, Insurance Undertakings and Development Banks


* Dr Frank Grund has been Chief Executive Director of Insurance and Pension Funds Supervision since October 2015.


* Elisabeth Roegele has been Chief Executive Director of Securities Supervision/Asset Management since May 2015.




* Béatrice Freiwald has been Chief Executive Director of Internal Administration and Legal Affairs since March 2016.

# 2 BaFin bodies

## 2.1 Members of the Administrative Council

**Representing Federal Ministries**

Dr Thomas Steffen (Chair – BMF)
Dr Levin Holle (Deputy chairman – BMF)
Reinhard Wolpers (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 Freiherr Frank von Fürstenwerth

**Representing asset management companies**

Thomas Richter

**Representing the academic community**

Prof. Isabel Schnabel
Prof. Brigitte Haar
Prof. Fred Wagner

As at: March 2016

## 2.2 Members of the Advisory Board

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Dr Karl-Peter Schackmann-Fallis
Gerhard P. Hofmann
Dr Oliver Wagner
Prof. Liane Buchholz
Jens Tolckmitt

**Representing insurance undertakings**

Dr Wolfgang Weiler (Deputy chairman)
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 (Chairwoman)

**Representing the Working Group on Occupational Retirement Provision**

Heribert Karch

**Representing consumer protection organisations**

Stephan Kühnlenz (Stiftung Warentest)
Prof. Günter Hirsch (ombudsman for insurers)
Dr h.c. Hans-Joachim Bauer (DSGV ombudsman)

**Representing the liberal professions**

Frank Rottenbacher (AfW)

**Representing associations for SMEs**

Ralf Frank (DVFA)

**Representing the trade unions**

Mark Patrick Roach (ver.di)

**Representing industry**

Folkhart Olschowy

As at: April 2016

## 2.3 Members of the Insurance Advisory Council

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Dr Alexander Barthel

Dr Karin Becker

Dr Frank Ellenbürger

Lars Gatschke

Prof. Nadine Gatzert

Martina Grundler

Prof. Maria Heep-Altiner

Norbert Heinen

Michael H. Heinz

Sabine Krummenerl

Uwe Laue

Katharina Lawrence

Dr Ursula Lipowsky

Adelheid Marscheider

Prof. Petra Pohlmann

Dr Markus Rieß

Holger R. Rohde

Prof. Heinrich R. Schradin

Ilona Stumm

Prof. Manfred Wandt

Michael Wortberg

Dr Maximilian Zimmerer

Prof. Jochen Zimmermann

As at: February 2016

## 2.4 Members of the Securities Council

Baden-Württemberg State Ministry for Finance and Economics

Bavarian State Ministry for Economics, Infrastructure, Transport and Technology

Berlin Senate Department of Economics, Technology and Research

Ministry of Economics and European Affairs of the State of Brandenburg

Free Hanseatic City of Bremen
Senator for Economic Affairs, Labour and Ports

Free and Hanseatic City of Hamburg
Departmental Authority for Economic Affairs, Transport and Innovation

Ministry of Economics, Energy, Transport and Regional Development of the State of Hesse

Ministry of Economics, Construction and Tourism of the State of Mecklenburg-West Pomerania

Ministry for Economics, Labour and Transport of the State of Lower Saxony

Ministry of Finance of the State of North Rhine-Westphalia

Ministry of Economics, Transport, Agriculture and Viniculture of the State of Rhineland-Palatinate

Ministry of Economics and Science of the State of Saarland

Ministry of Economics, Labour and Transport of the State of Saxony

Ministry of Science and Economics of the State of Saxony-Anhalt

Ministry of Finance of the State of Schleswig-Holstein

Ministry of Finance of the State of Thuringia

As at: March 2016

## 2.5 Members of the Consumer Advisory Council

**Representing the academic community**

Prof. Brigitte Haar (Deputy chairwoman)
Prof. Kai-Oliver Knops
Prof. Udo Reifner

**Representing consumer and investor protection organisations**

Jella Benner-Heinacher
Stephan Kühnlenz
Dorothea Mohn (Chairwoman)
Katharina Lawrence

**Representing out-of-court dispute settlement systems**

Wolfgang Arenhövel
Prof. Günter Hirsch
Dr Peter Frellesen

**Representing the Federal Ministry of Justice and for Consumer Protection**

Dr Erich Paetz

**Representing the trade unions**

Christoph Hahn

As at: January 2016

# 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 2015 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 2015 is compared with the number of policies in the respective insurance class as at 31 December 2014. 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. In terms of syndicate business, the number of complaints is given for the consortium leader, whereas the contracts are assigned to the individual undertakings participating in the consortium. 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 2014 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 2014 | Complaints |
|---|---|---|---|
| 1001 | AACHENMüNCHENER LEB. | 5,210,825 | 69 |
| 1006 | ALLIANZ LEBEN | 10,444,271 | 181 |
| 1007 | ALTE LEIPZIGER LEBEN | 1,274,793 | 16 |
| 1035 | ARAG LEBEN | 332,271 | 4 |
| 1017 | ATHENE LEBEN AG | 331,263 | 8 |
| 1020 | AXA LEBEN | 3,024,483 | 105 |
| 1011 | BARMENIA LEBEN | 239,228 | 5 |
| 1028 | BASLER LEBEN | 736,228 | 16 |
| 1012 | BASLER LEBEN (CH) | 120,597 | 6 |
| 1013 | BAYER. BEAMTEN LEBEN | 227,918 | 8 |
| 1015 | BAYERN-VERS. | 1,814,215 | 19 |
| 1122 | CONCORDIA LEBEN | n.a. | 1 |
| 1021 | CONDOR LEBEN | 221,925 | 7 |
| 1335 | CONTINENTALE LV AG | 674,615 | 11 |
| 1022 | COSMOS LEBEN | 1,424,145 | 47 |
| 1115 | CREDIT LIFE AG | 1,523,400 | 3 |
| 1146 | DBV DEUTSCHE BEAMTEN | n.a. | 1 |
| 1023 | DEBEKA LEBEN | 3,453,336 | 38 |
| 1136 | DEVK ALLG. LEBEN | 811,310 | 10 |
| 1025 | DEVK DT. EISENBAHN LV | 628,152 | 1 |
| 1113 | DIALOG LEBEN | 281,391 | 1 |
| 1110 | DIREKTE LEBEN | 125,574 | 1 |
| 1180 | DT. ÄRZTEVERSICHERUNG | 208,572 | 7 |
| 1130 | ERGO DIREKT LEBEN AG | 1,113,761 | 32 |
| 1184 | ERGO LEBEN AG | 5,068,431 | 126 |
| 1107 | EUROPA LEBEN | 466,720 | 5 |
| 1310 | FAMILIENFüRSORGE LV | 250,699 | 9 |
| 1139 | GENERALI LEBEN AG | 4,557,926 | 81 |
| 1108 | GOTHAER LEBEN AG | 1,382,468 | 39 |
| 1312 | HANNOVERSCHE LV AG | 933,732 | 22 |
| 1114 | HANSEMERKUR LEBEN | 285,622 | 4 |
| 1033 | HDI LEBEN AG | 2,380,800 | 78 |
| 1158 | HEIDELBERGER LV | 404,169 | 29 |
| 1137 | HELVETIA LEBEN | 149,314 | 4 |
| 1055 | HUK-COBURG LEBEN | 692,574 | 41 |
| 1047 | IDEAL LEBEN | 581,558 | 3 |
| 1048 | IDUNA VEREINIGTE LV | 1,801,620 | 30 |
| 1330 | INTER LEBENSVERS. AG | 134,315 | 3 |
| 1128 | ITZEHOER LEBEN | 70,492 | 2 |
| 1045 | KARLSRUHER LV AG | 97,577 | 2 |
| 1062 | LEBENSVERS. VON 1871 | 688,603 | 9 |
| 1112 | LVM LEBEN | 793,250 | 5 |
| 1109 | MECKLENBURG. LEBEN | 165,397 | 2 |
| 1064 | MÜNCHEN. VEREIN LEBEN | 136,026 | 4 |
| 1162 | MYLIFE DEUTSCHLAND | 115,312 | 2 |
| 1164 | NEUE LEBEN LEBENSVERS | 907,016 | 12 |
| 1147 | NÜRNBG. LEBEN | 2,817,212 | 73 |
| 1056 | OEFF. LEBEN BERLIN | 225,913 | 2 |
| 1200 | OERA WESTPREUSS.I.L. | n.a. | 1 |
| 1194 | PB LEBENSVERSICHERUNG | 1,145,104 | 13 |
| 1123 | PLUS LEBEN | 79,982 | 1 |
| 1309 | PROTEKTOR LV AG | 116,122 | 5 |
| 1081 | PROV. LEBEN HANNOVER | 827,823 | 13 |

! Please refer to the "Explanatory notes on the statistics" on page 274.

| Reg. no. | Name of insurance undertaking | Number of life insurance policies in 2014 | Complaints |
|---|---|---|---|
| 1083 | PROV.NORDWEST LEBEN | 1,710,212 | 21 |
| 1082 | PROV.RHEINLAND LEBEN | 1,294,972 | 24 |
| 1018 | RHEINLAND LEBEN | 97,990 | 5 |
| 1141 | R+V LEBENSVERS. AG | 4,257,485 | 55 |
| 1150 | SAARLAND LEBEN | 149,973 | 2 |
| 1157 | SKANDIA LEBEN | 300,173 | 7 |
| 1153 | SPARK.-VERS.SACHS.LEB | 534,297 | 1 |
| 1104 | STUTTGARTER LEBEN | 469,243 | 5 |
| 1091 | SV SPARKASSENVERS. | 1,689,262 | 18 |
| 1090 | SWISS LIFE AG (CH) | 865,141 | 18 |
| 1132 | TARGO LEBEN AG | 1,686,038 | 12 |
| 1092 | UNIVERSA LEBEN | 180,710 | 5 |
| 1140 | VICTORIA LEBEN | 1,194,338 | 54 |
| 1099 | VOLKSWOHL-BUND LEBEN | 1,406,078 | 16 |
| 1151 | VORSORGE LEBEN | 165,584 | 4 |
| 1160 | VPV LEBEN | 834,394 | 18 |
| 1149 | WGV-LEBEN | 56,987 | 1 |
| 1005 | WÜRTT. LEBEN | 2,290,371 | 23 |
| 1103 | WWK LEBEN | 913,992 | 20 |
| 1138 | ZURICH DTSCH. HEROLD | 3,451,236 | 75 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

## 3.3 Health insurance

| Reg. no. | Name of insurance undertaking | Number of persons insured as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 4034 | ALLIANZ PRIV.KV AG | 2,575,454 | 73 |
| 4142 | ALTE OLDENBURGER AG | 162,220 | 4 |
| 4112 | ARAG KRANKEN | 552,675 | 14 |
| 4095 | AXA KRANKEN | 1,663,880 | 177 |
| 4042 | BARMENIA KRANKEN | 1,233,600 | 29 |
| 4134 | BAYERISCHE BEAMTEN K | 1,103,794 | 36 |
| 4004 | CENTRAL KRANKEN | 1,747,392 | 58 |
| 4001 | CONTINENTALE KRANKEN | 1,283,951 | 50 |
| 4028 | DEBEKA KRANKEN | 3,882,929 | 71 |
| 4131 | DEVK KRANKENVERS.-AG | 358,086 | 1 |
| 4044 | DKV AG | 4,396,985 | 92 |
| 4013 | DT. RING KRANKEN | 625,972 | 8 |
| 4121 | ENVIVAS KRANKEN | 396,586 | 4 |
| 4126 | ERGO DIREKT KRANKEN | 1,424,590 | 6 |
| 4119 | GOTHAER KV AG | 581,635 | 24 |
| 4043 | HALLESCHE KRANKEN | 637,180 | 33 |
| 4144 | HANSEMERKUR KRANKEN_V | 1,439,277 | 24 |
| 4122 | HANSEMERKUR S.KRANKEN | 6,005,188 | 3 |
| 4117 | HUK-COBURG KRANKEN | 994,280 | 34 |
| 4031 | INTER KRANKEN | 370,827 | 15 |
| 4011 | LANDESKRANKENHILFE | 379,270 | 28 |
| 4109 | LVM KRANKEN | 334,056 | 3 |
| 4123 | MANNHEIMER KRANKEN | 76,482 | 3 |
| 4037 | MÜNCHEN.VEREIN KV | 284,739 | 6 |
| 4125 | NÜRNBG. KRANKEN | 257,073 | 6 |
| 4135 | PROVINZIAL KRANKEN | 156,533 | 1 |
| 4116 | R+V KRANKEN | 763,608 | 7 |
| 4002 | SIGNAL KRANKEN | 1,966,015 | 45 |
| 4039 | SÜDDEUTSCHE KRANKEN | 658,070 | 18 |
| 4108 | UNION KRANKENVERS. | 1,152,697 | 20 |
| 4045 | UNIVERSA KRANKEN | 358,421 | 10 |
| 4139 | WÜRTT. KRANKEN | 323,946 | 2 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

## 3.4 Motor vehicle insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 2,286,182 | 11 |
| 5135 | ADAC AUTOVERSICHERUNG | 1,074,017 | 31 |
| 5581 | ADLER VERSICHERUNG AG | n.a. | 2 |
| 5312 | ALLIANZ VERS. | 12,790,536 | 99 |
| 5441 | ALLSECUR DEUTSCHLAND | 1,016,334 | 63 |
| 5397 | ASSTEL SACH | 179,183 | 2 |
| 5155 | AXA EASY | n.a. | 2 |
| 5515 | AXA VERS. | 4,238,326 | 50 |
| 5317 | BARMENIA ALLG. VERS. | 221,513 | 2 |
| 5633 | BASLER SACH AG | 356,793 | 6 |
| 5310 | BAYER. BEAMTEN VERS. | 200,751 | 1 |
| 5324 | BAYER.VERS.VERB.AG | 1,760,244 | 9 |
| 5098 | BRUDERHILFE SACH.AG | 412,430 | 1 |
| 5338 | CONCORDIA VERS. | 1,037,457 | 11 |
| 5339 | CONDOR ALLG. VERS. | 261,044 | 5 |
| 5340 | CONTINENTALE SACHVERS | 690,875 | 9 |
| 5552 | COSMOS VERS. | 821,038 | 17 |
| 5343 | DA DEUTSCHE ALLG.VER. | 1,262,802 | 48 |
| 5311 | DBV DT. BEAMTEN-VERS. | 714,713 | 7 |
| 5549 | DEBEKA ALLGEMEINE | 831,843 | 7 |
| 5513 | DEVK ALLG. VERS. | 3,834,154 | 29 |
| 5344 | DEVK DT. EISENB. SACH | 1,008,345 | 5 |
| 5055 | DIRECT LINE | 1,096,726 | 44 |
| 5562 | ERGO DIREKT | n.a. | 3 |
| 5472 | ERGO VERSICHERUNG | 2,363,515 | 16 |
| 5508 | EUROPA VERSICHERUNG | 590,272 | 23 |
| 5470 | FAHRLEHRERVERS. | 319,247 | 3 |
| 5024 | FEUERSOZIETÄT | 138,713 | 1 |
| 5505 | GARANTA VERS. | 621,123 | 6 |
| 5473 | GENERALI VERSICHERUNG | 2,437,289 | 25 |
| 5858 | GOTHAER ALLGEMEINE AG | 1,370,459 | 9 |
| 5585 | GVV-PRIVATVERSICH. | 208,858 | 1 |
| 5131 | HANNOVERSCHE DIREKT | n.a. | 5 |
| 5085 | HDI VERSICHERUNG | 3,052,608 | 125 |
| 5096 | HDI-GERLING INDUSTRIE | 1,047,454 | 13 |
| 5384 | HELVETIA VERS. (CH) | 316,337 | 6 |
| 5521 | HUK-COBURG ALLG. VERS | 7,763,290 | 57 |
| 5375 | HUK-COBURG UNTER. | 7,105,867 | 57 |
| 5086 | HUK24 AG | 3,035,439 | 33 |
| 5401 | ITZEHOER VERSICHERUNG | 1,269,940 | 25 |
| 5078 | JANITOS VERSICHERUNG | 182,191 | 4 |
| 5058 | KRAVAG-ALLGEMEINE | 1,486,558 | 21 |
| 5080 | KRAVAG-LOGISTIC | 985,837 | 13 |
| 5402 | LVM SACH | 5,576,232 | 35 |
| 5061 | MANNHEIMER VERS. | 201,371 | 2 |
| 5412 | MECKLENBURG. VERS. | 836,692 | 1 |
| 5426 | NÜRNBG. ALLG. | 215,815 | 8 |
| 5787 | OVAG – OSTDT. VERS. | 236,016 | 33 |
| 5446 | PROV.NORD BRANDKASSE | 768,315 | 2 |
| 5095 | PROV.RHEINLAND VERS. | 1,416,754 | 7 |
| 5798 | RHEINLAND VERS. AG | 239,574 | 1 |
| 5438 | R+V ALLGEMEINE VERS. | 3,964,109 | 27 |
| 5137 | R+V DIREKTVERSICHER. | 354,325 | 20 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5051 | S DIREKTVERSICHERUNG | 266,118 | 10 |
| 5690 | SCHWARZMEER U. OSTSEE | n.a. | 3 |
| 5125 | SIGNAL IDUNA ALLG. | 1,067,948 | 10 |
| 5036 | SV SPARK.VERSICHER. | 939,362 | 6 |
| 5463 | UNIVERSA ALLG. VERS. | n.a. | 1 |
| 5042 | VERSICHERUNGSK.BAYERN | 160,181 | 2 |
| 5400 | VGH LAND.BRAND.HAN. | 2,017,902 | 7 |
| 5862 | VHV ALLGEMEINE VERS. | 4,309,187 | 76 |
| 5169 | VOLKSWAGEN AUTO AG | 451,494 | 23 |
| 5093 | WESTF.PROV.VERS.AG | 1,410,965 | 2 |
| 5525 | WGV-VERSICHERUNG | 1,112,382 | 22 |
| 5479 | WÜRTT. GEMEINDE-VERS. | 1,014,025 | 7 |
| 5783 | WÜRTT. VERS. | 2,817,559 | 38 |
| 5476 | WWK ALLGEMEINE VERS. | 209,841 | 2 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

## 3.5 General liability insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 1,280,141 | 6 |
| 5498 | ADAC – SCHUTZBRIEF VERS. | n.a. | 1 |
| 5035 | AGILA HAUSTIER AG | n.a. | 1 |
| 5370 | ALLIANZ GLOBAL SE | 2,605 | 1 |
| 5312 | ALLIANZ VERS. | 4,313,968 | 50 |
| 5405 | ALTE LEIPZIGER VERS. | 210,134 | 3 |
| 5068 | AMMERLÄNDER VERS. | 1 | |
| 5455 | ARAG ALLG. VERS. | 21,130,008 | 7 |
| 5397 | ASSTEL SACH | n.a. | 3 |
| 5515 | AXA VERS. | 2,749,929 | 26 |
| 5792 | BADEN-BADENER VERS. | n.a. | 1 |
| 5317 | BARMENIA ALLG. VERS. | 170,778 | 1 |
| 5633 | BASLER SACH AG | 344,144 | 4 |
| 5324 | BAYER.VERS.VERB.AG | 1,099,003 | 6 |
| 5083 | BVAG BERLINER VERS. | n.a. | 1 |
| 5338 | CONCORDIA VERS. | 353,556 | 2 |
| 5340 | CONTINENTALE SACHVERS | 407,215 | 1 |
| 5552 | COSMOS VERS. | 306,282 | 2 |
| 5343 | DA DEUTSCHE ALLG.VER. | n.a. | 1 |
| 5311 | DBV DT. BEAMTEN-VERS. | 593,664 | 2 |
| 5549 | DEBEKA ALLGEMEINE | 1,320,567 | 6 |
| 5513 | DEVK ALLG. VERS. | 1,169,444 | 7 |
| 5344 | DEVK DT. EISENB. SACH | 589,596 | 1 |
| 5472 | ERGO VERSICHERUNG | 1,673,929 | 34 |
| 5508 | EUROPA VERSICHERUNG | n.a. | 1 |
| 5024 | FEUERSOZIETÄT | 157,824 | 1 |
| 5505 | GARANTA VERS. | n.a. | 2 |
| 5473 | GENERALI VERSICHERUNG | 1,680,776 | 21 |
| 5858 | GOTHAER ALLGEMEINE AG | 1,349,639 | 6 |
| 5485 | GRUNDEIGENTÜMER-VERS. | n.a. | 2 |
| 5469 | GVV-KOMMUNALVERS. | 2,981 | 4 |
| 5374 | HAFTPFLICHTK.DARMST. | 1,227,515 | 3 |
| 5501 | HANSEMERKUR ALLG. | n.a. | 1 |
| 5085 | HDI VERSICHERUNG | 1,411,475 | 31 |
| 5096 | HDI-GERLING INDUSTRIE | 15,952 | 9 |
| 5384 | HELVETIA VERS. (CH) | 354,002 | 3 |
| 5521 | HUK-COBURG ALLG. VERS | 1,441,113 | 6 |
| 5375 | HUK-COBURG UNTER. | 1,990,548 | 4 |
| 5086 | HUK24 AG | 400,643 | 2 |
| 5546 | INTER ALLG. VERS. | 120,868 | 3 |
| 5401 | ITZEHOER VERSICHERUNG | 166,180 | 1 |
| 5078 | JANITOS VERSICHERUNG | 208,659 | 8 |
| 5080 | KRAVAG-LOGISTIC | n.a. | 1 |
| 5402 | LVM SACH | 1,285,540 | 6 |
| 5061 | MANNHEIMER VERS. | 143,706 | 1 |
| 5412 | MECKLENBURG. VERS. | 277,288 | 1 |
| 5414 | MÜNCHEN. VEREIN ALLG. | 33,472 | 2 |
| 5426 | NÜRNBG. ALLG. | 326,792 | 2 |
| 5017 | OSTANGLER BRANDGILDE | n.a. | 1 |
| 5787 | OVAG – OSTDT. VERS. | n.a. | 7 |
| 5446 | PROV.NORD BRANDKASSE | 374,476 | 1 |
| 5095 | PROV.RHEINLAND VERS. | 829,116 | 5 |
| 5798 | RHEINLAND VERS. AG | 94,285 | 3 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5121 | RHION VERSICHERUNG | 148,980 | 1 |
| 5438 | R+V ALLGEMEINE VERS. | 1,809,381 | 27 |
| 5125 | SIGNAL IDUNA ALLG. | 681,925 | 3 |
| 5781 | SPARK.-VERS.SACHS.ALL | 123,678 | 1 |
| 5036 | SV SPARK.VERSICHER. | 1,018,098 | 3 |
| 5459 | UELZENER ALLG. VERS. | 190,656 | 1 |
| 5463 | UNIVERSA ALLG. VERS. | n.a. | 1 |
| 5042 | VERSICHERUNGSK.BAYERN | 15,933 | 2 |
| 5400 | VGH LAND.BRAND.HAN. | 767,551 | 10 |
| 5862 | VHV ALLGEMEINE VERS. | 1,292,837 | 19 |
| 5484 | VOLKSWOHL-BUND SACH | 145,524 | 2 |
| 5461 | VPV ALLGEMEINE VERS. | n.a. | 1 |
| 5093 | WESTF.PROV.VERS.AG | 819,504 | 7 |
| 5783 | WÜRTT. VERS. | 1,183,031 | 15 |
| 5590 | WÜRZBURGER VERSICHER. | n.a. | 1 |
| 5476 | WWK ALLGEMEINE VERS. | 139,781 | 2 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

## 3.6 Accident insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 2,497,341 | 3 |
| 5498 | ADAC – SCHUTZBRIEF VERS. | 3,886,404 | 4 |
| 5581 | ADLER VERSICHERUNG AG | 121,506 | 1 |
| 5312 | ALLIANZ VERS. | 4,086,615 | 31 |
| 5455 | ARAG ALLG. VERS. | 20,968,311 | 1 |
| 5515 | AXA VERS. | 708,676 | 6 |
| 5792 | BADEN-BADENER VERS. | 270,995 | 6 |
| 5633 | BASLER SACH AG | 399,387 | 8 |
| 5310 | BAYER. BEAMTEN VERS. | 102,203 | 5 |
| 5340 | CONTINENTALE SACHVERS | 611,670 | 2 |
| 5552 | COSMOS VERS. | 180,570 | 1 |
| 5311 | DBV DT. BEAMTEN-VERS. | 212,870 | 2 |
| 5549 | DEBEKA ALLGEMEINE | 1,909,136 | 5 |
| 5513 | DEVK ALLG. VERS. | 900,656 | 5 |
| 5562 | ERGO DIREKT | 243,391 | 7 |
| 5472 | ERGO VERSICHERUNG | 2,224,014 | 27 |
| 5473 | GENERALI VERSICHERUNG | 2,411,050 | 12 |
| 5858 | GOTHAER ALLGEMEINE AG | 695,087 | 7 |
| 5365 | GVO GEGENSEITIGKEIT | n.a. | 1 |
| 5085 | HDI VERSICHERUNG | 503,004 | 8 |
| 5096 | HDI-GERLING INDUSTRIE | 48,924 | 1 |
| 5384 | HELVETIA VERS. (CH) | 122,495 | 2 |
| 5521 | HUK-COBURG ALLG. VERS | 605,389 | 2 |
| 5375 | HUK-COBURG UNTER. | 958,170 | 1 |
| 5086 | HUK24 AG | n.a. | 1 |
| 5573 | IDEAL VERS. | n.a. | 2 |
| 5780 | INTERRISK VERS. | 437,954 | 3 |
| 5078 | JANITOS VERSICHERUNG | 164,937 | 3 |
| 5402 | LVM SACH | 939,441 | 1 |
| 5412 | MECKLENBURG. VERS. | 155,914 | 1 |
| 5070 | NECKERMANN VERS. | n.a. | 1 |
| 5426 | NÜRNBG. ALLG. | 524,966 | 10 |
| 5686 | NÜRNBG. BEAMTEN ALLG. | 74,082 | 1 |
| 5074 | PB VERSICHERUNG | n.a. | 1 |
| 5095 | PROV.RHEINLAND VERS. | 2,545,794 | 1 |
| 5798 | RHEINLAND VERS. AG | n.a. | 1 |
| 5121 | RHION VERSICHERUNG | 113,615 | 4 |
| 5438 | R+V ALLGEMEINE VERS. | 1,446,660 | 3 |
| 5125 | SIGNAL IDUNA ALLG. | 1,696,723 | 17 |
| 5586 | STUTTGARTER VERS. | 441,031 | 15 |
| 5036 | SV SPARK.VERSICHER. | 271,634 | 3 |
| 5790 | TARGO VERSICHERUNG | 96,463 | 4 |
| 5463 | UNIVERSA ALLG. VERS. | 61,391 | 1 |
| 5484 | VOLKSWOHL-BUND SACH | 170,417 | 2 |
| 5099 | VRK | n.a. | 1 |
| 5093 | WESTF.PROV.VERS.AG | 865,485 | 2 |
| 5525 | WGV-VERSICHERUNG | n.a. | 5 |
| 5479 | WÜRTT. GEMEINDE-VERS. | 145,500 | 1 |
| 5783 | WÜRTT. VERS. | 717,570 | 4 |
| 5590 | WÜRZBURGER VERSICHER. | n.a. | 2 |
| 5476 | WWK ALLGEMEINE VERS. | 251,976 | 6 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

## 3.7 Household contents insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 925,252 | 8 |
| 5312 | ALLIANZ VERS. | 2,443,926 | 18 |
| 5405 | ALTE LEIPZIGER VERS. | 126,302 | 1 |
| 5068 | AMMERLÄNDER VERS. | 237,695 | 4 |
| 5455 | ARAG ALLG. VERS. | 755,854 | 4 |
| 5397 | ASSTEL SACH | n.a. | 1 |
| 5515 | AXA VERS. | 1,017,388 | 9 |
| 5317 | BARMENIA ALLG. VERS. | n.a. | 1 |
| 5633 | BASLER SACH AG | 266,136 | 3 |
| 5324 | BAYER.VERS.VERB.AG | 538,201 | 3 |
| 5098 | BRUDERHILFE SACH.AG | 183,762 | 1 |
| 5340 | CONTINENTALE SACHVERS | 200,309 | 3 |
| 5311 | DBV DT. BEAMTEN-VERS. | 307,206 | 2 |
| 5549 | DEBEKA ALLGEMEINE | 781,685 | 4 |
| 5513 | DEVK ALLG. VERS. | 900,915 | 6 |
| 5328 | DOCURA VVAG | n.a. | 2 |
| 5472 | ERGO VERSICHERUNG | 1,062,112 | 15 |
| 5024 | FEUERSOZIETÄT | 109,512 | 1 |
| 5473 | GENERALI VERSICHERUNG | 1,275,404 | 17 |
| 5858 | GOTHAER ALLGEMEINE AG | 711,803 | 6 |
| 5374 | HAFTPFLICHTK.DARMST. | 192,149 | 2 |
| 5085 | HDI VERSICHERUNG | 714,692 | 22 |
| 5384 | HELVETIA VERS. (CH) | 242,643 | 1 |
| 5521 | HUK-COBURG ALLG. VERS | 847,063 | 3 |
| 5375 | HUK-COBURG UNTER. | 1,407,152 | 6 |
| 5057 | INTERLLOYD VERS.AG | 145,858 | 1 |
| 5780 | INTERRISK VERS. | 176,201 | 1 |
| 5078 | JANITOS VERSICHERUNG | 112,618 | 3 |
| 5404 | LBN | n.a. | 5 |
| 5402 | LVM SACH | 773,692 | 10 |
| 5061 | MANNHEIMER VERS. | 65,710 | 1 |
| 5412 | MECKLENBURG. VERS. | 180,307 | 2 |
| 5334 | MEDIENVERS. KARLSRUHE | n.a. | 1 |
| 5426 | NÜRNBG. ALLG. | 159,493 | 4 |
| 5015 | NV-VERSICHERUNGEN | n.a. | 2 |
| 5787 | OVAG – OSTDT. VERS. | n.a. | 4 |
| 5095 | PROV.RHEINLAND VERS. | 502,389 | 2 |
| 5583 | PVAG POLIZEIVERS. | n.a. | 1 |
| 5438 | R+V ALLGEMEINE VERS. | 1,023,816 | 8 |
| 5798 | RHEINLAND VERS. AG | n.a. | 1 |
| 5125 | SIGNAL IDUNA ALLG. | 324,114 | 2 |
| 5781 | SPARK.-VERS.SACHS.ALL | n.a. | 1 |
| 5036 | SV SPARK.VERSICHER. | 489,162 | 2 |
| 5463 | UNIVERSA ALLG. VERS. | n.a. | 1 |
| 5042 | VERSICHERUNGSK.BAYERN | n.a. | 1 |
| 5400 | VGH LAND.BRAND.HAN. | 480,134 | 1 |
| 5862 | VHV ALLGEMEINE VERS. | 364,953 | 4 |
| 5484 | VOLKSWOHL-BUND SACH | n.a. | 1 |
| 5461 | VPV ALLGEMEINE VERS. | 160,916 | 2 |
| 5093 | WESTF.PROV.VERS.AG | 561,674 | 3 |
| 5783 | WÜRTT. VERS. | 747,249 | 9 |
| 5590 | WÜRZBURGER VERSICHER. | n.a. | 1 |
| 5476 | WWK ALLGEMEINE VERS. | n.a. | 2 |

! Please refer to the "Explanatory notes on the statistics" on page 274.

## 3.8 Residential building insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5342 | AACHENMüNCHENER VERS. | 384,961 | 8 |
| 5581 | ADLER VERSICHERUNG AG | n.a. | 2 |
| 5312 | ALLIANZ VERS. | 2,297,921 | 47 |
| 5405 | ALTE LEIPZIGER VERS. | 121,478 | 1 |
| 5455 | ARAG ALLG. VERS. | n.a. | 3 |
| 5515 | AXA VERS. | 653,598 | 23 |
| 5317 | BARMENIA ALLG. VERS. | n.a. | 1 |
| 5633 | BASLER SACH AG | 172,117 | 9 |
| 5319 | BAYER. HAUSBESITZER | 26,466 | 1 |
| 5043 | BAYER.L-BRAND.VERS.AG | 2,140,723 | 9 |
| 5324 | BAYER.VERS.VERB.AG | 791,801 | 10 |
| 5146 | BGV-VERSICHERUNG AG | 54,666 | 1 |
| 5339 | CONDOR ALLG. VERS. | 114,907 | 2 |
| 5340 | CONTINENTALE SACHVERS | 118,500 | 3 |
| 5311 | DBV DT. BEAMTEN-VERS. | 181,746 | 3 |
| 5549 | DEBEKA ALLGEMEINE | 250,700 | 1 |
| 5513 | DEVK ALLG. VERS. | 370,602 | 6 |
| 5522 | DOLLERUP.FREIE BRANDG | n.a. | 1 |
| 5472 | ERGO VERSICHERUNG | 416,999 | 20 |
| 5508 | EUROPA VERSICHERUNG | n.a. | 3 |
| 5473 | GENERALI VERSICHERUNG | 575,172 | 19 |
| 5858 | GOTHAER ALLGEMEINE AG | 319,974 | 7 |
| 5485 | GRUNDEIGENTÜMER-VERS. | 75,986 | 3 |
| 5365 | GVO GEGENSEITIGKEIT | n.a. | 3 |
| 5469 | GVV-KOMMUNALVERS. | n.a. | 2 |
| 5032 | HAMB. FEUERKASSE | 160,572 | 3 |
| 5085 | HDI VERSICHERUNG | 301,070 | 30 |
| 5448 | HELVETIA | 1 | |
| 5384 | HELVETIA VERS. (CH) | 163,521 | 1 |
| 5126 | HÜBENER VERSICHERUNG | n.a. | 1 |
| 5521 | HUK-COBURG ALLG. VERS | 245,823 | 5 |
| 5375 | HUK-COBURG UNTER. | 645,651 | 13 |
| 5057 | INTERLLOYD VERS.AG | 53,511 | 1 |
| 5780 | INTERRISK VERS. | 86,453 | 1 |
| 5402 | LVM SACH | 584,955 | 9 |
| 5061 | MANNHEIMER VERS. | 53,393 | 4 |
| 5412 | MECKLENBURG. VERS. | 105,894 | 4 |
| 5334 | MEDIENVERS. KARLSRUHE | n.a. | 4 |
| 5426 | NÜRNBG. ALLG. | 69,693 | 3 |
| 5446 | PROV.NORD BRANDKASSE | 303,537 | 2 |
| 5095 | PROV.RHEINLAND VERS. | 550,173 | 14 |
| 5583 | PVAG POLIZEIVERS. | n.a. | 2 |
| 5798 | RHEINLAND VERS. AG | 40,748 | 1 |
| 5438 | R+V ALLGEMEINE VERS. | 1,047,298 | 32 |
| 5773 | SAARLAND FEUERVERS. | 75,141 | 2 |
| 5491 | SCHLESWIGER VERS.V. | n.a. | 7 |
| 5125 | SIGNAL IDUNA ALLG. | 174,286 | 4 |
| 5036 | SV SPARK.VERSICHER. | 1,812,590 | 26 |
| 5042 | VERSICHERUNGSK.BAYERN | n.a. | 1 |
| 5400 | VGH LAND.BRAND.HAN. | 473,494 | 4 |
| 5862 | VHV ALLGEMEINE VERS. | 126,545 | 2 |
| 5093 | WESTF.PROV.VERS.AG | 596,446 | 6 |
| 5525 | WGV-VERSICHERUNG | 77,423 | 1 |
| 5783 | WÜRTT. VERS. | 459,329 | 11 |
| 5476 | WWK ALLGEMEINE VERS. | n.a. | 1 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

## 3.9 Legal expenses insurance

| Reg. no. | Name of insurance undertaking | Number of insured risks as at 31 Dec. 2014 | Complaints |
|---|---|---|---|
| 5826 | ADAC-RECHTSSCHUTZ | 2,345,367 | 8 |
| 5809 | ADVOCARD RS | 1,533,369 | 47 |
| 5312 | ALLIANZ VERS. | 2,382,180 | 47 |
| 5405 | ALTE LEIPZIGER VERS. | 351,115 | 45 |
| 5455 | ARAG ALLG. VERS. | n.a. | 5 |
| 5800 | ARAG SE | 1,388,765 | 65 |
| 5397 | ASSTEL SACH | n.a. | 1 |
| 5801 | AUXILIA RS | 519,999 | 9 |
| 5838 | BADISCHE RECHTSSCHUTZ | 170,308 | 1 |
| 5310 | BAYER. BEAMTEN VERS. | n.a. | 3 |
| 5146 | BGV-VERSICHERUNG AG | 1 | |
| 5098 | BRUDERHILFE SACH.AG | 94,290 | 1 |
| 5831 | CONCORDIA RS | 411,195 | 11 |
| 5340 | CONTINENTALE SACHVERS | 114,697 | 3 |
| 5802 | D.A.S. ALLG. RS | 2,504,404 | 37 |
| 5343 | DA DEUTSCHE ALLG.VER. | n.a. | 2 |
| 5549 | DEBEKA ALLGEMEINE | 404,341 | 8 |
| 5803 | DEURAG DT. RS | 1,203,899 | 53 |
| 5513 | DEVK ALLG. VERS. | 2 | |
| 5829 | DEVK RECHTSSCHUTZ | 1,074,604 | 18 |
| 5834 | DMB RECHTSSCHUTZ | 869,011 | 17 |
| 5472 | ERGO VERSICHERUNG | n.a. | 8 |
| 5365 | GVO GEGENSEITIGKEIT | n.a. | 1 |
| 5085 | HDI VERSICHERUNG | n.a. | 2 |
| 5818 | HUK-COBURG RS | 1,647,754 | 22 |
| 5086 | HUK24 AG | 106,462 | 3 |
| 5573 | IDEAL VERS. | n.a. | 2 |
| 5401 | ITZEHOER VERSICHERUNG | n.a. | 6 |
| 5402 | LVM SACH | 751,933 | 12 |
| 5412 | MECKLENBURG. VERS. | 144,447 | 2 |
| 5334 | MEDIENVERS. KARLSRUHE | n.a. | 1 |
| 5805 | NEUE RECHTSSCHUTZ | 445,793 | 11 |
| 5813 | OERAG RECHTSSCHUTZ | 1,639,270 | 60 |
| 5807 | ROLAND RECHTSSCHUTZ | 1,786,187 | 64 |
| 5438 | R+V ALLGEMEINE VERS. | 754,854 | 8 |
| 5400 | VGH LAND.BRAND.HAN. | 198,739 | 1 |
| 5525 | WGV-VERSICHERUNG | 437,993 | 19 |
| 5783 | WÜRTT. VERS. | 674,801 | 8 |

! Please refer to the "Explanatory notes on the statistics" on page 274.

## 3.10 Insurers based in the EEA

| Reg. no. | Abbreviated name of insurance undertaking | Com-plaints |
|---|---|---|
| 1182 | CARDIF LEBEN (F) | 6 |
| 1189 | CIGNA LIFE INS. (B) | 1 |
| 1300 | CANADA LIFE (IRL) | 4 |
| 1311 | VDV LEBEN INT. (GR) | 1 |
| 1319 | AXA LIFE EUR.LTD(IRL) | 2 |
| 1320 | STANDARD LIFE (GB) | 9 |
| 1324 | ATLANTICLUX LEBEN (L) | 1 |
| 1328 | SWISS LIFE PROD.(L) | 1 |
| 5029 | AIOI NISSAY (GB) | 2 |
| 5048 | DOMESTIC AND GEN.(GB) | 17 |
| 5056 | CARDIF VERS. (F) | 12 |
| 5079 | HISCOX INS. (GB) | 2 |
| 5115 | EUROMAF SA (F) | 2 |
| 5119 | ASSURANT ALLG. (GB) | 1 |
| 5120 | QBE INS. LTD.(GB) | 1 |
| 5128 | SOGECAP DNL (F) | 1 |
| 5130 | MAPFRE ASISTENC.(E) | 6 |
| 5142 | CHUBB INSUR. (GB) | 2 |
| 5145 | BTA INS. (LV) | 3 |
| 5151 | ZURICH INSURANCE (IRL) | 82 |
| 5152 | W.R. BERKLEY (GB) | 3 |
| 5157 | TELEFONICA INSURANCE (L) | 17 |
| 5163 | AIG EUROPE LIMITED (GB) | 16 |
| 5174 | SOCIETATEA (RO) | 16 |
| 5175 | EULER HERMES (B) | 1 |
| 5592 | LLOYD'S VERS. (GB) | 1 |
| 5636 | AGA INTERNATION. (F) | 39 |
| 5788 | INTER PARTNER ASS.(B) | 3 |
| 5902 | ACE EUROPEAN (GB) | 28 |
| 7159 | QBE Insurance (Europe) | 1 |
| 7203 | ATLANTICLUX (LU) | 3 |
| 7214 | HELVETIA VERS. (A) | 6 |
| 7268 | GENERALI VERS.AG (A) | 1 |
| 7270 | HANSARD EUROPE (IRL) | 1 |
| 7315 | AXA PPP HEALTH.(GB) | 1 |
| 7323 | ASPIS PRONIA (GR) | 4 |
| 7415 | R+V LUXEMBOURG L (L) | 1 |
| 7453 | CLERICAL MED.INV.(GB) | 12 |
| 7455 | PROBUS INSURANCE (IE) | 4 |
| 7456 | VDV Leben International | 2 |
| 7481 | FORTUNA LEBEN (FL) | 1 |
| 7483 | VORSORGE LUXEMB. (LU) | 1 |
| 7509 | AMTRUST INT. (IRL) | 1 |
| 7587 | INTERN.INSU.COR.(NL) | 1 |
| 7617 | BÂLOISE VIE (L) | 3 |
| 7643 | VIENNA-LIFE (FL) | 3 |
| 7659 | ZURICH LIFE ASS.(IE) | 1 |
| 7688 | INORA LIFE (IRL) | 1 |
| 7690 | CIGNA LIFE (B) | 1 |
| 7723 | PRISMALIFE AG (FL) | 11 |
| 7724 | CREDIT LIFE INT. (NL) | 4 |
| 7730 | RIMAXX (NL) | 2 |
| 7763 | STONEBRIDGE (GB) | 2 |
| 7775 | AXA FRANCE VIE (F) | 2 |
| 7786 | CANADA LIFE (IE) | 3 |
| 7806 | NEW TECHNOLOGY (IRL) | 1 |
| 7811 | CACI LIFE LIM. (IRL) | 4 |
| 7813 | FINANCELIFE (A) | 1 |
| 7814 | FRIENDS PROVID. (GB) | 3 |
| 7829 | UVM VERZEKERING.(NL) | 1 |
| 7868 | EUROP ASSIST. (IRL) | 1 |
| 7878 | SWISS LIFE (FL) | 1 |
| 7894 | QUANTUM LEBEN AG(FL) | 1 |
| 7956 | INTER PARTNER (B) | 3 |
| 7985 | ADVIGON VERS. (LI) | 8 |
| 9019 | ACE EUROP.GROUP (GB) | 6 |
| 9031 | LIBERTY EURO.(IRL/E) | 3 |
| 9064 | STANDARD L. ASS. (GB) | 1 |
| 9069 | SWISSLIFE PREVO. (F) | 3 |
| 9104 | GLOBALITY S.A. (LU) | 2 |
| 9158 | RCI INSURANCE (MT) | 2 |
| 9159 | RCI LIFE LIM. (MT) | 1 |
| 9241 | SURESTONE (IE) | 1 |
| 9306 | SANTANDER INS. EUROPE (IE) | 1 |
| 9307 | SANTANDER INS. LIFE (IE) | 16 |
| 9313 | METLIFE EUROPE (IE) | 7 |
| 9357 | ALLIANZ WORLDWIDE (FR) | 1 |
| 9374 | AXA LIFE EUROPE (IE) | 1 |
| 9905 | LV 1871 PENSIONS.(FL) | 1 |

! Please refer to the “Explanatory notes on the statistics” on page 274.

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